

THE Arbitration Debate

ARBITRATION IS A POPULAR ALTERNATIVE TO LITIGATION, BUT TWIN CITIES ATTORNEYS WARN THAT IT'S NOT A ONE-SIZE-FITS-ALL SOLUTION.

BY ANDREW BACSKAI

To arbitrate or to litigate? If that's the question, the answer is unlikely to emerge from a side-by-side comparison of the two dispute-resolution processes. Although arbitration still tends to be regarded as a lower-cost alternative to taking your case to court, some legal experts contend that arbitration's primary appeal isn't necessarily its potential price tag.

"When I'm consulting with a client, I tell them not to pick arbitration because you think you're going to save money," says Tom Shroyer, CEO of Moss & Barnett, a Minneapolis-based law firm. "You might, but you might not."

Attorney Keith Broady, for example, recently prepared a client for an arbitration hearing involving a substantial sum of money. When the hearing was still three months out, the discovery process—in which plaintiff and defendant find evidence and build their cases—was assuming the appearance and expense of litigation.

"We have depositions going on on the East Coast, on the West Coast, and in the Midwest. There is a lot of money at stake, and I don't think the discovery expense is any less than what a court proceeding would be," says Broady, a partner in the Minneapolis firm Lommen Abdo Cole King & Stageberg.

Discovery typically is more streamlined in arbitration hearings, and the rules governing such things as the admission of evidence tend to be more relaxed, he explains. However, when the dollars involved in a dispute

stack up, both sides tend to ramp up their efforts to secure a favorable decision, which runs counter to arbitration's traditional function as a lower-cost, more time-compressed dispute-resolution tool. "This is a concern I have with arbitration—when larger dollar amounts are involved," Broady says. "People want to make sure that their legal rights are being protected or asserted, depending on what side they're on. There can be a substantial expense to doing that."

For this and other reasons, some attorneys actively avoid arbitration for settling clients' disputes. "I prefer to have a jury trial in almost all circumstances," says Shannon McDonough, a partner with Fafinski Mark & Johnson, a law firm in Eden Prairie.



Unlike jury trials, arbitration cases typically are decided by a neutral arbitrator, either an attorney or a retired judge, who commonly has expertise in the subject matter from which the dispute stems. "In my experience, I've found that the jury system works and it's generally fair," McDonough says. "I like having a number of individuals making a decision. I like having a panel of my client's neutral and impartial peers hearing the case."

Other attorneys, however, contend that deciding between arbitration and litigation isn't necessarily an either-or choice. "Arbitration is an alternative that can be very beneficial if it's well-suited for a particular case,"

notes Roger Kramer, a partner with Gislason & Hunter, LLP, a law firm in Minneapolis.

“It really depends on the situation, whether arbitration is appropriate or not,” Broady adds. “It clearly, at times, is quicker and less expensive than a courtroom proceeding, and it can be a fair forum. So it certainly can achieve those goals.”

That said, it’s up to client and attorney to choose wisely.

Arbitration 101

Arbitration’s origins in the United States actually precede the American Revolution, when merchants in the British Colonies would opt to settle disputes in accordance with the rules of arbitration in Great Britain. These days, arbitration is an increasingly employed dispute-resolution tool for two or more parties who agree to resolve a legal dispute outside the courtroom.

According to Roger Haydock, managing director of Minneapolis-based National Arbitration Forum, an arbitration administration organization, many Americans—individuals and businesses alike, especially those with cases involving less than \$60,000—have been priced out of the legal system, and arbitration has emerged as a more accessible option. “Arbitration developed because businesses, consumers, individuals, and companies wanted and needed a fair, inexpensive, quick, and effective civil justice system,” Haydock says.

In some cases, plaintiff and defendant jointly select a single arbitrator to hear both sides of the case and determine who wins and loses. Other times, each side selects an “advocate,” and these two opposing arbitrators select a third and work to generate a two-to-one majority.

Except in rare cases, the arbitrator’s ruling is binding and not appealable. That’s an attractive quality for those who want quick and absolute resolution to a dispute. “The specter of winning a jury verdict and having it appealed for two years and possibly taken away is horrifying for some people,” explains Linda Holstein, a partner in Minneapolis-based law firm Holstein Kremer.

Others, however, are more reluctant to essentially concede the right to appeal afforded them by the court system. “Especially if you are a defendant, and someone is suing you for a large sum of money, you would like to have as many procedural protections—and the right to appeal is a big one—as you’re entitled to,” Broady says.

In general, the ground rules of arbitration are set by the arbitrator or the panel. Or, as is often the case, the parties will agree to proceed under the rules of an established organization, such as the National Arbitration Forum; JAMS, a provider of dispute-resolution services that’s particularly active in the western United States; or, most commonly, the New York City-based American Arbitration Association, which Holstein describes as “the granddaddy of the arbitration world.”

Arbitrators are generally paid by the hour; their fees typically are dictated by their experience and expertise. Arbitrators provided by the National Arbitration Forum, for example, command hourly rates ranging from \$100 to \$600, according to Haydock. The arbitrator bill typically is shared by defendant and plaintiff, unless the loser is instructed to pick up the tab.

In addition to paying for the arbitrator’s time, both sides of a dispute must cover their own attorney fees and the cost of conducting their discovery. Also, if an organization like the American Arbitration Association is chosen to administer the case, filing and service fees, which vary based on the dollar figure of the dispute, are assessed. “Say you have a \$500,000 to \$1 million case and you wanted to bring that to arbitration—there is a \$6,000 filing fee and a \$2,500 service fee. On top of that, you have to pay for the cost of the arbitrator’s time—let’s say that’s \$250 to \$350 an hour, which may be split—plus your own attorney fees,” McDonough says.

“Contrast that with going to Hennepin County to file your action,” she adds. “No matter what your damages are, the filing fee is \$252, the jury is \$75, and the judge is paid by your taxes. You don’t have to pay on an hourly basis for the use of the court system. So people think that arbitration is going to be cheaper, and that’s not necessarily true.”

Attorneys generally seem to agree that though the cost and duration of arbitration proceedings can rival that of court cases, those who decide to arbitrate typically can secure hearing dates quicker than they would if they were waiting on the court system. McDonough, for example, filed a case in Cook County, Illinois, four years ago, and a court date is still nowhere in sight. “You’re going to get to a resolution more quickly with arbitration,” Holstein says.

Case-by-Case Consideration

The bottom line is that the pros and cons of arbitration are circumstance dependent. So how do you know when you’re better off taking your case outside the courtroom? In many cases, the choice of arbitration is decided for you. Pre-dispute arbitration clauses are routinely included in such consumer and business-to-business literature as investment documents, employee or executive contracts, customer and vendor agreements, real estate and construction contracts, and joint-venture agreements or buy-sell agreements between owners of closely held businesses.

“Arbitration clauses frequently come up when two entities are getting together to share or develop a business idea. It’s ‘How do we get divorced?’ basically, if we decide it’s not going well,” explains Wade Wacholz, managing partner of Gislason & Hunter.

If a pre-dispute arbitration agreement exists, the path is predetermined and features no detours. If no such clause has been composed, there are several key questions to an-

swer and issues to consider when deciding between arbitration and litigation.

● **Are you willing to give up procedural protections?**

“Arbitration tends to be a much looser process [than court proceedings],” Holstein says. “I believe that more evidence is going to be admitted in an arbitration. There are going to be fewer safeguards, like the hearsay rule and others that are there in the courts as a matter of steering the proceeding away from being a free-for-all, if you will.”

Hearsay, or second-hand information, isn’t admissible in the courtroom. If you want to fortify your court case with an expert witness, that witness must testify in person and potentially be cross-examined by the opposition. In arbitration hearings, conversely, expert reports often are allowed in lieu of the actual, physical expert. “If you’re the defendant, and there is some expert who says you got a bunch of stuff wrong, then that expert has to show up in court and testify and then be subject to cross-examination. Some experts completely fall apart in cross-examination,” Broady explains. “If you’re in arbitration and the arbitrator is letting a written report go in, there’s no chance to cross-examine that expert. Even though you might think the expert would get killed on cross-examination, well, the arbitrator let the report in, those are the rules, and you’ve just lost a big procedural protection.”

● **How complex is the case?** According to Shroyer, arbitration is an effective tool for resolving what he terms “routine, contained kinds of disputes.” In Minnesota, for example, nearly all claims for no-fault insurance benefits are arbitrated. The discovery in such cases is typically minimal; the disputes tend to be tightly focused around the facts.

Complex, highly technical, industry-specific disputes also can be well suited for arbitration, Shroyer adds. Remember, arbitrators commonly are selected for cases based on their expertise in specific areas. Consequently, if you’re involved in, say, a dispute related to a construction defect, it likely will be far easier and more efficient to

plead your case in front of an individual or panel with industry background. “The complexity of a construction-defect dispute is just a mind-boggling thing to present to a jury,” Shroyer explains. “You’ve got a general contractor, an architect, engineers, and a bazillion subcontractors all talking about industry practices and using arcane language. How are you going to present that in any efficient, intelligent way and get a meaningful output from a jury?”



Tom Shroyer,
Moss & Barnett



Linda Holstein,
Holstein Kremer

● **How substantial are the damages you’re seeking?**

Arbitrators and arbitration panels are notorious for “splitting the baby”—legalese used to describe the act of sending both parties home winners, to some degree, rather than definitively siding in favor of one side or another. “There is a pronounced tendency towards baby splitting,” Shroyer notes.

Wacholz adds that arbitrators also tend to shy away from making substantial financial awards to plaintiffs, or awarding punitive damages. “The top-end awards don’t seem to happen in arbitration very often,” he says. “If you really want to ring the bell big, juries are probably the way to go.” The reason, at least in part: Juries are capable of being swayed by emotion, or the so-called “sympathy factor.” Industry-expert arbitrators have a tendency to empathize with a defendant in their own industry and go easy on them in a settlement.

● **Are you arbitrating for the right reasons?** Arbitration agreements are flexible and can be tightly structured to be more fleet and require fewer funds than litigation. “You can make the arbitration process to be very simple and very inexpensive. If both sides agree, for example, your clause can say, ‘There will be a one-day discovery, it will be a one-day hearing, and the dispute will be resolved with binding arbitration in that one day,’” Wacholz says. “You can do that, but you run the risk of that perhaps not being a quality result for you. Have the factors that truly matter to doing justice, which is what everyone wants from this process, really been considered? Has the evidence been worked up in a way that’s reliable? Do you have adequate expertise at the table to make the decision? Have they had adequate time to hear what’s going on?”

“It’s a tradeoff between the quality of the process and the quality of the decision you want,” he continues. “It’s not necessarily the case, of course, that the longer and more involved the process is, the better the quality of the decision will be. But there’s a threshold you’ve got to get to first.” **TCB**

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