

Business-to-Business Mediation/Arbitration vs. Litigation

*What Courts, Statistics & Public Perceptions Show About
How Commercial Mediation and Commercial Arbitration
Compare to the Litigation System*

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Abstract:

Business owners and managers who are familiar with the court litigation system know that high litigation costs and lengthy delays make it difficult and expensive to resolve business disputes in court. They also know that most civil cases that enter the court system are settled before trial, usually *after* significant time and money has been spent in the complex pre-trial phase but just in time to avoid the risk of trial.

What business people may not know—but should—is that mediation and commercial arbitration are regarded as providing superior solutions for resolving business disputes. Mediation puts the parties immediately in control the outcome without expending vast resources on litigation procedures. And arbitration is endorsed by the Congress and the courts as a means to get legally based and legally binding decisions in less time and at lower cost than the court system. As United States Chief Justice Warren Burger so aptly put it, “I cannot emphasize too strongly to those in business and industry—and especially to lawyers—that every private contract of real consequence to the parties ought to be treated as a candidate for binding private arbitration.” This White Paper focuses on the advantages of arbitration compared to litigation, and also shows the role mediation plays in saving time and money in resolving commercial disputes.

Contents

Introduction	1
ADR Cost Savings are Compelling	2
Additional Benefits of ADR	4
Drafting Considerations and Tips	7
Conclusion	10
About the National Arbitration Forum	11

Introduction

With increasing regularity, businesses are selecting alternative dispute resolution (or “ADR”) procedures of mediation and arbitration instead of the court system for resolving legal disputes. Businesses are bringing in trained mediators early in the dispute resolution process to help them fashion a preferable resolution before spending vast resources on pre-trial court litigation tactics. When businesses anticipate disputes that might not be resolved through mediation, they are agreeing at the time contracts are signed to submit future disputes to private arbitration.

Arbitration’s advocates agree that the arbitral process will never replace or displace traditional litigation. However, the arbitral process supplements the traditional system, serving as a cost-effective alternative to lengthy delays and high-priced litigation. Arbitration is a process more flexible and more adaptable, capable of accommodating the particularized needs of disputants, the business community, and society at large.

Arbitration can be an ideal forum to decide commercial disputes. Business parties commonly disagree as to their individual rights and obligations, even under the most carefully constructed contracts. Such disagreements can lead to delayed shipments, complaints about the quality of the merchandise, claims of nonperformance, and a multitude of similar misunderstandings. The resolution of such disputes, however, need not be costly and rancorous. Commercial arbitration can save time and money while preserving valuable business relationships.

Governor Al Smith implored voters to “look at the record.” To properly compare arbitration to litigation, it is worthwhile reviewing results and costs of commercial arbitrations versus the court system and in probing the prevailing perceptions and opinions from courts and the general public.

“Let’s look at the record.”

*Al Smith, former Governor of New York
and the original “Happy Warrior”*

ADR Cost Savings Are Compelling

The most universally accepted reason favoring commercial arbitration is the favorable cost of the arbitral process versus traditional litigation.

After thorough analysis, one expert concluded that “by its very nature litigation is very expensive, particularly if either party chooses to make it so. The cost of arbitration, if efficiently run, can be a fraction of the cost of litigation. A ratio of 3 or 4 to one, litigation versus arbitration, is a fairly realistic estimate and a reasonable expectation is that the cost of an arbitration will not be in excess of half the cost of litigating.”¹

In a 1997 survey of 1000 of the largest U.S. corporations conducted jointly by Cornell University, the Foundation for the Prevention and Early Resolution of Conflict (PERC), and Pricewaterhouse illustrates this cost-and-time-savings analysis. The survey indicated that of the 530 survey respondents:

- 90% viewed ADR as a critical cost-control technique and more than half (54%) said cost pressures directly affected their decisions to use ADR.²
- 79% used arbitration to resolve commercial disputes in the last three years.³
- 13% saved more than \$1 million by using ADR, up 11 percent from the previous year.⁴
- 80% considered ADR as a more satisfactory process.⁵
- 66% said ADR provides “satisfactory settlements.”⁶
- 59% said ADR “preserves good relationships.”⁷

ADR Can Be More Time-Effective

Judge Learned Hand said, “As a litigant, I should dread a lawsuit above all else, other than sickness and death.”⁸ Compared to long and expensive court proceedings, arbitration offers a more timely and cost-effective process for settling disputes.

In a study comparing litigation and arbitration of employment disputes, empirical data shows that arbitrations were significantly more efficient than litigation. The median time from filing to judgment was just 16-½ months for arbitrations.⁹

Meanwhile the average time from filing to judgment for litigation was 25 months.¹⁰

Backlogs and delay are common in litigation. In the most comprehensive study of court delay ever undertaken, the National Center for State Courts found:

- Final disposition for civil cases in some jurisdictions took nearly five years.¹¹
- 80% of Americans said that court cases were not resolved in a timely manner.¹²

Tight budgets are squeezing court systems across the country and in some states can seriously impact the ability of parties to gain access to the justice system. Some recent examples:

- Oregon closed courthouses every Friday from March through June and postponed processing minor criminal cases.
- Colorado froze hiring throughout the court system and mandated eight days of unpaid furlough for all court employees.
- Alabama temporarily suspended jury trials in 2002.
- In 2002, Massachusetts cut 1,000 court employees, with the result that judges in twenty-five Superior Courtrooms had no support staff and stopped conducting civil trials.
- New Hampshire suspended jury trials for two months in 2002 and for three months in 2003.

A number of judges have spoken out about the court crisis, including Kevin S. Burke, Chief Judge of the Minnesota’s Fourth Judicial District

Court, who earlier this year wrote to his colleagues urging them to “join the effort to solve this community’s crisis in justice.” He went on to say, “The work of the courts has a significant impact on the health of children, families, communities and even the economy. Across the country, too many courts, public defenders and Legal Aid offices are on financial life support. With your help we can avoid the calamity that has occurred elsewhere.”

Burke’s fears became a reality in the spring of 2003 when the Minnesota courts failed to get funding in light of that state’s \$3 billion budgetary shortfall. Minnesota courts raised civil court filing fees by \$100 to \$235 per case and imposed a fee of \$55 for filing a motion.

In a similar vein, Los Angeles Superior Court Judge Robert A. Dukes addressed a group in May of 2003 and told the gathering that then proposed budget would create a constitutional crisis that could force the closing of sixty to one-hundred courtrooms countywide. Dukes said that under the governor’s proposed budget, “We would not be able to fulfill our constitutional mandate.”

Additional Benefits of ADR

Neutral Expertise

Modern business-to-business dealings involve increasing complex interactions coupled with many technical and sophisticated subject areas. Judges are wonderful generalists and are indeed capable of learning about a case in a short period of time. Still, the advantage of having a neutral mediator or arbitrator, expert in the field, with years of experience on the subjects involved in the dispute is obvious.

Lay decision-makers may be ill-equipped to decide the cases brought before them. In a recent poll, many potential jurors said they could not be impartial toward business defendants.¹³

While the unpredictable nature of a lawsuit poses significant challenges in managing the risks of litigation, mediation provides the opportunity for parties to resolve issues that will otherwise be left to someone else to decide, and arbitration lets them predict and control their liability risks.

Flexibility

“In the middle of difficulty lies opportunity.”

Albert Einstein

Traditional litigation is not flexible and necessarily has been described as a “one size fits all” model.¹⁴ The judge must follow applicable law and the binding decisions of appellate courts. In the arbitration process much greater flexibility is possible.

Primarily the flexibility flows from the innovation and ingenuity of the parties in fashioning their arbitration agreement. Because arbitration is a species of contract law, parties can craft the terms or parameters by which an arising dispute will be handled in arbitration. Such flexibility is not possible in litigation.

For example, depositions, document requests, interrogatories, request for admissions and the like are so often abused in the litigation process that parties, by mutual agreement, can control discovery either in the arbitration clause in the pre-dispute contract or by agreement after arbitration has commenced.¹⁵ Another common example is that business parties may agree whether punitive damages will be awarded.¹⁶

A common myth regarding the flexibility of arbitration is that arbitrators do not have to follow the law. It is important to note that any flexibility bestowed on an arbitrator is derived wholly from the agreement of the parties as affected by the arbitration agreement. If there is nothing in an arbitration clause to differentiate the arbitration from a court proceeding, then arbitration rules require arbitrators to follow the law, holding them to the same standards as judges.¹⁷

Similarly, there is nothing inherent in arbitration that leads to “split-the-baby” awards. The agreement of the parties and the arbitration rules they specify will determine the kind of award they receive. If the rules provide (like those of a major national ADR provider) that the arbitrator can render awards based solely on equity versus the law, parties may receive split awards.¹⁸ However, if the arbitration rules provide that arbitrators must follow and apply the substantive law (like FORUM rules) then parties can expect awards that are solidly based upon legal principles.

Lastly, arbitration provides parties the opportunity to craft flexible boundaries governing their dispute. This opportunity is simply not available to litigants. While flexibility is undoubtedly one of arbitrations biggest advantages, it should be mentioned that careful drafting is an essential component to ensure that both parties agree to the scope of the arbitration proceeding.

Amiability

Many experts cite the preservation of business relationships as the single biggest advantage to resolving commercial disputes through arbitration. Recent surveys have identified the greater likelihood of amicable ongoing business relations between the disputants in arbitration as opposed to litigation.¹⁹ This seems to be reasonably based on the fact that litigation often degenerates into total war.

Although it results in final legal decisions like court, the nature of arbitration is less confrontational, less likely to trigger issues of pride and ego, and more conducive to enabling the parties to work together.²⁰ Further, arbitration affords the parties the opportunity, by agreement, to shape the course of the resolution of the dispute.

Confidentiality

Trials in the traditional litigation process are public. Mediation is entirely confidential. And many litigants in business-to-business disputes like the fact that arbitration hearings and proceedings are private, and that this can be made a part of the arbitration agreement.

Party Representation

In the U.S. court litigation system, companies are typically not permitted to appear in court except through an attorney. Mediation and arbitration, however, allow business owners and managers to make their case directly. Parties to mediation and arbitration have the option of self-representation or being represented by an attorney or other advocate. Self-representation offers benefits of greatly reduced costs and familiarity with the facts of the case.

Attorney representation in ADR proceedings offers other benefits, including skilled advocacy to present facts to best substantiate legal claims

and defenses. ADR is among the fastest growing areas of professional practice for attorneys in the U.S. By one measure, a decade ago only a handful of state bar associations had ADR committees or sections, while today all but three state bar associations (South Dakota, Massachusetts and Pennsylvania) have large and growing ADR sections.

Attorneys can play a vital role in complex business ADR matters in the following ways: informing their clients about mediation and arbitration procedures, assisting their clients inclusion of mediation and arbitration agreements, assessing cases for ADR resolution, assisting in the selection of mediators and arbitrators, preparing parties and witnesses for mediation sessions and arbitration hearings, overcoming barriers to settlement.

Mediation and arbitration do not restrict a business' right to counsel. And since these ADR procedures eliminate the complicated and expensive trial and pre-trial tactics, attorneys can focus on effectively advocating on the client's behalf in the forum.

Drafting Considerations and Tips

When drafting arbitration agreements governing commercial disputes, drafters should take great care to ensure that the necessary elements of a proper arbitration clause are present. A review of agreements that have failed to meet court challenges—and those that met such challenges—is a logical first step. But that's just a start.

Crafting an agreement that meets the client's needs requires a mixture of talents—legal know-how, common sense, a clear sense of objectives, and in some cases, a touch of constructive imagination. Below are tips toward drafting better agreements:

Grease the Wheels: Typically, in business disputes, neither party wants to destroy the relationship. So, pursuing the least abrasive approach can be advantageous for both parties. In their contract language, they may want to include a dispute resolution process that starts with an agreement to negotiate in good faith for a period of time, followed by a mediation session, followed by binding arbitration if the parties cannot resolve their legal dispute. To avoid delay, be sure to specify time frames for each procedure. The goal is to end the dispute as quickly, fairly and amicably as possible. Business parties may consider language such as this:

ARBITRATION. *Whether or not mediation is requested by any party, any claim, dispute or controversy between us or arising from or relating to this agreement or the relationships which result from this agreement, including the validity of this arbitration clause or the entire agreement, including any that remain unresolved 120 days after an agreement for mediation, shall be resolved by binding arbitration by the National Arbitration Forum, under the Code of Procedure then in effect.**

Specify What’s Covered: If the goal is to ensure that the arbitration agreement governs all disputes arising between the contracting parties, specify that clearly in the contract. Also, be sure to indicate that the arbitrator has the authority to decide whether the arbitration agreement is valid and enforceable. In this area, the United States Supreme Court has established something akin to a “magic words” formula for arbitration agreements. Agreements that indicate that all disputes will be decided by arbitration—including the validity of the arbitration provision itself—provide maximum authority for the arbitrator to decide all the issues of the case, thereby saving the parties a pit stop at the courthouse to wrangle over legal issues.

Take Advantage of the Federal Arbitration Act: Different states have different laws governing arbitration. This can be confusing, especially for lawyers who are trying to draft an agreement that can be used in a number of different states. To avoid any doubts and confusion, consider invoking the Federal Arbitration Act (FAA). The FAA affords parties the flexibility to structure their agreement, as they deem appropriate, while at the same time providing assurance that the arbitration agreement will be enforced uniformly in different states. The FAA covers any dispute involving interstate commerce, and, according to a recent decision by the U.S. Supreme Court, the standard is expansive, covering disputes that are “affected” by interstate commerce.

Specify What Law Applies: Laws can vary from jurisdiction to jurisdiction, so if it’s important that the arbitrator apply the substantive law of a specific jurisdiction, state that clearly in the dispute resolution agreement. Note that if you want the FAA to govern the procedural aspects of the arbitration, draft the agreement so that it is clear that the arbitration will be “governed” by the FAA, but that the arbitrator will

* Businesses and business counsel desiring further information and assistance drafting comprehensive commercial arbitration clauses are invited to contact the National Arbitration Forum.

“apply the substantive law” of a particular state. If the language is muddy, you may find your arbitration proceedings subject to a state law that is not favorable to your dispute.

Follow the Legal Remedies: Laws can vary from jurisdiction to jurisdiction. So if it’s important that the arbitrator or mediator be a legal professional and that he or she apply the substantive law of a specific jurisdiction, state that clearly in the dispute resolution agreement, or select the rules of an arbitration administrator that explicitly provide for this.

Crimping Punitive Damages Can Be Risky: Drafting parties are often tempted to limit an arbitrator’s ability to award punitive damages. But, before doing so, they should check out *Pacificare Health Systems, Inc. v. Book*²¹, a recent case in which the U.S. Supreme Court cast doubt on setting such limits.

Select a Reputable ADR Administrator: The best way to ensure that an ADR agreement will be enforced in court, if it comes to that, is to specify that the proceedings will be handled by a reputable ADR administrator with court-tested rules and fees. Doing so makes it unnecessary to draft lengthy provisions addressing discovery, selecting ADR neutrals, and a number of other issues. As one ADR expert put it: “Parties are decidedly better off engaging the services of a reputable ADR services provider to help them manage the arbitration proceeding rather than winging it on their own.”

Check Whether Your Arbitrator Will Be a Legal Professional Who Applies the Law: When selecting an arbitrator or using an arbitration administrator, be sure to clarify whether the arbitrators will be legal professionals or laypeople. Even though you have a legal dispute, some arbitration providers will use arbitrators who have no legal background. It pays to ask. The National Arbitration Forum utilizes seasoned legal professionals who are bound by the *Code of Procedure* to follow and apply the law.

Specify the Award Review Process: The Federal Arbitration Act and various state laws restrict the right of courts to review arbitration awards, although a number of courts have suggested that this is a default standard that can be altered. Parties who want a greater right to appeal an arbitration award can do this through explicit contract language or by simply incorporating, by reference, procedural rules (such as those of the

National Arbitration Forum) that provide for review by a court to determine whether the arbitrator properly applied the law.

Conclusion

Mediation and commercial arbitration save businesses time and money in resolving commercial disputes, with greater control over outcomes and confidentiality.

While arbitration will never replace litigation, it does provide a cost-effective, time-effective adjudication method. Properly run, commercial arbitration can provide parties with similar or better legal decision-making than the court system without the hangover that results from tight court budgets and the resulting reduced legal services.

Careful drafting of a commercial arbitration agreement is imperative to a successful arbitration experience for all parties. Attorneys would do well to consider all angles of a commercial arbitration agreement to provide the best possible “court” for their business clients.

About the National Arbitration Forum

The National Arbitration Forum (FORUM) is one of the world's leading providers of alternative dispute resolution services, including arbitration and mediation. Committed to the integrity of America's legal process, the FORUM has maintained a distinguished panel of over 1,500 attorneys and retired judges who follow and apply the substantive law when rendering legal decisions for the past 20 years. FORUM mediators and arbitrators are located across the U.S. and in 35 countries around the world. By administering dispute resolution solutions that save time and money, the FORUM provides an efficient and effective service for all legal parties. Publisher of the *ADR Law & Policy Update*, the FORUM is headquartered in Minneapolis, Minnesota with offices in New Jersey and Southern California.

For more information visit the FORUM's website at www.adrforum.com or contact the FORUM at 877-655-7755.

¹ William G. Paul, *Arbitration vs. Litigation in Energy Cases*, Presentation at the First Annual Energy Litigation Program (November 7-8, 2002) (transcript available at <http://www.adrforum.com/articles/pdfs/Paul-pdf.pdf>).

² See *U.S. Corporations Now Widely Use Alternative Dispute Resolution over Litigation to Solve Disputes*, Cornell Business News, May 21, 1997 available at <http://www.news.cornell.edu/business/May97/ADRstudy.html>.

³ *Id.*

⁴ See Harry N. Mazadoorian, *At a Crossroad: Will the Corporate ADR Movement be a Revolution, or Just Rhetoric?*, *Disp. Resol. Mag.*, at 5 (Summer 2000) (stating “[t]he 1999 Price Waterhouse Survey reported that 13 percent of survey respondents said they saved more than \$1million by using ADR, up 11 percent from the previous year”).

⁵ *U.S. Corporations Now Widely Use Alternative Dispute Resolution over Litigation to Solve Disputes*, *supra* note 2.

⁶ *Id.*

⁷ *Id.*

⁸ Judge Learned Hand, *The Deficiencies of Trials to Reach the Heart of the Matter*, 3 LECTURES ON LEGAL TOPICS 87, 105 (1926).

⁹ See National Arbitration Forum, *The Case for Pre-Dispute Arbitration Agreements: Effective and Affordable Access to Justice for Consumers* (2004), available at http://www.adrforum.com/articles/emprcl_study_04/copy.asp (last visited Jul. 14, 2004).

¹⁰ *Id.*

¹¹ Goerd, J.A., et al., *Examining Court Delay: The Pace of Litigation in 26 Urban Trial Courts*, 1987 (Williamsburg, VA: National Center for State Courts 1989).

¹² National Center For State Courts, *How the Public Views the State Courts: A 1999 National Survey by the National Center for State Courts*, (May 14, 1999) available at http://www.ncsconline.org/WC/Publications/Res_AmtPTC_PublicViewCrtsPub.pdf.

¹³ Third Annual Juror Outlook Survey, available at <http://www.decisionquest.com/site/index.htm> (last visited March 3, 2003)

¹⁴ Paul, *supra* note 1.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ National Arbitration Forum Rule 1- Arbitration Agreement; Edward Brunet, *Replacing Folklore Arbitration with a Contract Model of Arbitration*, 74 *Tul. L. Rev.* 39, 57 (1999).

¹⁸ See e.g., American Arbitration Association (“AAA”) *Rules for Commercial Arbitration*, Rule 43.

¹⁹ Paul, *supra* note 1.

²⁰ *Id.*

²¹ 538 U.S. 401 (2003).