The Case against Arbitration

BY STEPHANIE ADWAR

"It is well settled that arbitration is both favored and encouraged as a means of conserving the time and resources of the courts and the contracting parties . . . ."[1] It is upon this premise that parties agree to enter into contracts that include arbitration clauses. It is, on its face, a sensible idea. A dispute arises between parties and that dispute is brought before an arbitrator or panel of arbitrators, i.e., an impartial third party who will move through the process and will make a decision much more quickly and at less expense than an overtaxed court. The public is told that it is in their interest to arbitrate because they will able to lower the fees that they would otherwise experience with a court proceeding. In fact, they might even be able to proceed without an attorney because the rules of procedure are more informal in an arbitration. Obviously, without an attorney, an arbitration should be less costly than litigation before a court where appearance without an attorney is an exceptionally foolish move. (Old adage: The man who represents himself has a fool for a client.) So, you ask, what could possibly be the problem with arbitration? It seems less expensive, faster, and easier. Looks, however, can be deceiving.

ARBITRATORS ARE NOT JUDGES WHO, WHILE FALLIBLE, ARE OPEN TO REVIEW.

This article addresses the growing frustration among clients and attorneys with the present arbitration system and accounts for the increasing reluctance by attorneys to accept arbitration clauses in their contracts (including their own attorney retainer agreements), providing real-world, anecdotal evidence that has resulted in my law firm's current counsel to clients to avoid arbitration clauses at every possible turn.

AN OVERVIEW OF ARBITRATION

Basically, an arbitration choice is specified in a contract between the parties. There can be no arbitration unless the parties agree in advance. Additionally, the contract will specify the venue for the hearing, name the private organization that will supervise the proceeding (e.g., the American Arbitration Association, JAMS), and specify the number of arbitrators to be appointed. The arbitration is commenced when one party—the claimant—files a "demand for arbitration" and pays the arbitration organization's filing fee. Unlike a court, the arbitration organization sets its own fee schedule. Once the demand is received by the arbitration organization, it notifies the other party—the respondent. The respondent answers the demand by disputing the claim(s) and raising any counterclaims. The claimant then replies. All this is a pattern familiar to those who practice before the courts.

The parties will then usually be requested by the organization to have an initial telephone conference with the organization's administrator to discuss the procedure of the pending arbitration. The organization will have its own procedures and rules, which may or may not conform to those of the courts before which you regularly appear. It is wise to review these rules prior to agreeing to a specific organization. The organization will advise the parties about their respective responsibilities, including the importance of responding to the arbitrator's directives in a timely manner, confirming their understanding and compliance with the organization's rules and an obligation to share the arbitration fees. The parties will be directed to split the cost of the proceedings, including the arbitrator's time and any charges for use of the venue. (Contrast this with a court where the expenses of a judge, venue, and court reporter are borne by the taxpayer.)

The parties are then provided a list of potential arbitrators from the organization's panel from which to jointly make their election. Once chosen, the arbitrator will hold an initial telephone conference with the parties where they are expected to set forth their respective positions. On this call, the arbitrator will set the parameters for the arbitral proceeding. In a pattern reminiscent of court proceedings, the arbitrator may inquire whether the parties wish to submit an opening statement, what discovery the parties intend to request from each other and how long that might take, dates by which requested discovery will be produced, whether the parties wish to submit closing arguments, and for how many days the parties believe the arbitration will run. The parties are then expected to proceed as agreed up to and including the hearing. Upon completion, the arbitrator renders an award. The award is then submitted to a court that has jurisdiction of the matter, and the award is entered as a judgment of the court.

This seems simple enough. Make a demand, answer, get an arbitrator, present your case, make your best arguments, do some discovery (if necessary), and get a decision. Done. And sometimes an arbitration occurs in just this fashion. However, more often than not, in our experience, nothing is quite this simple.

THE PROBLEMS WITH ARBITRATION

Disputes over Choice of Arbitrator

The difficulties usually begin with the choice of an arbitrator or arbitration panel. The parties are provided a list of available and approved arbitrators from the organization's panels, their résumés, and their hourly rates. In the many arbitrations in which my firm has taken part, we select arbitrators with significant experience, especially in the law to which the case relates. Such arbitrators will typically have hourly rates greater than others on the list. In cases of fee disputes with former clients, more experienced attorneys are more likely to understand the actual

rates charged by attorneys of similar experience and expertise in the geographic region in which the attorney practices. More than likely, the party on the other side will try to choose an arbitrator with the lowest hourly rate. In this situation, the parties will have to come to a compromise which, inevitably, means they will choose another arbitrator with an hourly fee below that of the more experienced arbitrator chosen. This can result in choosing an arbitrator who does not necessarily have the skill set to understand how to adjudicate the case. This may be a distinct disadvantage. If the arbitration concerns a legal fee dispute, it may be deadly.

The ability and legal experience of the arbitrator is the single most important factor in any arbitration. This is so because of the circumstances under which arbitrators practice. Arbitrators are not judges. They are not overseen by the Office of Court Administration. They are not subject to guidelines and laws to which judges are subject. They need no judicial training or judicial continuing legal education. For the most part, they are not subject to review (see below). The lower the hourly fee for the arbitrator, the more likely that he or she will be less experienced (both as an arbitrator and as an attorney).

In New York City, hourly rates of attorneys vary, but it is not uncommon for one who is a partner in a firm, in practice for over 20 years and who concentrates his or her practice in a specific area of the law, to bill $500 to $1,200 or more an hour. Suppose you are an attorney seeking unpaid fees and your hourly rate is $600. The arbitrator you choose has an hourly rate of $400 (and is the highest paid and most experienced arbitrator available). Inevitably, the respondent will attempt to choose as the arbitrator one with a lower hourly rate. You may then be forced to appear before an attorney who has never in his or her life been qualified to bill over $300 an hour and cannot comprehend how you, the attorney, can justify getting paid the higher amount sought (despite the fact that there is a contract for the provision of these services at that hourly rate). There is an inherent bias that simply cannot be erased and inevitably becomes evident in the award that is rendered.

Disputes over Arbitration Fees

Suppose the respondent decides not to pay its share of the arbitration fees. What are the remedies? Unfortunately, there are no remedies. If you want the award, the burden will be on the claimant to pay the fees. Moreover, if the respondent doesn't answer, the claimant will still be liable for the fees *and* the necessity of going through a procedure with the arbitrator at his or her hourly fee, which the claimant will have to pay.

Compare this procedure to a typical court proceeding when the suit is for a sum certain and the defendant defaults. In many state courts, the default for a sum certain is entered by the clerk of the court and relief is up to the defendant to secure. In federal court, there is one extra step of getting the clerk to certify the default. There is no inquest. The judgment may be filed in the court and with the relevant county clerks and remains a valid lien for as long as the state law allows (in New York, it's 20 years).

In an arbitration, the respondent can continue to move through the procedure and nevertheless refuse to pay its share of the fees, including the hourly fees of the arbitrator. This can mount up.

Consider this real-world example: A claimant filed a demand and the respondent answered denying the claim. The arbitrator was chosen. The respondent made arguments regarding liability that proved the claimant's demand. The facts were supported by documents and the validity of the claim was self-evident. Nevertheless, the arbitrator said that she would have to conduct research on the matter (arbitrators do not have law clerks who conduct research at the taxpayer's expense). She billed her rate of $250 an hour for that research and billed a total of over $3,000 on an issue to which the answer was facially obvious. The issue, in the opinion of counsel, did not require over 10 hours of research. The respondent refused to pay the $1,500 share of the arbitrator's fee. The arbitration organization advised the claimant that, under its rules, if the claimant refuses to pay its share *and* the respondent's share, the matter would be peremptorily dismissed and the claimant would be liable for all other fees and expenses, including the previously unbilled time by the arbitrator.

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The claimant could not afford to carry the costs of the entire arbitration and was very concerned that even if successful and granted costs and fees, the respondent would never have sufficient assets to pay the extensive fees and disbursements incurred during the arbitration (fees that in this example would have been substantially lower in court). The claimant could not avoid the arbitration. If he went to court, the respondent would ask the court to invoke the arbitration clause and the claimant would be ordered into the arbitration. A lose-lose proposition.

(Applying this example to the case where an attorney claims a fee on unpaid bills, bills to which no objection was raised, the pitfalls become abundantly clear. The attorney has the simplest of all claims: an account stated. But because the client-respondent refuses to pay, the attorney will lose and may then be sued *by the "judge."*)

A court has the power to order a defendant to respond to discovery requests, and if the defendant does not do so, a court can impose sanctions, limit discovery, or, courting an extreme case, enter judgment on behalf of the plaintiff. An arbitrator has no authority to impose sanctions. At most an arbitrator can limit discovery or enter an award. That is all.

Lack of Supervision, Interference, and Review

"[A]rbitrators are not bound by principles of substantive law or rules of evidence that govern the traditional litigation process—their duty is to reach a just result *regardless of the technicalities*."[2] As one appellate judge stated, this is "wild west" justice. It often is not only unfair, but it also can be incredibly frustrating and time-consuming in a manner not ever experienced in a court. Even in situations where the arbitration clause includes a

requirement that the arbitrator must adhere to particular rules, such as the Federal Rules of Evidence and applicable state law, arbitrators can still completely disregard those directives with impunity. The plain, unvarnished fact is that the courts do not supervise arbitrators.

"[T]he courts have generally not interfered, with few exceptions, in this mode of dispute resolution."[3] The reason courts do not wish to interfere with the decision by arbitrators is because, as the New York Court of Appeals held in *In re Aimcee Wholesale Corp.*: "Arbitrators are not bound by rules of law and their decisions are essentially final. . . . More important, arbitrators are not obliged to give reasons for their rulings or awards."[4]

Now think abqut the above holding and about that arbitration clause you are about to place into your client's agreement. How much confidence can attorneys have in a process without predictable rules and lacking in judicial supervision? How pleased is a client going to be when it has to spend thousands of dollars for the services of a judge, thousands of dollars on a reporter, the cost of the arbitral venue, and then the legal fees? Arbitration is held out as a less expensive procedure. That was true when the procedure discouraged discovery. Today, an arbitration without discovery is the exception. As we all know, it is discovery that makes U.S. litigation more expensive, by far, than litigation anywhere else in the world.

What happens when an arbitrator makes an award that flies in the face of the law and/or the facts? Section 7511 of the New York Civil Practice Law and Rules (similar in most other states) provides that an arbitral award may be vacated only in cases of corruption, fraud, or misconduct in procuring the award; partiality of an arbitrator; or where the arbitrator exceeded his or her power or so imperfectly executed it that a final and definite award upon the subject matter submitted was not made. However, courts are loathe to make such vacaturs, and they happen very, very seldomly.

"Thus our courts may be called upon to enforce arbitration awards which are directly at variance with statutory law and judicial decision interpreting that law. Furthermore, there is no way to assure consistency of interpretation or application. The same conduct could be condemned or condoned by different arbitrators."[5] In other words, your client is out of luck. In our experience, even if the decision of an arbitrator is outrageous, objectively unreasonable, or nonsensical, no court will overturn that award. To do so would defeat the benefit of arbitration to the courts (but neither the litigants nor their counsel)—i.e., lessening the case load. It is simply an example of an institution benefiting itself to the detriment of those it is intended to serve.

The takeaway is this: arbitrators are not judges who, while fallible, are open to review. Instead, they act as modern day Solomons. In our experience, arbitrators often make awards based upon some sense of unspecified and anomalous establishment of "fairness" unknown to the litigants. Arbitrators can and will ignore the contractual instructions as to how they are to conduct the proceedings and what law and procedure they are to apply. They do not necessarily know the law or attempt to learn what the law holds to decide a case because they simply do not have to do so. As held by the courts, they can decide whatever they want, and the litigants are bound by their decisions with no chance of review.

CONCLUSION

There are many situations where arbitration makes sense—where arbitrators make thoughtful, well-reasoned, and competent awards. The system can be invested with procedures that will make it reliable and a time saver for our courts. What is needed is that legislatures impose strict obligations of review of arbitral awards upon our courts. The stricture of appeal and review, that another will be looking over the shoulder of the arbitrator, raises the level of performance and will weed out the incompetents and result in more uniform decisions and create a level of predictability to the result. Predictability leads to early settlements. If the goal is to also reduce the costs of litigation, then strict limits may be placed on discovery and the length of proceedings and the number of witnesses so that those who elect to engage in arbitration will know in advance precisely what they are getting into. From our vantage point, the present system is only slightly more rational than Russian roulette.

ENDNOTES

1. D'Agostino v. Forty-Three E. Equities Corp., 820 N.Y.S.2d 468, 487–88 (Civ. Ct. 2006), *aff'd*, 842 N.Y.S.2d 122 (Sup. Ct. 2007) (emphasis added).
2. *Id.* at 488 (emphasis added) (citing *In re* Raisler Corp., 298 N.E.2d 91 (N.Y. 1973)).
3. *Id.* (citing *In re* Sprinzen, 389 N.E.2d 456 (N.Y. 1979)).
4. 237 N.E.2d 223, 225 (N.Y. 1968).
5. *Id.*

Stephanie Adwar is a partner in Furgang & Adwar, LLP, a New York City entertainment and intellectual property law firm, and serves part time as acting village justice of Suffern, New York.