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Are You Maximizing The Benefits Of Your Arbitration Agreements?

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"Get it and forget it." That is how many companies approach arbitration clauses. That is a mistake for two reasons. First, an arbitration agreement enables a company to structure the dispute resolution process to meet its needs. A company should not waste that unique opportunity through inattention or lack of preparation. Second, the law relating to arbitration agreements continues to evolve. For example, the Supreme Court issued two decisions relating to arbitration this past term.[1] And it has agreed to hear another arbitration-related case next term.[2] Furthermore, Congress continues to scrutinize pre-dispute arbitration agreements. Both houses of Congress have proposed amendments to the Federal Arbitration Act, which, if enacted in their current form, would significantly alter the legal landscape.[3]

By periodically reviewing its standard arbitration clauses, a company can adjust those provisions in response to the evolving law and ensure it is maximizing the potential benefits of its pre-dispute arbitration program. Moreover, companies should consider, on a transaction-by-transaction basis, whether they want an arbitration clause at all and if so, whether they should use their standard clause or some modification thereof.

In appropriate circumstances, arbitration can enable a company to resolve disputes more efficiently, in both time and money, than it otherwise would through litigation. But arbitration is not without risks. For example, there is essentially no right of appeal should the arbitrator reach the wrong conclusion. While it is theoretically possible for a court to overturn an arbitrator's decision, the grounds upon which it can do so are very limited.[4] As a result, in all but the most extreme cases, the arbitrator's decision will be final. A company that thoughtfully considers its views on arbitration is more likely to avoid the potential pitfalls of arbitration, while maximizing its potential benefits.

This article identifies some of the myriad issues a company should consider to maximize the benefits of its arbitration agreements.

What Types Of Disputes Do You Want To Arbitrate?

Arbitration is a matter of contract between the parties. In evaluating an arbitration agreement, courts generally "apply ordinary state-law principles that govern the formation of contracts."[5] As with any contract, a company with sufficient bargaining power should tailor the agreement to fit its needs.

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The first step in implementing a business-useful arbitration philosophy is to be sure that the arbitration agreement includes those claims the company wants to arbitrate, and excludes claims that it would prefer not to arbitrate. There could be some circumstances where a company would prefer to litigate rather than arbitrate a dispute. Considerations of both privacy (which arbitration affords) and size of claim (arbitration is generally cheaper than litigation) may influence this decision. For example, a company may wish to arbitrate consumer and employee disputes, but not disputes with suppliers. Even within certain categories of disputes, a company may want to arbitrate smaller claims, but not larger ones. The "right" answer will necessarily depend on the circumstances and needs of the individual company.

How Do You Want To Structure The Arbitration?

For those claims it wants to resolve through arbitration, the company should decide on the structure of the arbitration and delineate that structure in its arbitration clause. Many companies fail to give serious consideration to this issue and either adopt the standard procedures of certain arbitration entities or leave these issues for future resolution or to the discretion of the arbitrator. While common, that approach is not desirable. Rather than pick a process off the rack or leave it unsettled, a company should seize the opportunity to customize the process to meet its needs. In structuring the arbitration, a company should consider the following issues:

1. Discovery And Schedule

A company often requires arbitration because it wants to resolve disputes more quickly and with less expense than through conventional litigation. To help ensure that the company realizes the anticipated benefits of arbitration, while still providing for a meaningful process that enables each party to present its case effectively, a company should include a schedule for the proceedings and identify what discovery is permissible.

The schedule and scope of discovery can be tailored to reflect the type and magnitude of the case. For example, in cases where the amount at issue does not exceed a certain threshold, a company may want to provide that no depositions will be allowed, but the parties will be available to testify at the hearing, whereas, in cases involving more substantial sums, the company may want to provide for depositions and more extensive discovery. A company concerned about implementing rules that may one day be to its detriment should some unanticipated scenario occur can hedge its rules by granting the arbitrator authority to deviate from the general rule in certain narrowly defined circumstances. For example, an arbitration agreement may prohibit depositions in smaller arbitration disputes, but grant the arbitrator authority to permit a deposition where necessary to preserve testimony due to anticipated unavailability of an important witness.

Although there is no one right plan, to the extent allowed by the company's bargaining power and the relevant law, a company should make these choices itself, rather than have them made for it.

2. Power of the Arbitrators

This issue has come up recently in several cases and surprised parties to their detriment. Because arbitration is a matter of contract, parties can limit the arbitrator's powers, but they should do so clearly in the pre-dispute arbitration agreement.

For example, the parties can agree that the arbitrator, and not a court, decides in the first instance whether a particular dispute is subject to arbitration under the agreement. If they intend that to be the case (which usually makes sense), it is best if the agreement explicitly so provides. If the agreement is silent on this issue, courts will infer that the parties did not agree to submit the "arbitrability" issue to arbitration.

Likewise, if a company intends that each party shall bear its own attorney's fees under any and all circumstances, it should say so explicitly. Recently, the United States Court of Appeals for the Second Circuit held that because an arbitration agreement lacked clear language to the contrary, an arbitrator to a dispute between sophisticated insurance companies had the power to sanction one party for arbitrating in bad faith by awarding attorney's fees to the other party.[6]

Finally, the number of arbitrators may be outcome determinative. Having a three-person panel decreases the risk of an aberrant outcome; but it increases the chances of a compromise result. The company should, therefore, give careful consideration to the number of arbitrators it wants to decide disputes.

3. Qualifications and Selection of Arbitrators

A company should consider what type of experience an arbitrator hearing a certain type of dispute should have. Would a retired judge who has extensive legal training and decision-making ability but limited technical expertise be preferable to a non-judge or even non-lawyer who is an expert in a particular field? And for three-person panels, how is the third person selected? Do the parties agree, or do the other two panelists pick the third member? As with all these issues, there is no one answer for every company or for every type of arbitration that a company may confront. Each approach has its benefits and potential drawbacks, and it is incumbent on the company and its counsel to weigh the potential benefits and risks and decide on a course of action.

Is Your Agreement Enforceable?

The Supreme Court has made clear that in interpreting arbitration agreements, federal courts will apply the relevant state law. Each state has its own approach, and a company should pay careful attention to the state laws where disputes might arise. While choice of law and choice of venue provisions will generally be enforceable provided that they are not unfair, a company should make sure that it wrote its arbitration agreement to be enforceable.

Likewise, a company must attend to the details of its agreements. A recent decision from the Mississippi Supreme Court illustrates that inattention to detail can result in an arbitration agreement not being enforced. In *Byrd v. Simmons*, 5 So.3d 384 (Miss. 2009), the son of a nursing home patient who died while under the nursing home's care filed a claim in state court alleging breach of contract and tort claims. The nursing home moved to compel arbitration because the son had signed an arbitration agreement on behalf of his mother when she was admitted to the nursing home. The son responded that the arbitration agreement was not binding. He argued that there was no mutual assent to the contract, because no representative of the nursing home ever signed the agreement, and, further, that he revoked his offer to enter into that agreement via letter and by filing the lawsuit. The Mississippi Supreme Court found that there was no agreement to arbitrate. In reaching that conclusion, the court emphasized that where parties to the contract intend that each shall execute the contract, the agreement does not take effect until signed by all relevant parties.[7]

Conclusion

Like any business decision, a company should weigh the costs and benefits of implementing arbitration plans to maximize the benefit to the company. Those companies who realize significant benefits by arbitrating disputes should seriously consider investing the time and money to ensure that their arbitration program is tailored to fit their needs. The best way to avoid the potential pitfalls of arbitration is to plan ahead and then follow the plan.

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[1] 14 Penn Plaza LLC v. Pyett, *129 S.Ct. 1456 (2009) (holding that a provision in a collective bargaining agreement requiring union members to arbitrate statutory claims arising under the Age Discrimination in Employment Act was enforceable), rev'g, 490 F.3d 88 (2d Cir.);* Arthur Andersen v. Carlisle, *129 S.Ct. 1896 (2009) (holding that a non-party to the arbitration agreement can invoke the agreement to compel arbitration if the relevant state law allows enforcement of contracts by (or against) a third-party, for example, under a third party beneficiary theory).*

[2] Stolt-Nielson, S.A. v. AnimalFeeds International Corp., *129 S.Ct. 2793 (2009), granting cert., 548 F.3d 85 (2d Cir. 2008) (finding that arbitration panel did not "manifestly disregard" law in construing arbitration clauses that were silent as to permissibility of class arbitration to allow class arbitration).*

[3] *H.R. 1020, 111th Cong. (1st Sess. 2009); S. 931, 111th Cong. (1st Sess. 2009).*

[4] See, e.g., *9 U.S.C. § 10 (A court may set aside an arbitration award procured by corruption, fraud, or undue means, or where the arbitrator exceeded his powers).*

[5] First Options of Chicago, Inc. v. Kaplan, *514 U.S. 938, 944 (1995).*

[6] Reliastar Life Ins. Co. v. EMC Nat'l Life Co., *564 F.3d 81 (2d Cir. 2009).*

[7] Id. *at 389 (citing* Turney v. Marion County Bd. of Educ., *481 So.2d 770, 774 (Miss. 1985) (quoting 17 C.J.S. Contracts § 62 (1963)).*

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