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Arbitration's Fall From Grace

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GC South
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For general counsel Jonathan B. Wilson, arbitration started to lose its gloss when the much-vaunted method of resolving cases quickly and cheaply landed his company in a costly, protracted court battle over an issue that, by contract, never should have ended up in court at all.

The trouble started when a customer sued Wilson's employer, Interland Inc., in federal court, alleging breach of contract. Interland, an Atlanta-based Web services provider, motioned for dismissal, citing the terms of service in its customer agreement -- which stated that such disputes would be resolved via arbitration rather than litigation.

The judge, however, questioned whether Interland and the customer actually agreed to those terms of service, so Interland weathered discovery and then a trial. In the end, Interland won: A jury found that the parties did enter into a contract subject to Interland's terms of service. As a result, Interland and its customer resolved the matter in arbitration after all -- just as the terms of service had originally envisioned.

But the process took its toll on Interland and on Wilson. He hasn't sworn off arbitration, and he continues to use it for some business-to-business contracts. But that experience has led him to question its effectiveness as a broad-based method of dispute resolution.

His case in point: "Our company ended up investing more than a year's worth of time and substantial legal fees simply to enforce in court our right not to have to go to court." Wilson isn't alone in reconsidering the merits of arbitration. A decade ago, many GCs turned to arbitration in hopes of slicing their companies' soaring litigation expenses; now they're taking a second look at that decision and finding that arbitration isn't the cure-all they'd once envisioned.

While some GCs are reluctant to discuss specific arbitration stories for publication, privately their accounts of resolution attempts gone amok are strikingly similar. The most frequent complaints involve not just money, but enforceability issues. Arbitration offers virtually no appellate rights, no discovery rights and no provision for summary judgment.

To be sure, stories such as Wilson's aren't everyday occurrences. And many times, arbitration can be a cheaper, simpler way to resolve disputes. But complications happen often enough to give some companies reason for pause. One of the main complaints is the expense. If the opposing party demands a trial, the resulting court sessions can easily run up a six-figure tab before any of the original issues are resolved.

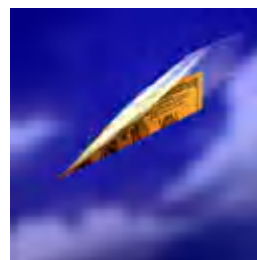


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General counsel say they settle many disputes just to avoid the spiraling cost of protracted deliberations -- even if they believe they'll eventually win. That was the case at one *Fortune* 500 company based in the South. It recently pulled the plug on an arbitration and forged a settlement just to stop the expense meter.

"We had three arbitrators billing us at \$500 per hour, and the case was going nowhere with no end in sight," the general counsel at that company says. "I remember commenting to an associate that at least in court the judge is paid for by the taxpayers."

What made that case particularly difficult, the GC says, was that it involved a number of related commercial disputes between the company and a customer. "It was a lot for any of us to try to understand and nearly impossible to present clearly at arbitration," he explains. Wilson has been there, done that. "All too often you end up with a mini-trial which is as expensive as litigation but without any appeal rights," he says.



WHY SOME GCS SHUN ARBITRATION

The lack of appeal rights -- and other enforceability issues -- presents another set of factors causing GCs to turn away from arbitration. It's not uncommon for companies to end up in court arguing over whether an arbitration ruling should be upheld -- which, of course, defeats the purpose of using arbitration in the first place.

And that's assuming a true verdict is reached. All too often, general counsel say, they have been underwhelmed by the decisions arbitrators make. The most frequent complaint: In-house lawyers say that arbitrators tend to split their decisions, leveling a judgment that stops well short of what a company sought going in.

What's more, many corporate counsel say they think arbitrators are trained by professional associations and colleagues to issue split decisions in an attempt to please both parties and, the cynics say, not to dissuade either side from turning to arbitration in the future.

Arbitrators deny it, but even some involved in the practice concede that they have heard general counsel express those views, and they suspect such feelings have contributed to arbitration's fall from grace in the corporate world.

Larry Parker, director of corporate communications at the American Arbitration Association in New York, counters that reports of arbitrators' splitting the baby are overblown. He stresses the code of ethics arbitrators use to ensure the same level of fairness that a business would expect from a judge and says that arbitrators offer advantages judges don't. "What we are always pitching to our clients is the strength of our expertise," Parker says. "For example, you don't expect a judge on a construction-related trial to have the architectural or building expertise that a panel of arbitrators can have."

One *Fortune* 500 GC has a different assessment. "Simply put, most arbitrators are not as good as most judges. Combine the number of tools available in trial that are not available in arbitration with the quality of decision making in a court setting, and arbitration appears penny wise, pound foolish."

FORUM SHOPPING FOR BARGAINS

Often the determination of whether arbitration or a trial will ultimately be the cheaper, more efficient route depends on where a dispute has taken place, according to attorney John F. Wymer III.

"In a place like California that is very litigious, it is better to go to arbitration rather than spend half your life in court," says Wymer, an employment specialist at King & Spalding in Atlanta. "But in a state like Georgia and other places in the Southeast, the trial option has to be more carefully considered."

Location matters not just because Southeastern dockets tend to be less crowded than those in California and cases can go to trial quicker, but also because Georgia and other Southeastern states have labor laws that are friendlier to corporations.

Wymer says that corporations are partially to blame for the troubles they are now having. Arbitration programs often were put together without a clear understanding of issues such as how the program should be designed, how an arbitrator would be selected and whether discovery would be allowed.

"A lot of businesses did this without really knowing what the issues are," Wymer explains. "Businesses that have refined arbitration and made it more focused and more fair to their employees or other parties are better off."

On top of that, despite possible drawbacks, GCs often have no choice but to arbitrate because they've inherited arbitration clauses that were placed in contracts years earlier, when the practice was growing in popularity as part of a wider trend by corporations trying to avoid court time.

"All too often these clauses were drawn up by litigators who had no understanding of the intricacies of arbitration," one general counsel says now. The GC, who works for a multinational corporation with operations throughout the Southeast, adds, "We are still paying for the mistakes made by our predecessors and the people who were advising them."

Interland's Wilson says that arbitration could get a second look from the business world should federal law be changed to clarify when arbitration clauses are enforceable. "If we had an act on the federal level that says if a clause meets certain requirements a court should dismiss a complaint in favor of arbitration, it would add much-needed clarity," he explains.

Unfortunately for GCs, the movement to enact such a law appears to be low on the list of legislative priorities. The Federal Arbitration Act, which governs matters including the dispute between Interland and its customer, calls for a trial to resolve disputes over the enforceability of an arbitration agreement.

THE RISE OF MEDIATION

As arbitration has fallen out of favor, mediation, a less frequently discussed alternate dispute resolution method, seemingly is gaining traction among corporations. Though the same issues that plague arbitration -- a lack of discovery rights and enforceability -- remain in mediation, the less-structured environment tends to be cheaper, less adversarial and quicker than an arbitration hearing.

At a recent continuing legal education event for corporate counsel in Atlanta, speaker David C. Vigilante, associate general counsel and chief litigation counsel at Turner Broadcasting, told the audience that he's not a fan of arbitration because the process requires companies to give up some legal rights -- and it's binding. He called mediation "the worthwhile companion to its less worthwhile exercise, arbitration."

In an interview after the event, he added that "most lawyers will tell you today that mediation is one of the most fantastic things to come along."

Unlike arbitrators, mediators do not decide a case; rather they work with the parties to help reach a settlement. The results are binding if and when the parties enter into a settlement contract, but not before.

Despite the complaints, no one is predicting the demise of arbitration. The number of arbitration cases grew from 76,000 in 1997 to 159,676 in 2004, according to the American Arbitration Association. However the data, which only represent cases involving the AAA and its members, do show signs of a plateau: The number of cases in 2004 was down 8 percent from 2003 and steady compared with 2002 statistics.

Parker of the AAA attributes the slowdown to his own organization and not to declining interest in arbitration.

"Anecdotally we do sense that the field continues to expand," Parker says. "But as other firms outside of the AAA aggressively expand, it impacts our data."

Joseph D. Wargo, a partner with Wargo & French in Atlanta and an arbitration specialist, says he believes some of the complaints today are a backlash against the 1990s trend by businesses to jump headfirst into arbitration.

"In years past, when arbitration was new, it was more common to get a knee-jerk response from business people that they wanted to try it," says Wargo, who is involved in more than 100 arbitration disputes at any given time. "Through the effort to just try something different, there have been some entities that chose arbitration when it was not the best dispute resolution vehicle for them."

ARBITRATION BACKLASH

The backlash against arbitration has its roots in the securities industry, which turned to mandatory arbitration as a quick and easy way to deal with unsatisfied customers who believed they were given unsound or biased advice by their brokers. Over the years those customers have been granted more weapons to pursue higher damages figures, turning the hearings, in the eyes of some, into court procedures.

General counsel say that there are no set guidelines to determine when arbitration works and when it does not. Many say that it is most effective in business-to-business disputes, where both parties are more likely to be mindful of the high costs associated with either litigation or a prolonged arbitration hearing and therefore eager to resolve a dispute as efficiently as possible.

But others argue that arbitration is better suited for consumer and small-business claims because the amount in question is typically much smaller than in a large-business dispute. A \$200 claim for late fees is less likely to justify the expense of a full-blown court

case, for example, and is less likely to burden a company with an unappealable decision should an arbitrator rule against it.

Also, small businesses and noncommercial clients usually are given more leeway when arguing that an arbitration clause was not understandable or fully disclosed, and can win sympathy if the clause requires an individual to travel great distances to resolve a dispute or creates some other perceived unfairness.

Many companies that have turned away from arbitration to resolve some disputes still use it for others.

J. Henry Walker IV, chief litigation counsel at BellSouth, says his company still frequently uses arbitration to resolve disputes. But BellSouth makes that decision on a case-by-case basis.

"It is not a default decision," Walker says. "There are clear advantages to arbitration, but there are also disadvantages that need to be considered."

That is also the case at Turner Broadcasting, according to Vigilante, who says that arbitration is one of many tools the company considers, along with litigation and mediation, when determining how to resolve a conflict. Turner uses arbitration only when he sees a clear strategic advantage over other forms of resolution, such as in certain cross-border contracts in areas where the legal system is less defined or the company's rights might be harder to defend in the event of a dispute.

Still other companies remain committed to arbitration as a broad-based method of dispute resolution and say they have been pleased with its results.

Paul B. Nix, vice president and general counsel of Lanier Worldwide, is among those who continue to use arbitration extensively. When he arrived at the Atlanta-based document-solution company a decade ago, he found Lanier had an arbitration clause in its standard commercial contract with clients but had never really pursued it.

One of his first assignments at the company was to grow Lanier's understanding and use of arbitration. He has not slowed down.

"Over the last 10 years, we have built up considerable experience in arbitration disputes, and there is no question in my mind that it is preferable to litigation," Nix says. "It is more efficient for both sides, and compared to the unknowns of the courtrooms, there is some predictability to the process."

Nix says the times when a judge has thrown out Lanier's arbitration clause or when a customer has refused to abide by an arbitrator's ruling have been "few and far between." He adds that the company does have the power of the judicial system behind it should a party not follow through on a decision.

The keys to making arbitration work, say advocates, include devoting resources to researching arbitration clauses and guidelines, and to getting advice from people who know arbitration -- as opposed to litigators and consultants more familiar with trial settings. Nix says companies should have internal and external teams that are well-versed in the sometimes arcane rules that govern arbitration hearings.

"We use one team that has extensive experience in arbitration, and who knows everything about the facets of the arbitration process," Nix says, referring to both his in-house team and his outside counsel. "Our overall experience supports us proceeding with this route. In fact I wouldn't want to do it any other way."

"The truth is that arbitration is not a panacea, and it is not for every company," Wargo says. "But I do think that the factors that made arbitration favorable to certain companies do remain, and companies should continue to take a look at whether it works for them."