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Your Business"™*

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KEEPING THE PEACE

Discourage litigation. Persuade your neighbors to compromise whenever you can. Point out to them how the nominal winner is often a real loser – in fees, expenses, and waste of time. As a peacemaker the lawyer has a superior opportunity of being a good man. There will still be business enough.

– Abraham Lincoln¹

The United States is a litigious society. Perhaps it has always been so. And, Abraham Lincoln was concerned enough that he penned this warning to prospective lawyers. What, however, distinguishes the U.S. is that her citizens perceive litigation as transparent, fair and equitable, in both process and result.

Alternative dispute resolution, or ADR, has been around at least as long as Abraham Lincoln, who promoted it by admonishing the lawyer to be a “peacemaker.” The American Arbitration Association, the AAA, promotes binding arbitration – one of several forms of ADR – with this comment: “Arbitration has proven to be an effective way to resolve . . . disputes privately, promptly, and economically.”² Not all people agree.

The Current Arbitration Debate

The current debate about mandatory, binding arbitration, particularly pre-dispute agreements, focuses on standard consumer contracts that include arbitration provisions, *e.g.*, credit card agreements. But, this debate could spill over into commercial agreements – the

¹ Abraham Lincoln, Notes for a Law Lecture (Jul. 1, 1850), <http://showcase.netins.net/web/creative/lincoln/speeches/lawlect.htm>.

² Am. Arbitration Ass’n, Commercial Arbitration Rules and Mediation Procedures (Including Procedures for Large, Complex Commercial Disputes), Introduction (Sep. 1, 2007), <http://www.adr.org/sp.asp?id=22440#A1> [hereinafter AAA Commercial Rules].

business-to-business arrangements that have often included mandatory, binding, pre-dispute arbitration mechanisms.

What is the debate about? Arbitration is essentially a contractual agreement between parties to resolve disputes in a particular way that does not involve litigation in a court. Parties to a contract agree in advance of any dispute between them to submit the dispute to binding arbitration. Often, parties give little attention to these provisions because they are included in the “miscellaneous boilerplate” at the end of a contract. But, the precision of and adherence to ADR provisions can be key to the resolution of a dispute.

The most familiar of such provisions is the standard pre-dispute arbitration clause suggested by the AAA:

Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association under its Commercial Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.³

This language leaves a lot open to interpretation. First, before accepting such a provision, one must thoroughly understand the rules that will apply to dispute resolution.⁴ Further, what does “administered” mean? This can be a murky area that obtains definition only in the context of a claim.

Aside from the “Solomonic” decisions of arbitrators who dispense justice by halving the baby, the November 2004 decision by JAMS to allow its arbitrators to decide whether to enforce an arbitration agreement’s ban on class action claims really brought a firestorm of criticism. Even though in March 2005 JAMS withdrew that announcement, the fact that an ADR organization believed that it could make such a procedural policy, notwithstanding the parties’ agreement to the contrary, was troublesome at best.⁵

Further, those supporting ADR, and arbitration in particular, maintain that it is timelier and less costly than litigation. One thing is for sure; it costs less to file a lawsuit in most jurisdictions than it does to file a demand for arbitration with the AAA. Also, because of the expanding scope of discovery and pleading that is allowed, the time and cost advantage has narrowed and maybe even disappeared.

In agreeing to a pre-dispute arbitration clause, the parties give up their prospective right to a trial in court (which might include the right to a jury trial), the protection afforded by

³ AAA Commercial Rules, Standard Arbitration Clause, <http://www.adr.org/sp.asp?id=22440#A2>. Of course, AAA is only one of a number of alternative dispute resolution organizations that have recommended language and rules. Two of the most notable are JAMS, the Judicial Arbitration and Mediation Services, Inc., located in Southern California (<http://www.jamsadr.com>), and the Minneapolis-based National Arbitration Forum (NAF) (<http://www.arbitration-forum.com>).

⁴ Unless the rules are by contract fixed in time, they may be changed after the contract is executed but before a dispute under it arises. AAA Commercial Rules, Rule 1(a), <http://www.adr.org/sp.asp?id=22440#R1>.

⁵ The NAF quickly announced that it would enforce arbitration agreements as written, and the AAA in February 2005 stated that it would also enforce agreements as they are written. *See* Am. Arbitration Ass’n, AAA Policy on Class Arbitrations (Jul. 14, 2005), <http://www.adr.org/sp.asp?id=28779>.

judicial review to ensure that the decision maker has adhered to the law and to the well-defined procedural and discovery rights available in court. These waivers are in exchange for what is a less and less efficient and timely mechanism for dispute resolution.

The Cure vs. The Cold

Is the “cure” better than the “cold”? The answer depends upon one’s perspective and experience. In the commercial context – business-to-business disputes between parties of equal bargaining power – the answer is often quite different. But, it always depends upon several common factors.

The Arbitration “Boilerplate”

In an AAA-administered arbitration, before the arbitrator is even selected, there are numerous matters that are decided by AAA staff. Case administration is not governed by an explicit set of rules. A case administrator’s decision can be arbitrary and unreviewable. She can fix the locale for arbitration, take actions that limit discovery and even control aspects of case presentation.

The arbitrator, once appointed, also interprets the rules of the game. For instance, the AAA rule on discovery states: “At the request of any party or at the discretion of the arbitrator, consistent with the expedited nature of arbitration, the arbitrator may direct i) the production of documents and other information . . .”⁶ The qualifier “consistent with the expedited nature of arbitration” can be used to deny a party information from its opponent that is necessary to the full and fair presentation of a claim or defense, information that the party would get in a court.

Standard arbitration rules do not necessarily implement the parties’ expectations. That is why one must be familiar with the ADR organization that will administer a demand, the rules that will apply and how the administrator typically implements these rules. This has led ADR legal practitioners to draft their own arbitration provisions. The contracting parties can decide what discovery will be allowed, how and where hearings will be conducted, who the decision maker will be, the kinds of relief that can be awarded, whether the proceedings will be private and confidential and if court review is permissible. The result often is arbitration provisions that are detailed and lengthy.

The Decision Maker

Even when both contracting parties find the forum and the process that are acceptable to them, an arbitrator may simply refuse to follow the parties’ agreements or the law or to short-circuit the process. And, the ADR organization that administers an arbitration can, like JAMS sought to do, frustrate the parties’ choices.

Recent Client Newsletters

“The Price Escalator Clause: A *Masked Bandit?*,” the February 2005 newsletter, discusses the behavior of pricing indices and how they may overstate inflation and, thus, vendor cost increases.

ePayments and how they challenge the new regulatory environment is the topic of the January 2005 newsletter “ePayments Put the Paper Check ‘Out to Pasture’.”

Client newsletters are available at <http://www.carpenterlaw.net/newsletters/archivednewsletters.html>.

⁶ AAA Commercial Rules, Rule 21(a), <http://www.adr.org/sp.asp?id=22440#R21>.

This can be the worst of all possible worlds because there is usually neither a record of the proceedings nor a “reasoned opinion,” a written decision that lays out the basis – both in law and fact – for the arbitration award. There may, therefore, be no meaningful way to review the award. The losing party feels failed by the system. The transparency, fairness and equity that distinguish the U.S. system have evaporated.

Well-drafted arbitration provisions can remedy some of these deficiencies. But, court-like procedures and an agreed upon judicial review, rather than the finality of binding arbitration, defeats the *raison d’être* for ADR.

The Mediation Alternative

Mediation is an informal and non-binding process in which the parties attempt, through a trained professional, to settle their competing claims. How, where and when the mediation is conducted can be set forth as a pre-dispute resolution provision in the parties’ contract. Most major ADR organizations have rules for the administration of mediation, or the parties may agree to their own rules. In any event, and like for arbitration, the rules must be thoroughly articulated and understood.

Sometimes a good faith attempt at mediation is a contractual prerequisite to a party’s filing a lawsuit in court. Here is an abbreviated example of such a provision:

If a dispute arises out of or relates to this agreement, the parties agree first to try in good faith to settle the dispute by mediation conducted under the Commercial Mediation Rules of the American Arbitration Association (except for those changes specifically set forth herein) before resorting to litigation or some other dispute resolution procedure. A party must bring a claim, by filing with the other party a request for mediation, within 2 years of the occurrence that is the basis for the claim.

This sample provision adopts in part the AAA mediation rules, but allows the parties to administer the mediation. The key to the success of such a mediation proceeding is that the parties select a mediator who will faithfully evaluate the strengths and weaknesses of each party’s case, including the existence and provability of the factual basis for claims and governing legal principles, and who will clearly and with conviction and credibility present that evaluation to each party in the context of the prospective lawsuit. If mediation does not result in a settlement, then the parties may proceed to court.

The mediation alternative gives the lawyers the opportunity to fulfill Lincoln’s injunction to be “peacemakers” and preserves the distinguishing characteristics of the U.S. system for dispute resolution. In the end, whether arbitration or court is the elected forum, knowing in advance what each means is essential.

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