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Avoid surprises; be aware of arbitration's shortcomings

LITIGATION LANDSCAPE
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Although arbitration is the preferred method of resolving disputes for many businesses, there are certain disadvantages to this method that should be considered before an arbitration clause is accepted in a commercial contract. If a company, with assistance of counsel, agrees to accept an arbitration clause, it should craft one that provides specific procedures for the arbitration.

Most advocates of arbitration will emphasize that the process is less expensive, discovery is more limited and the process more expedited than other forms of dispute resolution.

In order to avoid surprises, however, it is important to be aware of not only the advantages, but also the disadvantages that a business may confront in arbitration. This article will describe some of those shortcomings. (See page 29 for use of arbitration in international disputes)

■ **Limited ability to seek court review**

Once the arbitration decision is issued, the parties have a very limited ability to appeal that decision in court. New York Civil Practice Law and Rules § 7511 sets forth the grounds for the review of an arbitration decision by a New York State Supreme Court, and those grounds are limited to such items as "corruption, fraud or misconduct in procuring the award, the partiality of an arbitrator appointed as a neutral, or the arbitrator exceeded his or her authority."

The Federal Arbitration Act, applicable in federal courts, contains comparable limitations. The FAA was enacted in 1925 by Congress, which stated that it was created in order to "overcome judicial resistance to arbitration and to declare a national policy favoring arbitration of claims that parties contract to settle in that manner." Furthermore, state and federal courts in New York have consistently made it extremely difficult to challenge arbitration awards. In fact, the general theme of the courts, including the Court of Appeals, is that an award will be upheld so long as "the arbitrator offers even a barely colorable justification for the outcome reached." *Matter of Professional, Clerical, Technical Employees Association, 103 A.D.3d 1120, 1122 (4th Dep't 2013).*

In essence, arbitration is a creature of contract and, as a result, courts are extremely reluctant to interfere with that contract and to second guess an arbitrator's decision. The test is not whether the court would have reached a different result, but rather, it must be demonstrated that the arbitrator violated responsibilities.

The Second Circuit Court of Appeals in *NYKCool A.B. v. Pac. Fruit Inc., 507 F. App'x 83 (2d Cir. 2013)* provided for an additional ground in the event the arbitration decision "reflected a manifest disregard of the law." However, to vacate an arbitration award for "manifest disregard of the law," a court must conclude that "the arbitrator knew of the relevant legal principle, appreciated that this principle controlled the outcome of the disputed issue, and nonetheless willfully flouted the governing law by refusing to apply it."

So, both state and federal courts have made it clear that there is a significant reluctance to disturb an arbitration decision. The courts are not merely reluctant to interfere with the arbitrator's decision—there have been instances when the court has concluded that the appeal lacked merit and has assessed sanctions, including attorney's fees against the party who chose to appeal the arbitration decision.

■ **Expense**

Arbitration can be a pricy endeavor. Though it is often claimed that businesses can save money by arbitrating a dispute rather than litigating it in court, the savings that can be achieved are usually the result of a reduction in attorney's fees. But filing fees and the cost of arbitrators can add up quickly.

The standard fee schedule for the American Arbitration Association provides an initial filing fee of $2,800 for a claim of $150,000 to $300,000. It also provides for a final fee ($1,250 for a claim of $150,000 to $300,000). In addition, parties must pay for the compensation of the arbitrators. I was recently involved in a matter involving AAA in which we filed a counterclaim, participated in a two-day hearing and received a bill of $37,400 ($29,000 of which represented the arbitrator's compensation).

■ **Limited discovery in proceedings**

Though limited discovery is pointed to as a benefit of arbitration since it clearly reduces the expense of both parties, it also places parties at a disadvantage of having a very limited view of the evidence as compared to the material that can be obtained through effective discovery devices.

Whether discovery is permitted is generally within the discretion of the arbitrators. See American Arbitration Association Commercial Arbitration Rule 21:9 USC § 7 (Federal Arbitration Act). There is no provision in the New York CPLR permitting arbitrators to direct prehearing disclosure. Still, a party may be able to obtain disclosure under New York CPLR 3102(c) "to aid in an arbitration" before an action is commenced, but only upon making a motion and obtaining a court order.

While parties can agree among themselves to engage in discovery, in the absence of an agreement discovery is usually very limited in arbitration.

■ **Improve the process**

As I said earlier, arbitration is a creature of contract and therefore, the parties can improve the arbitration process by agreeing to an arbitration clause that spells out all aspects of the procedure, including the following: selection of arbitrators, what discovery is permitted, venue and scheduling of the hearings.

The arbitration clause is included in the commercial contract before any dispute has arisen. Even if it is unclear which party would be advantaged by having a detailed arbitration clause, it is a far better process to describe in detail the procedure that is acceptable to both sides. It is very unlikely the parties will agree on the procedure to

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be followed if it is left to the time a dispute arises.

Though arbitrations can be effective in resolving business disputes, it is essential that any company entering into a commercial contract with an arbitration clause be aware of the disadvantages. Furthermore, it is essential that any arbitration clause provide details of the procedure that will be followed in the event of a dispute.

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