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news
Corporate & Business Law Newsletter
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ARBITRATION: A COST-EFFICIENT APPROACH TO SMALL BUSINESS DISPUTES

How to resolve business disputes without over-spending on legal fees.

Arbitration is an adjudication process that may not be well understood by many business people. While it is generally intended to be a cost efficient, expeditious and less combative alternative to court litigation, this is not always the case. However, a knowledgeable attorney can analyze a situation to determine (a) when the inclusion of a mandatory arbitration clause will best serve the client's interests and (b) how to shape the arbitration clause to foster expeditious dispute resolution on a cost-efficient basis. This Newsletter is intended to educate the reader as to some history and some procedure and thereby help the business person identify possibilities to use an arbitration clause as an effective business tool.

History

Americans have been submitting commercial and other disputes to arbitration since the founding of our republic. It is reported that George Washington's will included a clause requiring that disputes about interpreting the will be submitted to a three-person panel to adjudicate and render a binding decision.[i]

While arbitration has been the standard dispute resolution tool in labor relations since the1930s[ii], it is not so universally utilized for commercial disputes. In fact, commercial arbitration was hardly employed until the 1920s, simply because there was no statutory framework for enforcing agreements to arbitrate or to enforce the awards that were rendered. This changed dramatically in the 1920s when New York enacted its Arbitration law in 1920[iii] and Congress enacted the United States Arbitration Act in 1925. Since that time commercial arbitration has blossomed, especially in certain industries. For example, when the garment and textile industries flourished in the north-east United States and especially in New York City, the American Arbitration

Association maintained a separate division devoted solely to disputes in those two industries. However, with the regretful "off shoring" of those industries to Asia, the separate garment and textile panel was terminated and those disputes are now administered by the AAA's Commercial Division.

***What is a Commercial Arbitration*?**

Commercial arbitration is often said to be a "creature of contract." That means a party can only be required to arbitrate a business dispute if the party has agreed to do so. Such agreements often arise in a contract for a commercial transaction between two or more parties which includes an "arbitration clause" with a provision to the effect that "all disputes arising from this agreement will be submitted to arbitration." The AAA's suggested commercial arbitration clause reads:

> "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."

However, arbitration can also arise from the parties' agreement to arbitrate an already existing dispute, i.e. a dispute that has arisen from a commercial transaction where the contract has no arbitration clause, but the parties agree that both sides would be better served by arbitration rather than Court litigation. The AAA provides the following language for submission of an already existing dispute:

> "We, the undersigned parties, hereby agree to submit to arbitration administered by the American Arbitration Association under its Commercial Arbitration Rules the following Controversy: (describe briefly). We further agree that the above controversy be submitted to (one) (three) arbitrator(s). We further agree that we will faithfully observe this agreement and the rules, that we will abide by and perform any award rendered by the arbitrator(s), and that a judgment of any court having jurisdiction may be entered on the award."

***Who May Serve as an Arbitrator*?**

An arbitrator can be most anyone. Often, however, arbitrators are lawyers…some of whom are retired judges. One significant distinction between arbitrators and judges is that arbitrators often are picked by the parties to a case because of some special experience and expertise. For example, the arbitration clause in an Asset Purchase Agreement for the sale of a franchise business, might well provide: "The arbitration shall be conducted before one neutral arbitrator who shall be an attorney with offices in Nassau County with substantial experience acting for parties engaged in franchise operations." Contrast this to Court proceedings where the dispute may well be heard by a judge who has had no meaningful experience with franchise transactions or operations.

One noteworthy fact is that in recent years the AAA and other arbitration organizations have severely tightened up the qualifications for people on their arbitrator panels. Back "in the day" one could become an AAA arbitrator with little or no credentials. Today however the AA and others have greatly reduced the numbers of candidates on their panels by requiring substantial credentials,

including rigorous special arbitrator training. A typical minimum criterion is the three day thirty-hour course given regularly by joint effort of the AAA and the New York State Bar Association.

*What is the most significant difference between Arbitration and Court***?**

There are many differences, some of which will be discussed below. However, the most significant difference by far for small businesses is that the parties, or their lawyers, get to make the rules.

In Court, the Judge administers the case pursuant to the applicable procedural law[iv]. The parties have little ability to adapt the rules to best serve their needs…and often the Judges have little inclination to change the rules from the ones they follow every day.

In arbitration, however, while the tribunals like AAA do publish procedural rules which will generally apply, those tribunal rules expressly recognize that those rules are subordinate to rules agreed to by the parties. AAA Commercial Rule R-1 (a) provides: "The parties, by written agreement, may vary the procedures set forth in these rules."

While the AAA suggested clause will obligate the parties to arbitrate disputes, it does absolutely nothing to "rein in" the process to avoid disproportionate legal expense. In other words, under the AAA clause, the lawyers may not be restrained from conducting hundreds of hours of pre-hearing depositions of scores of party witnesses and third-party witnesses.

Contrast that with a clause that limits pre-hearing disclosure as follows:

> "In the absence of special circumstances, each party's pre-hearing disclosure will be limited to: (a) inspection and coping of documents and things in the possession or control of the other party and (b) a detailed statement of the opposing party's claims and defenses and (c) one deposition of the opposing party appearing by a representative with knowledge of the transactions at issue."

Conclusion

While many lawyers view an arbitration clause as "boiler plate" to be thrown into an agreement, without too much thought, in the view of our law firm, a carefully considered arbitration clause can be an invaluable tool for successful dispute resolution.

If you have any questions about arbitration law and processes, or about other facets of alternative dispute resolution, please contact Richard Waxman at: rwaxman@waxmanlaw.com

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[i] "History of Arbitration and Grievance Arbitration in the United States" by Robert V. Massey, Jr. http://www.laborstudiesandresearch.ext.wvu.edu/r/download/32003

[ii] The National Labor Relations Act was enacted in 1935.

[iii] Review of New York arbitration history is found at http://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=3414&context=law_lawreview

[iv] In New York State courts, the Civil Actions Procedures and Laws (CPLR) and in federal courts the Federal Rules of Civil Procedure (Fed. R. Civ. P)