

# AN ARBITRATION PRIMER

**JOHN K. BOYCE, III**

Trinity Plaza II  
745 E. Mulberry, Suite 850  
San Antonio, Texas 78212-3166  
210/736-2222  
210/735-2921-Fax  
[jkiii@boycelaw.net](mailto:jkiii@boycelaw.net)  
[www.boycelaw.net](http://www.boycelaw.net)

for use in the  
*San Antonio Lawyer*

August 1, 2004

## I. OVERVIEW

Arbitration is here to stay. Driven by what parties perceive as fundamental deficiencies of the formal judicial system, including expense, protracted length, gamesmanship, belligerency, and wastefulness, arbitration has grown exponentially in the last ten years. Because of its confidentiality, empirical statistics are difficult to come by. Nonetheless, the American Arbitration Association ("AAA"), probably the largest administrator in the world, notes a 34% increase in commercial case filings alone from 1993 to 2002—i.e., from 12,713 to 17,105 cases per year. (The AAA's *total* caseload in 2003 was 174,000 cases, which includes all non-commercial areas such as insurance no-fault cases, etc.) The National Association of Securities Dealers ("NASD"), where arbitration is mandated in customer agreements, notes a 64% increase in securities claims filings from 1994 to 2003—i.e., from 5,500 to 8,500 cases per year. See <http://www.nasdaq.com/statistics.asp>. And courts and legislatures—both federal and state—continue wholeheartedly to sanction this trend. Arbitration's dramatic increase must be viewed as a seismic shift in the notions of justice in this America. Given the \$200 to \$300 billion annual cost of civil litigation, studies seem to confirm general public acceptance of the process. For an empirical study, see generally *Dispute-Wise Management: Improving Economic and Non-Economic Outcomes in Managing Business Conflicts* American Arbitration Association (2003). For an interesting but non-empirical survey of attorneys see generally *Survey of Arbitration* ABA Section of Litigation, Task Force on ADR Effectiveness (August 2003) <http://www.abanet.org/litigation/taskforces/adr/surveyreport.pdf>.

What is arbitration? In a nutshell, it is the process whereby a dispute is submitted to one umpire or a panel of three umpires—the arbitrators—for a final and binding determination, known as the award. The panel conducts itself similarly to a judge. That is, it conducts an evidentiary hearing, hears opening and closing arguments, rules on evidence, reviews the testimony and evidence presented by the parties, and renders an award enforceable in court. Typically, to maintain the integrity of the process and to handle the numerous administrative details that inevitably come up, a neutral administrator such as the AAA, Judicial Arbitration and Mediation Services ("JAMS"), or the National Arbitration Forum ("NAF") is used, although not required by law. Arbitration does not replace the formal litigation system but, rather, coexists with it as an alternative; hence, it is one of the alternative dispute resolution ("ADR") procedures, along with mediation, mini-trials, summary jury trial, and moderated settlement conference. It is often repeated that arbitration is not viewed as a diminution of the rights of the parties but merely as a change in the venue.

Normally, arbitration takes place only in the context of a consensual relationship between the parties, i.e., an arbitration clause in a contract. Thus, arbitration law is governed by classic principles of contract law. As such, courts construe arbitration clauses just like they construe any other contract clause to give effect to the parties' intent. Although parties may enter into such an arrangement either at the beginning of their contractual relationship or at some later date after the controversy has arisen, the former is more common.

In comparing arbitration to formal litigation, it is helpful to note these major features of arbitration:

### **A written clause for resolving disputes by the use of arbitration.**

As noted, an exception to this general rule is the inclusion of an arbitration clause in a will or trust.

### **Informal procedures.**

Procedural rules relative to court procedure are simple: strict rules of evidence are not applicable, and there are no requirements for transcripts of the proceedings or for written opinions of arbitrators unless the parties agree otherwise. See, e.g., AAA Commercial Arbitration Rules 26, 30-32 [hereinafter "AAA Rule \_\_\_"]. Although there is no formal discovery, AAA Rule 21 allows the arbitrator to direct the "production of documents and other information." While frowned upon, depositions are permissible, particularly if the parties are in agreement.

### **Objective and knowledgeable neutrals serve as arbitrators.**

Arbitrators are selected by the parties for the specific cases because of their knowledge of the subject matter. Based on that experience and expertise, arbitrators can render an award based on thoughtful and thorough analysis. Thus, the selection of an appropriate arbitrator is critical, and studies show that an arbitrator's knowledge of a specific type of case is the most important qualification for his or her effectiveness, not whether the arbitrator has litigation or judicial experience. Typically, most arbitrators are practicing attorneys who, unlike judges, do not

maintain "dockets" of hundreds of seemingly anonymous cases; hence, they have a comprehensive grasp of each individual case.

### **Arbitration is confidential.**

Hearings are closed, and proceedings are not a matter of public record. In sensitive estate, trust, or other family matters, this keeps the "dirty laundry" from being hung out to dry on the front page of the newspaper.

### **Economy.**

The costs of arbitration proceedings are generally less, even including the not insubstantial fees to the administrator and panel, than formal litigation, primarily because of the absence of formal discovery, extensive motion practice, rescheduling, or interlocutory and post-award appeals. *Arbitration is efficient.*

### **Speed.**

The AAA reports that the vast majority of cases are disposed of within twelve months from the date of filing, with 90% of all arbitration hearings concluded in two days or less; the National Arbitration Forum notes the median time of an arbitration from filing to award at two-thirds that of a formal lawsuit.

### **Final and binding awards are enforceable in court.**

Arbitrators have broad discretion in rendering awards. AAA Rule 43 provides that an arbitrator "may grant any remedy or relief that the arbitrator deems just and equitable within the scope of the agreement of the parties.." Court intervention and review are limited by applicable state and federal law, and award enforcement is facilitated by these same laws. Judicial review is generally limited to egregious defects in the arbitration procedure, *not* with the merits of the case. Arbitration laws draw narrow limits around the court's authority to review awards.

The Federal Arbitration Act (FAA), 9 U.S.C.A. §§ 1 et seq., is a *substantive* (as opposed to procedural) statute which encourages arbitration and makes arbitration awards binding and enforceable in federal court. Each state has its own act, the Texas Arbitration Act, Tex. Civ. Prac. & Rem Code §§171.001 et seq. (2004).

## **II. ANATOMY OF AN ARBITRATION**

The beauty of arbitration is derived in its flexibility to customize each individual arbitration to the needs of the parties. *It is designed to be user friendly.* While the parties' knowledge of the minimal rules is indispensable, arbitration is not designed to be a trap for the unwary. For example, there are no default procedures in arbitration for parties who do not answer by a certain date.

Once the parties have selected the panel by reviewing a list of candidates and striking the conflicts from a list provided by the institutional provider, the parties have a preliminary conference. Most of the time this is done by telephone, but in complex arbitrations it is done in person with all parties or attorneys in attendance. This conference is a frank but informal discussion tool to resolve issues, identify the scope of the dispute, address the future conduct of the case, such as clarifying issues and claims, setting deadlines to exchange witness lists and documents and to engage in discovery, scheduling the hearings, and any other preliminary matters. In the author's experience, the importance of this meeting cannot be underestimated in setting the tenor of the case and the respect to be accorded the panel as well as the process. Other issues that may be addressed in a preliminary hearing include (1) the very issue of the arbitrability of the dispute; (2) whether the parties are subject to the arbitration clause; (3) determination of the status of any collateral arbitration or pending litigation and whether to sever or consolidate if appropriate; (4) and ruling on any question of waiver by either party. Preliminary hearings may last fifteen minutes, fifty minutes, or two hours.

After the preliminary hearing has been held, the panel typically issues a scheduling order which sums up all that was decided during the preliminary hearing. In larger cases, it is drafted by the parties and approved by the panel. The scheduling order serves as the governing document for the case. Scheduling orders can be as short and

to the point or as long and creative as the case and the attorneys can conceive. Generally, the panel does as much as possible to encourage the parties to agree to the order, particularly as to reasonable discovery, since it is the parties and their attorneys who presumably have the best grasp of the case.

During the next phase of the process, the parties engage in discovery usually without a great deal of involvement from the panel. If the panel has done a good job during the preliminary hearing, the discovery controversy will be kept at a minimum. On the other hand, the efficiency of the process is such that when and if a discovery controversy comes up a hearing can be held promptly, often by telephone with the panel, and an order issued directly. This remedies the complaint heard about many lawsuits that discovery motions either simply drag on for months without any resolution or force the case to settle on terms that might have been different had discovery been forthcoming due to the parties having grown weary of the process.

Generally, the parties have to make a stronger showing than in formal litigation for the need of depositions, and the question of depositions will usually be specifically addressed at the preliminary hearing. It avoids the "Rambo" type tactics of burying the other side in expensive, wasteful, time-consuming discovery. Once again, panels try to encourage agreement.

The hearing proceeds several months down the line much like any formal trial. Oaths are administered to witnesses, there is often a stenographic record of these hearings, attorneys ask questions, and so forth. Attorneys advocate their clients' position similar to court proceedings. The panel has broad discretion on the conduct of the proceedings. AAA Rule 30. Absent specific direction in an arbitration clause (such as a directive that the panel use the Federal Rules of Evidence), it is up to the panel to determine the admissibility, relevance, and materiality of evidence, and the panel should take into account the applicable principles of privilege, such as attorney-client confidentiality. Given the informality of the process and the specialized knowledge of the panel, a great deal of evidence—i.e., hearsay—that comes in at the hearing probably would not be allowed in court. Even affidavits are permissible. Arbitration otherwise is very similar to the judicial trial with opening arguments, evidence, resting, more evidence, closing arguments, etc.

After the hearing is over, the panel will sometimes schedule post-hearing briefing and even oral arguments before the panel. This is particularly true in complex cases. Once the hearing is "closed," the arbitrators have thirty days to render their decision ("the award"), much like a court's judgment. Arbitrators may grant any remedy or relief that is deemed just and equitable and within the scope of the agreement of the parties. AAA Rule 43. Once the award is delivered to the parties, they may seek to reduce it to judgment by a court.

Courts have generally held that an arbitrator is *not* bound to apply the strict letter of the law, and courts will not second guess an arbitrator's interpretation of the law even if it is "mistaken." *In re Nestle USA Beverage Division, Inc.*, 82 S.W.3d 767, 777 (Tex. App.—Corpus Christi 2002, orig. proceeding); *Anzilotti v. Gene D. Liggin, Inc.*, 899 S.W.2d 264, 266 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1995, no writ). The standard to reverse or "vacate" an arbitrator's award on its substantive merits is that of "manifest disregard of the law," perhaps the most stringent existing. There is nothing resembling the factual or legal sufficiency inquiries found in the record of a formal appellate court.

State and federal statutes spell out the narrow grounds for reversing an arbitration award on procedural grounds. Under Section 10(a) of the FAA, the court may enforce an arbitration award unless one or more of the following statutory grounds are proven:

1. Where the award was procured by corruption, fraud, or undue means;
2. Where there was evident partiality or corruption of the arbitrators;
3. Where the arbitrators were guilty of misconduct in refusing to postpone the hearing upon sufficient cause shown or in refusing to hear evidence pertinent and material to the controversy; or
4. Where the arbitrators exceeded their powers or "so imperfectly executed them that a mutual, final and definite award upon the subject matter submitted was not made."

### III. CONCLUSION

While unqualified judicial endorsement has played a role arbitration's acceptance at state and federal levels, it is the rising costs of formal litigation, with its perceived deficiencies, which make its use compelling. If arbitration can indeed deliver "better, faster, cheaper" results this trend will continue.

