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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Arbitration Snags And How To Unsnag Them

By **Julie Gerchik and Makoa Kawabata** (February 26, 2019, 5:16 PM EST)

Julie Gerchik

Makoa Kawabata

The Eighth Circuit famously criticized arbitration over 30 years ago as "an inferior system of justice, structured without due process, rules of evidence, accountability of judgment and rules of law."[1] Nonetheless, the business community often still seeks to make private arbitration the exclusive forum for dispute resolution based on the assumption that arbitration offers the advantages of confidentiality, expediency and predictability, as compared to a jury trial.

As the U.S. Supreme Court noted, "by agreeing to arbitrate a statutory claim, a party ... trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration."[2] Some large corporations may even believe that the potential to provide "friendly" arbitrators repeat business could sway arbitrators to resolve matters in their favor, whereas courts have no similar incentive structure.

There is data to support this belief in "repeat player bias:" a 2015 New York Times study disclosed that 41 arbitrators each handled 10 or more cases for one company during a 4-year period.[3] However, it should be noted that this effect can cut both ways — plaintiff-side law firms who appear frequently in arbitration often reap the benefits of repeat player bias as well.[4]

This article discusses the perceived benefits of confidentiality, expediency and predictability, and whether these perceived attributes of arbitration really bear out. Additionally, this article suggests ways counsel can advise clients in order to mitigate some of the risks associated with private arbitration.

Confidential, Until it Is Not

Clients may be interested in maintaining the confidentiality of proceedings for a wide variety of reasons, from a general desire to keep disputes out of the public eye and avoid potentially negative publicity to the desire of famous individuals to avoid airing out their personal lives on the world stage. Arbitration proceedings take place in private and filings are not a part of the public record; therefore, private arbitration often accomplishes the client's desire for confidentiality.

That being said, it is important to remember that the promise of confidentiality is not foolproof. For

example, arbitration communications are discoverable in subsequent actions. While arbitrators themselves are not permitted to testify as to the proceedings, testimony and evidence submitted by the witnesses during the course of arbitration may be subject to discovery.

Typically, an arbitration is confidential because the parties agreed in their contract to resolve their dispute in a confidential arbitration. However, the parties' stipulation that it remain confidential is often not considered sufficient grounds to maintain confidentiality if a party attempts to discover prior testimony or evidence from an arbitration.

Additionally, in order to confirm arbitration awards as enforceable judgments, the arbitration award — which often is more than ten pages containing a discussion of the evidence — must be publicly recorded. At that point, there is no way to protect the confidentiality of any evidence the arbitrator cites, unless a party tries to submit the judgment under seal.

Another caution is that although confidentiality is a highly desirable feature of arbitration for many, a party cannot just draft broad confidentiality provisions in the arbitration agreement and consider the matter closed. Counsel must pay close attention to the contract law of each individual state, since parties seeking to avoid enforcement of arbitration agreements may use generally applicable contract defenses such as fraud, duress and unconscionability to do so.[5]

For example, in California, courts are empowered to invalidate arbitration agreements upon a finding of sufficient procedural and substantive unconscionability (i.e., if the agreement is presented from a relatively more powerful party to a relatively less powerful party on a "take-it-or-leave-it" basis and contains terms that give an unfair advantage to the more powerful party).[6] Moreover, California courts have the discretion to refuse to sever unconscionable provisions from an arbitration agreement if they determine that unconscionability "permeates" the agreement — in which case, the arbitration agreement in its entirety may be invalidated.[7]

In fact, some courts have held that although bilateral confidentiality provisions are facially neutral, they unconscionably favor large companies over individuals because they place corporate defendants in a "far superior legal posture" compared to their opponents by permitting them to accumulate a "wealth of knowledge" while leaving individuals with no way to contact potential witnesses or access the precedent needed to build a case based on patterns or intentional misconduct.[8]

Although some courts in other states have expressed a skeptical view of broad confidentiality provisions in arbitration agreements,[9] not all courts share this view. For example, the Eastern District of New York held in 2013 that "[T]he confidentiality of proceedings does not, by itself, render an agreement to arbitrate unconscionable" even where the dispute took place between individual consumers and a company at the top of the Fortune 500.[10]

Given the risk that a court will invalidate a confidentiality provision, parties and their counsel may want to try to minimize that risk by including strategic limitations on the scope of the confidentiality provision, such as permitting disclosures when seeking out advice or witnesses or withdrawing the confidentiality requirement upon the parties' prior written consent.[11] Consequently, no matter how likely it is from a practical perspective for a party to obtain written consent to make disclosures, a court may find that such customized terms reduce the level of procedural unconscionability in an otherwise pro forma "take it or leave it" arbitration provision[12] — thus weighing in favor of the court's enforcement of the agreement as a whole.

However, parties on both sides of the dispute should take note that defeating the unconscionability argument against compelling arbitration is not the end of the battle — the party in favor of disclosure of information related to the dispute is then "free to argue during arbitration that the confidentiality clause is not enforceable."[13]

Both sides can use the multiple battlegrounds to fight the enforceability of a confidentiality provision to their advantage — which can result in a lengthy, expensive battle — so long as they know the value of confidentiality both to themselves and their opponent. Counsel should advise clients that while the content of arbitrations usually remains confidential in the first instance (barring unconscionability challenges), confidentiality is not permanently guaranteed. Bilateral confidentiality provisions carefully crafted and narrow in scope are the best chance of keeping a client's desired information protected.

How Expedient is Expedient?

A detailed empirical study comparing various aspects of arbitration concluded that the average resolution time of arbitration is significantly shorter than that of litigation.[14] The mean length of awarded arbitrations according to the study was less than 11 months — whereas the average disposition time for jury trials was 26.6 months and bench trials was 20.8 months.[15]

However, a wrinkle in these statistics is that orders compelling arbitration and dismissing the suit or conversely denying arbitration are directly appealable.[16] In the federal courts, the median time from notice of appeal to disposition as of Sept. 30, 2018, was 8.7 months, with the median times in different circuits ranging from 5.4 months in the Fourth Circuit to 13.6 months in the First Circuit.[17]

In the state courts, the amount of time from notice of appeal to disposition can be even longer. For example, in California, the statewide median time from notice of appeal to opinion is 17.8 months, and the median time in different appellate districts ranges from 13.8 to 26.4 months.[18]

Therefore, the time it takes to appeal a decision to compel or deny arbitration also must be considered, in addition to the resolution time of the arbitration itself. Although the proceeding itself is faster, it may behoove counsel to assess the likelihood of such an appeal before arbitration even begins when advising clients as to how quickly (and cheaply) they can obtain a resolution of the dispute.

Once in arbitration, counsel can take other steps to reduce the amount of time of the proceeding by incorporating provisions limiting discovery or agreeing to expedited procedures. For example, the JAMS Streamlined Arbitration Rules & Procedures do not permit depositions unless there is a reasonable need, there is no availability of other options to obtain the information, and the arbitrator has weighed the burden of the request. Although practically speaking, depositions still occur under the streamlined rules, these guidelines often serve to limit the scope or breadth of discovery in which counsel otherwise might engage. Even if not a party to a JAMS arbitration, parties can still incorporate and stipulate to such procedures in order to expedite their own arbitration.

Is Arbitration Arbitrary?

"[A]rbitrators are not bound to award on principles of dry law, but may decide on principles of equity and good conscience" and, as a consequence, parties "who stipulate in an agreement that controversies ... shall be settled by arbitration, may ... find themselves bound by an award reached by paths neither marked nor traceable and not subject to judicial review."[19] Moreover, under default arbitration rules such as AAA Commercial Arbitration Rule 42, an arbitrator may award remedies beyond those within the

power of the courts as long as the arbitrator reasonably draws the remedies from the parties' agreement.[20]

By contrast, parties to a jury trial have the right to review by the trial court by way of motion for judgment notwithstanding the verdict or motion for new trial, in addition to a review of any final order by the court of appeal. At least in theory, the parties and the courts meticulously examine every stage of the proceedings and the decision looking for error and, after extensive review, the court issues a reasoned opinion that (ideally) explains in a logical manner every step leading to the court's conclusion.

In arbitration, however, the arbitrator's final order is not usually held to the same standard. In California, for example, arbitration awards can only be vacated in very limited circumstances, such as corruption, fraud or misconduct — error in law does not constitute grounds for a court to vacate an award, even if the error causes substantial injustice.[21]

Indeed, the conditions necessary for a court to vacate an arbitration award are construed narrowly.[22] A court may hold that an arbitrator has "exceeded" her or his powers by issuing an award that violates public policy, but this is "relatively rare."[23] In fact, "courts are reluctant" to use this as a ground to invalidate an arbitral award in the face of the "strong presumption in favor of private arbitration" under which "an arbitral award should ordinarily stand immune from judicial scrutiny."[24] The Federal Aviation Administration and a number of other states follow a similar approach.[25]

In order to avoid an arbitrary ruling with no chance of judicial review, counsel can advise clients to include provisions expressly providing that legal errors are an excess of arbitral authority and providing for judicial review of the award for legal error.[26] Another alternative is that parties can stipulate to a "reasoned award" and the same judicial review for errors in law that would have been available had the parties tried the matter before a court.

Additionally, in order to avoid the potential of a "runaway arbitrator," counsel can advise clients to limit the type and amount of damages that the arbitrator is authorized to award (as long as the limitation does not violate any statute or the unconscionability concerns previously discussed).

For instance, the arbitration agreement may provide that the arbitrator has the authority to award only relief that a court of that state could order — and no other relief.[27] The arbitration agreement may limit the type of damages to actual damages, and state that the parties waive any potential special, consequential or punitive damages.[28] The agreement may even limit the amount of potential damages to a dollar figure, stating that the parties agree upfront to a maximum potential award for certain claims and waive the right to any monetary recovery in excess thereof. Including such limitations on the arbitrator's authority can be an effective way to make arbitration less arbitrary and more predictable.

In sum, private arbitration can offer many of the features typically ascribed to it — confidentiality, expediency and predictable results; however, neither clients nor counsel may assume that they automatically achieve these goals by entering into a pro forma arbitration agreement. In order to get the desired results, parties and their counsel must carefully tailor both the actual arbitration provisions themselves, as well as their litigation strategy at the outset of the arbitration.

Julie R. F. Gerchik is of counsel and B. Makoa Kawabata is an associate at Glaser Weil Fink Howard Avchen & Shapiro LLP.

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[1] Stroh Container Co. v. Delphi Indus. (1986) 783 F.2d 743, 751 n.12.

[2] Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc. (1985) 473 U.S. 614, 628.

[3] "In Arbitration, a 'Privitization of the Justice System'", https://www.nytimes.com/2015/11/02/business/dealbook/in-arbitration-a-privatization-of-the-justice-system.html.)

[4] Arbitration Nation: Data from Four Providers (2019, forthcoming) 109 Cal. L. Rev. 1, 60, https://ssrn.com/abstract=3238460)

[5] AT&T Mobility LLC v. Concepcion (2011) 563 U.S. 333, 333.

[6] Baltazar v. Forever 21, Inc. (2016) 62 Cal.4th 1237, 1244.

[7] Ingalls v. Spotify USA, Inc. (N.D. Cal., Nov. 14, 2016, No. C 16-03533 WHA) 2016 WL 6679561, at *8.

[8] See, e.g., Ting v. AT&T (9th Cir. 2003) 319 F.3d 1126, 1152.

[9] See, e.g., Longnecker v. American Exp. Co. (D. Ariz. 2014) 23 F.Supp.3d 1099, 1110.)

[10] See, e.g., Damato v. Time Warner Cable, Inc. (E.D.N.Y., July 31, 2013, No. 13-CV-994 ARR RML) 2013 WL 3968765, at *12.

[11] See, e.g., Chin v. Advanced Fresh Concepts Franchise Corp. (2011) 194 Cal.App.4th 704, 714.)

[12] Changing the provisions of a standardized contract as the result of negotiations of the parties results in the contract no longer being a contract of adhesion and reduces procedural unconscionability — meaning that more substantive unconscionability of the terms themselves is required to come to the conclusion that the agreement is unenforceable. Armendariz v. Foundation Health Psychcare Services, Inc. (2000) 24 Cal.4th 83, 114.

[13] Velazquez v. Sears, Roebuck and Co. (S.D. Cal., Aug. 26, 2013, No. 13CV680-WQH-DHB) 2013 WL 4525581, at *6.

[14] Arbitration Nation: Data from Four Providers (2019, forthcoming) 109 Cal. L. Rev. 1, 52, https://ssrn.com/abstract=3238460.

[15] Id.

[16] Some Federal Circuit courts hold that when a district court compels arbitration, it is required to instead stay proceedings. Katz v. Cellco P'ship, 794 F.3d 341 (2d Cir. 2015); Lloyd v. Hovensa, LLC, 369 F.3d 263 (3d Cir. 2004); Cont'l Cas. Co. v. Am. Nat'l Ins., 417 F.3d 727 (7th Cir. 2005); Adair Bus Sales, Inc. v. Blue Bird Corp., 25 F.3d 953 (10th Cir. 1994). However, after an adverse ruling on arbitrability and an

adverse arbitrator's award, a party can avail itself of the appellate courts.

[17] https://www.uscourts.gov/sites/default/files/data_tables/fcms_na_appprofile0930.2018.pdf.

[18] http://www.courts.ca.gov/documents/2018-Court-Statistics-Report.pdf.

[19] Vandenberg v. Superior Court (1999) 21 Cal.4th 815, 832.

[20] Advanced Micro Devices, Inc. v. Intel Corp. (1994) 9 Cal.4th 362, 384.

[21] CCP § 1286.2.

[22] See, e.g., Pearson Dental Supplies, Inc. v. Sup.Ct. (2010) 48 Cal.4th 665., 675-76, 680 (adopting a narrow rule when vacating an arbitration award where the arbitrator clearly erred by barring an employee from exercising his unwaivable statutory right to a hearing on the merits of his FEHA claim).)

[23] Moncharsh v. Heily & Blase (1992) 3 Cal.4th 1, 32.

[24] Id.

[25] 9 U.S.C.A. § 10; Cavalier Mfg., Inc. v. Gant (Ala. 2013) 143 So.3d 762; N.Y. C.P.L.R. 7511; Whitehead v. Pullman Group, LLC (3d Cir. 2016) 811 F.3d 116.

[26] See, e.g., Cable Connection, Inc. v. DIRECTV, Inc. (2008) 44 Cal.4th 1334, 1340 (holding that parties' agreement that "[t]he arbitrators shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected on appeal to a court of competent jurisdiction for any such error" was enforceable).

[27] O'Flaherty v. Belgum (2004) 115 Cal.App.4th 1044, 1061.

[28] Mastrobuono v. Shearson Lehman Hutton, Inc. (1995) 514 U.S. 52, 56–57 ("[I]f the contract says "no punitive damages," that is the end of the matter, for courts are bound to interpret contracts in accordance with the expressed intentions of the parties.").