

# WHERE SHOULD YOU LITIGATE YOUR BUSINESS DISPUTE?

*In an arbitration?  
Or through the courts?*

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**A key issue for business managers and executives is to decide on the process for dealing with disputes of various kinds, particularly those arising out of business transactions, such as those with suppliers, customers, partners, licensees, and others. There are many factors to consider in deciding whether the court or the arbitration hearing is the best place to resolve these disputes. This article discusses the relevant factors and suggests how they could affect a businessperson's decision.**

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**L**awyers who advise business entities commonly confront the question of whether to resolve disputes by arbitration. This usually comes up when the parties are negotiating a transaction agreement. Often the decision is made, not as a result of any systematic consideration of the merits of arbitration versus a judicial forum, but rather as a result of anecdotal information about good or bad experiences with each process. This article aims to provide the basis for a more systematic consideration of the arbitral versus judicial alternatives.

At least since the early 1990s, arbitration has become more popular with American business, which has been moving away from resolving commercial and business disputes through courtroom litigation and toward arbitration.<sup>1</sup> I use the term “courtroom litigation” to distinguish it from arbitration, which also can be considered a form of litigation, because both processes are adversarial and are conducted before an independent, neutral decision maker. Courtroom litigation is always administered by independent administrative staff, while arbitration is administered by a neutral administrative body only if the parties agree to it.<sup>2</sup> While an arbitral award can be voluntarily complied with by the losing party, often it must be entered in a court of law so that judicial mechanisms made possible by governmental power will allow for its enforcement against a noncomplying party. The era of judicial hostility to enforcing arbitration agreements, and enforcing arbitration awards, has been dead for several decades.<sup>3</sup>

Arbitration of commercial disputes always results from an agreement to arbitrate entered into either before or after a dispute arises. Whether to agree to arbitration turns on an understanding of the pros and cons of arbitration and courtroom litigation, in the context of considerations that matter to commercial entities. These will be discussed next.

### **Key Factors in Deciding Whether to Arbitrate**

Most companies involved in a business-to-business (B2B) dispute consider minimizing out-of-pocket costs and the cost of tying up management to be of high importance. When compared with courtroom litigation, arbitration is normally the more economical alternative. The principal factors informing this view are lower discovery costs in arbitration, fewer pre-trial motions (e.g., dispositive motions in arbitration can, in certain cases, be

allowed in the arbitrator’s discretion, but are not that common), and a more limited right to appeal.

#### **1. Discovery**

Discovery in arbitration almost always involves lower discovery costs than courtroom litigation. While document discovery is routinely authorized in arbitration under the rules of most ADR providers, wide-ranging document requests are not.<sup>4</sup> Moreover, interrogatories do not exist in arbitration, unless the parties have agreed to them. More significantly, depositions can be taken only with the agreement of both parties, and even then, deposition testimony can only be used as evidence.<sup>5</sup> As a result, depositions are rarely taken in small cases, and they are limited in the large, complex case.

There is a good reason why depositions have been available for many decades in courtroom litigation. They are thought to be a particularly effective means of discovery. However, this general proposition should be evaluated in the context of the dispute for which an arbitration is being considered. For example, the need for depositions may be much reduced in a B2B dispute between contracting parties who already know each other and each other’s personnel (or can be expected to have this knowledge by the time a dispute arises), so that a “surprise” witness is unlikely to surface. Depositions also may be unnecessary when the parties know (or probably will know) much of the evidence that will be critical at a hearing on the merits. This evidence usually takes the form of the parties’ written and electronic communications, and notes of meetings they attended relating to the dispute.

Since the taking and defending of depositions are usually the most costly aspect of courtroom litigation, the fact that they are used in a much more limited way in arbitration substantially reduces attorneys’ fees and interference with

management time. Indeed, the main savings in arbitration compared to litigation may well be the avoidance of depositions. These costs can seem particularly wasteful to a business executive whose B2B dispute is filed in court and then settles (as courtroom litigation usually does).<sup>6</sup> While federal courts have made it possible to reduce courtroom litigation costs by imposing some discovery limitations in the Federal Rules of Civil Procedure,<sup>7</sup> in general, these limitations are not followed.

There is one exception to the generally lower cost of discovery in arbitration. That is if the parties agree to conduct the arbitration under state or federal rules of judicial procedure. This is usually undesirable because most if not all of the benefits of arbitration will be lost.

## **2. Need for Third-Party Discovery**

An issue related to discovery, but not a cost issue, is the possible need for discovery from third parties. This issue bears on the choice of arbitration versus courtroom litigation. There is a split in the federal circuit courts on the issue of whether arbitrators have the power to subpoena documents from non-parties.<sup>8</sup> Whether or not this power exists in the relevant jurisdiction, the Federal Arbitration Act grants arbitrators the power to summon witnesses to appear before them at the hearing and order those witnesses to bring documents with them. Thus, if documents or other information in the hands of a third party is likely to be critical to a resolution of a B2B dispute, then arbitration will be less attractive than courtroom litigation.

## **3. Evidence, Scheduling, and Finality as Cost Factors**

Many pre-trial procedures associated with courtroom litigation are not used in arbitration, so the costs of these procedures will be saved in the arbitral forum. For example, pre-trial memoranda are required in most federal courts.<sup>9</sup> This expensive undertaking is designed to save time for a federal judge, whose services are paid by the taxpayers. Arbitration is usually conducted with considerably more informal and less expensive pre-hearing filings.

A courtroom trial is also likely to be more expensive than an arbitration hearing on the merits for several reasons.

First, evidence in arbitration can be introduced more quickly and with less dispute. In arbitration, fewer motions are filed challenging the admissibility of evidence because court rules of evidence do not apply. Thus, hearsay and other proof that might be excluded in a courtroom are usually admitted into evidence in arbitration but then reviewed quickly, and given little or no weight by the arbitrator. As a result, the costs of reviewing the evidence may be less in arbitration.

Second, courtroom trials are often conducted in the morning only so that judges can deal with motions in the afternoon. Trials conducted this way last longer but usually are no cheaper than trials conducted on a full-day basis. Arbitration hearings, in contrast, normally are conducted on one or more whole days. Indeed, it is not uncommon for an arbitration to continue well after the time a trial court has suspended its activities for the day, because the workday of court clerks and other court personnel must be accommodated.

Third, judges are frequently interrupted by emergency matters that will take precedence over a trial. This problem normally has no counterpart in arbitration.

Finally, in comparing bench trials to arbitration, the judge's decision may be delayed by the time it takes for the judge to be furnished with a written transcript. In arbitration, however, transcripts can be provided by private reporting services, which usually generate transcripts faster than official court reporters.<sup>10</sup>

Parties generally have much more control over the schedule in an arbitration than they have in a court proceeding. Arbitrators tend to set schedules that are convenient and not contrary to the wishes of the parties. They also tend to grant a modest number of extensions to the schedule. The convenience of a party's senior executive may be given much more consideration by an arbitrator than by a judge.

## **4. Finality as an Issue**

An arbitration award is more likely to produce a final resolution of the dispute than is a trial court judgment, which can be appealed as of right on much broader grounds than those on which an award can be challenged in court. This will save both parties the cost of appellate legal fees and costs. To be sure, the loss of expanded appellate

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review may seem significant on the surface. But since the typical contract-based, B2B dispute is unlikely to present novel legal issues, even if tried in court, appellate interference with a jury verdict or bench trial judgment is not very likely.<sup>11</sup>

### 5. *Controlling Arbitrators' Fees*

In a lengthy arbitration, the arbitrator's compensation can become expensive. This is especially true if the parties are using a panel of three arbitrators. Parties can reduce arbitration costs by choosing a single arbitrator. If a panel is a must, the parties could select panelists from the same geographic location as the location of the hearing, since this should ease scheduling difficulties and lower travel expenses.<sup>12</sup> In addition, the parties can further reduce expenses by agreeing that all procedural and discovery disputes will be resolved by the chair of the panel.

***The parties have greater control over the arbitration process than they do in courtroom litigation—"an often overlooked factor" that should be important to business.***

In a consumer arbitration (i.e., a consumer dispute with a business), depending on which ADR provider is selected, the filing fees in arbitration could be much higher than judicial filing fees. However, this is not true of the American Arbitration Association, which has adopted special procedures and very low fees for consumer-related disputes involving small amounts at issue.<sup>13</sup>

### 6. *Speed as a Factor*

Arbitration proceedings are typically concluded more expeditiously than courtroom litigation (unless the court has a "rocket docket" or the case is susceptible to early resolution via summary judgment, which is easier to obtain in federal court<sup>14</sup>). The speed of arbitration is likely to be a favorable factor from a business standpoint, unless you're the defendant and have a weak case. Then you might prefer to postpone the day of financial judgment.

The principal reason that arbitration is usually faster, at least in the case of B2B litigation, is that depositions generally are not taken and disputes over document production are quickly resolved by the parties or the arbitrator.

The American Bar Association is currently studying the question of whether, and in what circumstances, arbitration resolves disputes faster than courtroom litigation.<sup>15</sup>

### 7. *The Danger of Juries for Business*

Businesses may have good reasons to prefer an arbitrator to a jury. If the case involves a large "out-of-state" party, there is the spectre of jury bias. There is also the possibility of jury cynicism toward business, which can make litigation unpredictable, regardless of the strength of a party's case. There are also certain "infamous" locations where businesses may prefer arbitration to litigation.<sup>16</sup>

There is considerable evidence (albeit of the polling variety) that the recent corporate scandals have increased juror skepticism.<sup>17</sup> A nationwide survey of 1,000 jury-eligible subjects revealed that American jurors' distrust is "on the rise" in the post-Enron and WorldCom environment and warns "Corporate counsel [to] beware."<sup>18</sup> A study of 543 mock jurors conducted by *Litigation Insights* found that "our mock jurors have taken a decidedly cynical turn" about business corpora-

tions.<sup>19</sup> One writer noted that "[a] study of juror attitudes [shows that] companies across the board will be paying the price in the courtroom for the corporate misdeeds that have dominated this year's [2002's] headlines ... [J]urors in communities with a significant corporate presence, such as in ... the Northeast, are actually the most hostile to corporations."<sup>20</sup>

### 8. *Control Over the Process*

Business entities do not like ceding control. In arbitration, the parties retain considerably more control over the process than they do in courtroom litigation. This often overlooked factor should be of considerable importance to those who decide whether to arbitrate or litigate disputes.

In arbitration, the parties have considerable control over the selection of the arbitrator, using whatever process they have agreed upon in their contract. The parties also can agree on the type of experience and expertise the arbitrator should have. They may wish to have an arbitrator with expertise in the subject matter if the transaction out of which the dispute arose is complicated (e.g., sale and license agreements in the high tech industry, construction, or venture capital limited partnership matters), or if standard business prac-

tices or possibly even the course of performance (e.g., parties to a particular trade association or treaty) are relevant to the dispute.

In contrast, parties to courtroom litigation have little control over which judge hears the case and cannot choose a judge with particular knowledge or experience. Thus, in courtroom litigation, the parties risk having a judge with no subject-matter expertise, except perhaps in some specialty business courts.<sup>21</sup>

Some lawyers believe that an arbitrator who lacks knowledge of the subject-matter may be more likely to “split the baby” than an arbitrator with such knowledge. However, there is no empirical support for this belief. Indeed, a survey of all AAA commercial awards in 2000 comparing the amount originally claimed to the amount awarded showed that awards were clearly in one party’s favor 75% of the time. Only 9% of the time, arbitrators awarded between 41-60% of the amount claimed.<sup>22</sup> Arbitrators who handle B2B litigation, such as those serving on the AAA commercial arbitration panel, simply want their awards to reflect good analytical and reasoning skills.

## 9. The Privacy Factor

Privacy in arbitration is a factor that should be given great weight, particularly in this era of electronic court filings. Arbitration can be kept a private matter if the parties agree to keep it that way. Of course, an arbitration will become public as a result of a motion to enforce an arbitration agreement, or to confirm or vacate an award, because judicial proceedings and decisions are always public. Parties and witnesses can also leak information to the press. But in general, arbitration offers considerable privacy, whereas litigation offers much less. Moreover, with electronic case filing, particularly in conjunction with discovery motions that may disclose information from otherwise non-public depositions or other discovery, confidential information that surfaces

in a litigation could end up on the Internet,<sup>23</sup> as will the pleadings and any dispositive motion papers.

Even if an arbitration award becomes public as a result of a motion to confirm or vacate, it may not disclose much confidential information.<sup>24</sup>

## Other Issues to Consider

### 1. Enforceability

Enforceability is not a major concern when comparing arbitration to litigation. Arbitration awards can be confirmed in court. First they are converted to court judgments, and then they are enforced in exactly the same manner as any other judgment.<sup>25</sup>

### 2. Need for Consolidation

The possibility of consolidation of related arbitrations is also not a major concern. The parties can expressly agree to consolidation of specified arbitrations between named parties. This is not uncommon in multi-party transactions. The Revised Uniform Arbitration Act expressly provides in § 10 for consolidation where each agreement to arbitrate has one party in common. The FAA is silent on consolidation and thus may not allow it absent authorization in state law.<sup>26</sup> In the 1st Circuit at least, a designation of state law can supplement the FAA to allow consolidation,<sup>27</sup> if the arbitration agreements do not prohibit it.

## Going Forward in Arbitration

If the parties decide to use the arbitration process to resolve their future disputes, they also need to consider whether the arbitration arrangements to which they propose to agree will serve the ends they seek. A narrow arbitration clause might well lead to courtroom litigation about whether a particular dispute is arbitrable under the terms of the contract in question, while a broad clause might not. ■

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## ENDNOTES

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<sup>1</sup> David B. Lipsky & Ronald L. Seeber, *The Appropriate Resolution of Corporate Disputes: A Report on the Growing Use of ADR by U.S. Corporations* 5 (Cornell/PERC Institute on Conflict Resolution, 1998).

<sup>2</sup> Occasionally *ad hoc* arbitration is used. In this type of arbitration, the arbitrator administers the arbitration working with the parties.

<sup>3</sup> *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983) and *Mitsubishi Motors Corp. v.*

*Soler Chrysler-Plymouth, Inc.* 473 U.S. 614 (1985). See also *Steelworkers v. Warrior & Gulf Nav. Co.*, 363 U.S. 574, 582-83, 80 S.Ct. 1347, 4 L.Ed.2d 1409 (1960) (arbitration should be ordered “unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute”).

<sup>4</sup> *E.g.*, Rule R-21 of the Commercial Arbitration Rules of the American Arbitration Association

(AAA Comm'l Rules), effective July 1, 2003.

<sup>5</sup> See, *e.g.*, the Mass. Uniform Arbitration Act (MUAA), Mass. Gen. Laws, ch. 251, § 7(b) (arbitrator may permit a deposition “for use as evidence”); Revised Uniform Arbitration Act 2000(RUAA), § 17 (same). The Federal Arbitration Act is silent on depositions.

<sup>6</sup> It may be argued that discovery in arbitration is inadequate because the arbitration demand is usually less

informative than a notice-pleading complaint. However, arbitrators can and do see that they and the parties have an adequate statement setting forth the nature of the dispute. See AAA Comm'l Rules, Rule R-4(a)(i) & (d).

<sup>7</sup> See Fed. R. Civ. P. 16(a)(3), 26(b)(2), and, e.g., D. Mass. Local Rule 26.1(C).

<sup>8</sup> See *In re Security Life Ins. Co. of Am.*, 228 F.3d 865, 870-871 (8th Cir. 2000) ("We thus hold that implicit in an arbitration panel's power to subpoena relevant documents for production at a hearing is the power to order the production of relevant documents for review by a party prior to the hearing."); *Meadows Indemnity Co. v. Nutmeg Ins. Co.*, 157 F.R.D. 42, 45 (M.D. Tenn. 1994) ("The power of the panel to compel production of documents from third-parties for the purposes of a hearing implicitly authorizes the lesser power to compel such documents for arbitration purposes prior to a hearing."); But see *Hay Group, Inc. v. E.B.S. Acquisition Corp.*, No. 03-1161/1162 (3rd Cir. filed March 12, 2004) (holding that the plain language of the FAA clearly grants arbitrators the power to order witnesses to bring documents with them, but nothing more), *COMSAT Corp. v. National Science Found.*, 190 F.3d at 269, 276 (4th Cir., 1999) (holding that arbitrators cannot generally issue pre-hearing document subpoenas, but noting in dicta that arbitrators may be able to do so upon "a showing of special need or hardship").

<sup>9</sup> See, e.g., D.Mass. Local Rule 16.5(D).

<sup>10</sup> See Report of the Study Committee on Trial Transcripts, June 30, 2003, on file with the Mass. Sup. Jud. Ct., Pt. III (surveying courtroom transcript delay and causes) available at [www.mass.gov/courts/trialtransrep.pdf](http://www.mass.gov/courts/trialtransrep.pdf).

<sup>11</sup> Award confirmation is "usually routine or summary." *Riccard v. Prudential Ins. Co.*, 307 F.3d 1277, 1288 (11th Cir. 2002).

<sup>12</sup> Note that in considering relative cost, and absent the parties' contrary agreement, an arbitrator may be able

to award punitive damages, even where they might be unavailable in court. *Raytheon Co. v. Automated Business Sys.*, 882 F.2d 6, 9 (1st Cir. 1989).

<sup>13</sup> AAA Supplementary Procedures for Consumer Related Disputes, Rule C-8, effective July 1, 2003 (maximum consumer responsibility for arbitrator's fee of \$125 for claims under \$10,000, and \$375 for claims between \$10,000 and \$75,000, with waiver, and no consumer responsibility for administrative fees for claims up to \$75,000).

<sup>14</sup> The AAA Commercial Rules, which are in common use in business arbitrations, do not expressly provide for summary judgment. Disposition of a particular claim on motion more easily fits with the arbitrator's power under these rules than disposition of all claims (see Rules R-30(b) and R-34, as well as the Procedures for Large Complex Commercial Disputes, Rule L-4(a)), as arbitrators are wary of the danger of vacatur under § 10(a)(3) of the FAA for "refusing to hear evidence pertinent and material to the controversy." Section 15 of the RUAA expressly provides for summary disposition of a claim or particular issue.

<sup>15</sup> Atlas, Scott, "Have You Ever Tried to Make Up Your Mind about Arbitration," 1 *ABA Litigation* (Fall 2002).

<sup>16</sup> See *State v. Hometown Lending*, 826 A.2d 997 (Vt. 2003) refusing to give full faith and credit to an Alabama judgment, which it characterized as a "'drive by' class action."

<sup>17</sup> See e.g., Hsieh, "Post-Enron Juror Attitudes Are Hardening Against Corporate Defenders," *Lawyers Weekly USA* (9/02/02), available at [www.lawyersweeklyusa.com/subscriber/archives.cfm?page=/archives/usa/02/902055.htm](http://www.lawyersweeklyusa.com/subscriber/archives.cfm?page=/archives/usa/02/902055.htm)

<sup>18</sup> DecisionQuest/MCCA Juror Perception Survey (10/16/02), available at [infor@decisionquest.com](mailto:infor@decisionquest.com).

<sup>19</sup> *Litigation Insights*, June 20, 2002.

<sup>20</sup> Loomis, "Business Scandals Rock Jury Attitudes," 228 *N.Y. L. J.*, Oct. 16, 2002, at 1.

<sup>21</sup> E.g., the Delaware Chancery Court, or the Massachusetts Superior Court Business Law Session.

<sup>22</sup> Stephanie E. Keer, & Richard W. Naimark, "Arbitrators Do Not 'Split the Baby': Empirical Evidence from International Business Arbitration." 18 *J. Int'l Arb.*, 573-578 (October 2001).

<sup>23</sup> With the advent of Electronic Case Filing (ECF), some judges have issued standing orders that all written materials must be filed electronically. The availability of case information on the internet makes it very simple for any member of the public to view the documents in the case. See Fed. R. Civ. P. 5(e) (authorizing district courts to establish electronic filing rules). See [www.mad.uscourts.gov/CaseInfo/CM\\_ECF.htm](http://www.mad.uscourts.gov/CaseInfo/CM_ECF.htm) for information about the District of Massachusetts ECF program, and [www.nysd.uscourts.gov/cmecf/cmecfindex.htm](http://www.nysd.uscourts.gov/cmecf/cmecfindex.htm) for information about the Southern District of New York's program.

<sup>24</sup> The reason is that arbitrators "need not" render a reasoned award unless the parties request one prior to appointment or the arbitrator determines that such an award is appropriate. AAA Comm'l Rules, R-42(b). The growing trend is for parties to request reasoned awards in most commercial arbitrations. The old fear that a reasoned award was more vulnerable to a motion to vacate has substantially abated.

<sup>25</sup> This legal judgment is authorized by statute: e.g., the FAA § 10, MUAA § 11. See also RUAA § 22.

<sup>26</sup> See Michael Hoellering, "Consolidated Arbitration: Will it Result in Increased Efficiency or an Affront to Party Autonomy?," *Disp. Resol. J.* (Jan. 1997), and cases cited at ns. 25-30; Domke, *Commercial Arbitration*, § 27.02.

<sup>27</sup> *New England Energy v. Keystone Shipping Co.*, 855 F.2d 1 (1st Cir. 1988). An express choice-of-law clause designating Massachusetts law may enhance the likelihood of consolidation because the Massachusetts arbitration statute expressly permits it. Cf. *Volt Information Sci. v. Board of Trustees of Leland Stanford Jr. Univ.*, 489 U.S. 468 (1989) (state arbitration rules can be incorporated into parties' arbitration agreement).