Mediation and Arbitration

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by David K. Taylor

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One of the most important changes in the legal system over the past 10 years has been the explosion of the use of mediation and arbitration by parties and lawyers to resolve civil legal disputes. Many business fields, such as construction and securities, have for years placed arbitration clauses in standard contracts that prevent a party from filing a claim in court. Most courts, faced with the overwhelming number of cases that have flooded the legal system, have embraced arbitration and mediation. Over the past two years, following decisions of the United States Supreme Court, many employers are also requiring their employees (even "at will" employees) to sign arbitration agreements. Many businesses are also following this trend. Banks and insurance companies are placing binding arbitration clauses in form contracts, and many credit card companies, such as American Express, require their customers to arbitrate disputes. Fortune 500 companies as well as the federal government have formally pledged to use alternatives to the existing court system to resolve legal disputes. There are also many groups, such as the American Arbitration Association, that offer dispute resolution services as well as a roster of experienced mediators and arbitrators. Many lawyers also augment their traditional legal practice by offering their services as arbitrators and mediators.

Problems with the Current Legal System

The primary reason why the legal and business communities have accepted mediation and arbitration and are pushing for such alternative methods of dispute resolution (commonly known as "ADR") is the perception of problems with the existing legal system. Any company that has been through a lawsuit, even if resolved in its favor, does not wish to go though the process again. Some of the problems are as follows.

Costs of Litigation. The existing court system is extremely expensive and time consuming for any business. Lawyers are very expensive. More important, while fully 98 percent of all civil cases settle before trial, settlement usually takes place on the courthouse steps *after* the parties have incurred the vast majority of the hard and soft costs of litigation. A company must consider the hard costs of litigation, such as attorney fees and expenses. Under Tennessee law, unless there is an attorneys' fees provision in the contract, such expenses are not recoverable—even to the winning party. A company may win the battle in court but in fact lose the war when it realizes that after subtracting the fees and expenses spent on a litigated case the bottom line is a net zero recovery. There are many horror stories in which the attorneys' fees and expenses incurred by all sides to a dispute far exceed the amounts at stake.

A business must also consider (and managers and owners frequently do not) the substantial soft costs of litigation. This factor is also sometimes not fully understood by lawyers. Time is money and, in any case, management and other key employees must give and spend a considerable amount of time to the dispute. The simple fact that a company is being accused of fraud or breaching a contract also has a psychological impact on the company. One client said it best: "While only one percent of my deals have ended up in a lawsuit, that one deal cost me 75 percent of the profit I made on the other 99 percent of the deals."

Publicity and Public Filings. Litigation also damages reputations and sometimes helps

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competitors. Court filings are public record, and one cannot "un-ring" a bell. While the filing of a lawsuit, even if frivolous, may make the front page of the newspaper, the dismissal of that claim a year later may not get reported. All filings in court and transcripts of testimony at trial are open to any competitor seeking a competitive edge or inside information. In a case involving a claim for lost profits, for instance, the business making the claim must open up its records in order to prevail.

Time. Some lawsuits may take years to get to trial, and then, even after a trial, the party has an automatic right to appeal, which may take another two to three years. The fact is that any smart clients and lawyers, if they want, can make the other side wait a considerable amount of time before paying the piper—which in some circumstances may be exactly what they intended. There are many instances where an otherwise solvent defendant has been able to delay a final hearing for frivolous reasons, and by the time a judgment has been rendered, that company's assets are gone or a bankruptcy has been filed. While there are ways in which to trace the assets, that process can mean more lawsuits and attorneys' fees.

Unpredictable Results. There is no way to guarantee what a judge or jury may do in a civil case. More important, if the case involves complicated facts, expert testimony, or industry-specific issues, there is a potential for the jury and even the judge to get confused and render an unfair judgment. It is also very difficult in the short time of a trial to educate the jury and judge about the particular subject matter of the dispute. Therefore, when a business places a substantial legal dispute (especially where the outcome of the business may be at stake) in the hands of a judge or jury, it is engaging in nothing less than legalized gambling.

Mediation to Resolve Legal Disputes

Mediation is the fastest growing method of ADR. In mediation the parties hire a neutral third party (a mediator) to help them negotiate a face-to-face settlement. Mediation is confidential and not open to the public. Statistics show that 85 percent of all disputes submitted to mediation settle. Mediation can be set up in a matter of weeks and normally does not take more than one business day. Mediation can take place at any time before or after a lawsuit has been filed, and there is no need to obtain court approval. Lawyers also may or may not be involved in the process.

The role of the mediator is much different than that of an arbitrator or a judge. The mediator does *not* make or impose a decision. Mediation is also "nonbinding," meaning the parties do not give up any rights by participating in mediation. The sole purpose of mediation is to attempt to negotiate a settlement between the parties by breaking down the barriers to communication and encouraging offers and counteroffers. Mediation is most effective when both parties have a genuine interest in settlement and have a history of cooperating with one another and when the disagreement has not escalated to the point of real animosity. The solutions sought in mediation can also be business solutions and not strictly legal solutions. All a court can normally do is decide who gets money and how much. Parties in mediation can agree to continue to do business together or settle the claim for something other than a monetary payment.

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Binding Arbitration

Binding arbitration is the reference of the dispute to an impartial (third) person chosen by the parties, who agree in advance to abide by the arbitrator's award issued after a hearing at which both parties have an opportunity to be heard. When parties agree to arbitrate a dispute they forego enforcing their legal rights, choosing to rely instead upon the arbitrator's sense of fair play. The arbitrator is usually someone with knowledge and expertise in the field being disputed. Legal considerations in arbitration will not be disregarded entirely, but the rules of procedure and evidence specifically followed in the courts are not employed unless the parties agree otherwise. For example, it is almost impossible to appeal an arbitration decision. Unlike litigation, finality is the rule rather than the exception.

The decision to place an arbitration clause in a contract or to agree to arbitrate a claim after a dispute has arisen is a vital business decision that cannot be taken lightly. As stated above, many fields, such as construction and securities, have determined that binding arbitration is a better method of dispute resolution. However, there are many businesses and lawyers who are firmly opposed to arbitration. For these reasons, especially when reviewing all of the "disadvantages" of litigation set out above, it is important for businesses making this decision to fully understand the pros and cons of arbitration.

Pros and Cons of Binding Arbitration

Predictability. Probably the most frequent complaint of litigation is that judges or juries do not understand complicated business disputes, often leading to unpredictable and unsatisfactory results. There can never be any real answer to why a jury or judge ruled the way it did in a case. Arbitration employs a third party neutral or neutrals who have extensive experience and knowledge in the area of dispute, e.g., construction, personal injury, real estate, labor, finance, or securities. Arbitrators also do not have to be lawyers. This characteristic of arbitration can eliminate the substantial problems and costs of educating a judge or jury in the nuances of a specified business field. Properly selected arbitrators are able to understand and focus on the most relevant issues in the dispute and are not easily swayed by lawyers' emotional arguments. Moreover, there is considerably less formality in an arbitration hearing. For instance, strict adherence to conventional rules of evidence and procedure are not followed. Instead, the focus is on the facts and testimony and not any archaic rule of evidence.

Time. Because there is no need to conform to a crowded court docket, arbitrations can be set for hearing in a matter of months, not years, even when millions of dollars are at stake. In addition, it is almost impossible to appeal an arbitration award, and so finality is the rule rather than the exception. Being able to schedule a hearing and have a dispute resolved quickly is to the benefit of all parties.

Costs. In most cases, the costs and expenses of arbitration are much less than litigation. Since litigation is most often criticized for the abuse of pretrial discovery (i.e., scores of unnecessary depositions), it is significant that, with a few exceptions, such discovery is *not* allowed in arbitration. In most arbitrations, the absence of prehearing motions and depositions, as well as the finality of the decision, significantly reduces attorneys' fees and costs. The normal rule is that one day of arbitration equals two to three days in court, again saving money for both parties. Finally, prolonged personal involvement by crucial officers and employees of a company in depositions and discovery-planning conferences, which takes away from the pursuit of other business, is avoided.

Privacy. Unlike the public court system, arbitration is private and confidential. The proceedings are *not* subject to the requirement for openness and accessibility in proceedings of civil litigation. Arbitrators and mediators maintain the privacy of the hearings unless some law provides to the contrary.

Conclusion

Arbitration and mediation are not panacean, and in some instances parties are better off in court. However, businesses should determine with their lawyers whether or not they want to place ADR clauses into their contracts and should know about the availability of ADR in the event that a legal claim arises. Finally, any lawyer advising a company should, as an ethical requirement, advise a client that there are, in fact, alternatives to court. A business should not charge blindly headfirst into litigation but should examine all alternatives available to resolve a dispute to its best interests. With very few exceptions, going through an expensive, delay-ridden trial is not in the best interests of any business. If the dispute can be resolved through ADR, clients can be assured of proceedings that will, in most instances, be faster, more confidential, more predictable, and less expensive than litigation. ■

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