

Attack on Arbitration:
A Growing and Troublesome Trend or a Passing Fad?

New Trends in Domestic and International Arbitration

Alternative Dispute Resolution Section Program

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"I was only ruined twice in my life; once when I lost a lawsuit and once when I won one." (Voltaire)

I. In recent years, there has been a large increase in use of arbitration and mediation in U.S. Important not only to outside and corporate counsel of U.S. corporations, but also to counsel for foreign corporations doing business in U.S. and, therefore, subject to U.S. legal system.

II. New Trends:

- A. Increased court ordered arbitration and mediation;
- B. Increased contractual mandatory binding arbitration and use of mediation:
 - 1. consumer disputes;
 - 2. employment disputes;
 - 3. commercial disputes.

III. Most frequently used forms of alternative dispute resolution

- A. Arbitration- private trial before one arbitrator or a panel of arbitrators.
- B. Mediation- facilitation of settlement negotiations between the parties and their counsel by neutral mediator.

III. Arbitration and mediation are increasingly used to avoid court litigation because of:

- A. Court congestion, pressures on judiciary, counsel and parties to dispose of cases; delay vs accelerated docket.
- B. Dissatisfaction of domestic and foreign corporations with specific features of U.S. legal system: excessive discovery, high litigation costs, adverse publicity, destruction of long term relationships between parties; punitive damages; class actions; jury trials and unpredictability of jury verdicts.

C. Advantages of arbitration and mediation: less expense, less discovery, less technical rules of procedure and evidence, confidentiality of proceedings, and expertise of arbitrator or mediator. In mediation, flexibility in designing remedy, controlling result and preservation of parties' relationship. Recent survey by ABA Litigation Section Task Force on ADR: arbitration more efficient (78%) and cost effective (56%) than litigation.

IV. Court ordered proceedings.

- A. New rules and decisions in almost every state and federal court requiring arbitration and/or mediation:
1. Mandatory, nonbinding arbitration of lawsuits involving less than a certain amount. e.g. U.S. District Court in Arizona: optional non-binding arbitration of claims under \$150,000 (Local Rule of Practice 2.11); Arizona Superior Court: mandatory non-binding arbitration of claims under specific amount, Rules 72-76, Ariz. R. Civ. Proc. Amount varies by county: e.g. Maricopa (Phoenix) County and Pima (Tucson) County- \$50,000, Maricopa County Rule 3.10, Pima County Rule 3.9. Party can "appeal" arbitration award by requesting a jury trial de novo.
 2. Waiver of mandatory arbitration if parties agree to mediation, Rule 72 (d), Ariz. R. Civ. Proc.
 3. Mandatory meeting of counsel within 90 days after first appearance of a defendant to consider ADR options and file report with court within 30 days thereafter re potential settlement, Rule 16(g), Ariz. R. Civ. Proc. Under consideration: amendment that would require ADR before judge sets a trial date.
 4. Settlement conferences, Rule 16.1, Ariz. R. Civ. Proc. and Maricopa County Rule 3.11.
 5. Increased use of mediation: in mid May, 2003 Delaware House of Representatives approved creation of new task force to improve mediation of complex business cases in Court of Chancery; 1st Circuit ruled that a federal trial court has "inherent power" to order mediation, *In re Atlantic Pipe I*, 304 F. 3d 135 (1st Cir. 2002); 2nd Circuit has extended its mediation pilot program.

6. Practical effect: corporate and individual litigants and counsel are forced into earlier evaluation of cases and initiation of settlement discussions thereby changing the prior “culture of litigation” to a “culture of settlement”.

V. Increased contractual use of mandatory binding arbitration as a result of recent U.S. Supreme Court decisions that have approved such clauses. This has been highly controversial and has been subject to continuing challenges in lower courts.

A. Consumer Agreements:

1. Green Tree Financial Corp- Alabama v. Randolph, 531 U.S. 79 (2000) upholding mandatory arbitration clause in mobile home financing agreement. But see Ting v. AT&T, (No. 02-15416, 9th Cir. 2003), cert. den. Oct. 6, 2003, invalidating service agreement with mandatory arbitration clause barring class action and punitive damages.
 - a. Where contract is silent as to class actions, split in authority as to whether they can be brought. Allowed: Keating v. Superior Court, 183 Cal. Rptr. 36 (Cal. 1982), Dunlap v. Berger, 567 S.E. 2d 265 (W. Va. 2002), cert. granted January 10, 2003; Denied: Champ v. Trading Co., 55 F.3d 269 (7th Cir. 1995); Green Tree Financial Corp v. Bazzle, (U.S. Supreme Ct. No. 02-634, June 23, 2003) reversing 569 S.E. 2d 349 (S.C. 2002). Discover Bank v. Superior Court, 129 Cal. Rptr. 2d 393 (Cal. App. 2003) denied class action and held that Federal Arbitration Act § 2 preempts California consumer laws that allow class actions. On appeal to California Supreme Court.

B. Employment Contracts:

1. Circuit City Stores, Inc. v. Adams, 532 U.S.105 (2001) upheld mandatory arbitration clause in employment agreement. Accord, Martindale v. Sandvik, 801 A. 2d 872 (N.J. 2002), In re Halliburton, 80 S.W. 3d 566 (Tex. 2002) upheld binding mandatory arbitration provision adopted after employee was hired. Contra, Leodori v. Cigna Corp., (No. A-120-01, N. J. 2003). See also Ferguson v. Countrywide Credit Industries, Inc., 298 F. 3d 778 (9th Cir.2002) invalidating clause on grounds of lack of mutuality.
2. 9th Circuit (en banc) upheld refusal of law firm to hire a prospective secretary who refused to sign an employment arbitration agreement

on grounds it was discriminatory under federal discrimination statutes, *EEOC v. Luce, Forward, Hamilton & Scripps* (No. 00-57222, 9th Cir., Sep. 30, 2003) On May 13, 2003, the 9th Circuit struck down Circuit City's arbitration clause, citing California law, because the prospective employee could not refuse to sign it or opt out altogether, *Ingle v. Circuit City*, 328 F. 3d 1165 (9th Cir. 2003).

C. Insurance Policies:

1. Automobile – Uninsured/Underinsured Motorist first party claims-usually binding arbitration as to amount of claim, but not coverage issues or bad faith claims. Arbitration cannot be compelled to determine if insured sufficiently corroborated UM claim. *Scruggs v. State Farm Mut. Auto. Ins. Co.*, 62 P. 3d 989 (Ariz. App. 2003);
2. Homeowners, Inland Marine, Umbrella first party claims- usually, binding appraisal as to amount of loss, but not coverage issues or bad faith claim;
3. Comprehensive General Business Liability, Workers Compensation, Professional Liability. Generally, no arbitration of first party disputes;
4. Reinsurance- Binding arbitration extensively used in cedent-reinsurer treaties.

D. Mandatory binding arbitration in other contracts:

1. Construction contracts between general contractors, subcontractors and owners;
2. Manufacturers/Distributors and customers;
3. Securities industry-under National Association of Securities Dealers (NASD) Code of Arbitration Procedure, customer brokerage agreements require mandatory binding arbitration of disputes between customers and brokers, between brokerage firms, and brokers and their employees except employment discrimination cases which can be arbitrated if the parties agree. Recent stock market conditions have increased these claims.

4. Professional services agreements:

- a. Medical services: Patient agreement with arbitration clause for malpractice claims held unenforceable as contract of adhesion. *Broemmer v. Abortion Services of Phoenix*, 840 P. 2d 1013 (Ariz. 1992). But, court did not address issue of whether a properly authorized, drafted and executed agreement, with informed consent, would be valid.
- b. Legal services: ABA Formal Opinion 02-425- Model Rules of Professional Conduct do not prevent lawyers from including binding arbitration of fee and malpractice disputes in retainer agreements. Fee disputes are arbitrable in Arizona. In the Matter of *Connelly*, 55 P. 3d 756 (Ariz. 2002). But see *In re John M. Quinn P.C.*, (Tex. Civ. App. No. 12-02-00352-CV, June 25, 2003) denying arbitration of class certification issues in fee dispute in breast implant litigation.
- c. Nursing homes: Emerging cases holding resident arbitration agreements valid. *Integrated Health Services v. Lopez-Silvero*, 827 So.2d 338 (Fla. App. 2002).

VI. Concepts and language of arbitration agreement are critical when drafting arbitration agreements.

- A. There must be a clear written intent to have binding arbitration. A written agreement to arbitrate is “valid, enforceable and irrevocable” unless otherwise unenforceable. Federal Arbitration Act, 9 USC § 2; ARS § 12-1501. It is enforceable only as to parties. Third party non-signatories cannot be compelled to arbitrate.
- B. Scope of arbitration must be clearly expressed, preferably as broadly possible. A frequently litigated issue is whether all or only some issues are arbitrable, e.g. whether a breach of contract caused by tortious conduct (as distinguished from non-tortious conduct) must be litigated in court or arbitrated. Compare *Flower World of America, Inc. v. Wenzel*, 594 P. 2d 1015 (Ariz. App. 1979) allowing arbitration of fraud claim under broad clause with *Dusold v. Porta-John Corp.*, 807 P. 2d 526 (Ariz. App. 1990) denying arbitration of personal injury claim arising out

of contractual relationship. See also *Bratt Enterprises, Inc. v. Noble International Ltd.*, (6th Cir. No. 01-4244, July 31, 2003) denying arbitration as to issues outside arbitration clause. Clause providing for arbitration of claims “related to or connected with” the contract held to mean “every dispute between the parties having a significant relationship to the contract regardless of the label attached to the dispute.” *J.J. Ryan & Sons v. Rhone Poulenc Textile, S.A.*, 863 F. 2d 315, 321 (4th Cir. 1988).

C. Binding vs. non-binding arbitration. Must be an explicit agreement for binding arbitration. E.g. arbitration clause in excess policy construed as non-binding where it did not contain express provision for binding arbitration, institutional arbitral rules providing for binding arbitration were not incorporated and arbitration clause referred to arbitration as a “condition precedent to any right of action under [the] policy.” *Dow Corning Corp. v. Safety National Casualty Corp.*, 335 F. 3d 743 (8th Cir. July 9, 2003).

D. Choice of institutional or ad hoc arbitration administration.

1. Institutional arbitration- arbitration is administered by an institution e.g., American Arbitration Association or Chartered Institute of Arbitrators.

a. the arbitral institution furnishes lists of arbitrators with relevant specialties and parties choose arbitrators.

b. the institution’s rules of procedure apply. These vary between institutions. Counsel must be familiar with them before designating a specific institution.

2. Ad hoc arbitration-

a. typically, the parties agree on an arbitrator or each party chooses an arbitrator and the two arbitrators choose the third. Parties can specify qualifications of arbitrators and can designate who will choose third arbitrator if the two cannot agree within a specified period- usually, a court applying the law of the place of arbitration.

b. parties can agree which rules of procedure apply.

E. Several related contracts- all should have uniform arbitration clauses

1. If there are several related contracts, some requiring arbitration, others not, under “intertwining doctrine”, arbitration of otherwise arbitrable contracts may be denied if they are “intertwined” with non-arbitrable contracts. Contracts with arbitration clauses must be arbitrated. *Hallmark Industries, LLC v. Systech International, Inc.*, 52 P. 3d 812 (Ariz. App. 2002).

F. Choice of place of arbitration. Potentially, very significant issue. Law of forum may govern over procedural and substantive law chosen by parties in such matters as choice of third arbitrator if two cannot agree, vacating an award contrary to the public policy of the arbitral situs even though not contrary to public policy of the governing substantive law chosen by the parties, whether the dispute is even arbitrable, whether there has been a waiver of the right to arbitrate, appeal of the award, etc. E.g. *Alghanim & Sons v. Toys R Us, Inc.* 126 F.3d 15 (2d Cir. 1997) cert. den., held U.S. law applies to vacating award rendered in U.S. in international arbitration between Kuwaiti claimant and U.S. defendant.

G. Ex parte communications with arbitrators.

1. In international arbitration and sometimes in domestic, all arbitrators are neutrals- no ex parte communications between arbitrators and parties are permitted. In some domestic arbitrations, ex parte communications are permitted between a party and its designated arbitrator where each party designates one arbitrator and the two choose the third. E.g. American Arbitration Association Code of Ethics for Arbitrators in Commercial Disputes, Canon VII.C.
2. But, to what extent can a party designated arbitrator have pre-hearing communications with the designating party without risking disqualification under the “evident partiality” test of Federal Arbitration Act, § 10 (a) (2) and ARS § 12-1512.A.2.
 - a. *Employers Ins. of Wausau v. Nat. Union Fire Ins. Co.*, 933 F. 2d 1481 (9th Cir. 1991) appeals court reversed disqualification order of trial court stating that “Unlike the standard for judges, parties must demonstrate more than a mere appearance of bias to disqualify an arbitrator... Nothing in the record indicates that [the

challenged arbitrator] who had consulted with Wausau's attorneys regarding case came to the hearings with a closed mind or a predeliction to rule for Wausau."

b. In *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 US 145, 150 (1968), Supreme Court held that "arbitrators are not automatically disqualified by a business relationship with the parties before them if both parties are informed of the relationship in advance."

c. In *Sphere Drake Ins. Ltd. v. All American Life Ins. Co.*, 307 F. 3d 617 (7th Cir. 2002), court reversed trial court's disqualification of an arbitrator who, four years prior to the arbitration, while a partner in a large law firm, had represented a subsidiary of one of the parties in an unrelated matter. The court emphasized the distinction between party appointed and neutral arbitrators.

d. In *Metropolitan Prop. & Cas. Ins. Co. v. J.C. Penney Cas. Ins. Co.*, 780 F. Supp. 885 (DC Conn, 1991) court disqualified Penney's designated arbitrator based on pre-hearing discussions at Penney's headquarters of its defenses, examination of documents and efforts to discuss case with other arbitrator prior to selection of third arbitrator.

H. Punitive damages

1. No specific authority in Federal Arbitration Act or Arizona Arbitration Act to award punitive damages. Split in federal circuit decisions. Authority to impose punitive damages depends on language of arbitration clause, applicable statutes, case law and governing arbitral rules. E.g. American Arbitration Association Commercial Arbitration Rule R-45 provides "... arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties..." which arguably includes authority to award punitive damages. Many consumer contracts now bar punitive damages. This is being challenged in court.

a. *Pacificare Health Systems v. Book*, 123 S. Ct. 1531 (2003) lawsuit by doctors against HMO under RICO statutes, arbitration clauses barred award of punitive

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damages. U.S. Supreme Court held that case could be arbitrated although RICO laws allow treble damages.

- b. Excessive punitive damages: *Sawtelle v. Waddell & Reed, Inc.* (No. 2330, N.Y. App. Div. 2003) invalidated \$25 million arbitration award that was approximately 25 times the amount of compensatory damages. First case applying constitutional test of *BMW of North America v. Gore*, 517 U.S. 559 (1996) to an arbitration award.

I. Disclosure and Discovery

1. Under some state statutes, e.g. ARS § 12-1507.A, arbitrators may permit the deposition of an unavailable witness. There is no inherent right to discovery depositions, interrogatories, etc. under the Federal Arbitration Act. Discovery is permitted in the discretion of the arbitrators, in accordance with arbitration clause, applicable law and rules of the arbitral organization. See, e.g. *Stanton v. Paine Webber Jackson & Curtis, Inc.*, 685 F. Supp. 1241 (S.D. Fla. 1988) "...arbitrators may order and conduct such discovery as they find necessary."

J. Pre-arbitration dispute resolution. Some commercial agreements provide a three step process in event of a dispute: (1) personal discussions between senior executives, (2) mediation, (3) arbitration.

K. General or reasoned award.

1. In domestic arbitration, Federal Arbitration Act and most state arbitration statutes do not require arbitrators to state the reasons for the award. ARS § 12-1508 provides only that the award must be in writing and signed by the arbitrators joining in it. American Arbitration Association Commercial Rule 44(b) provides that a reasoned award need not be rendered unless requested by the parties prior to appointment of the arbitrator(s) or unless they determine that it is appropriate. "...arbitrators need not disclose the rationale for their award..." *New York Stock Exchange Arbitration Between Fahnestock & Co., Inc. v. Waltman*, 935 F. 2d 512, 513 (2nd Cir. 1991), cert. den. 502 U.S. 942.
2. Most international arbitration awards require that reasons be stated. E.g. American Arbitration Association

International Arbitration Article 27. "The tribunal shall state the reasons upon which the award is based unless the

parties have agreed that no reasons need be given.”

3. In ad hoc arbitration, the parties can agree to the type of award.

L. Enforcing award.

1. In U.S., an international award is enforceable under the 1958 New York Convention through the Federal Arbitration Act, § 201. It can be vacated under § 10 only if the award was procured by corruption, fraud, undue means, misconduct, refusing to postpone hearing for good cause, refusing to hear material evidence, misbehavior, exceeding powers or evident partiality. ARS § 12-1512 provides similar grounds for opposing enforcement of the award. Where arbitration agreement is challenged in an action to confirm an award, arbitrability of dispute under contract terms is determined by district court, not arbitration panel. *First Options v. Kaplan*, 514 U.S. 938 (1995)(domestic arbitration under Federal Arbitration Act); *China Minmetals Materials Import and Export Co., Ltd. v. Chi Mei Corporation* (U.S. Supreme Ct. Nos. 02-2997, 02-3542, June 26, 2003).
2. There is no statutory right to appeal an award (as opposed to seeking vacatur of award). New trend: contractual creation of broader or narrower scope of appeal than provided by Federal Arbitration Act. Split in federal circuits as to whether such provisions are enforceable. 3rd and 5th Circuits hold that parties may expand right of appeal; 7th, 8th, 9th and 10th Circuits say no. E.g. *Gateway Technologies, Inc. v. MCI Telecommunications Corp.*, 64 F. 3d 993 (5th Cir. 1995), (contractual right of appeal enforceable), *Bowen v. Amoco Pipeline Company*, 254 F. 3d 925 (10th Cir. 2001), *Kyocera Corporation v. Prudential-Bache Trade Services, Inc.* (9th Cir. No. 01-15630, Aug. 29, 2003) (contractual right of appeal unenforceable). See also *Richard Hoeft III v. MVL Group, Inc.* (2nd Cir. No. 02-9155, Sep. 3, 2003) holding that parties may not contractually waive judicial review. This issue may be headed for the U.S. Supreme Court.

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M. Confidentiality.

1. International arbitrations are generally confidential. London

Court of International Arbitration Rules, Article 10.4; International Chamber of Commerce Arbitration Rules, Article 21.3; American Arbitration Association International Arbitration Rules, Article 20.4, provide for confidential proceedings. No statutory requirement of confidentiality in domestic arbitration.

2. In drafting confidentiality provision, review law of arbitral situs and institutional rules of procedure selected by parties.

N. Other Special Provisions

1. If there will be special provisions, e.g. compelling arbitration in consumer and employment contracts, barring class actions and punitive damages, it is critical to review both the substantive law that governs the agreement and the law of the place selected for the arbitration.

VII. Mediation

A. Advantages: confidential; preserves relationship between parties; allows practical and creative solutions not available in court or arbitration; avoids further litigation; avoids surprises; limits exposure for damages and litigation expenses including, potentially, opposing party's attorneys' fees and costs; in ad hoc mediation-no set protocol; in institutional mediation, most arbitral institutions have mediation rules.

B. Issues to consider in initiating mediation

1. Is the client ready? What does the client want? Why? Does the client understand that a settlement now for less may be more than a larger amount later with additional costs, assuming client gets a more favorable judgment than the offer? Is the client willing to take the risk of not settling? Is the potential recovery or exposure worth the risk and cost of trial? Is the client sufficiently flexible to compromise?
2. Is the lawyer ready? Litigation mentality-winning- vs mediation approach- compromise; realistic evaluation of trial risks, i.e. what is "the best case scenario" vs "the worst case" scenario and what are the probabilities of each occurring.

3. Has there been/will there be sufficient disclosure/discovery by the date of the mediation to put critical

issues into focus.

C. Choosing the mediator

1. Trial experience before juries and appellate experience from which the mediator has the background to evaluate the case realistically, anticipate how the parties' positions will be received by a judge, jury and appellate court and the ability to see the case from the perspective of the parties' counsel.
2. Practical judgment.
3. Common sense.
4. Good temperament; respectful to all parties and counsel but ability to keep the parties moving toward settlement; patience with parties and counsel- reevaluation of positions and willingness to compromise take time.
5. Ability to handle temperamental parties and lawyers.
6. Respected, reputable, trustworthy.
7. Effective- Good track record in settling cases.
8. Willingness and persistence in trying to achieve a settlement at the mediation. Continuing to contact lawyers in an effort to settle case after the mediation if it does not settle at the mediation.
9. Compatibility of mediator's style with clients and lawyers.
10. Familiarity with jury verdicts, trial rulings and appellate decisions in comparable cases and projection to possible litigation results in this case. Evaluation of impressions parties will make on jury and intangible factors affecting jury verdicts.
11. Thorough preparation by mediator including advance analysis of possible settlement solutions. Ability and willingness to craft

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creative solutions. E.g. In a dispute between International Paper and another corporation, the settlement gave the other company

incentives to buy International Paper products with rebates and credits; in a dispute Unocal had with another corporation, under the settlement, the other company performed work for Unocal without charge and a future business relationship developed; in a breast implant claim against 3M by a lady nearing retirement who needed a house with stairs, 3M settled by buying her a one floor home, paying her lawyers and doctors, and giving her an apology.

12. Cost is the least important factor if the mediator is qualified and gets results. Parties customarily split costs.

VIII. Pre-mediation position papers of the parties

- A. Purpose- to educate the mediator about the parties, case background, parties' positions, potential outcome of litigation, negotiation history, why the case has not settled, etc.
- B. Give the mediator as much information as possible- exhibits, statutes, cases, deposition extracts, contracts, expert reports, medical records, photos, etc.
- C. Confidential vs exchanged memoranda-pros and cons.
- D. Papers should be factual, informative and persuasive, but not adversarial in tone.

IX. Mediation preparation by counsel

- A. 100% commitment to getting the case settled.
- B. Preparing the client for the process- compromise vs inflexibility- objective discussion of expectations.
- C. Planning negotiation strategy and anticipating the other side's moves; what are the other side's objectives and what is driving them? Recognizing signals from the other side and the mediator; what are the client's real objectives and how can they be achieved?
- D. Corporate representative- appearance in person or by phone-pros and cons of each.

- E. Objective evaluation of the impressions the parties will make on the judge and jury and the effect of those

impressions on probable outcome of trial. Evaluation of intangible factors that may influence the jury.

- F. General estimate of past and projected litigation expenses to evaluate the net settlement figure.
- G. Thorough knowledge of case- facts, law, themes and strategy; strengths and weaknesses.
- H. Credibility and reasonableness- willingness to concede positions and issues when appropriate.
- I. When planning strategy, keeping in mind any past and future relationship between the parties, how to keep it intact and at the same time settle the dispute with a creative solution.
- J. Consideration of potential solutions to suggest to the mediator.
- K. Advance consideration of special provisions of settlement agreement (e.g. confidentiality) to avoid last minute settlement breakdown.
- L. Pros and cons of a joint opening session with statements by counsel versus immediate private meetings with parties and counsel; advance discussion with mediator.
- M. Private meetings between counsel and mediator without clients present.
- N. Legal issues:
 - 1. Settlement discussion confidentiality privileges: Rule 408, Fed. and Ariz. Rules Evid.; ARS § 12-2238; American Arbitration Association Commercial Mediation Rule M-12.
 - 2. Settlement agreement must be in writing, Rule 80(d), Ariz. R. Civ. Proc.
- X. If case does not settle at initial session(s), continue negotiations and involvement of mediator.

