



PROTECTING THE COST ADVANTAGES OF ARBITRATION

by Mitchell L. Marinello

Parties often complain that arbitration is no less expensive than traditional litigation. This is disturbing not because it is not true, but because it should not be. Arbitration has natural cost advantages over litigation and yet it is often just as costly. What factors account for this? The answer lies in how clients and their attorneys use arbitration and whether they take advantage of its natural cost advantages over litigation – or if they instead try to override them. Ultimately, arbitration is just a procedural mechanism for resolving disputes. It can be economical or not, depending on how it is used.

Arbitration: Cost Advantages and Disadvantages

Theoretically, arbitration should have several cost advantages over litigation. It is supposed to and generally does do the following:

- permits less discovery than litigation and, partly as a result, gives rise to fewer discovery disputes and motions
- eliminates almost all pre-trial motions to dismiss and for summary judgment
- eliminates detailed pre-trial orders and moves promptly towards a final evidentiary hearing
- permits evidence to be presented in a simpler, less technical manner
- acts as a final ruling, with very limited bases for appeal

Arbitration also has at least one cost disadvantage compared to litigation. A judge, jury, and court administrators are paid by the taxpayers, not the litigants, who generally are charged only nominal filing and jury fees. In an arbitration, the parties do not get a free or heavily subsidized administrator or decision maker. Instead, they must pay for those services themselves. Thus, it is easy to see how the cost advantages of arbitration can be lost.

Using Multiple Arbitrators

One of the most direct ways to increase the cost of an arbitration is to maximize its chief economic disadvantage – to increase the cost of administering and deciding the case. One way to accomplish this is to insist on a panel of three arbitrators when one arbitrator is sufficient.

Each arbitrator selected for a case is entitled to be compensated. To insist on a panel of three arbitrators triples this cost. In actuality, the cost probably increases more than three times, because having three arbitrators often leads to more postponements and scheduling problems. Also, it contributes to the lengthening of the proceedings because the three arbitrators have to reach a consensus amongst themselves with respect to many decisions.

Certainly, there are types of disputes or particular cases where three arbitrators may be preferable to one. If that is the situation, then the extra expense may be worthwhile. But choosing to have three arbitrators hear a case instead of one should not be done reflexively. Consider at the outset whether the dispute is likely to be large or complex enough to justify the expense of three arbitrators.

If you want three arbitrators simply on the theory that three heads are better than one, consider whether there is some other less expensive way to obtain the security and confidence in the ultimate decision that you are seeking. One alternative may be to specify in the arbitration agreement the qualifications and experience the arbitrator must have. Another method is to carefully screen the arbitration candidates.

Conducting Excessive Discovery

Although almost everyone recognizes that an arbitration is supposed to involve less discovery than litigation, there is probably no consensus on how much less discovery there should be. The discovery rules of arbitration organizations are often general and do not state what kind or how much discovery is permitted.

For example, the commercial arbitration rules of the American Arbitration Association (AAA) provide for the exchange of documents but are silent on whether interrogatories or depositions are available. The AAA rules for large and complex commercial cases expressly recognize that depositions may sometimes be appropriate, but they do not contain specific guidelines or limitations. This leaves arbitrators with a lot of discretion.

The discovery rules of the Finance Industry Regulatory Authority (FINRA) are somewhat more detailed and less hospitable to discovery. For example, the FINRA rules for consumer disputes provide that depositions should be allowed only “under very limited circumstances.” One of those “very limited circumstances,” however, is “[t]o expedite large or complex cases.”¹ This too leaves room for argument and gives arbitrators considerable discretion.

A reasonable amount of discovery, including depositions, is often necessary or helpful in a case. This is particularly true when one side has sole possession of critical information or when complex fact issues are involved. Another useful guideline is the size of the dispute. When a large sum of money is at stake, depositions are easier to justify.

Sometimes, however, counsel for the parties act as if the amount of discovery available in arbitration is and should be no different than in the typical lawsuit. If both sides agree to engage in extensive discovery, then the arbitrator is likely to allow it. As a result, one of the chief cost savings of arbitration over litigation will be diminished if not lost.

There are at least two ways to prevent discovery expenses from becoming excessive. One way is to

place limitations on discovery in the arbitration agreement itself. For example, the arbitration clause can state specifically whether depositions will be permitted and, if so, how many depositions may be taken and how long they may last.

Another way is for clients to stay involved in the arbitration process. Clients can provide their counsel with guidance on how much discovery they should seek. Similarly, when the opposition seeks large amounts of discovery, clients can ask their counsel to oppose it. When the parties disagree on the scope of discovery, arbitrators are more likely to impose restraints on it.

Filing Dispositive Motions with a Low Probability of Success

The fundamental difference between litigation and arbitration arguably is not either that litigation is public, whereas arbitration is private, or that litigation permits broad appellate review whereas arbitration does not. Instead, the difference is much more basic and general.

Litigation provides for extensive pre-trial proceedings; only a small portion of business cases are actually tried. In fact, if one out of every ten or even fifteen commercial lawsuits that were filed went to trial, the courts probably would become so crowded that they could not function. Litigation, including motion practice, is designed to eliminate claims that clearly have no merit and to reveal extensive factual information about the claims that survive so that the parties can settle them.

It is probably true that about the same percentage of arbitrations settle as lawsuits, but the mechanism is different. Arbitration does not work through a process of extensive discovery and motion practice. Rather, it achieves settlements through a credible threat of a prompt trial on the merits.

Partly as a result, dispositive motions usually do not play a significant role in the vast majority of arbitrations. For example, the rules of the AAA and FINRA do not even provide for dispositive motions on substantive issues and instead require that the parties be given a fair opportunity to present evidence on the merits of their positions. Careful arbitrators are wary of motions to dismiss or for summary judgment and often will discourage or even forbid them.

Indeed, except in the most clear-cut situations (e.g., claims filed after the statute of limitations has expired or claims that are nonsensical or devoid of any legal basis), granting a motion to dismiss or for summary judgment can result in a successful judicial challenge to the arbitrator's

decision and wind up wasting everyone's time and money. One of the few bases on which an arbitral decision can be overturned is the arbitrator's failure to hear relevant evidence.² Hence, the prudent course for an arbitrator is usually to let the case be heard at an evidentiary hearing and then to decide the merits of the parties' respective legal and factual positions.³

From a practical standpoint, dispositive motions are also less important in arbitration than in litigation. In arbitration, there is no pre-trial order and no set of jury instructions. There is also no risk of jury confusion. As a result, there is less need to reduce the number of claims presented at trial.

Although dispositive motions are disfavored in arbitration, the parties sometimes insist on presenting them. And, when both parties agree that dispositive motions should be heard, the arbitrator is more likely to permit them. The expense of briefing and arguing such motions eliminates another substantial cost advantage of arbitration over litigation.

Postponing Deadlines and Hearing Dates

One of the chief goals of arbitration is to move cases to the final, dispositive hearing quickly. This may result in indirect economic savings, but its primary function is to resolve disputes promptly so that the parties are not forced to endure uncertainty. A good arbitrator will allow the parties to have enough time to prepare their positions, and respect legitimate scheduling problems, but will also push for a prompt hearing date.

The rules of the AAA and FINRA allow (and in some cases, require) the arbitrator to grant postponements of the hearing when the parties jointly request it or when either party shows good cause. Postponements can increase costs if they occur after one or both parties have spent time preparing for the hearing and have to repeat part or all of that preparatory work. Postponements also can create indirect costs when witnesses arrange their schedule to be available for the hearing only to find that the hearing date has been moved.

Both sides can avoid these issues by selecting a realistic hearing date at the outset, committing to complete their work on time, communicating regularly with their witnesses, and protecting the hearing date from other scheduling conflicts.

Failing to Stipulate to Evidence

To shorten the time and expense of trial, courts often encourage the parties to stipulate to the

admissibility of evidence and to reduce the number of witnesses as well as the length of their testimony. The same time-saving practices are often used in arbitration. In addition, an arbitration hearing can be structured in ways that save time and resources and that are not possible in a court of law.

For example, at an arbitration hearing, direct testimony sometimes can be presented in narrative fashion or through affidavits or other sworn writings. Further, distant witnesses can testify by telephone, or opposing experts can testify at the same time, taking turns answering the same questions or responding to each other's positions.

Of course, these mechanisms do not always save time nor are they always appropriate. It is almost never a good idea to present testimony that is important or contested in writing or by telephone. Having the witness tell his or her story in person and letting the arbitrator observe the witness' demeanor are usually essential in such circumstances. In addition, if the testimony is complex or lengthy, putting it in writing may take more time than presenting it orally.

Some arbitrators will insist on moving the hearing along in an expeditious fashion; others will be more deferential to the parties' wishes. Counsel and their clients must recognize that they share responsibility for the efficiency of arbitration proceedings. If you are uncooperative or drag out the proceedings, you cannot rightly complain that arbitration is not as fast and inexpensive as it is supposed to be.

Filing Meritless Appeals

After an award has been rendered by the arbitrator, the victorious party generally is required to confirm the award in a court of law so that the award has the same effect and can be enforced through the same legal means as a regular judgment. The losing party has the opportunity to challenge the award, but the bases for doing so are extremely limited.

Under the Federal Arbitration Act, an award may be vacated:

- where the award was procured by corruption, fraud or undue means
- where there was evident partiality or corruption in the arbitrators
- 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 of any other misbehavior by which the rights of any party have been prejudiced

- 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 made⁴

The Uniform Arbitration Act, which has been adopted by most states, provides essentially the same grounds for challenging an arbitration award.⁵

There is probably no way to prevent one's opponent from challenging an award or appealing if the award is confirmed, but such behavior can be discouraged. One way to accomplish this is to provide in the arbitration agreement that if the appeal is taken and if the award is confirmed, the losing party will pay the other side's legal fees and expenses for the appeal.

Conclusion

Arbitration has natural cost advantages over litigation. It generally involves less discovery, less motion practice, more streamlined evidentiary hearings on the merits, and fewer bases for appeal. These advantages can be lost, however, if counsel for the parties, as well as the parties themselves, do not defend them. Consequently, if reducing costs and increasing efficiency are concerns, it is imperative that a party and its counsel work together to vigorously protect both.

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¹ NASD CODE OF ARBITRATION PROCEDURE FOR CUSTOMER DISPUTES, R. 12510.

² See 9 U.S.C.A. § 10(a)(3) (West 2008); UNIF. ARBITRATION ACT §12(a)(4) (2008).

³ The arbitrator's obligation to hear relevant evidence does not mean the arbitrator is at the parties' mercy and must hear evidence that is redundant, unnecessary or unhelpful. Arbitrators have substantial discretion in structuring the hearing and making evidentiary rulings. *Generica Ltd. v. Pharm. Basics, Inc.*, 125 F.3d 1123, 1130-31 (7th Cir. 1997).

⁴ 9 U.S.C.A. §10(a) (West 2008); see *Hall Street Assoc., L.L.C. v. Mattel, Inc.*, 128 S. Ct. 1396, 1403 (2008)(discussing the limited grounds for challenging an arbitration award).

⁵ See UNIF. ARBITRATION ACT §23.

\$70 Million Victory for Novack and Macey Client

Novack and Macey attorneys Eric Macey, Andrew Fleming, John Shonkwiler and Christopher Moore recently teamed with Jerry Hartzell of North Carolina to present a case to federal Magistrate Judge Morton Denlow. Following a seven-day bench trial in Chicago, a \$70 million dollar judgment was entered in favor of the firm's client, Pentech Pharmaceuticals, Inc., and against Par Pharmaceutical, Inc.

The case arose out of a contract concerning a generic alternative to the GlaxoSmithKline (GSK) drug "Paxil." The defendant, Par, brought a generic alternative to Paxil to market as a result of a settlement resolving patent infringement litigation between GSK and Pentech. The trial concerned how a Pentech-Par contract applied to Par's revenues from the generic Paxil sales.

The case was tried in December 2008 and the Court entered its judgment in February 2009. The defendant, Par, was represented by Cravath, Swaine & Moore LLP, a New York based law firm employing over 400 attorneys. In addition to the \$70 million judgment, Pentech was awarded its costs of suit.

Novack and Macey Welcomes Two New Partners

Novack and Macey LLP is pleased to announce that Andrew D. Campbell and Courtney D. Tedrowe have become partners. The firm is proud to welcome these outstanding litigators to the partnership.

Campbell represents a variety of clients in commercial litigation matters, including contract actions, business torts, real estate and intellectual property disputes. Before joining Novack and Macey in 2003, Campbell was an associate at Mayer Brown LLP. He graduated from Loyola University Chicago School of Law, *magna cum laude*.

Tedrowe's practice encompasses a broad range of commercial, financial and partnership disputes. His clients range from individuals and start-up businesses to Fortune 500 Companies. Prior to joining Novack and Macey in 2002, Tedrowe practiced at Dewey Ballantine LLP in New York City. He graduated from Cornell Law School, *cum laude*.

Stephen Novack Named Illinois Top 100 Lawyer

Founding partner Stephen Novack has been named an Illinois Top 100 Lawyer. The honor was the result of an extensive research and review process that involved nominations from attorneys across the state. Novack, who has litigated disputes on behalf of a variety of prestigious law firms and other well-known parties, is immensely pleased.

In addition to Novack, seven other Novack and Macey partners were also named Illinois Super Lawyers. Yet another seven Novack and Macey attorneys were recognized as Illinois Rising Stars. Only 5 percent of the lawyers in the state are named Super Lawyers each year and a mere 2.5 percent are named Rising Stars.

Richard Miller Successfully Defends Hedge Fund

In early 2008, Novack and Macey partner Richard Miller was retained to defend a Chicago hedge fund. Miller joined forces with attorneys from Vedder Price P.C. in defending three lawsuits brought against the fund, its management company and the principals of both entities. Miller represented the hedge fund itself while Vedder Price represented the remaining defendants.

In September 2008, a Lake County court ruled on a joint motion to dismiss filed by Miller and Vedder Price. All of the eleven plaintiffs' twenty-five counts were dismissed. Although fifteen of the counts were dismissed with prejudice, the plaintiffs were granted the opportunity to re-plead ten of their claims, five of which had been directed at Miller's client, the hedge fund.

In October 2008, seven of the original eleven plaintiffs filed an amended complaint, alleging that the hedge fund violated the Illinois Consumer Fraud Act. Miller and Vedder Price filed a joint motion to dismiss that complaint. On January 7, 2009, after hearing oral argument, the court dismissed all of the fraud claims against Miller's client with prejudice. Accordingly, Miller's client has prevailed on all claims brought against it by all of the plaintiffs.

ABOUT THE FIRM

Novack and Macey LLP is a litigation firm that concentrates in complex commercial matters, including matters involving banking, contracts, class actions, creditors' rights, energy, RICO, securities, business torts, real estate, partnerships, close corporations, employment, unfair competition and antitrust, insurance coverage and environmental issues.

The firm prides itself on being creative while providing sound, practical and cost effective advice and representation. Please contact us if you have a legal problem that you wish to discuss. *Litigation Review* is a periodic publication that addresses legal issues that impact commercial litigation. The publication is edited by Mitchell L. Marinello, Monte L. Mann and Richard L. Miller II.

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Issues of *Litigation Review* may be downloaded from our web site, www.novackmacey.com, using Adobe Acrobat.

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