ADR Section of the Orange County Bar Association

February 2012 Section Meeting

Economy, Speed, and Justice:

What Neutrals, Forum Providers, Advocates and Parties Can do to Control and Reduce the Cost of Arbitration

Program Agenda

- Overview of where the American Arbitration Association and its panel of neutrals fit into the arbitration picture
- The Economy, Speed and Justice Initiative (ESJI) and the key findings of the 2010 AAA Survey of business executives
- Some ways in which ESJI is threatened
- 2011 RAND Study of corporate counsel's attitudes concerning commercial arbitration – key findings
- Concluding Comments
- Q&A

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Mr. English is a distinguished honor graduate of Pepperdine University's Graziadio School of Business and Management, with an emphasis on organizational behavior and management.

Mr. English is a United States Air Force veteran, having served over 11 years in the active USAF and California Air National Guard, where he received numerous decorations and awards.

Rebecca Callahan is an AV-rated litigation lawyer who acts as an independent neutral in private mediations and arbitrations, and as a litigation consultant regarding settlement evaluation and preparation for mediation and arbitration.

Ms. Callahan received her JD from the University of California at Berkeley / Boalt Hall and her undergraduate degree from the University of Southern California. In 2007, she earned an LLM degree in Alternative Dispute Resolution from Pepperdine University School of Law / Straus Institute.

Ms. Callahan speaks and writes frequently on various ADR topics and is the Chair-Elect of the ADR Section of the Orange County Bar Association.

Little Known Facts About the American Arbitration Association?

Founded in 1926 as a not-for profit 501(c)(3) corporation

Why is that important?

Because AAA's mission is the development and widespread use of prompt, effective and economical methods of dispute resolution.

As a not-for-profit organization, AAA's mission is one of **service** and **education**.

It is committed to providing exceptional neutrals, proficient case management, dedicated personnel, advanced training, and innovative process knowledge to meet the conflict management and dispute resolution needs of the public – *now and in the future!*

When, where and how does AAA enter the arbitration picture?

How? Parties contract for arbitration by (a) including a pre-dispute arbitration clause in their contract or (b) agreeing post-dispute to submit a matter to arbitration for resolution.

When? Over 90% of all cases filed with AAA start with a demand based upon a pre-dispute arbitration clause. And those clauses typically provide for AAA Rules to govern the process.

> *Note: When a pre-dispute arbitration clause has been included in a contract, the decision has been made at that point in time to forego a jury trial, right to appeal and rules of procedure and evidence found in litigation in order to achieve speed, economy and **finality**.*

Where? Domestic arbitration cases are administered out of regional offices. There are 4 regional offices in the USA. The Western Region is comprised of California, Arizona, Alaska, Colorado, Hawaii, Montana, Nevada, New Mexico, Oregon, Utah, Washington and Wyoming. It is located in Fresno, California.

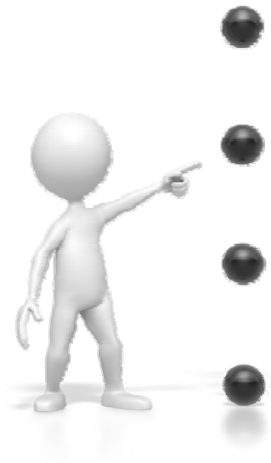
Economy, Speed & Justice Initiative [ESJI]

AAA is concerned with the trajectory concerning the cost of the process over the past 5 years. For example, looking at Employment Panel Cases:

	2011	2006	Increase
Median Arbitrator Compensation	$11,658	$6,966	67%
Median AAA Fees	$1,650	$1,391	19%
Median # of Hearing Days	3	3	0%
Median Days to Award	353	349	1%

The average hearing days has remained constant, but costs associated with the process have increased – due in part to an increasing number of motions being filed between the time of the preliminary hearing and the start of the scheduled hearing date(s).

EJSI – continued:



- Increased utilization of arbitration and more complex cases coming in the door
- Party expectations re the arbitration process and attorney advocate strategies are not in sync
- The CEO of AAA – Bill Slate – has challenged the organization and its neutrals to focus on EJSI
- The delivery of justice in an efficient and economical manner is the goal so as to maintain the viability of arbitration as an option parties will select over litigation

	Users	Arbitrators
Saves Money	13	43%
Saves Time	22%	57%
More Satisfying Process	22%	21%
Party Choice / Control	26%	31%
Limited Discovery	22%	38%
Decision Maker Expertise	39%	60%
Confidentiality	30%	53%
Contract Mandated	**61%**	**54%**

EJSI is also motivated by the results of a 2010 AAA Survey of business decision makers which asked why their company utilized arbitration.

The survey said: Most businesses are utilizing arbitration because they signed a contract that mandated it. And that the key attributes of arbitration rated fairly low.

	Users	Arbitrators
Cost	45%	59%
Winning	78%	81%
Predictability	**65%**	**65%**
Speed	53%	56%
Fairness	**93%**	**87%**
Decision Maker Expertise	**68%**	**75%**
Privacy	49%	60%
Appeal Rights	35%	15%

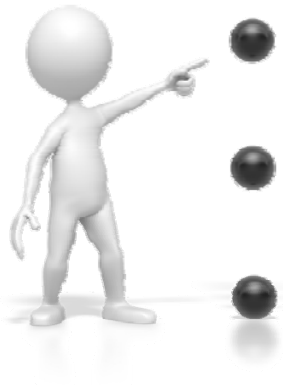
Similarly, the 2010 AAA Survey showed that – putting aside the desire to "win" - what was most important to businesses when they found themselves in a dispute was fairness, predictability and subject-matter expertise of the decision maker when utilizing arbitration to settle the dispute.

	Users	Arbitrators
Cost	**50.5%**	**57.6%**
Speed	**57%**	**55.4%**
Fairness	93.5%	82.6%
Neutral's Expertise	72.9%	72.8%
Finality	74%	73%
Predictability	72%	58.7%
Maintaining Relationships	46%	30%

While arbitrators are meeting users' expectations in terms of fairness and expertise, the 2010 AAA Survey showed that they were not earning high marks with respect to the speed and cost associated with the arbitrations they managed.

And the arbitrators' responses to the same survey showed an awareness of that shortcoming.

What is AAA doing to improve as a forum provider?



- Upgrading its case management system and web presence
- Obligating executive leadership to seek out new and innovative service delivery modalities
- Reminding panel neutrals that they need to manage their cases in a manner that is consistent with the underpinnings of the arbitral process
- Asking parties to make sure arbitration is a good fit for the dispute and the parties / counsel involved

Perhaps most importantly, AAA is offering more guidance, resources and training to businesses and attorneys re clause drafting.

The object is to make sure that businesses / people who include arbitration clauses in their contracts (a) understand what they are bargaining for, and (b) want that contracted benefit.

E.g., you **get** finality and a subject-matter expert as your decision maker, but you **give up** the right to appellate review and to exclude evidence based upon rules of evidence.

What are some ways in which economy, speed and/or justice in arbitration are threatened?

Postponements:

These consist of party requests for continuances or extensions after the scheduling order has been issued and the proceedings are nearing the time of the evidentiary hearing. These requests are frequently a **delay tactic** – meaning a reason or excuse given to intentionally delay an arbitration from proceeding.

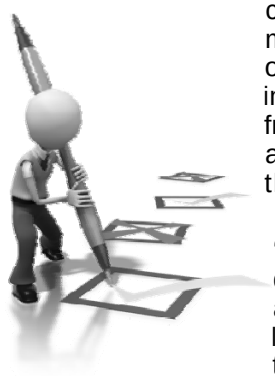
The object of this tactic?

- Avoid or delay resolution of the dispute
- Avoid or delay paying attorney's fees, arbitrator's fees or both
- Achieve unfair advantage by key witness testimony becoming stale or witnesses becoming lost or unavailable
- Frustrate the process and perhaps confuse the arbitrator

The need for postponements is sometimes occasioned by the arbitrator because his/her calendar is overbooked.

Regardless of the cause of the change in scheduling, continuances or extensions that move the hearing date out after the scheduling order has been issued and partially implemented is one of the ***chief reported complaints*** made by parties, attorneys and arbitrators.

2010 AAA Survey - Responder's Own Words



"It seems to me critical that arbitrators be committed to attending promptly to the matters on which they sit and to not allow other commitments to interfere with or delay interim or final decisions. The greatest frustrations I have with the most able arbitrators arise from delays resulting from the arbitrator's competing commitments."

"If an arbitrator is unable to schedule the first day of a case within two months of appointment, he/she should withdraw and let the case move to the next arbitrator on the list."

"I like an arbitrator who takes charge from the beginning, is organized, provides a road map and ***sticks to the time line*** and process within reason."

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AAA Commercial Rule R-28 grants arbitrators the authority to postpone any hearing upon the request of a party for "good cause shown" or upon the arbitrator's own initiative. So, it is left to the arbitrator's discretion to determine what constitutes "good cause" and whether it exists in a particular case.

Factors to consider include:

1. Reasonableness of the request – are the supporting reasons sound?
2. Comments / objections of the party (parties) opposing the request.
3. Whether granting or denying the request will result in prejudice to any party.

4

The number of prior postponements and whether mutually or unilaterally requested.

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The added cost that may be imposed on the parties or the process by granting the continuance.

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Whether denying the request could be interpreted as "misconduct" sufficient to warrant vacatur of the final award.

Note: When deciding postponement requests, a delicate balance must be met between moving the process forward in a fair and just manner, on the one hand, and protecting against vacatur, on the other.

Section 10 of the FAA provides for vacatur "[w]here the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown. CCP 1286.2(a)(5) provides for vacatur based upon the "refusal of the arbitrators to postpone the hearing upon sufficient cause being shown."

This circumstance militates in favor of written, reasoned interim orders! Your orders are the record.

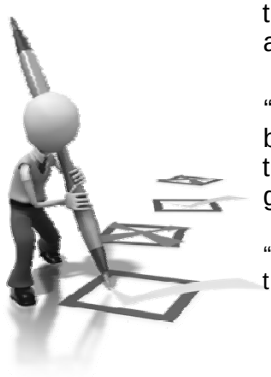
Discovery:

Party requests for formal discovery such as depositions and formal document production requests are a leading cause of delay and expense in arbitration.

As "big stakes" cases have migrated from the courts to private arbitration, arbitration has started to look more and more like litigation, particularly with respect to discovery – which is by far the largest driver of cost and delay, whether litigating in court or before a private tribunal.

Requests for discovery and disputes about discovery are also among the ***chief reported complaints*** made by parties, attorneys and arbitrators.

2010 AAA Survey - Responder's Own Words



"You need to minimize discovery to shorten the process. Trial attorneys are converting arbitration into litigation."

"We need to stop the trend of arbitration becoming too much like litigation. It needs to be thorough, but needs to move with greater dispatch."

"The neutral should be . . . dedicated to moving the case along and following AAA rules."

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Discovery Bedrock in Arbitration: The reasonable disclosure of the parties' claims and defenses and the exchange of relevant documents.

Beyond that, parties are only allowed to take depositions, serve formal documents requests or propound interrogatories *if* they can demonstrate to the satisfaction of the arbitrator that they need them. . . .

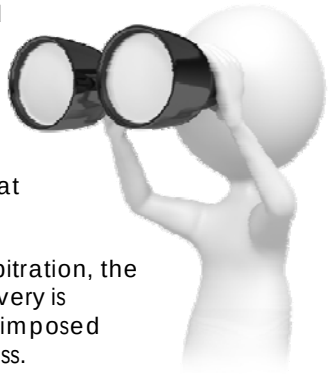
Unless the parties' arbitration clause provides for discovery or the parties, through their counsel, agree to more extensive discovery than the arbitrator may think is necessary.

There is no statutory or common law right to discovery in arbitration. What disputants have lost sight of is that when the FAA was enacted in 1925, civil litigation in the courts was generally conducted without benefit of discovery.

The Federal Civil Discovery Rules were not enacted until 1938.

So, there was not much distinction between arbitration and litigation in terms of pre-hearing discovery.

In both processes, each party to the dispute relied on the documents in its possession and the testimony given by its witnesses. And cross-examination was an art form!



Bottom Line: Unless the parties' contract provides otherwise, there is no right to discovery beyond that which the parties agree to or the arbitrator orders.

To the extent that parties agree to discovery in arbitration, the extra cost and delay associated with broad discovery is something *they bargained for* and not something imposed upon them as part of the private arbitration process.

How Should Neutrals Handle Discovery in Arbitration?

Because arbitration is a creature of contract, providers and neutrals who conduct arbitrations should assume that the parties knew and understood what they were bargaining for when they included an arbitration clause in their contract ***and*** understood that they could contract for more court-like procedures – including discovery.

If the arbitration contract does not provide for discovery ***and*** the parties do not reach an agreement regarding discovery procedures post-dispute, the rules and general arbitration law control the issue and it is up to the arbitrator to manage discovery so as to achieve an appropriate balance between fairness and economy and moving the case forward.

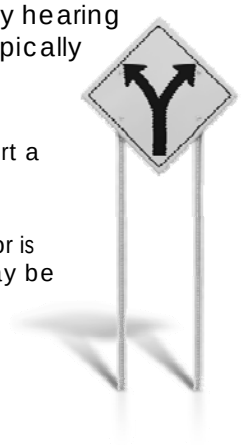
1. Witnesses should testify once, and that should be at the hearing.
2. Documents for production or exchange should relate specifically to the dispute. No "fishing expeditions."
3. Parties have a right to know the particulars of the other side's claims, defenses, purported damages, relief being sought, etc.
4. Neutrals should engage in dialogue with counsel about discovery and attempt to create consensus on a reasonable discovery plan.
5. Neutrals should set limits and deadlines and incorporate them into the preliminary hearing scheduling order.
6. Even if the parties say they don't intend to use experts, set deadlines in the scheduling order for the identification of expert witnesses and the exchange of reports.

The power of the recess as a "Safe Harbor" for arbitrators who move their arbitrations forward over a party's objection:

AAA Commercial Rule R-30(a) ameliorates the harshness of the "no discovery" rule because it gives the arbitrator broad discretion to conduct the evidentiary hearing so as to assure that "the parties are treated with equality and that each party has the right to be heard and is given a fair opportunity to present its case." This power can be exercised to recess a hearing to give one or more parties an opportunity to deal with an unexpected development, evidentiary or otherwise.

Pre-Hearing Motions

As the courts have become more congested, more and more parties involved in disputes traditionally resolved through litigation in the courts have turned to arbitration. Partly as a result of this diversification, various "pretrial motions" have found their way into arbitration. These motions occur after the preliminary hearing scheduling order has been issued and, if granted, typically invite delay and additional cost to the parties.



One such motion is the motion for leave to amend to assert a new claim or defense or to assert a counterclaim.

AAA Commercial Rule R-6 provides that after the arbitrator is appointed, no new or different claims or counterclaim may be submitted without the consent of the arbitrator.

Factors to be considered when deciding whether to allow new or different claims or counterclaims, include:

1. Will allowing the claim/counterclaim be prejudicial to the other party?
2. Will not allowing the claim/counterclaim be prejudicial to the requesting party?
3. Will allowing the claim/counterclaim promote judicial economy and fairness?
4. Is the request substantive or is it put forth for the purpose of delay – *e.g.*, the new or amended claim is coupled with a postponement request and/or a request for further discovery and is made late in the process?

To avoid this situation, neutrals should plan ahead.

Consider requiring as part of the preliminary hearing scheduling order that the parties submit a statement of their case (or defense) and the issues that the parties believe the arbitrator must decide.

This way you can assess whether an amendment request is simply a new legal theory that operates on the same set of facts as set forth in the original statement or something new and different.

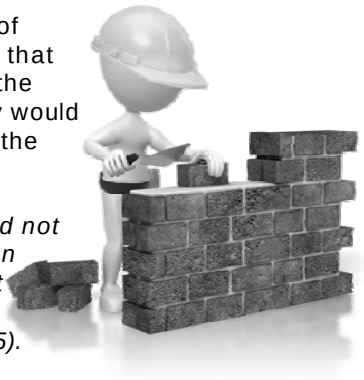
Likewise, with regard to a respondent's request to add a counterclaim, you can assess whether it operates on the same set of transactions and events which have been the subject to discovery and exchange or something new and different.

Pre-Hearing Motions - continued

Another pre-hearing motion that challenges justice in arbitration is the one seeking to limit or exclude evidence.

AAA Commercial Rule R-31(b) provides that the arbitrator has authority to determine the admissibility, relevance and materiality of the evidence offered and may exclude evidence if the arbitrator deems it to be ***irrelevant*** or ***cumulative***.

But the argument frequently made in support of motions seeking to limit or exclude evidence is that the evidence would be ***unfairly prejudicial*** to the requesting party: *i.e.*, that the requesting party would be deprived of a fundamentally fair hearing if the challenged evidence was admitted.



Note: Excluding evidence is the exception and not the rule. Section 10 of the FAA provides that an arbitrator's refusal to hear evidence "pertinent and material to the controversy" is ground for vacating the award. Accord, *CCP 1286.2(a)(5).*

"Process Litigation" – aka, court proceedings that challenge or test various aspects of arbitration and thus increase cost, cause delay and threaten finality.

Some recent examples:

1

Challenging the enforceability of an arbitration clause contained in a contract alleged to be unenforceable because illegal or induced by fraud, duress or coercion.

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 404-404 (1967)

Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 445 (2006)

2

Contracting for review expanded judicial review of the arbitration award and then initiating vacatur proceedings on grounds other than the statutory grounds for vacatur. OK under California Arbitration Act, but not for disputes governed by the FAA . . . . But maybe if contract provides for contract to be governed by California law.

Cable Connection, Inc. v. DIRECTV, Inc., 44 Cal. 4th 1334 (2008)

Hall Street Assocs., LLC v. Mattel, Inc., 552 U.S. 576 (2008)

3

Challenging the right to maintain an action in federal court to enforce an arbitral subpoena issued under Section 7 of the FAA based on dicta in *Moses H. Cone Memorial Hospital* (footnote 32) and *Southland Corp. v. Keating* (footnote 9).

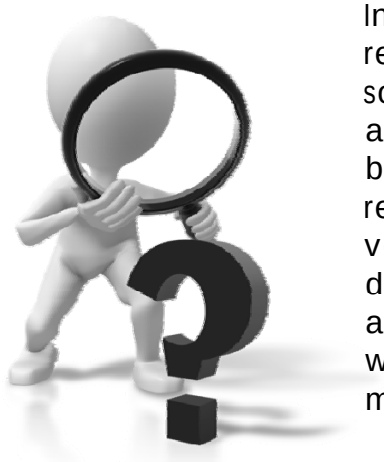
Charles E. Harris Article in handout booklet.

4

Challenging the authority of an arbitrator to decide whether a dispute is arbitrable where there is an express delegation of such power to the arbitrator in the agreement.

Rent-A-Center West, Inc. v. Jackson, 130 S.Ct. 2772 (2010)

2011 RAND STUDY



In 2011, RAND published the results of a study in which it sought to learn what attorneys who counsel businesses think about the relative benefits of litigation versus arbitration in resolving domestic business disputes in an attempt to understand why arbitration is not used more frequently.

The study consisted of a survey questionnaire of 28 questions which explored respondents' perspectives on:

- the benefits of arbitration as compared with litigation
- the factors that encourage or discourage them to include arbitration clauses in their business contracts
- their experiences with arbitration

To the extent survey respondents indicated a willingness to be interviewed, RAND selected interviewees which it felt represented a range of perspectives. The interview was intended to provide context to responses and to highlight issues that could not be explored in the survey.

Note: The survey was small. Although RAND sent invitations to approximately 900 attorneys, it received only 121 responses.

Key Findings:

A majority of respondents believe that arbitration is better, faster and cheaper than litigation, *but that endorsement was only "somewhat so."*

A majority of respondents believe that in addition to time and cost savings, four factors encourage the use of arbitration: (1) avoiding exposure to potentially uncertain or emotionally driven jury awards; (2) control over the decision maker's qualifications; (3) confidentiality of the proceedings; and (4) complexity of the case or contract.

One of the top complaints about arbitration was that a large majority - **71%** - perceive that arbitrators "split the baby" when making their awards rather than ruling strongly in favor of one or the other party.

	Agree	Disagree	Neutral or No Opinion
Arb Saves Time	52%	26%	18%
Arb Saves Money	59%	29%	12%

While a majority of the the respondents in the RAND Study agreed that arbitration saves time and money as compared to litigation, there were still a considerable number of respondents who did not rate the time or cost saving features of arbitration very high.

The finding that caught AAA's attention was the perception that arbitrators are indecisive and tend to "Split the Baby" rather than make rulings that are strongly in favor of one side or the other.

71% responded that they believe arbitrators "split the baby" when making their awards.

Only 14% disagreed with the statement that arbitrators tend to "split the baby."

And 15% were neutral or had n opinion.

The prevalence of the "split the baby" perception caused AAA to analyze its awards.

Looking at a random sample of 300 decisions and defining the "middle" as 41% to 60% of the amount claimed, AAA found that there was a clear winner and clear loser 92% of the time:

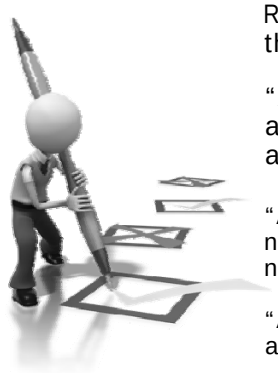
49% award was more than 80% of what was claimed

24% award was less than 41% of what was claimed or between 61% and 80% of what was claimed

19% no award - claim denied completely

8% award was between 41% and 60% of the amount claimed

2011 RAND Study – Respondents' Own Words



Respondents interviewed as part of the RAND Study offered the following reasons for their "split the baby" beliefs:

"Arbitrators are interested in repeat business and do not want to upset either part or gain a reputation for lopsided decisions."

"Arbitrators who as "industry experts" believe they need to split awards in order to appear fair and neutral to the parties."

"Arbitrators who are not retired judges are not accustomed to making 'hard decisions'."

In contrast, several respondents said that there was no difference between arbitrator awards and judge decisions; that disputants do not get everything they claim in court absent an emotionally driven jury award.

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CONCLUDING THOUGHTS

Our challenge is to deliver on the expediency and economy parties expect when they include an arbitration clause in their contracts.

We need to be proactive in the way we manage the process.

We need to work with the parties and their counsel to educate them about the arbitration process.

We need to consider the extra cost and/or delay that may be occasioned by granting relief from the original schedule set out in the preliminary hearing scheduling order.

We need to make decisions that will move the process forward.