

# A Guide to Cost-Effective Customer-Focused Arbitrations

Charles E. Rumbaugh\*

There have been several recurring issues or trends that arise in the use of Alternative Dispute Resolution (ADR) that could be more appreciated by contract drafters/negotiators and/or advocates in an arbitration.<sup>1</sup> This article is intended to provide an overview on some of those issues and ADR trends with a primary aim toward the B2B world and voluntary use of ADR.<sup>2</sup>

What is offered here is a suggested 12-step self-assessment guide for your consideration in the analysis and use of ADR with a goal of having a more proactive, cost-effective, and timely dispute resolution process within the arbitration world! Let's start at the beginning... the first step being...

1. **Proper Cost Allocation Incentives Parties to Settle.** While there is excellent literature available on when to use ADR, greater focus on another key aspect is needed...the viability of all the parties using ADR in a constructive manner with an objective of resolving the underlying dispute rather than a "check-the-box" frame of mind. So, what are some of the additional tools that could be considered in that quest in determining if ADR is the option of choice?
  - What is the financial incentive for the parties to settle as early as reasonably possible? How can the ADR process assist in that determination?
  - For example, does your organization consider where and how the potential damages and/or cost of litigation/arbitration are internally charged by **all** of the parties? It is often over-looked. Those charges should be allocated back to the operating unit that allegedly created the dispute (or is responding thereto) in the first place. It is submitted that more diligence by the parties is needed to ascertain the accounting for those costs. If those costs are merely collected in an overhead account, there is *limited* incentive to settle by the operating unit. If the bonuses or other compensation of that unit are at risk with that "back-charging," this will get the attention of the

unit's leadership and have them actively involved in the process as compared to those transactions where "corporate office collects the costs" which are allocated across all the business units. There is no "free lunch" and ADR/litigation costs should be properly allocated.

- *Settlement opportunities follow, and increase, where the ADR cost resides at the impacted operating unit!*

2. **Existence of an Organizational ADR Culture.** Coupled with a responsive cost allocation analysis, a second step in this process... what is the business, legal, and culture of the parties in using ADR?<sup>3</sup> How do you determine the indispensable "ADR-responsibility" of your customers AND suppliers? Should an ADR culture be a discriminator in that due diligence calculus?

- ADR is a tool for an organization when it is acting as a seller or buyer. If an entity will only use ADR in one capacity, does it really have a culture of using ADR to settle matters? Is it an ethical issue of doing what is right in a mutually beneficial manner as well as doing so in accordance with their respective Code of Conduct?
- Accordingly, there are some excellent websites that post pledges or other commitments made by organizations to use ADR.<sup>4</sup> But the inquiry could go beyond those pledges/commitments and should include, for example...
  - Has the specific operating unit, i.e. the unit that was/is the purported source/responsive to the dispute, subscribed to pledges/commitments? Or, is the outward action (only) stated as a corporate statement—and, if so, is that sufficient?
  - Are the operative terms and conditions of those organizations (usually posted on their websites) reflective of using and, thus having, an ADR culture?
  - And, as noted, do those terms/conditions include ADR when engaged in either capacity as a buyer or seller— and include the entire supply chain where/when the dispute involves multiple entities?
- *An ADR culture is required!*

3. **A Proper Role of Negotiated/Mediated Resolution of Disputes.** Is negotiation or the use of a mediator a viable option for your dispute in facilitating a resolution?
- What is the incentive to use a voluntary non-binding ADR process? More and more contracting parties are engaging in mediation as a stand-alone process or as part of a multi-step ADR clause incorporated into a contract.
  - The parties may need to focus more on the default mode if negotiation/mediation is going to work. Why expend the time/cost for an endeavor that does not ensure success by knowing the end-result with certainty? Having negotiation or mediation operate in a vacuum and not having that “ensured success” tool may be too expensive. A refocus on cost containment issues rather than being confronted by the prospects of a so-called “runaway judge/jury” should be considered.
  - Specifically, this 12 step process would be remiss if not advocating the use of some form of final offer, or “baseball arbitration.” This tool is not sufficiently utilized, especially where the contracting parties have a special or on-going relationship. The parties need to be motivated to engage in the negotiation, or mediation, dance! Again, there are additional resources on this topic but this option is not fully appreciated. There needs to be recognition of the power of having as a “default” a mini-arbitral hearing whereby the arbitrator is charged to make a binding decision with only one of the final offers being an option. And, it works because having the parties know what that final decision will be during the negotiation/mediation process drives the parties to settle/compromise. The (potential) Best Alternative To Negotiated Agreement (BATNA) is unacceptable. Further, in those situations where the flow of information between the parties has not succeeded, then this will provide a real opportunity for the exchange of relevant information since otherwise an arbitrator may not have sufficient info to find for the “withholding” party.<sup>5</sup>
  - Finally, extreme caution is needed if specific time periods are specified for actions in any multi-step ADR process as well as determining whether the arbitrator(s) still have jurisdiction for any non-compliance to those timeframe conditions/gates.
  - *An ADR atmosphere may need to be created by contract!*

**4. In the Area of Potential International Disputes, the Downside to Foreign Litigation Cannot Be Minimized.**

- There are currently no treaties which ensure that court judgments will be enforced in a foreign jurisdiction. Why should parties submit to litigation costs by not having an enforceable judgment? The risk of being subject to foreign court jurisdiction is real.
- However, there is a treaty, the so-called New York Convention, that provides reasonable predictability and enforcement opportunities when international B2B disputes arise and are resolved through arbitration.<sup>6</sup>
- *The New York Convention works!*

**5. Litigation and Transaction Attorneys are a Team.**

- Some so-called boiler-plate B2B arbitration clauses need to be reviewed on a periodic basis. Some areas of the substantive and arbitral law are very robust and “long-term” agreements with arbitration clauses have increased “operating” risk over time. The effect of an ADR clause must be understood and the litigation attorney/advocate can provide meaningful guidance to the transaction attorney as well as other contract drafters.
- *Perhaps a “reopener” or “sunset” provision is needed!*

**6. The Selection of Applicable Arbitral Rules may be Critical.**

- Which specific arbitration rules will apply? While those rules are primarily procedural in nature, will the dollar amount in dispute decide the “final” set of arbitral rules?<sup>7</sup>
- The contractual selection of a specific arbitration association rules including case administration services and cost cannot be minimized. A significant concern in this sixth step is, after selection of same, which version of those rules will control your dispute? Most arbitral associations mandate that it is the version of their rules that are in effect at the time the arbitration demand is filed. While experience suggests to some that there have been minimal substantive amendments to those rules over the years, should the drafting parties incorporate a final version of those rules that have not been drafted or reviewed?
- *Do you know the applicable arbitral rules?*

## 7. Multi-Party Transactions.

- Are all the “necessary” parties in the transaction subject to the same ADR clause? For example, in many out-sourcing scenarios, including construction, several entities may be necessary parties even if not witnesses in the arbitration of the dispute in chief.
- Will non-signatories need to be “brought-into” the arbitration and/or is there a risk of inconsistent judgments with multiple proceedings or court actions? Should the ADR clause cover this risk and potential stays? Should there be one forum for all transactional disputes to be heard?
- *How are the ADR requirements flowed-down and “out”?*

## 8. The Role of Discovery in Arbitrations Needs to be Greater Appreciated from the Get-Go.

- By the parties selecting arbitration they knowingly are engaging in a different world when it comes to discovery and, in particular, e-discovery or ESI (Electronic Stored Information). With arbitration being contract driven, the contract generally controls the topic of discovery but what does that mean? Normally, court-directed discovery process does not exist. Accordingly, if the underlying facts in a dispute are not reasonably available, what are the effective means to “discover” them in an arbitration? In the ESI context...
  - is the information reasonably accessible,
  - in a reasonably useable format,
  - searchable, and
  - cost-effectively managed as to time and scope, etc.?
- And, when more and more international B2B arbitrations have so-called restrictions on US-style discovery, then information exchanges, etc. must be explored early-on in the negotiation/drafting of arbitration clauses.
- In the absence of the parties' agreement on discovery, many of those arbitral associations rules noted above may provide “limited” opportunities for (unbridled) “information” exchanges, or discovery, if that is desired. This is particularly a concern when the parties have not adequately covered the topic in their B2B arbitration clause. By incorporating those arbitral rules into your B2B arbitration clause, arbitral flexibility in the exchange of “information” may be in the

eyes of the beholder for the one that needs more facts, i.e. if one needs to know where the “smoking gun” is, you need tools to find it.

- As to any non-signatories that are important to the dispute resolution, what are the outer limits on discovery? Are depositions for evidence, as compared to discovery, a viable option?<sup>8</sup>
- *“Justice” for your arbitration may require more/less discovery!*

## 9. Venue in Arbitrations.

- Venue has a huge impact in an arbitration. And, as in the other steps in this article, space limitations do not permit a full discussion of each step but merely a launching point. Historically, there has been only one venue for an arbitration and that is where it was physically going to be conducted/held.
- However, the concept of venue is also evolving in the current technical/media age on how people interact with each other. The (available) electronic media must be clearly understood and, perhaps, leads to the conclusion that venue may be multi-faceted.
- Venue is important as to procedural aspect if court action is needed during the arbitration process and the applicable choice of law that should/must be applied by the arbitrator. And, as alluded to above, venue has a direct bearing on discovery issues. Yet, many arbitral associations will only provide a list of potential arbitrators from the venue that is to be utilized. Considering issues associated with having only “home-town” people on the panel, perhaps a search for geographical diversity and/or those arbitrators that do not charge for travel is necessary.<sup>9</sup>
- But, one significant aspect included in this step is how venue is decided in the absence of a B2B arbitration clause providing for same. Some arbitral associations provide that “default” answer on venue when the parties by their clause are silent on the subject. The ramifications of venue also impacts travel, document production, etc. Should important “venue determinations” be made by someone independent to the pending dispute?
- *Drafting considerations can determine where venue resides!*

## 10. ADR in Government Contracting.

- In the area of US Government related disputes, there are numerous resources on ADR in the government contract arena and the Administrative Law/Contract Board annexed ADR processes. Those Board connected processes should be considered, e.g. the Armed Services Board of Contract Appeals.<sup>10</sup>
- However, some overlooked components include the allowability of ADR costs to government contracts, the access/use to the so-called Board Judgment Fund when those disputes are resolved through ADR at those administrative law boards, as well the absence of independent arbitration authority by the military departments.
  - The Defense Contract Audit Agency—the DoD primary government auditor—has adversely opined on several occasions on the (un)allowability of certain ADR costs. Industry in the late 1990s recommended to the government that the FAR have ADR costs be specifically allowable contract management costs. If the government “supports” ADR should your contract or subcontract explicitly state that ADR is an allowable cost and, if not, perhaps by regulation?
  - Further, the use of the Board Judgment Funds (and by not being immediately replenished) may impact the willingness/ability to settle. If the costs were immediately charged to that contract, the parties could take a more direct interest in the matter.
  - And, FAR Part 33 is not self-executing on the use of independent arbitrators and in the DoD only the Navy has authorized arbitrations. Consequently, the use of baseball arbitration for/in contract formation or performance is limited.<sup>11</sup>
- *ADR in government contracting needs to be fully implemented!*

## 11. Arbitration Panel.

- The degree of independence of proposed arbitrators is an increasing area of interest. What are the memberships/affiliations of proposed arbitrators and what are the incumbent (legal) duties associated with them? Are the arbitrators truly independent if they have any duties/loyalty that may impact the process? For example, will the panelists have some form of fiduciary duty to one of the parties or...?

- More and more B2B clauses are specifying, in effect, that the panelists have some form of prior/disclosed relationship/expertise. However, if a potential panelist, for example, is an officer/director of an entity, can that person perform the requisite arbitral duties when a statutory/fiduciary duty may be involved? Can mere agreement to a voluntary arbitral Code of Conduct trump a statutory duty on loyalty, etc.?
- The parties should be under a continuing disclosure duty as to potential conflicts of interest since the dispute is between the parties.
- Coupled with the noted "duty" and geographical inquiries, how will the individual arbitrator or panel be selected...by the arbitral rules or other process? How will the panel chair be named? Does that panel chair recognize that s/he is an equal voting member but administratively s/he manages the process and when/what will be deferred for consideration by the entire panel? Should the proposed arbitrators be jointly interviewed by the parties?
- Given the spectrum of arbitrator(s) fees, costs, etc. the entire area of compensation and in particular the deposit/payment aspect may suggest greater scrutiny. For example, when one arbitrator composes the panel, normally deposits are based upon estimated professional time/fees and usually equally assessed. However, in the event that one party is a little "short," the other party may have to advance an additional amount...and, of course, request reimbursement later in the award since the funds are normally segregated by the arbitral association. But, if interim relief is needed on those deposit obligations, it should be considered early in the process, e.g. from a court/arbitrator where there is a direct contract obligation and basis for same being clear. Where there are three arbitrators, an additional, *albeit* more unique, consideration is that the deposit funds may be deemed "more" fungible by the arbitral association whereby subsequent arbitrator payments from the deposits may not be necessarily equal! For example, while the amounts dispensed may be "equal," one party may, in effect, be paying part of the more expensive arbitrator(s) where there is a different professional fee for each arbitrator. Accordingly, clarity from the arbitral association as to disbursement protocols and pooling from deposited funds may be desired.
- *Additional insight and background "investigations/research" of potential arbitrators should be explored.*

## 12. Form of Arbitration Award.

- What is the intended form of an arbitration award? Who will affirm or challenge any award? Will the arbitrator be required to follow and apply a particular law? Some arbitral rules provide that the arbitrator can do what is “just and equitable.”<sup>12</sup> Where is the award “bar” set for your arbitrations?
- Most importantly, while the arbitrator(s) will endeavor to issue an enforceable award, it is only the parties and their advocates that can ensure same—after all it is their award.
- A standard award including, e.g. prevailing party, damages, assessment of any costs, time for payment, the award is “final and binding on the parties,” etc. may be all that is needed. If a reasoned award with law/rationale is desired the costs and preparation time in the process should be understood, e.g. will the parties have an opportunity to provide draft awards, review proposed arbitration awards, etc. during the proceeding? Again, it is the parties’ award and they could be more involved.<sup>13</sup>
- The risks/opportunities of an arbitral appeal should be understood as part of the decision on award form. There is an increasing use of an arbitration clause with an appellate award process, e.g. whether or not a court can be delegated that duty and/or whether another arbitration panel would hear any appeal with the latter being the current path of least resistance.<sup>14</sup>
- *Whose award is it?*

This article has provided a suggested 12-step process that provides the reader with a calculated overview of current ADR issues that may make your arbitration experience more success-oriented. Undertaking the analysis suggested in these steps including drafting a well-considered and balanced arbitration clause as well as being cognizant of these steps throughout the subsequent arbitration hearing are the basics in the successful navigation of the arbitration process. Having as a goal a full and fair opportunity for a cost-effective and timely arbitration should be the overarching criteria in this multi-step review. And, being closer to “bullet-proofing” your ADR clause and the process is worth the effort from the initial steps!

\*Charles E. Rumbaugh, Esq. is a full-time arbitrator/mediator and private judge with offices in Los Angeles and San Francisco. He can be reached at [ADROffice@Rumbaugh.net](mailto:ADROffice@Rumbaugh.net) © Charles E. Rumbaugh 2011

## Endnotes

1. Several guides are available on drafting arbitration clauses including for example the American Arbitration Association (AAA) at <http://www.adr.org/sp.asp?id=28780> as well as the International Institute for Conflict Prevention & Resolution (CPR) at <http://www.cpradr.org/Resources/ADRTools/ADRProtocolsModelClauses.aspx>. AAA's web entry portal is [www.adr.org](http://www.adr.org) with its major arbitration/mediation rules posted at <http://www.adr.org/sp.asp?id=28751>
2. Earlier ADR articles of potential interest include a three part series on the use of Arbitration "Preliminary Hearings" published by National Contract Management Association (NCMA) in Contract Management, January-March 2002 (also available at [www.Rumbaugh.net](http://www.Rumbaugh.net)); "Using Alternative Dispute Resolution Methods to Resolve Government, Prime Contractor and Subcontractor Disputes" NCMA Contract Management, July 1997; and a series of over 17 articles/columns under the heading, "ADR "Tips"" published quarterly (1997-2001) by AAA in Dispute Resolution Times.
3. AAA conducted an exhaustive survey on the characteristics of a "dispute-wise" organization with the results posted at <http://www.adr.org/si.asp?id=4124>. And, the law firm of Fulbright & Jaworski L.L.P. conducts an annual "Litigation Trends" on US and international arbitration/litigation at <http://www.fulbright.com/>
4. CPR has posted its pledges and those organizations that have subscribed thereto at <http://www.cpradr.org/About/ADRpledge.aspx>
5. See "Having Trouble Getting to the Negotiation Table? Try Baseball Arbitration," a two-part series on incentivizing parties to negotiate, which appeared in NCMA Contract Management, October and November 2002 (also available at [www.Rumbaugh.net](http://www.Rumbaugh.net)).
6. The New York Convention or "Convention on the Recognition and Enforcement of Foreign Arbitral Awards" is available at <http://www.adr.org/si.asp?id=2512>
7. For example under the rules of certain arbitral associations an expedited or fast-track processes may be required for disputes under \$75,000 which could limit discovery, evidence production, scheduling, etc. And, if a dispute involves over \$500,000 certain "large, complex case" rules could apply with greater information exchange, larger arbitration panel, etc. All of this could impact the cost/time of an arbitration. See generally AAA rules at [www.adr.org](http://www.adr.org).
8. See, e.g. Hay Group, Inc. v EBS Acquisition Corp., 360 F3d 404 (3d Cir.2004), which significantly limits the use of non-party subpoenas for discovery. There are other court decisions that have ruled differently. While generally beyond the scope of this overview article, some are of the opinion that having a "discovery" pre-hearing before an arbitrator and/or taking of depositions for evidence purposes may be workable options since they usually expedite the overall arbitration process. Finally, having sworn witness statements covering direct examination testimony is a very useful tool.

9. The Choice of Law impacts other steps, too. For example, will local substantive law and/or the Federal Arbitration Act (9 USC Sect. 1 et seq) apply to the parties on a multitude of issues in addition to the venue related inquiries but also to rules on vacating/confirming awards, power of arbitrators, etc.? Also, see Buckeye Check Cashing, Inc. v. Cardegna, 546 US 440 (2006), on challenges to the validity of an ADR clause and/or the entire agreement between the parties as well as threshold inquiries by an arbitrator/court stated in First Options of Chicago v. Kaplan, 514 US 938 (1995). The role, if any, in the Federal Rules of Civil Procedure is generally overlooked or downplayed in the drafting of arbitration clauses.

10. The Armed Services Board of Contract Appeals ADR rules are available at <http://www.asbca.mil/ADR/adr.html>

11. For example, the Air Force has an excellent ADR website with relevant statutes, rules, Executive Orders, protocols, etc. at <http://www.adr.af.mil/>. The Air Force has also posted the names of those companies that have entered into Corporate-level ADR industry pledges but see text in Step 2 above.

12. See e.g. AAA Commercial Rules 42 and 43.

13. Courts in some jurisdictions have found that one ground to overturn an arbitral award is based upon the non-statutory standard in finding an award that is in "manifest disregard of the law." The full import in such a holding to resolve B2B disputes needs to be appreciated. See Stolt-Neilsen SA v. AnimalFeeds International Corp., 130 SCt 1758 (2010), where the Supreme Court discussed but did not decide whether "manifest disregard" standard in "viable."

14. See Hall Street Associates, LLC v. Mattel, Inc., 552 US 576 (2008), where, the court held, in part, a private agreement cannot expand the jurisdiction of courts.