CORPORATE LAW UPDATE

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EN GARDE! CHOOSE YOUR WEAPON: ARBITRATION OR LITIGATION

Near the end of every commercial contract comes the dispute resolution clause, where the parties specify whether disputes will be resolved through arbitration or litigation, and sometimes further provide that the chosen method will be preceded by management negotiations and/or non-binding mediation.

It can be easy to hold a rosy view of commercial arbitration, perhaps because litigation can be a very trying experience (pun intended). Litigation is often inordinately lengthy with extended discovery and motion practice causing what seems like a small, simple matter to drag on and on. Such a drawn-out public process takes a toll on litigants in terms of management focus and time, energy and money. Arbitration is conducted in private, outside of court under the supervision of a non-governmental service. The parties, as opposed to a judge, take the lead in setting the schedule of deadlines and hearings, and discovery may be curtailed, perhaps completely eliminated. The parties even select the arbitrator or panel of arbitrators who will decide the matter and specify required subject matter expertise of the arbitrators.

As a result, arbitration has a reputation for being flexible, fast and relatively inexpensive. Accordingly, many companies have a default preference for arbitration regardless of circumstances.

Sometimes, arbitration works wonderfully, delivering all of the anticipated benefits. Other times, however, arbitration may be problematic resulting in a process that is not only slow and expensive but also one that yields a faulty result. Litigants don't have to pay judges during a litigation, but arbitrators charge hundreds of dollars per hour, a cost on top of attorney fees and expenses. Adding to the bill are the frequently large filing fees that are charged by arbitration services. Perhaps, most importantly, arbitrator decisions are subject to appeal only in a limited number of situations. While the majority of arbitrators strive to make rulings in accordance with facts and law, bad decisions do happen, and a party that feels victimized by a "raw deal" has little recourse.

While neither arbitration nor litigation is perfect, one may be preferable depending on the situation. When deciding whether to have a dispute resolution clause call for arbitration of a particular type or litigation, businesses should consider the following factors:

Little Money – A dispute over a relatively small amount may call for arbitration. The parties can agree to dispense with discovery. Moreover, some dispute resolution services have expedited procedures that allow for decisions based on pleadings alone rather than in-person hearings. The parties can also chose an arbitrator/arbitration service which charges lower rates.

Lots of Money – In contrast, if a dispute is more likely to involve a substantial amount or is a "bet the company" transaction, then litigation with its procedural safeguards and right to appeal may be preferable.

Location – Arbitration may allow businesses to use expertise closer to home. For example, Delaware corporation shareholders who are domiciled in California might specify an arbitration in Los Angeles overseen by an arbitrator experienced in Delaware corporate law rather than be in California court where the judge may lack the relevant knowledge or incurring the expense of traveling to Delaware.

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Sensitivity – Arbitrations are conducted in secret and rulings of arbitrators remain confidential. If the subject of a dispute is likely to involve trade secrets or other confidential information or might be embarrassing to a party, arbitration may be preferable, although a "protective order" may be available in litigation**.**

Legal Complexity/Technical Subject Matter – If the parties anticipate a legally complex disagreement or dispute, they may opt for litigation where an appeal would be available to correct or confirm the initial ruling. Alternatively, if the subject matter of a dispute is likely to require technical knowledge or familiarity with the nuances of a particular industry, then the parties should consider arbitration with the technical qualifications or industry experience of the arbitrator specified in the arbitration clause.

Party Relationship – If parties are collaborating in many areas and want to minimize the adversarial nature of a potential dispute, they may desire a dispute resolution clause that provides for an extensive period of non-binding mediation, such as sixty or ninety days, prior to either party being able to commence arbitration or litigation.

The foregoing considerations are general in nature and may not be applicable every situation. Arbitration clauses are definitely not one-size-fits-all and must be customized to reflect the parties' intentions. Care should be taken to make sure each dispute resolution clause meets the specific needs of parties and their business objectives with respect to matters such as size of arbitration panel (one or three -- with the additional arbitrators mitigating risks of bias and capriciousness), arbitrator selection process, location, timing, allowance of discovery, arbitration service (of which there are several) and requirement of a written decision with legal rationale. FisherBroyles attorneys are always happy to discuss whether litigation or arbitration may be preferable in a particular circumstance, preferably at time of contract, but also when a dispute arises.

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