Standing Up To The Challenge

Courts Confirm Arbitration as a Favored Means of Dispute Resolution

By Dan Berman, Tracy Lewis and Walter McDonough

With lengthy delays and mounting costs of litigation, many organizations now make the affirmative decision to arbitrate their business, employment and other disputes. Sophisticated businesses and individuals seek to have their disputes resolved in a timely manner by a person or panel with some experience with their field. Arbitration, in theory, should meet those needs and avoid the long, expensive, often unpredictable path of litigation. Selecting arbitration as the right forum is only half the challenge. It requires a careful balancing of the risks and benefits, especially when the ADR provision may not be utilized until several years later. The remainder of the challenge is drafting an ADR provision that will be enforced by the courts, if needed. Fortunately, legislation and recent judicial decisions confirm that arbitration is a favored means of dispute resolution.

Legislating Arbitration

By enacting the Federal Arbitration Act (FAA) Congress confirmed a federal policy favoring arbitration. The statute mandates courts enforce arbitration agreements in contracts involving interstate commerce, unless unenforceable under standard state contract law principles. Doubts concerning the scope of arbitrable issues are to be resolved in favor of arbitration, irrespective of whether the problem stems from the contract language or allegations of unenforceability. However, the FAA does not give arbitration agreements a special status; it simply seeks to ensure the agreement of the parties is enforced.

Under the FAA, parties are permitted to structure arbitration agreements as they see fit. Accordingly, the issues subject to arbitration may be limited and the rules governing the arbitration may be specified. This flexibility affords one the opportunity to create a more customized solution for proactively managing risks. Still, to reap these benefits the contractual arbitration provision must be enforceable.

Enforcing the Agreement

The FAA sets forth only two limitations to the enforcement of an arbitration provision: the provision must be part of a written maritime contract or a contract evidencing a transaction involving commerce, and the provision may only be invalidated based upon the grounds that exist at law or in equity for the revocation of any contract. The FAA precludes courts from invalidating arbitration agreements under state law contract principles, which are applicable only to arbitration provisions. Given these limitations, the primary arguments advanced to support a finding that an arbitration provision is unenforceable include claims the contract is one of adhesion, is unconscionable, or the opposing party has waived the right to compel arbitration.

Following in the footsteps of the FAA, many states have enacted similar laws. These legislatures have confirmed that contracts to arbitrate cannot be ignored. Recent court decisions indicate the judiciary is following these legislative standards, and avoiding contractual arbitration is becoming a more difficult endeavor.

Challenging Arbitration

Over the last 12 years, California courts have trended toward rejecting claims of adhesion, unconscionability and waiver, asserted in an effort to avoid enforcement of contractual arbitration provisions. Such a result seems to coincide with the financial crisis of an already over-loaded judicial system. This is especially true in California where over the last four years courts have faced $650 million in budget cuts, and the current budget proposes an additional $500 million in cuts.

Most recently, the California Supreme Court rejected claims of unconscionability in upholding an arbitration provision set forth in a condominium's recorded Conditions, Covenants & Restrictions (CC&Rs). Specifically, the court found the provision, which covered claims stemming from alleged construction defects, should be enforced because it manifested the intent and expectations of the developer as well as those who took title in the development. The court affirmed that placing a provision to arbitrate in the CC&Rs, which are drafted and recorded by the developer before a home owners association (HOA) is formed, does not support a finding of adhesion/procedural unconscionability. Accordingly, even though a HOA may not bargain with a developer over the terms of the CC&Rs or participate in the drafting of the CC&Rs, the terms in the CC&Rs reflect written promises that are subject to enforcement against the HOA.

Is Arbitration Right for You?

While the courts, especially in California, appear to favor arbitration, challenges to enforcement of arbitration provisions are more prevalent. As such, it is important to consider whether this ADR option is appropriate for the risks of your company or your client, and then make an informed decision about the benefits of arbitration to resolve them. Factors to consider include:

- Scope of disputes you expect to arbitrate
- Availability of a pool of qualified arbitrators
- Which ADR service you would like to use
- Whether the rules of that service will meet your needs for cost, timing and final resolution
- Amount and type of discovery available
- Likely cost

Finally, in considering whether an arbitration provision is appropriate for you or your client, the potential cost associated with enforcing such a provision must also be considered. Although the trend of the courts is to enforce arbitration provisions, this does not mean compelling arbitration is always an easy process. Extensive costs, attorneys' fees and time may be spent in court fighting to enforce the provision if one side refuses to voluntarily submit to arbitration. Accordingly, all of the risks and benefits associated with utilizing arbitration must be separately considered for each company or client because it is certainly not a one-size-fits-all solution for litigation management.

If there are two points that can be learned here, they are that courts have a natural tendency to enforce agreements to arbitrate and people considering arbitration should think about it BEFORE the dispute arises. LM

Dan Berman is the Managing Partner of Wood, Smith, Henning & Berman LLO. Tracy Lewis is Senior Counsel, Wood, Smith, Henning & Berman LLP. Wally McDonough is President of ELK Consulting Services, LLC.