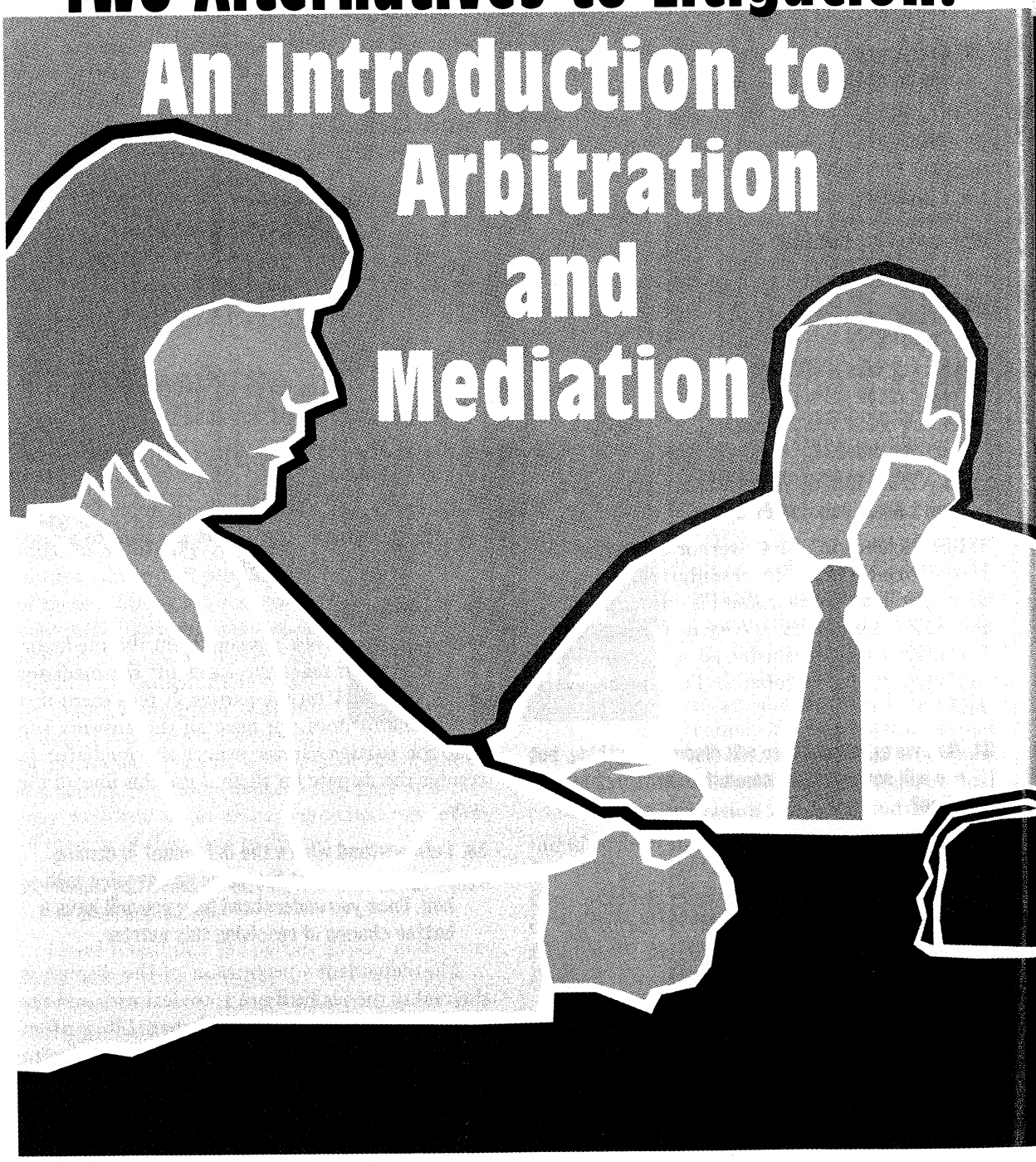
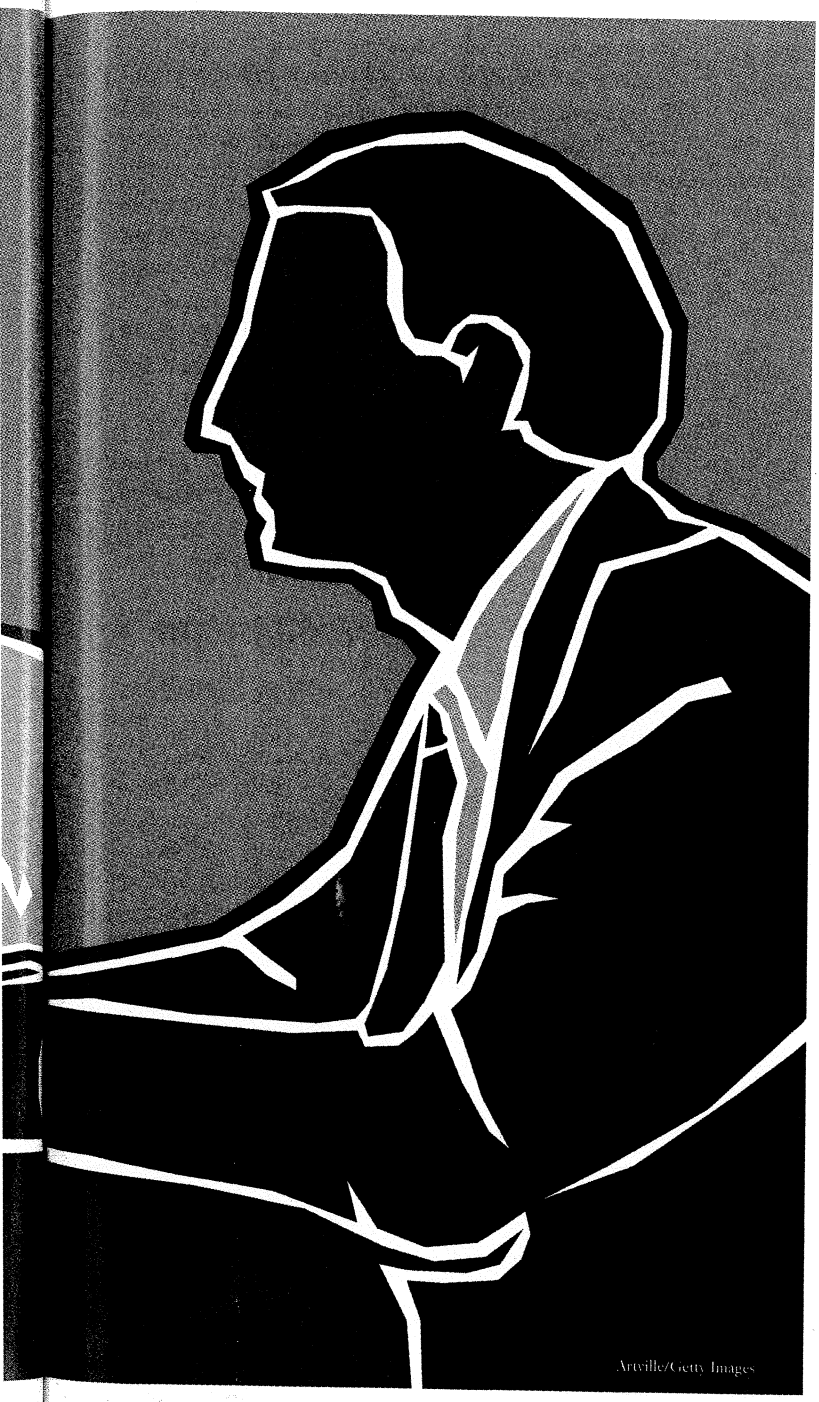
Two Alternatives to Litigation:

An Introduction to Arbitration and Mediation



Many civil disputes are still decided in courts of appropriate jurisdiction. However in our litigious era, courts in virtually every state have become overloaded, causing justice to be unreasonably delayed. In Colorado, where this is being written, the backlog of civil cases in many courts requires three or more years between filing and trial of the case. Mary Mullarkey, Chief Justice of the Colorado Supreme Court, noted[1] that every judge in Colorado needs to make a decision each and every day in order to keep up with the backlog. Obviously that is impossible.

The result has been to look for other means of resolving disputes. The common option for commercial disputes is called alternative dispute resolution (ADR), which primarily means arbitration and mediation.[2] ADR processes, when properly



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People who are unfamiliar with arbitration and mediation often confuse the two processes. They may not know that arbitration results in a final and binding award that is enforceable in court, and subject to limited judicial review. They may not know that mediation is non-binding, and that the goal of mediation is for the parties to reach a voluntary agreement to settle with the assistance of a neutral third-party mediator. In this article, the authors explain the basics of both processes for those who need an introduction to ADR.

designed, provide due process and an opportunity to be heard in a less formal and therefore less intimidating setting than the courtroom. And the cost is generally dramatically less.

The two common ADR processes, arbitration and mediation, are often confused by the general public. However, they are very different. Arbitration is an adjudicatory process in which one or more neutral arbitrators hear the parties' evidence and arguments and then issue a binding award. Mediation, by contrast, does not include a third-party decision maker. Rather, a neutral mediator facilitates and guides negotiations among the parties to allow them to reach a voluntary settlement.

The procedures used to resolve disputes in the two processes are, as one might suspect, very different.

ABCs of Arbitration

Agreement of the Parties. Theoretically anyone with a legitimate legal claim can file a lawsuit. The defendant need not consent to be sued. Filing an arbitration is completely different, for arbitration is the product of an agreement by all parties to arbitrate a current dispute, or specified disputes that may arise in the future.[3] Thus, a party that has not agreed to arbitrate cannot be compelled to do so.[4] An agreement to arbitrate must be written into transaction documents between the parties in a clause that may be headed "Arbitration" or "Dispute Resolution" or just "Disputes." The provisions agreeing to arbitrate can be simple, or in a complex relationship, can be very detailed.

Current Importance of Arbitration. Although arbitration is hardly new (it goes back more than 400 years in Britain), it is only over the last 15 years that it has become essential for the resolution of a wide variety of commercial disputes. Its acceptance by business, governments and the legal profession means arbitration is common for all kinds of disputes, including employment, construction, breach of contract, real estate taxation, credit card, banking, and legal fees, among others. The broad acceptability and use of arbitration is also due to supportive decisions by the U.S. Supreme Court.[5]

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Arbitration is also well accepted for international business transactions because international arbitration awards are enforceable in the many countries that are signatories to the United Nations Convention on the Recognition and Enforcement of Arbitral Awards.[6] Agreeing to arbitrate an international dispute avoids having to litigate in a foreign court with unfamiliar laws or unpredictable enforcement. In an arbitration clause, the parties can specify the applicable law, arbitration procedures and seat of the arbitration.

Procedural Differences from Litigation. If a dispute arises and the arbitration clause is invoked, the parties' dispute will be heard and their evidence presented at an arbitration hearing before one or more neutral arbitrators, who will rule on the dispute. A key feature of arbitration is that the arbitrator's ruling is final and binding.[7] Thus, if an arbitrator issues an award and the losing party does not comply, the prevailing party may commence an action in a court of law to have a judgment entered to enforce the arbitral award. And the ability of the losing party to vacate the arbitration award is very limited.

Second, the setting of arbitration hearings is less formal than court proceedings. Well-managed hearings are usually completed more quickly (and therefore at less cost) than court proceedings. And they are commonly held in a conference room, not a courtroom, which offers a certain feeling of egalitarianism among the parties.

Third, the rules and procedures applicable to arbitration proceedings are less onerous than litigation rules. For example, formal rules of evidence[8] are commonly not applied in an arbitration hearing, unless the parties or the arbitrator agree otherwise. Arbitration laws and rules recognize that an arbitrator may conduct an arbitration proceeding in the manner the arbitrator considers appropriate for a fair and expeditious disposition of the proceeding.[9]

Fourth, the parties generally select the arbitrator. Usually one arbitrator hears a small case. A panel of three arbitrators may be appointed to hear a large, complex case, if the parties so desire. The ability to select the arbitrator is a critical advantage in arbitration over litigation. It enables the parties to select individuals who are uniquely qualified, based on their education and experience in the subject area. The usual result is a decision with which the parties are more satisfied.

Designing the Process. Because arbitration is a creature of contract, the parties have the ability to design their own arbitration proceeding. They can select a recognized arbitration forum with its own rules and procedures, such as the American Arbitration Association (AAA), to administer the arbitration and provide the neutral arbitrator, or they can choose to arbitrate privately using rules and procedures of their own design (non-administered or *ad hoc* arbitration) and employ neutral arbitrators from other sources.

There are distinct advantages to administered

arbitration under the auspices of an established arbitration provider. One is neutrality. As a neutral organization, there is a presumption of legitimacy, which makes the losing party more accepting of the award and more likely to comply with it. There is another advantage to protecting the integrity of the process. Administered arbitration insulates arbitrators from having unilateral (*ex parte*) contact with the parties in dealing with such issues as compensation and disclosures of potential conflicts of interest.

When parties agree to arbitrate, they can provide in their contract such matters as the locale of the arbitration, the qualifications of the arbitrator, the scope or limitation of arbitrable issues, the scope of discovery, and the procedural and substantive laws that will apply.

Role of Law and Private Forum Rules. Both federal and state arbitration laws must be consulted in drafting an arbitration agreement. The Federal Arbitration Act (FAA) applies to an arbitration agreement in a transaction involving interstate commerce.[10] States generally have their own arbitration laws, which may differ from each other and from the FAA. Most states enacted the 1955 Uniform Arbitration Act (UAA) in whole or in part. Only about a dozen states have enacted the revised UAA (RUAA), approved in 2000 by the National Conference of Commissioners on Uniform State Laws. Colorado[11] is among them, yet the state has modified the uniform law. Other states may have done the same, so an attorney representing a party who desires to arbitrate in an "RUAA state" should determine whether the chosen state has altered any provisions or added new ones.

One of the issues when drafting an arbitration agreement, is what should be the governing law. Should it be the law in effect at the time the arbitration agreement was drafted, or at the time the dispute arose, or some other date. A similar determination should be made with regard to the rules of the arbitration provider organization, since providers periodically update or revise their rules. Thus, counsel should become familiar with the applicable state and federal law and the rules and procedures of the chosen arbitration organization.

Certain areas of business activity automatically require arbitration for the resolution of disputes. A key area is securities. Both investor and employee disputes involving securities brokers are required to be arbitrated under rules of self-regulatory organizations like the New York Stock Exchange and the National Association of Securities Dealers. These forums, as is the case with the AAA, have well thought rules for arbitration proceedings. One often sees in arbitration agreements in commercial contracts a statement that the arbitration shall be held in accordance with AAA rules.

Arbitration Procedures

Conflicts of Interest. Because neutrality is so important in arbitration, arbitration rules and codes of ethics require arbitrator candidates to comply with stringent rules of disclosure of actual or potential conflicts of interest. This means that if an arbitrator candidate knows of any matter that could be considered an actual or perceived conflict of interest-which can simply be a social relationship with one of the parties or its counsel, he or she must disclose it prior to appointment. Moreover, appointed arbitrators have a continuing obligation to disclose such conflicts. Thus, if a conflict is discovered during the arbitration proceeding, it must be disclosed immediately and the parties must agree that it either has or has no bearing on the arbitrator's neutrality. This is important since an undisclosed conflict is a recognized ground for vacating an arbitration award, thus creating costly delays in resolution of the matter.

Preliminary Hearings. The arbitrator usually conducts at least one preliminary hearing after the parties file their pleadings. Often these are conducted by telephone. In general, it is at a preliminary hearing that the arbitrator and counsel for the parties discuss the issues involved in the case and agree on scheduling the exchange of documents, witnesses to be called and the dates for the hearing. The arbitrator may also determine the need for subpoenas or other preliminary issues raised by the parties at a preliminary hearing. The arbitrator usually summarizes what has been agreed to in a written order.

In arbitration, the parties should limit their document exchanges and submissions to the arbitrator to documents that are clearly relevant and material. When they don't the arbitration takes longer and costs more. When parties request or deliver a voluminous amount of debatably rele-

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vant documents, they should realize the work involved. Example: one of us received 16,000 pages of basically irrelevant documents one day before an arbitration hearing, and the other, 8,000 pages of deposition transcripts on cross motions for summary judgment.

Submitting large quantities of documents without establishing their relevance disserves the arbitrator, whose job is to manage the proceeding. Although the arbitrator will do his or her best to maintain neutrality throughout the proceedings, such actions could have a conscious or subconscious impact on the arbitrator's perception of counsel and the merit of the client's case. Accordingly the parties and their counsel should read each document in their possession and then exchange only the most relevant. It is helpful to the arbitrator if the parties can agree to submit one set of joint exhibits (i.e., documents they both intend to rely on at the hearing), thus avoiding duplication and waste.

In a perfect world, all disputes would be mediated since mediation generally allows the parties to continue to do business. Parties seldom leave a mediation with hard feelings.

Evidence. As noted earlier, an arbitrator has discretion to conduct the arbitration in such manner as he or she considers appropriate, provided that the parties receive a fair and expeditious disposition of the case. This broad authority includes the power to determine the admissibility, relevance, materiality and weight of evidence offered during the hearing. An arbitrator, therefore, has no obligation to apply court rules of evidence, and often, based on the concept that arbitration is the consummate court of equity, will hear evidence that would not be admissible in court. (This, at times, drives hard-core litigators nuts.) An experienced arbitrator will immediately recognize an evidentiary issue like hearsay testimony and will give it the weight it deserves.

The Hearing. The first activity at an arbitration hearing should be an opening statement by each side, usually with the petitioner (also known as the claimant or the plaintiff) starting. Opening statements provide an opportunity to argue the client's case to the arbitrator. An opening statement should be succinct while clearly summarizing the key facts, issues and evidence from the client's point of view, the client's legal theory and proof of damages.

Documents or briefs created for the hearing are commonly exchanged and presented to the arbitrator at the hearing. These are often important to the flow of evidence presented at the hearing. And though the classic "just found this" has a wonderful impact on Perry Mason trials, it is suspect in an arbitration and, of course, requires review by the other party before acceptance by the arbitrator.

Use of Legal Briefs. The parties benefit the most when the arbitration is conducted fairly and efficiently. While briefing thorny legal issues is one way to increase efficiency without sacrificing due process, lengthy briefs with lots of case citations violate the concept of an expeditious process. Often the arbitrator will limit the page lengths of briefs. Indeed this is advisable. In one reasonably complex securities arbitration, one of us received two 60 page legal briefs. The briefs were over-kill so the attorneys were given a limited period of time at the hearing to orally highlight the main points of the briefs.

Briefs should be succinct and to the point. As a courtesy, counsel should give the arbitrator photocopies of the cases cited in briefs, with the relevant sections highlighted; it saves the arbitrator from having to find the decision and its relevant sections.

Closing Statement. Closing statements should be used to state why the case was proved or not proved and to summarize the evidence presented. A claimant's counsel should specifically itemize the damages or other remedy being sought. Generally a rebuttal is allowed for both parties.

The Arbitration Award. In general, an arbitration award is not required to have written findings of fact or conclusions of law. The arbitrator has no obligation to provide his or her reasoning in the award. If the parties wish to have a reasoned award, or findings of fact and conclusions of law, they should include it in their arbitration agreement or subsequently agree no later than at the commencement of the arbitration.[12] The parties should make the arbitrator aware of this at the preliminary hearing so that this requirement can be included in the preliminary hearing order. Parties should expect the arbitrator's compensation to be higher when a reasoned award is requested, and significantly higher when findings of fact and conclusions of law are requested because of the time that they take to prepare. For this reason the proceeding is also likely to take more time.

Arbitration rules often have a fixed time for the arbitrator to enter an award. The time period required by the AAA rules is 30 days. This time period generally runs from the time the arbitration is "closed" in accordance with the procedural rules of the AAA or other forum. We have found it to be a good practice to declare to the parties at the conclusion of the proceedings that the matter is "now closed," which provides certainty as to when the award is due.

Enforcement of Awards. One of the key reasons that arbitration is so effective is that the right to challenge an adverse award is limited by state and federal law. If the losing party fails to comply with the award, the prevailing party can seek to confirm the award in court, in accordance with the governing arbitration law.

Mediation: Facilitating Negotiations

The key difference between an arbitrated resolution of a dispute and a mediated one is that, under the mediation model, each party must agree to the resolution; no one can be forced to accept a particular settlement.

Certain mediation procedures are similar to arbitration: each party to a mediation must agree to participate in the process.[13] Except for a court-ordered mediation, the parties must also agree on the mediator, as well as his or her qualifications. The mediation is often held in an office conference room. However, in mediation, two additional offices generally need to be available so each side can have private discussions (called "caucuses") with the mediator. The mediator will also caucus with each party and go back and forth between them, conveying offers and counter offers and usually will bring the parties back together for joint sessions.

There are few prescribed rules for a mediation conference. Mediation is a forum for fact finding and fashioning solutions, guided and moderated by a mediator. Mediation is designed to achieve a solution crafted by the parties that satisfy both of their interests; thus, there is no decision by a third party, as with arbitration or litigation.

Mediation and Complex Disputes. Mediation can be very helpful in resolving small disputes-i.e., those in which a small amount is at stake or those with one or just a few issues. The question one might ask is, can it help resolve rancorous, large, complex disputes? The answer is usually yes, under the guidance of a skilled mediator. The obvious example is federal mediation of labor disputes.

A good mediator garners trust and therefore helps the parties focus on the key issues to pragmatically (not emotionally) look for common interests and a negotiated settlement. Often parties leave mediation knowing that they will continue to do business together. Thus, mediation is more likely to keep a business relationship alive than arbitration or litigation.

Mediation Settlement Agreements. A settlement agreement reached in mediation is binding on the parties in the same manner as any other contract. When a tacit agreement among the parties is reached, the terms must be reduced to a written binding contract. Usually a memorandum of the main points of agreement is prepared at the end of the mediation, which ripens into a formal settlement agreement. Some mediators prefer not to be involved in drafting this memorandum or the final settlement agreement. They prefer to have the parties' attorneys do the drafting. We do not subscribe to that view. We believe a neutral and if needed outside (and unrelated) counsel should prepare the memorandum and final settlement agreement. In Colorado the mediator is generally that neutral[4]

The memorandum of settlement should be executed by all parties to the mediation including the mediator. The reason for the *ex-officio* signature of the mediator is to document the fact that a third party witnessed that an agreement was reached by the parties. The memorandum of settlement can be enforced by a court, if necessary. An increasingly common practice is the inclusion of an arbitration clause in settlement agreements as a means of resolving disputes that may later arise out of the settlement's terms.

The success of mediation has been so great that many judges will often require it before hearing a civil case.

Who Are the Arbitrators and Mediators?

To understand the credentials of arbitrators or mediators, it is helpful to look at the types of individuals who serve in these roles.

Educational Background of Arbitrators. As you might suspect, many arbitrators are lawyers (both active and retired) as well as retired judges. An arbitration hearing has enough similarity to a trial that a sole arbitrator should have some knowledge of the law.[15] When making an award, legal correctness is generally important. Business or industry professionals and academics can also serve as arbitrators when properly trained in arbitration. Such individuals are often selected to serve on a panel when the parties want an expert in a particular subject to resolve their dispute, such as an accountant, appraiser or economist. The theory is that a person with expertise in the subject matter, who has been trained in arbitration procedure and the relevant law, can be an effective arbitrator.

Educational Background of Mediators. Mediators do not have to have a law degree or practice law (although many do). Mediators often have degrees in construction, economics, business administration, dispute resolution, political science, labor management, psychology, communication or other subjects. Mediators are usually experts in negotiation and conflict resolution and they may have expertise in the subject matter of the dispute.

Training of Arbitrators. Regardless of their educational backgrounds, arbitrators and mediators should have training in the processes they work with. The AAA requires neutrals on AAA panels to undergo a significant mount of preliminary training and experience before they are accepted on the panel. The AAA also requires substantial periodic training after joining the panel. That is also the case with the securities industry arbitration forums. There may be additional training requirements required by the jurisdiction for specified types of disputes. For example Colorado has a statutory training requirement for arbitrators of real estate tax disputes.[16]

There are currently no universally imposed training requirements for mediators. ADR providers generally train the individuals who serve on their panels. Courts have their own requirements for individuals who serve as court-appointed mediators. The minimum number of hours of training in mediation techniques varies.[17]

Mediators need skill in negotiation, communication, group dynamics, psychology, organizational behavior, law and familiarity with the subject matter of the mediation.

Conclusion

There are some disputes that should be litigated in court. An example is a case in which injunctive relief is sought, since injunctions, though they can be issued by arbitrators, can only be enforced by a court. But there are few business disputes that cannot be successfully arbitrated or mediated. As a result, arbitration and mediation are increasingly being used for these disputes.

In a perfect world, all disputes would be mediated since mediation generally allows the parties to continue to do business. Parties seldom leave a mediation with hard feelings. Why? Because with the aid of a competent mediator, the parties have negotiated and modified their interests and needs, allowing them to reach a mutually satisfactory agreement. A great example of the success of mediation is the Denver Bar Association Legal Fee Arbitration Committee. This committee used to meet every month to hear many disputes. Since the introduction of mediation three or so years ago, the committee has rarely met because legal fee disputes are resolved with the mediator's (settlement master's) help. And in a surprising number of cases, the client and lawyer continue to do business.

Certainly some civil disputes must be decided by a third party. With the backlog of cases due in part to courts hearing too many criminal cases, arbitration is an excellent option. It provides an environment where the parties can prove up their cases. As in litigation, the parties can always settle before an award (and they often do). Awards of arbitrators usually cut to the quick of the dispute and allow justice to be served without the confining trappings of a courtroom. ■

ENDNOTES

[1] Comments made at City Club of Denver, 2003

[2] Other forms of ADR exist including neutral fact-finding, summary jury trial, dispute review boards and private judges, among others.

[3] Clearly there can be more than two parties to the arbitration agreement. Although in most cases the agreement to arbitrate derives from a contractual relationship, there is no prohibition against agreeing to arbitrate after a dispute arises.

[4] The problem with this concept in complex disputes is parties may include *ex-officio* entities or persons who have not agreed to arbitrate. The common examples are corporate subsidiaries or corporate officers of a party. These situations have generated some litigation, because arbitration is contractual and a party can generally not be forced to arbitrate if it has not contracted to do so.

[5] See *Gilmer v. Interstate/Johnson Lane Corp.* 500 U.S. 20 (1991); *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985); *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79; *United Steelworkers of Am. v. American Mfg. Co*, 264 F.2d. 624

[6] New York, 10 June 1958.

[7] The arbitration agreement should provide that the award is binding and enforceable in a court of competent jurisdiction, though both federal and state laws elucidate that presumption.

[8] In Colorado they are in the Colorado Rules of Civil Procedure, Rule 43, "Evidence."

[9] Colo. Rev. Stat. 13-22-215 and RUAA § 15: Arbitration Process. This underscores the historical concept that an arbitration is, in fact, the "consummate court of equity," and should not be hampered by strict court rules.

[10] 9 U.S.C. § 1, *et seq.*

[11] Colo. Rev. Stat. 13-22-201, et seq. The states that have adopted the RUAA can be found at www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-aa.asp.

[12] AAA Commercial Rule R-42(b) requires this request to be made prior to the appointment of the arbitrator.

[13] An exception is court-ordered mediation.

[14] It is recommended that attorneys who are not related to the parties and are contracted by the mediator write the settlement agreement. This avoids the potential of conflicts of interest and further disagreement.

[15] When a panel of arbitrators for a complex dispute, it is valuable to have one or more qualified non-lawyers, as well as a lawyer on the panel.

[16] Colo. Rev. Stat. 39-8-108.5 requires real estate taxation arbitrators to have an appraisal license, among other things.

[17] In Colorado, 40 hours of mediation training is the common expectation.