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To Arbitrate Or Not To Arbitrate: That Is The Question.

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In professional services agreements and engagement letters, it is not uncommon to find a variety of dispute resolution provisions. These vary from a requirement that the parties mediate before filing suit, to shifting attorney fees depending on which party's offer at mediation turns out to be closest to the ultimate award, to simply fixing venue and jurisdiction in a particular court. This article discusses the pros and cons of arbitration provisions in professional services agreements in general, recent court decisions impacting the enforceability of arbitration provisions, and suggestions for the type of arbitration provision that provides the most flexibility to the professional and/or the professional's liability insurer.

1. Arbitration pros and cons:

The conventional wisdom regarding the benefits of arbitration is that it is efficient, economical, and private. The idea behind arbitration is to allow parties in a dispute to file claims that do not become a matter of public record, to quickly move through the arbitrator selection process (which normally provides the parties some degree of control at the beginning of the claim over who decides their case) and discovery, and to get to a private hearing where evidence is presented in a less formal environment (compared to a court trial)—resulting in a speedy and relatively inexpensive final decision.

While it is true that arbitrations are not a matter of public record (except perhaps if they are filed into the court system to enforce an award), they are not by default confidential. Unless the engagement letter specifies, the parties are not precluded from disclosing to anyone (including a professional's clients, the press, and others in the community) that claims have been made. The claims must normally be reported to the professional's licensing and/or regularity body, regardless of any confidentiality provisions. Further, in many cases the claimant files a lawsuit despite having agreed to arbitration and the only relief is to move to compel arbitration through the court system. Obviously, if the goal of the professional is to avoid the publicity associated with the filing of a lawsuit, a successful motion to compel is an unsatisfactory outcome.

In terms of efficiency and economy, while arbitration rules can be less burdensome than litigating a case under the federal rules of civil procedure, there can be added cost in the form of disputes about the applicability of the arbitration provision, the arbitrator selection process, and in extreme cases, disputes over the outcome of the arbitration. Each of these possibilities adds to rather than limits the costs of arbitration. The issue of arbitrability and arbitrator selection happens at the outset and adds costs immediately. Failing to assert the arbitration provision until later in the case may result in waiver (for example, courts tend to deny requests to refer a case to arbitration after dispositive motions have been decided, or if trial is imminent). If a lawsuit is filed, the normal response deadlines apply and within that timeframe a motion to dismiss and/or motion to compel arbitration must be prepared and filed. A determination must be made under the applicable law as to whether the court or the arbitrator decides the issue of arbitrability. If the court decides the issue, briefing and argument are required; which adds to the costs of litigation. In some instances, disputes over the selection of arbitrators end up in court if the agreement specifies a selection process and the parties dispute how the provision should be applied (this would normally take the form of a declaratory judgment action). In rare cases, where the arbitrator has engaged in fraud, corruption, or misconduct, a lawsuit seeking to vacate the ruling can be filed, again increasing the costs of the process. So, the intended benefits of efficiency and economy are not always realized either.

In addition, depending on the forum chosen for the arbitration and the discretion exercised by the arbitrator, the rules regarding discovery and litigation procedure can end up working just like a case filed in federal court. Multiple day depositions, discovery disputes, dispositive motions, and pre-hearing evidentiary practice can all lead to an expensive and inefficient procedure. For example, one of the most common arbitration provisions calls out AAA as the applicable "forum." The AAA rules provide wide discretion to the arbitrators in cases involving significant damages.

Turning from the potential benefits (and their limitations) to the risks of arbitration, the single biggest danger is that the arbitrator will fail to follow the law. If this happens, the aggrieved party normally has little chance of overturning the decision and must meet a high burden. The common requirement to vacate an arbitration ruling is to show that the arbitrator engaged in misconduct. Decisions overturning or vacating arbitration awards are few and far between, and normally limited to cases where there was provable fraud on the part of the arbitrator.

Another downside to arbitration is when enforcement of the provision results in duplicative litigation and inconsistent results. This can happen in a number of ways—some common, some not so common. The common scenario is a case in which there are multiple defendants and a common nucleus of operative facts, but one defendant has an agreement with an arbitration provision, while the others do not. This can result in the professional being required to defend itself in the arbitration, while participating in the discovery and trial of the companion case. The attorney representing the professional must prepare for and participate in both proceedings (at least to the extent the client is involved). The potential for inconsistent results is a function of the facts of the dispute and the applicable legal scheme. For example, in a pure comparative fault state, a negligence claim against all the defendants could result in a plaintiff obtaining 90 percent recovery at trial and then another 90 percent recovery in the arbitration. If the scheme is joint and several, a finding of 5 percent fault in the arbitration could lead to the professional paying 100 percent of the damages if there is a finding of no fault on the part of the trial court defendants. These results are avoided if all claims are adjudicated in the same proceeding.

As can be seen from the foregoing, the pros and cons are far from easy to assess or predict and the evaluation of whether arbitration is appropriate must be made on a case-by-case basis.

2. Recent decisions favor arbitration:

In the latest of a number of recent rulings of the United States Supreme Court—*CompuCredit Corp., et al. v. Greenwood, et al*., 565 U. S. __ (2012)—the Federal Arbitration Act (FAA) was applied to compel arbitration over objections by the counter-party to the agreement. In *Greenwood*, the plaintiff was a customer of a credit rehabilitation company and argued that a federal statute regulating the industry and requiring a written notice advising that customers "have the right to sue" the credit rehabilitation company, did not mean the arbitration provision in the agreement was unenforceable. The Court stated:
So also with respect to the statement's description of a "right to sue." This is a colloquial method of communicating to consumers that they have the legal right, enforceable in court, to recover damages from credit repair organizations that violate the CROA. We think most consumers would understand it this way, without regard to whether the suit in court has to be preceded by an arbitration proceeding
…
The parties remain free to specify such matters, so long as the guarantee of §1679g—the guarantee of the legal power to impose liability—is preserved.

Greenwood, et al., 565 U.S. __.

Similarly, in *AT&T Mobility LLC v. Concepcion, et ux.*, 563 U.S. __ (2011), the Supreme Court ruled that California's judicial rule that consumer arbitration agreements could not preclude class action arbitrations was invalid as it violated the FAA's mandate to apply arbitration agreements as written. The Conception's sued AT&T after being charged $30 in state taxes on their "free" mobile phone. They brought a claim under the arbitration provisions of the customer agreement that required arbitration but did not preclude (or allow) class action claims and sought to arbitrate a class action on behalf of all AT&T customers who had bought phones under the same program. A California Supreme Court case had previously held that arbitration agreements could not bar class action claims under similar circumstances. The Supreme Court stated:

[The] FAA was designed to promote arbitration. [Prior decisions] have repeatedly described the Act as "embod[ying a] national policy favoring arbitration," *Buckeye Check Cashing*, 546 U.S., at 443, and "a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary," *Moses H. Cone*, 460 U.S., at 24; see also *Hall Street Assocs*., 552 U.S., at 581.

Concepcion, 563 U.S. __.

Finally, in *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. __ (2010), the Supreme Court enforced an arbitration provision in an employment discrimination claim over the objections of the plaintiff that the agreement was a contract of adhesion, unconscionable and unenforceable under Nevada contract law. The Court not only upheld the arbitration provision, it also upheld the delegation clause giving the arbitrator the power to decide all issues, including the scope of the arbitrations clause.

In light of the obvious and persistent trend to expand and enforce arbitration clauses in the United States, the only challenge to compel an arbitration is likely limited to fraud in the inducement or a defense that goes to the formation of the agreement in the first place.

3. Drafting tips for arbitration provisions in professional services agreements:

The following suggestions are intended to provide a framework for considering what to put in and what to leave out of a standard engagement letter. As a precaution, these agreements should be reviewed by the body responsible for regulating the profession involved and by the professional's liability insurer.

A. Arbitration available at the election of the party against whom a claim is made;
B. Specify whether the court or the arbitrator decides arbitrability;
C. Put specific limits on discovery;
D. Include time limits to decide who arbitrates and when a decision is required;
E. No claim can be filed until mediation has occurred;
F. Fee shift based on party closest to offers at mediation;
G. Confidentiality of all aspects with liquidated damages provision (to be decided by arbitrator) if suit filed that is eventually dismissed/transferred to an arbitration proceeding.

Whether or not to use these provisions is a gamble as they only matter when it's too late to do anything about them. In the words of William Shakespeare:

There is nothing either good or bad, but thinking makes it so.

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