"Is the Promise of Arbitration Illusory?"

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A Little Story

I would like to begin with a little story. Global Oil, Inc., a Delaware corporation (Global) and Exploration Technologies, Inc. (Technologies), a New York corporation, enter into a multi-billion dollar oil exploration, supply, and service transaction. It is the first of what each side hopes will be a continuing series of future transactions between the companies.

The parties and their scriveners work night and day to negotiate and express the terms of the transaction, including one final all-nighter in which the provisions are put together, some well-drafted and others not so. At 6:00 a.m. on the final day, the parties discover that there is no dispute-resolution provision. The scriveners are then directed to agree in a hurry on a dispute-resolution clause as there is to be a signing and joint press release at 9:00 a.m.

The scriveners scramble to cobble together a skeletal dispute resolution provision that calls for a panel of three arbitrators, who must be experts in oil drilling, supply, and service contracts, but without providing how the arbitrators are to be appointed. Nor does the dispute-resolution provision set forth what law is to be applied, where the arbitration is to take place, and

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it is silent on any discovery limitations. It merely states generally that the Federal Rules of Civil Procedure shall be "strictly" applied.

Also, the agreement itself has other drafting defects. The inevitable happens four years later. An oil rig of Global in the Gulf of Mexico is hit by a Category 5 hurricane. The platform, which Technologies had built and serviced for Global, is destroyed, three workers are killed, and there is a horrendous oil spill contaminating the waters, shores, and wildlife.

Global brings an arbitration against Technologies in Louisiana for breach of contract, business interruption, expectation damages, indemnification for environmental liability, punitive damages, interest, and attorneys' fees. Somehow the parties finally agree on the selection of the arbitrators, but the arbitrator-selection process itself takes nearly a year.

When the arbitrators sit down at the preliminary hearing with the parties and their outside counsel, there is a dispute about the scope of the case, the extent of discovery, the venue, and the time period for the entire proceeding. The arbitrators timidly acquiesce in the request of Global, the party wishing the most discovery and the longest process. The arbitration drags on for two more years with many expansive amendments to the schedule along the way, finally resulting in a very large award for Global. Technologies challenges the award in a Louisiana state court.

This story is apocryphal, but not totally out of synch with some real dispute-resolution horror stories. So what is the lesson here?

Introduction

Over the years, I have tried to learn as much as I can about the metrics that corporate decision makers—especially the general counsel—apply to the conundrum of dispute resolution—whether to arbitrate or litigate in court. So, I shall get right to the point:

The conventional wisdom—in theory—had been for many years that arbitration promised to be superior to court litigation because of confidentiality, presumed cost savings, quicker results, and more flexibility. The question today is whether the promise of arbitration is real or illusory. The answer is that the promise is sometimes real, sometimes illusory. To the extent that it has panned out to be illusory in certain cases in the past, can anything be done in the future to turn the illusion into reality? In my opinion, the short answer is yes!

I came to that conclusion, in part as a result of my own experiences as an arbitrator and mediator. Recently, I thought it would be productive to learn more. I did some research of written materials and interviewed some of my corporate counsel friends, including some general counsel whom I had interviewed with a colleague, Christine Di Guglielmo, three-plus years ago as research for a book about the many difficult challenges that face corporate general counsel today in "The New Reality."[2]

I thought that some new corporate counsel interviews—this time solely about dispute resolution—would be helpful. So, my colleague, former Delaware Chancellor Grover Brown, and I had nineteen corporate counsel interviews on the subject of dispute resolution, and we then wrote an article for *The Business Lawyer*. That article, published earlier this year, focuses on the decision-making process of general counsel on dispute resolution strategies in complex business transactions.[3]

We came away from the interviews with an appreciation for the sensitive and difficult choices that face a general counsel when weighing the pros and cons of whether and when a

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[2] E. NORMAN VEASEY & CHRISTINE T. DI GUGLIELMO, INDISPENSABLE COUNSEL: THE CHIEF LEGAL OFFICER IN THE NEW REALITY (Oxford 2012).

[3] E. Norman Veasey & Grover C. Brown, *An Overview of the General Counsel's Decision Making on Dispute-Resolution Strategies in Complex Business Transaction*, 70 BUS. LAW 407 (2015).

complex business dispute is better suited for litigation in the public courtroom or private arbitration.

Analysis of the Tension

The first question is whether one choice is inherently more expensive, time consuming, or problematic than the other? The obvious answer is that each case is fact-intensive and neither choice is "inherently" better or worse than the other, in the abstract.

The second question involved the anatomy of the good, bad, and ugly, in both choices. Our interviews revealed some bad and some good anecdotal experiences with domestic arbitration. We concluded, of course, that the bad experiences should not pre-ordain a generally-negative bias. Nor should the good experiences dictate a generally-positive bias.

In short, "no one size fits all." The common-sense answer, of course, is that "it depends." Many case-specific factors will shape the analysis in searching for the system that is more likely than not—in the particular case—to result in the optimal resolution of the dispute. In some cases, the better choice will be court adjudication, and in others it will be an alternate dispute process, ending in arbitration.

Factors favoring public court adjudication in some cases include a perceived need for a definitive judicial resolution of legal principles, the importance of a plenary appeal, concerns about the competence of the arbitrator pool, and concerns about a tendency of some arbitrators to be timid or to compromise outcomes (*i.e.*, to "split the baby"). Many of these concerns may be dispositive and immutable in some cases (such as some intellectual property cases). Decisions about which way to go in other cases exemplify the tensions.

There are frequently concerns about delay and costs. But there are delays and costs in either tribunal. The issue is whether it is likely to be better or worse for the particular matter under consideration to be in court or in arbitration.

The overarching dynamic normally involves the general counsel's risk/reward analysis in selecting arbitration or litigation. Often that decision is framed at the negotiation stage—*before* there is a dispute—although it can arise later. That timing—while the transaction is being negotiated—makes the dispute-resolution decision particularly tricky.

In a transnational contract, the general counsel will usually conclude at the outset that international arbitration is preferred over adjudication in certain foreign court systems. A domestic dispute often requires a different analysis, however. It is here that opinions are mixed.

Consensus and Non-consensus Views of Corporate Counsel

The views of the corporate counsel whom we interviewed are varied, sometimes conflicting, and largely dependent on their diverse, anecdotal, experiences—some good and some bad. While our interviews were very revealing, they were hardly uniform. But there was general agreement on the relevant *issues* to be analyzed, as distinct from the divergent preferences in *how to resolve* those issues in particular cases.

For example, a general preference for mediation—at least as a step in either process—was almost universal. A key reason for that was the commonly-held belief, expressed in the interviews, that mediation tends to bring rationality and right-sizing to the thinking of corporate decision makers on both sides of the dispute.

The mediation process with an expert mediator can help to educate the decision makers of the respective disputants about the strengths and weaknesses of each side's position, the uncertainties, the time commitment, and the expense involved. It is often important for the

decision makers of any disputant party to be present at the mediation and to learn the arguments of, and the evidence favoring, the other party to the controversy. That process often is a "cold shower" of reality for the respective corporate decision makers.

Our interviewees generally agreed that international arbitration of transnational disputes is preferred over concerns about the risks that are inherent in the judicial or political systems of some foreign jurisdictions. Moreover, a key advantage of international arbitration is the relative certainty (if all goes well in the process) of being able to enforce the award through the available international conventions (*e.g.*, the 1958 New York Convention).[4]

Importantly, discovery is usually quite limited in international arbitrations. In my opinion, some of the limits on discovery in international arbitrations can be usefully imported into domestic arbitrations.[5]

One of the nearly universal opinions among our interviewees was that confidentiality is often an important factor in some cases and tends to favor arbitration over public court proceedings in those cases. Why?

Among the reasons are: the facilitation of recurring future business between the parties; secret commercial or scientific information; concerns about the company's reputation; avoiding the revelation of certain business or litigation strategies; and not upsetting customers with a public display of problems with a counterparty.

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[4] *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, N.Y. ARBITRATION CONVENTION, www.newyorkconvention.org. There are now about 150 nation signatories to this Convention.

[5] Although not strictly applicable in domestic arbitrations, the model of the International Bar Association (IBA) Rules on the Taking of Evidence in International Arbitration has useful provisions relating to limits on the procedure for requesting documents, which can be used in domestic arbitration. See Veasey and Brown, *supra* n.3 at 426-27.

In addition to confidentiality, many interviewees valued highly the general flexibility of both domestic and international arbitrations in the ability to select the arbitrators, the seat, the venue, and the scheduling.

Careful drafting of the dispute-resolution provisions in business contracts is of paramount importance. The timing and method of addressing the contractual dispute-resolution provision is key. Sometimes an agreement to mediate and then perhaps to arbitrate can be achieved after a dispute has arisen. But the tricky calculus is when the dispute resolution agreement is part of the transaction—before there is a dispute. In that case, waiting to the end of the business negotiation to provide in the transaction documents for dispute resolution often results in a poorly-drafted provision, slapped together at the last minute.

Costs of Delays and Discovery

In any dispute resolution process, there is the likelihood of some delay and high costs, including those arising from excessive discovery, fees, and other expenses. But out-of-pocket costs and delays in either arbitration or litigation are only two of the concerns that the general counsel must consider.

In both arbitration and litigation, there is the business cost of expended (perhaps sometimes "wasted") executive time and distractions. Where are these concerns better managed or mitigated? Where can executive attention and schedules be more effectively accommodated? Again, it depends on the matter, and these problems can occur in either tribunal. But one of the advantages of arbitration is the flexibility that often allows company executives to be more conveniently accommodated than in the public courts with their many other pressures and cases, including busy criminal calendars.

Busy court calendars, with criminal and other cases, may be a problem in many federal and state jurisdictions. But it is important here to be precise in balancing the pros and cons—to compare apples to apples and not to oranges.

In some court systems there may be fewer issues with busy criminal and civil calendars than in others. There may be real opportunities in a given matter for counsel to consider and realize important benefits in some court systems. Those benefits could outweigh some benefits of arbitration—except *confidentiality*. No public court system can provide that.

These are the court systems that have established "business courts." According to a recent report by the American Association of Corporate Counsel, 21 states had established business court programs as of 2014, with pilot programs in several more. While some business courts have jury trials, they are not overly burdened with criminal cases. Complex business cases can take priority. Business courts can be very accommodating in handling certain business disputes—often less expensively than in arbitration.[6]

And, of course, there is the "Granddaddy" of all business courts—the Delaware Court of Chancery, the nation's most experienced court of equity, expert and preeminent in adjudicating corporate disputes. Also, Delaware has another business court, the Complex Commercial Litigation Division (CCLD) of its law court, the Superior Court. The CCLD functions as a true business court in law cases where the Court of Chancery does not have jurisdiction.[7]

Business courts across the nation, generally and with few exceptions, can provide outstanding service in complex commercial disputes. When I was Delaware Chief Justice (1992-2004) I encouraged other states to institute business courts. That said, however, *all* of the

[6] See Melissa Maleske, *Why GCs Should Look Beyond Arbitration*, Law 360, October 23, 2015.

[7] Joseph R. Slights III and Elizabeth A. Powers, *Delaware Courts Continue to Excel in Business Litigation with the Success of the Complex Commercial Litigation Division of the Superior Court*, 70 BUS. LAW 1039 (2015).

business courts are public courts and none can provide the confidentiality that is available in arbitration.

Delaware had an "apple out of that barrel" when it tried to provide for private arbitration using the publicly-appointed Chancellor and Vice Chancellors of the Court of Chancery. The federal courts struck down that initiative, holding that it contravened the right of access under the First Amendment of the U.S. Constitution.[8] As I shall mention later, however, Delaware has corrected that problem with a new arbitration regime.[9]

As we all know, excessive costs and delays are often attributable to pre-hearing discovery—no matter the tribunal, whether court or arbitration. Outside counsel naturally resort to what they know best. As litigators, they feel a professional obligation to litigate to the hilt. That's what they do!

Court proceedings are sometimes helped when the trial judge can delegate the resolution of discovery disputes to a magistrate judge or a special master. The analog to that procedure in arbitration is often found in limitations on discovery, stern requirements that counsel "meet and confer," and delegation of discovery dispute resolution to one member of a panel, usually the chair.

We asked our interviewees this question: Why is arbitration *sometimes* perceived as resulting in worse *outcomes* than in court litigation? The answers were varied. One recurrent theme was that some arbitrators are timid and allow the litigators too much leeway, resulting in unnecessary cost and delay. Some arbitrators have an inordinate fear of being found on court review to have abused their discretion by unduly limiting discovery. Arbitrators often feel that it

[8] *Delaware Coalition for Open Government, Inc. v. Strine,* 733 F.3d 510, 512 (3d Cir. 2013). *See,* Veasey and Brown, *supra* n. 3 at 419-420.

[9] See text at nn. 12-14 *infra*.

is the parties' arbitration and they should be accommodating, whereas judges are inevitably concerned about the dockets of the public courts and they have potent authority to "ride herd" on the litigants.

Nevertheless, both trial judges and arbitrators have broad discretion and power in managing discovery. I tend to believe that private arbitrators may, in general, have more leeway than public judges. Judicial review of both a trial judge's discovery decisions and an arbitrator's award are very deferential. And often an arbitrator's evidentiary rulings are less open to attack than those of a trial judge. For example, hearsay testimony is sometimes admitted in evidence in arbitration, with virtually no vacatur consequence, but in court proceedings it may be different.

Courts will vacate an arbitration award only if the arbitrator's decision, including the handling of discovery, "strains credulity" or "does not rise to the standard of barely colorable," and the reviewing court concludes that the arbitrator "willfully flouted the governing law by refusing to apply it." That is a pretty narrow scope of review, a result of the over-arching dominance of the Federal Arbitration Act.[10] Although this permissive, broad discretion and narrow scope of review should not be a license for the arbitrator to be arbitrary, it does make clear that the arbitrators have considerable leeway in managing discovery as well as in making evidentiary rulings.

There are many methods of managing discovery in arbitration. First, one needs competent, fair, and strong arbitrators. Second, arbitrators have flexibility to use a number of tools.

Among those tools that are available to arbitrators by analogy and will soon be available to federal judges are the concepts embodied in the new amendments to the Federal Rules of Civil

[10] See Veasey and Brown, *supra* n.3 at 427.

Procedure, which are scheduled to become effective on December 1, 2015. The emphasis in these new rules is on the need for proportionality, permitting discretionary cost-shifting in discovery, and setting forth clear procedures for handling sanctions for failure to safeguard electronically-stored information. These are, in my opinion, good concepts to help guide arbitrators.[11]

Although the concept of proportionality is not new and has had some intuitive clarity for federal judges, new federal rule 26(b)(1) emphasizes prominently a workable framework to achieve the goal of proportionality, which includes the following factors:

> … the importance of the issues at stake in the action, the amount in controversy, the parties' relative access to relevant information, the parties' resources, the importance of the discovery in resolving the issues, and whether the burden or expense of the proposed discovery outweighs its likely benefit. …

Applying these concepts can be very productive and should be "bullet proof" on court review of an arbitration award, if the arbitrator manages the process fairly and efficiently.

Earlier I alluded to another brand new development that corporate decision makers might well consider. In an effort to streamline certain arbitration proceedings, the State of Delaware adopted just this year a new arbitration law. It is called the Delaware Rapid Arbitration Act (DRAA)[12].

The Act works roughly as follows: If the Act is *expressly* chosen by both contracting parties (one of which must be a Delaware business entity), it is triggered. The arbitrators under the Act are private neutrals either appointed by agreement of the parties or in default of such agreement appointed by the Delaware Court of Chancery.

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[11] *Id*. at 422-27.

[12] Del. Code Ann. tit 10 Ch. 58.

The framers of the DRAA intended it to provide a quick and inexpensive process for accelerating an arbitration to ensure a swift resolution, eliminate confirmation proceedings, and allow for narrow vacatur challenges directly to the Delaware Supreme Court,[13] unless the parties agree by contract that no court review will lie.

In order to achieve speed and efficiency, arbitrations brought under the Act must be completed within 120 days of the arbitrator accepting appointment. With the unanimous consent of the parties and the arbitrator, that timeline can be extended another 60 days. Arbitrators who do not issue final awards within the prescribed timeframe face specified reductions in their fees.

The Act contemplates the appointment of competent arbitrators who are given broad powers. Arbitrability is determined solely by the arbitrators, who also have the authority to grant injunctive and other remedies, thus eliminating parallel court proceedings. The arbitrator's final award is deemed confirmed by the Delaware Court of Chancery if not challenged within 15 days.

Challenges to the final award are made directly to the Delaware Supreme Court. Unless altered by contract such challenges proceed under the narrow Federal Arbitration Act vacatur standard of review, discussed above. It is too early now to predict how often and how effectively this brand new Act will be used.[14]

But it is likely that the DRAA would not be a practical solution in a number of matters because of the rigid timeline. Clearly, not every case can be completed from beginning to end in 120 or 180 days. Some cases, particularly many complex commercial cases, have a legitimate timeline—or may result in a legitimate timeline—greater than 180 days.

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[13] *See*, synopsis to H.B. 49, the predecessor of the Act as ultimately adopted.

[14] For a detailed explication of the regime of the DRAA, see Gregory V. Varallo, Blake Rohrbacher and John D. Hendershot, *The Practitioner's Guide to the Delaware Rapid Arbitration Act* (2015), available at www.rlf.com/DRAA.

This may be due to a number of factors, such as working around other schedules of the participants, suspensions for realistic settlement discussions, and unforeseen developments along the way. Many of us have had arbitrations that almost inevitably take longer than 180 days from start to finish, due to such understandable factors.

That said, however, there are cases that lend themselves to a quick outcome contemplated by the DRAA, and the other benefits of the Act—such as the narrow appeal process directly to the Delaware Supreme Court—which may outweigh concerns about being boxed in by the tight timeline. Again, this is a matter requiring careful consideration that may need to be accomplished during the deal negotiations in each fact-specific situation.

Contract Provisions for Dispute Resolution

I cannot over emphasize the critical importance of drafting the appropriate dispute-resolution provision, tightly tailored to the particular transaction. There are several criteria to consider in drafting the dispute-resolution clause in the contract, including, for example:

- Think through what legal or factual issues may arise, depending on the nature and provisions of the transaction.
- Consult with counsel experienced in litigation, mediation, and arbitration.
- Consider what provisions would be appropriate to streamline the arbitration (*e.g.*, limits on discovery).
- Advance planning in the deal negotiation is key. Do not wait until the last minute after other terms of the negotiation have been drafted to agree on a dispute-resolution provision.
- Avoid fatal drafting mistakes, some of which are called by one commentator, "The Seven Deadly Sins," such as equivocation, inattention, omission of vital provisions (*e.g.*,

governing law, place of arbitration, that judgment may be entered on the award), over-specificity, unrealistic expectations, "litigation envy," overreaching, etc.)[15]

Think back to the little story at the beginning of this presentation, where some of the "Seven Deadly Sins" were obviously perpetrated.

Management of the Arbitration Process

In addition to the importance of a carefully-drafted dispute-resolution clause in the transaction documents, the case-management skills of the arbitrator or panel of arbitrators are crucial to a workable arbitration proceeding. Management of the arbitration must be placed in the hands of competent and experienced neutrals.

The very outset of the arbitration is a critical time when the arbitrators conduct the preliminary hearing with the parties and their counsel. It is here that the process and the tone are set for the entire proceeding. The outcome of this hearing should be the organization and scheduling going forward on matters such as the pleadings, case-dispositive motions, discovery benchmarks, future conferences with the arbitrators, a hearing date, pre-hearing procedures, and the like. It is a great opportunity for arbitrators to exercise firm, fair, common sense protocols designed to accomplish speed and cost effectiveness.

Following the establishment of a scheduling order resulting from the preliminary hearing, the arbitrators need to keep track of the implementation of the steps in the scheduling order and to manage promptly all disputes along the way, many of which are likely to be in connection with discovery issues.

[15] *See*, John M. Townsend, *Drafting Arbitration Clauses: Avoiding the 7 Deadly Sins,* DISPUTE RESOLUTION JOURNAL, Vol. 58, No. 1, February-April 2003.

Conclusion

Dispute-resolution decisions are intensely contextual and depend upon many factors. Mediation with an expert mediator is ordinarily a low-risk/high-reward step that can advance rationality and common sense in the process. International arbitration is usually preferred over relegating a transnational dispute to resolution in some foreign court systems.

Domestic arbitration is where most of the controversial issues arise. Is domestic arbitration viewed as being so inherently bad that it is essentially intractable? Or can proper drafting and skillful handling of the process by arbitrators in specific cases make it manageable? In my opinion, the latter is correct.

Assuming that there is not an overarching need for a determination of the dispute by a federal or state court system, domestic arbitration, which embodies the benefits of confidentiality and flexibility, can be made to work effectively. If the arbitration can be set up with proper safeguards and state-of-the-art best practices, careful drafting and high-quality neutrals, the likelihood of disaster resulting from the arbitration should be diminished or avoided.

In those cases the promise of arbitration is *NOT* illusory.