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Should Arbitration Clauses Be in Your Contracts?

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For decades, companies have included arbitration clauses in their agreements with customers, employees, and other businesses. If your company is among them, be mindful that there are some good reasons to arbitrate your disputes—along with some less compelling ones.

Perhaps the biggest popular allure of arbitration is its cost savings. But do not be overly optimistic about how much money you will save by arbitrating a dispute rather than going to court. Many practitioners and companies have found arbitration to be an expensive endeavor indeed. The alleged savings from procedural informality and limited discovery can prove overblown, and are offset by such added costs as fees for the arbitrators and arbitral institutions.

In assessing whether arbitration will really be a relative bargain, ask yourself this: when your company has found itself a defendant in past litigation, were you often successful in getting the case thrown out of court early? If this is a common result, arbitration may not prove the cheapest way out of a dispute. Preliminary dispositive motions are not commonly used in arbitration, and arbitrators are often hesitant to resolve a case on the equivalent of a motion to dismiss or summary judgment. Rather, even the most frivolous arbitrations can go all the way through an evidentiary

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hearing with full briefing and witnesses. Of course, it is always hard to predict what type of dispute you are likely to find yourself in. But if you are confident that your disputes would likely be resolved early on in court, the path to resolution may be longer and costlier in arbitration.

If any result other than total victory in a dispute would be problematic for your business, arbitration might also prove disappointing. Although it is certainly not unheard of for one side in an arbitration to win across the board, arbitrators often take a conciliatory approach. Partial victors in arbitration have been heard to complain about a "split the baby" result—perhaps because of a holdout by a party-appointed arbitrator—when they believe a less evenhanded award was warranted.

Likewise, do not oversell the promises of confidentiality in arbitration. Arbitrations are typically non-public, and arbitral agreements are often explicit that the proceeding will be confidential. But never forget Benjamin Franklin's admonition that three people can keep a secret if two are dead. If you have ever experienced a highly publicized litigation, you likely found out that supposedly secret aspects of the case, such as settlement agreements or documents filed under seal, often leak their way out. The same thing can happen in arbitration—and the more you want to keep something under wraps, the more your opponent may look for ways to make it public, whether via official channels (such as a court proceeding over the validity of the arbitral award) or unofficial ones.

Similarly, the vaunted finality of arbitral judgments is a double-edged sword. If you are on the happy side of an award, it is great that it will not be reversed on appeal. And in theory, even the eventual loser of an arbitration might find *ex ante* commercial advantage in the certainty of a final result. But if you lose an arbitration, even on the flimsiest grounds, good luck getting it reversed. Absent an unusual procedural impropriety such as a partial arbitrator, an arbitral award is almost impossible to overturn, no matter how egregiously wrong on the merits.

Disappointment may also befall those who would prefer the reasoned

judgment of a handpicked, supposedly expert arbitrator to that of a randomly assigned, generalist judge (or even worse, a jury). In fact, surveys of arbitral practitioners and parties have found that many end up less impressed with their chosen arbitrators than they originally hoped. Moreover, conflicts, scheduling difficulties, and other constraints often make the potential bench of available arbitrators shallower and less impressive than you would expect.

All this is far from saying that arbitration lacks real advantages. For disputes involving sophisticated commercial questions or truly esoteric issues, both sides may prefer a specialist arbitrator with relevant expertise. Likewise, parties from different countries or states may prefer a neutral arbitral forum over the supposedly biased courts of one place or another. And if you seek procedural flexibility so that your dispute resolution can be tailored in a particular manner, arbitration may be the way to go.

If your transaction has an international component, perhaps the best reason to have an arbitration clause is to ensure the enforcement of an award. If you are entering into an agreement with a company or person that is based in another country or has assets abroad, arbitration may prove more effective than litigation in *any* country at effectively getting a judgment that is enforceable across borders. And even if you can persuade a foreign court to recognize another country's court judgment in your favor, the process for doing so is often far more onerous than in getting it to recognize an arbitral award. As my colleague Gary Born put it in his recent book International Arbitration: Law and Practice (Kluwer Law International, 2012), the New York Convention and many countries' arbitration laws "provide a 'pro-enforcement' regime, with expedited recognition procedures and only limited grounds for denying recognition to an arbitral award."

Another potential benefit of arbitration is that arbitral awards do not set precedent for future adjudications in the same way that court decisions do. If you are a repeat player in disputes with customers or partners, you might not want a single adverse result to be held against you in all others. But again, this factor is a double-edged sword. If you find yourself in the same kind of dispute over and over, you might *want* a decision that sets precedent, whether through preclusion, *stare decisis*, or simply a published opinion for future adjudicators to consider. This adds more certainty to your business and avoids having to refight the same issue from square one.

Finally, a very important reason to arbitrate that has emerged in the past few years is that it helps companies avoid class actions. In many states, courts have refused to enforce consumer contracts that prohibit the customer from joining a class action against the company. However, in its 2011 *AT&T Mobility v. Concepcion* decision, the U.S. Supreme Court held that when a class action waiver is part of an arbitration clause, the Federal Arbitration Act preempts these state rules. The Court expressly rejected the argument that customers will be unable to enforce their legal rights if they cannot join in a class proceeding. Thus, if your company has standardized agreements with large numbers of customers or other business partners, an arbitration clause with a class action waiver is a good form of insurance against the risk of an eventual—and potentially enormously expensive—class proceeding.

To be sure, many companies have sound reasons for including arbitration clauses in contracts, and once disputes arise they are often happy that they included such clauses. But when deciding whether to agree to arbitrate, be sure to consider all relevant factors—and do so with your eyes open.

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