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Common and avoidable pitfalls in arbitration

A LOOK AT WHO DECIDES ARBITRABILITY, COMMON ETHICAL ISSUES, NOTICE, MOTIONS, DISCOVERY AND THE HEARING

Litigation is no longer synonymous with merely "going to court." Arbitration has become ubiquitous throughout the United States and continues to expand. Unfortunately, many attorneys (even highly proficient and experienced trial lawyers) discover at or after their arbitrations that their strategies and tactics could – and should – have been different, whether at the evidentiary hearing itself and/or from the get-go. Blunders throughout the arbitral process can hamper attorneys' efforts to prove their claims or defenses. They can also cause clients to incur additional and otherwise unnecessary costs. It is thus important for both seasoned and new attorneys to appreciate the nature of arbitration and its myriad quirks.

This article examines common and easily avoidable pitfalls in commercial, employment, and personal injury arbitration (primarily under the federal system) in the context of related ethical duties under the American Bar Association's Model Rules of Professional Conduct (the "ABA Model Rules" or "Rules").

Arbitrability (and who decides arbitrability)

Arbitration is a process of dispute resolution in which a neutral third party (arbitrator) selected by the parties renders a final and binding decision (the award) on agreed-upon issues following a hearing at which both parties have an opportunity to be heard. (See Black's Law Dictionary, 6th ed., 1990, p. 105.) Arbitration therefore is inherently a creature of contract.

Since 1925, arbitration in the United States has been governed by the Federal Arbitration Act (9 U.S.C. §§ 1, et seq.; the "FAA") and related Supreme Court jurisprudence. The FAA makes written agreements for the arbitration of disputes arising out of contracts involving (i.e., "affecting") interstate commerce valid and enforceable. (FAA § 2; *Allied-Bruce Terminix Cos. v. Dobson* (1995) 513 U.S. 265.) In the federal system, once the court is satisfied that the "making of the agreement to arbitrate or the failure to comply therewith is not in issue," the court will compel arbitration.

Arbitration often requires preliminary or threshold findings on issues that go beyond the ultimate merits of the case, such as "arbitrability." Arbitrability pertains to issues regarding, for example, whether the parties agreed to have the arbitrator decide the ultimate merits (or some other claim or issue) in dispute, or whether the court should decide the merits or those claims/issues. (*First Options of Chicago, Inc. v. Kaplan* (1995) 514 U.S. 938.) A related issue concerns whether the court or arbitrator should decide issues of arbitrability.

In general, there is a distinction between issues of "substantive arbitrability" and "procedural arbitrability." On one hand, substantive arbitrability concerns issues such as the scope of the arbitration agreement and/or the claims which the parties agreed to arbitrate, and whether the parties are bound by an arbitration agreement. (*First Options*, *supra*; see also *John Wiley & Sons, Inc. v. Livingston* (1964) 376 U.S. 543, 546-47.) Subject to limited exceptions discussed further below, issues of substantive arbitrability are, by default, for the court to decide. On the other hand, issues of procedural arbitrability (e.g., issues of waiver and delay) are, by default, for the arbitrator. (*Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.* (1983) 460 U.S. 1, 25.) This article focuses on issues of substantive arbitrability.

In contemporary times, many disputes of substantive arbitrability concern multi-layered, pre-dispute contracts between parties. This article does not address "submission agreements," which are agreements to arbitrate entered into after a dispute has already arisen. Most pre-dispute scenarios involve an arbitration agreement found within a larger or so-called "container" contract. In many instances, there is also a "delegation clause" – a clause purporting to delegate issues of arbitrability to the arbitrator instead of the court – contained within the arbitration agreement within the container contract. Notwithstanding the fact that pre-dispute arbitration agreements (or at least putative ones) obviously appear within many container contracts, disputes often arise in which one party seeks to proceed in arbitration, whereas the other party seeks to proceed in court.

Otherwise unnecessary litigation concerning issues of substantive arbitrability can often be obviated by appreciation and consideration of relevant Supreme Court jurisprudence. Arbitration agreements within container contracts are deemed "separable" from the container contracts. In other words, a challenge or defense to the enforceability of a container contract as a whole that is not targeted specifically at the arbitration agreement within the container contract will generally be heard by the arbitrator. (*Prima Paint Corp. v. Flood & Conklin Mfg. Co.* (1967) 388 U.S. 395.) This is because, although the arbitration agreement within the container contract is implicitly being challenged as well, the "making of such agreement to arbitrate" is not specifically "in issue" under Section 4. Stated differently, substantive arbitrability is not at issue in this scenario. Thus, in such case, where the challenge is directed only at the container contract as a whole, the court will generally stay or dismiss any pending court proceeding and compel arbitration.

In contrast, a challenge directed specifically at the arbitration agreement contained within the container contract raises an issue of substantive arbitrability. As noted above, such issue is, by default, for the court. But when there is "clear and unmistakable evidence" that the parties intended to delegate issues of substantive arbitrability to the arbitrator (e.g., a "delegation clause"), such evidence will constitute an "agreement to arbitrate," the making of which is not "at

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issue." Thus, such a delegation clause (assuming it is valid and not directly challenged as discussed below) will be enforced and the arbitrator will have jurisdiction to determine those issues. (*Id.* at 939.)

Arbitral institutions such as JAMS and AAA have rules that contain such delegation clauses. (See JAMS Rule 11(b); AAA Rule 7.) Notably, most courts have held that an arbitration agreement's reference to such institutional rules constitutes "clear and unmistakable evidence" under *First Options* to delegate issues of arbitrability to the arbitrator.

With further respect to a case involving a delegation clause contained within an arbitration within a container contract, any challenge of substantive arbitrability – if it is to be heard by the court – must (except in very limited circumstances as set forth below) be directed specifically at the delegation clause and not merely at the arbitration agreement or container contract generally. (*Rent-A-Center, West. Inc. v. Jackson* (2010) 130 S. Ct. 2772.) This is because the delegation clause constitutes the "agreement to arbitrate" under FAA section 4 that, if the making thereof is not specifically at issue, requires the matter be sent to the arbitrator for determination. (*Ibid.*)

The Court expanded upon the above concepts in its recent decision in *Schein v. Archer and White Sales, Inc.* (2019) 139 S. Ct. 524. In *Schein*, the Court held that where the parties' contract delegates the question of arbitrability to the arbitrator (and there is no specific attack on the delegation clause), the court must send the dispute to the arbitrator – even if the court believes that the purported basis for arbitration as provided within the apparent arbitration agreement is "wholly groundless." (*Id.* at 527.)

Thus, in the vast majority of modern disputes, the existence of a delegation clause or reference to an arbitral institution's rules containing such delegation clause will result in the arbitrator deciding issues of substantive arbitrability, unless the challenge is directed specifically at the delegation clause (or directed specifically at the arbitration agreement, if no such delegation clause exists).

Some exceptions

Nevertheless, certain exceptions may lie. Challenges to basic or rudimentary contract formation (such as forgery, fraud in the execution, and/or any claim that party did not sign the container contract) may be for the court, even when the challenge is directed to the container agreement as a whole. This is the case even where there is no specific challenge to the putative arbitration agreement or delegation clause within the container contract. (See, e.g., *Rosenthal v. Great Western Financial Sec. Corp.* (1996) 14 Cal.4th 394.) This distinction – between issues of fundamental contract formation versus defenses to enforceability – appears to exist because even though in the former situation where the challenge is not directed specifically at the arbitration agreement or delegation clause, a party's claim that it did not execute the container contract renders the "making of the agreement to arbitrate at issue" under Section 4 of the FAA.

A tougher situation to analyze concerns a so-called "hybrid" challenge to a container contract. For example, consider a challenge to a container contract (and not directly to the arbitration agreement or delegation clause) based upon the party's purported lack of capacity to enter into such contract. Arguably, such challenge goes to formation. However, in that case, the party claiming lack of capacity signed the container contract. It is thus debatable whether such defense is based upon a claim of lack of basic or rudimentary contract formation (such as forgery or lack of signature), or rather upon a claim that the contract is illegal, voidable and/or otherwise unenforceable. Such a challenge, if deemed as one based upon illegality, would likely be for the arbitrator. (*Buckeye Check Cashing, Inc. v. Cardegna* (2006) 546 U.S. 440.) It is therefore unclear whether such hybrid challenges would result in decision by the court or the arbitrator.

Another exception was recently carved out by the Court in its decision in *New Prime Inc. v. Oliveira* (2019) 139 S. Ct. 532. In *New Prime*, the Court unanimously held that, even when there is a delegation clause within an arbitration agreement within a container contract – and when the delegation clause is not being challenged specifically – the court should decide the threshold issue of whether Section 1 of the FAA's exclusion for "contracts of employment" regarding workers in the transportation industry applies. The Court found that a Section 1 challenge is a gateway claim that the container contract itself falls outside the scope of or is exempt from the FAA. Thus, such a Section 1 challenge renders the "making of the agreement to arbitrate" at issue, regardless of whether such agreement is a delegation clause or an arbitration agreement within the container contract.

The Court's recent decisions of *Schein* and *New Prime* provide some useful clarity as to best practices regarding arbitrability issues. As noted above, many modern contractual arrangements (as they relate to arbitrability) consist of a delegation clause within an arbitration agreement within a container contract. Aside from the narrow exceptions that may apply to rudimentary contract formation defenses and Section 1 defenses regarding "contracts of employment" for workers in the transportation industry, it is clear that in most cases (i.e., those involving a delegation clause), issues of arbitrability remain in the purview of the arbitrator, absent a specific challenge to the narrowest clause (generally the delegation clause) that could be deemed an "agreement to arbitrate" under Section 4 of the FAA.

Ethical duties and arbitrability issues

It is reasonable to conclude that attorneys' ethical duties as to their practices concerning arbitrability issues have been similarly illuminated. While the ABA Model Rules, of course, require appropriate diligence and zealous representation of clients, Rule 3.1 provides that a lawyer shall not "assert or controvert an issue . . . unless there is a basis in law and fact for doing so that is not frivolous." Moreover, Rule 3.2 requires that a lawyer "shall make reasonable efforts to expedite litigation consistent with the

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interests of the client." In this regard, Rule 1.5(a) ("Fees") provides that a lawyer "shall not
. . . charge [or] collect an unreasonable fee"; factors considered include "the time and labor required [and] the novelty and difficulty of the questions involved." Thus, attorneys should bear in mind the above, now-firmly settled principles of arbitrability when disputes arise concerning arbitrability. Unnecessary pitfalls and wasteful litigation efforts can be avoided when considering the above ethical duties in the context of what should now be a clearer path going forward on threshold issues of arbitrability.

Notice of claims

Common pitfalls regarding issues of notice of claims and defenses often do not become apparent until close to or at the evidentiary hearing. But by that point, it is sometimes too late to alleviate the problem.

One of the arbitrator's primary concerns throughout every arbitration is ensuring that the final award is issued within the scope of the arbitrator's authority. Indeed, the most common basis for vacatur of awards under the limited grounds set forth in Section 10 of the FAA is where an arbitrator exceeds his or her powers provided under the arbitration agreement. Another frequently asserted claim for vacatur under Section 10 is related to due process concerns; i.e., an arbitrator fails to hear evidence "pertinent and material to the controversy."

To avoid putting the arbitrator in a situation where he or she is disinclined to consider untimely noticed claims, it is imperative for the parties to clearly set forth their respective claims throughout the process. Ideally, adequate notice is provided from the outset. The arbitration agreement itself defines the scope of arbitral issues. It may expressly limit remedies and/or exclude certain claims from determination. Beyond the arbitration agreement itself, the scope of the arbitration may be narrowed by the demand for the arbitration and/or any counterclaims. Best practices suggest that the respondent should assert all applicable affirmative defenses and/or jurisdictional challenges along with its initial response to the demand for arbitration, lest it risk a finding of waiver. For example, JAMS Rule 9(a) provides that "[n]o claim, remedy, counterclaim or affirmative defense will be considered by the Arbitrator in the absence of such prior notice . . . unless the Arbitrator determines that no Party has been unfairly prejudiced by such lack of formal notice."

Of course, not everything is known about a litigation from its commencement. Discovery often results in one party seeking to pursue a claim or defense that it did not originally assert. In such cases, counsel should notify the other side and arbitrator that it seeks to amend its demand or response to put all interested parties on notice as far in advance of the evidentiary hearing as possible. It is far more likely that an arbitrator will grant leave to assert new claims or defenses earlier in the process rather than later. This increased likelihood correlates to the arbitrator's broad concerns to ensure that the final award is rendered in accordance with the scope of the parties' arbitration agreement and in respect of the parties' due process rights.

Notwithstanding the above, arbitration is designed to be a more efficient and streamlined process. A party need not craft its demand for arbitration in extreme detail as it might if it were proceeding in court. For example, JAMS Rule 9(a) provides that notice of claims shall be "reasonable" and include a "short statement of its factual basis [for such claims]." A common pitfall is seen when inexperienced counsel serves an unnecessarily lengthy and dense demand for arbitration. Such demand is not only nonessential, but often goes to set a tone for the remainder of the proceeding by way of encouraging more time- and cost-consuming discovery and other motion practice.

In these regards, Rule 3.2 ("Expediting Litigation"; see *supra*) should be adhered to as much as is practicable. Counsel should, to the greatest extent, ensure that it provides adequate and timely notice of its claims, while simultaneously endeavoring to expedite litigation consistent with the interests of its client.

Dispositive motions

Unlike in court, dispositive motions are generally disfavored in arbitration. Pre-response motions to dismiss or demurrers are almost never granted. Motions for summary disposition are generally inappropriate, absent the parties' consent or a clear dearth of material issues of fact. Although this view appears to depart from arbitration's goal of providing an expedited forum for dispute resolution, arbitrators are hesitant to grant such motions out of concerns discussed above relating to the potential ground for vacatur under Section 10 in refusing to hear evidence pertinent to the dispute. When it is apparent that evidence beyond that capable of being presented or considered in a dispositive is material to the dispute (e.g., in-person percipient and expert witness testimony, witness credibility or other potential material issues in dispute), such motions will likely be denied. (See, e.g., *Schlessinger v. Rosenfeld, Meyer & Susman* (1995) 40 Cal.App.4th 1096.)

Nonetheless, dispositive motions can be useful where they effectively narrow the issues in dispute. But in general, out of respect for the ethical tenets and considering the nature of arbitration as a proceeding before an "audience of one" as discussed below, lawyers should exercise caution before filing such motions.

Discovery and the hearing

Arbitration has become a popular alternative to court litigation because it provides a forum for the parties to resolve their disputes in an expedited, and thus, less costly, manner. For example, the JAMS Rule 17 provides for limitations on e-discovery and depositions, absent good cause, lack of undue burden, and/or mutual agreement of the parties. Rule 17 also establishes that all relevant, non-privileged discovery should be exchanged in good-faith and on a cooperative basis. The basic assumptions

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employed in arbitrations, particularly those conducted via a provider organization, are that the parties know what is relevant and can produce a streamlined version of their case to an arbitrator who was presumably selected based upon his or her expertise and ability to circumvent irrelevant and unnecessary facts and issues. In other words, lawyers jeopardize their credibility and otherwise risk raising the ire of the arbitrator when they propound needlessly lengthy, cumulative, and/or irrelevant discovery demands.

These assumptions also apply to unduly recalcitrant parties. It is not prudent for counsel to withhold discovery with the same fervor that they may use in conventional court litigation. Experienced arbitrators can and will quickly cut through meritless objections. Additionally, arbitrators generally err on the side of admitting evidence at a threshold level, while reserving for a later time the more critical decision as to the weight and probative value of such evidence. These are techniques designed to efficiently cut through the morass often associated with litigation. Accordingly, best practices suggest that objections in discovery should be carefully raised and not asserted with reckless abandon, given that arbitrators, by their nature as experienced practitioners or retired judicial officers, are well equipped to consider issues of admissibility and probative value better than their layperson juror counterparts.

Unnecessary discovery disputes, whether caused by a party's excessive demands or by meritless objections, delay resolution of the merits and ultimately increase costs (sometimes by a significant amount). ABA Model Rules 3.1 and 3.2 (discussed above) and 3.4(d) (lawyers shall not make frivolous discovery requests or fail to make reasonably diligent efforts to comply with a legally proper discovery request) counsel against scorched-earth tactics, particularly in the arbitral setting. Additionally, advocacy in arbitration is directed toward an "audience of one" (or three, in tripartite arbitrations); the individual presiding over discovery disputes is the same factfinder who will be rendering a determination on the ultimate merits of the proceeding. It is therefore best to practice with the above in mind, both for purposes of fulfilling ethical duties and presenting one's case in the most effective manner possible.

For similar reasons, lawyers benefit from conducting themselves in accordance with the above at the evidentiary hearing. The rules of evidence are generally relaxed in arbitration as compared to court trials (e.g., objections not based upon claims of privilege are often overruled, subject to weight). Exhibits and documents already admitted in the record often do not need to be read verbatim by witnesses. Questions need not generally be asked in the strict form required in court (e.g., leading questions on direct examination are often permitted). Evidence can quickly become cumulative from a practical standpoint; this is relevant because time is often of the essence in arbitration. Best practices and ethical considerations thus suggest that attorneys should be adequately prepared to present their respective cases to the arbitrator in a streamlined, commonsense fashion. Counsel should endeavor to avoid getting lost in the weeds to the extent possible.

Conclusion

The popularity of arbitration exploded for good reason – parties and lawyers realized that they could adequately litigate their cases in an expedited, less formal setting. Clarity has emerged on several issues relating to the prosecution and defense of claims in arbitration. Such illumination will allow lawyers to perform their duties more effectively and with a better understanding of their ethical obligations. Best practices as suggested in this article should result in the effective representation of clients' goals and interests in arbitration.

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