

Making the Economic Case for Mandatory Binding Arbitration

BY GENE COMMANDER

Recent studies underlie the economic benefits of mandatory binding arbitration in complex civil cases. This article discusses those benefits.

ADR professionals have long touted binding arbitration for producing faster and less expensive results in complex commercial disputes, as compared to traditional civil litigation. Now there is convincing economic evidence of binding arbitration's real value. This article discusses the economic and other benefits of mandatory binding arbitration in complex cases.

Why Mandatory Binding Arbitration?

The health of our nation's economy depends on the vitality of its business community, including its customers, suppliers, employees, and local governments. Industry leaders have often relied on traditional civil litigation in state and federal courts to decide commercial disputes when parties are unable to do so on their own. But there is good reason for concern about the growing pattern of protracted and wasteful civil litigation, which will be potentially exacerbated by cuts to state and federal court budgets across the country. The inefficiencies and prohibitive costs associated with most traditional civil litigation will likely choke the effectiveness out of the time-honored judicial approach, becoming an even greater drag on the financial success of the litigants and our economy. It is thus prudent for industry leaders to examine other approaches to resolve business disputes.

A prompt, cost-effective, and well-reasoned outcome should be the universal goal of every dispute resolution proceeding. Proponents of alternative dispute resolution approaches have long encouraged the use of mandatory binding arbitration to produce faster, less expensive, and more satisfying results when compared to the uncertainties associated with judicial discretion and juries that are often present in traditional civil litigation. This sentiment is particularly strong when the debate is focused on the extraordinary time and expense required to resolve complex commercial disputes in state and federal courts.

Economic Reports Support Efficiencies

A March 2017 report by Micronomics, Inc. presents clear and convincing evidence to

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support the conclusion that, on average, mandatory binding arbitration is a significantly faster and less expensive method of resolving disputes between businesses.¹ Micronomics is an economic research and consulting firm that collects, tabulates, and interprets complex financial, economic, and statistical data. It provides litigation and business consulting services in various practice areas and industries.²

The 2017 report followed two prior efforts by Micronomics to analyze the economics of civil litigation: a March 2012 report, “Economic

Impact of Reduced Judiciary Funding and Resulting Delays in State Civil Litigation,”³ and a December 2009 study, “Economic Impact on the County of Los Angeles and the State of California of Funding Cutbacks Affecting the Los Angeles Superior Court.”⁴

Civil Litigation Delays

Micronomics' 2017 report compared the 2011 through 2015 nationwide civil caseload statistics published by the U.S. District Court and the U.S. Court of Appeals with similar data provided by the American Arbitration Association (AAA). It then focused more closely on the 2015 data from both forums. The 2015 U.S. District Court civil caseload exceeded 217,000.⁵ The AAA binding arbitration caseload the same year totaled 1,375.⁶

The report then compared the data to determine the average time required to get to trial in the U.S. District Court (24.2 months) versus the average time required to get to a final award through mandatory binding arbitration administered by the AAA (11.6 months).⁷ Micronomics concluded that it took 12 months longer to get to trial than it took to get a final arbitration award.⁸ Moreover, when Micronomics included the time required to appeal a district court judgment, it found that the federal court delays grew substantially (between 24.2 to 33.6 months versus the 11.6 months for a final award through binding arbitration).⁹

The Micronomics report highlighted the 2015 civil caseloads in eight of the 10 states with the highest U.S. District Court and AAA caseloads in the nation: California, Florida, Georgia, Illinois, New Jersey, New York, Pennsylvania, and Texas. The caseloads in the eight states also represented more than 50% of the total nationwide caseloads in both forums.¹⁰ The U.S. District Court caseload in the eight states exceeded 112,000.¹¹ AAA's caseload in the eight states totaled 789.¹²

When Micronomics compared the data from the eight states, it found that, on average, it took more than 15 months longer to get to trial in the U.S. District Court (27.3 months versus 11.8 months), and the delays grew to more than 24 months longer to get an appellate

decision (between 27.3 months to 36.5 months versus the 11.8 months for a final award through binding arbitration).¹³

Economic Impacts

Micronomics also projected the extent to which the additional time to get to trial in district court would result in increased direct and related secondary costs for the litigants. To support a reasonable estimate of the potential additional direct costs incurred by the litigants, Micronomics made three valid assumptions: (1) the disputed amount of money would not be available to the litigants for other business purposes during the extended period due to the uncertain outcome of the pending dispute (i.e., lost opportunity costs); (2) the litigants' additional direct costs would increase in proportion to the total amount in dispute; and (3) the same minimum estimated disputed amount

should be used to compare the cases in both forums (i.e., \$75,000 per case).¹⁴

Accordingly, Micronomics projected that the additional direct costs incurred by civil litigants nationwide during 2011 through 2015 due to the additional time to get to trial in U.S. District Court could be as much as \$10.9 billion to \$13.6 billion (or more than \$180 million per month).¹⁵ Micronomics also projected that the direct costs incurred during the extended period needed to obtain post-trial appellate decisions could increase the total to more than \$20 billion (or more than \$330 million per month).¹⁶

Taking it one step further, Micronomics employed a widely recognized economic model known as IMPLAN (an acronym for "Impact, Analysis and Planning"), which has been used for decades by academics, policymakers, and government officials to consider whether certain economic multiplier effects could

result in further secondary costs and losses to the country's overall economy. In doing so, Micronomics projected the total nationwide direct and secondary costs (i.e., indirect and induced costs) attributable to the additional time in U.S. District Court during 2011 through 2015 to be in excess of \$28.3 billion (or more than \$470,000 million per month).¹⁷ Micronomics also projected that the extended period needed to obtain post-trial appellate decisions could increase the total additional costs to more than \$51.9 billion (or more than \$860,000 million per month).¹⁸

The statistics needed to compare the time to trial in the same eight state courts were not readily available to Micronomics, but it opined that the state court civil litigation delays and resulting additional direct and secondary costs would likely be even greater than those projected for the federal courts.¹⁹ This opinion was based on Micronomics' prior investigations into state court economics where it found credible evidence of widespread administrative staff layoffs, judicial furloughs, reduced operating hours, and trial court closures across the country.²⁰

Like most analytical studies, one can examine the representative nature of the caseload data published by the federal courts and the data provided by AAA, as well as the reasonableness of the assumptions made and the methodology employed by Micronomics, to determine the delays and potential economic impacts during 2011 through 2015. But given the staggering size of Micronomics' projections, one simple conclusion seems obvious: traditional civil litigation in the state and federal trial and appellate courts across this country will, on average, result in unnecessary and costly delays for litigants that will drag on our nation's economy.

Proven Benefits of Arbitration Best Practices

Certainly, factors other than time and expense should be carefully considered when deciding whether to choose mandatory binding arbitration over traditional civil litigation to decide commercial disputes. But parties and counsel who seek a proactive strategy to resolve disputes between businesses in a prompt, practical, cost-effective, and well-reasoned manner will

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undoubtedly recognize the additional financial and substantive benefits that result from their ability to guide the outcome by taking advantage of opportunities to:

- resolve a dispute on its merits in a private and efficient business setting, to minimize negative publicity that could damage hard-earned company brands and personal reputations within the business community and marketplace.
- resolve a dispute with party autonomy and control over the process. As opposed to traditional civil litigation, in mandatory binding arbitration the parties can provide meaningful input to the third-party neutral regarding the best practices and procedures for their arbitration. This input includes adjustments to those practices and procedures when necessary to ensure that the ADR process remains fair and meets the parties' needs.
- select an experienced arbitrator with the desired personal characteristics (e.g., availability, unbiased attitude, patience, and fairness), industry experience, legal expertise, and willingness to adequately prepare for the evidentiary hearing and issue a decisive final award.
- agree on the applicable law and administrative rules and fees that will govern the proceeding.²¹
- agree on streamlined, flexible procedures for the administration of the proceeding, which are designed to afford a convenient venue, prompt hearing schedule, and practical prehearing guidelines. This levels the parties' playing field in obtaining and exchanging relevant information and documents in preparation for the evidentiary hearing. Such procedures include:
 - ▷ interim decisions by the arbitrator to provide emergency relief or other interim measures when needed to protect the property or other interests of the parties pending the entry of a final award. This can be an invaluable tool with an even broader reach than the judicial process in appropriate circumstances.

- ▷ stipulated protective orders to adequately preserve the parties' privileged, proprietary, and confidential business records and information.
- ▷ stipulated e-discovery agreements, including arrangements for the use of technology assisted preservation, collection, production, and review of the parties' paper records and electronically stored information.
- ▷ stipulated e-discovery cost-shifting arrangements when necessary to balance proportionality concerns.
- ▷ reasonable limits on the number and length of fact witness discovery depositions and written discovery that balance the complexity of the issues and dollars in dispute with the extent of the parties' resources. Unlimited and protracted discovery generally make no sense in either traditional civil litigation or in mandatory binding arbitration.
- ▷ submission of timely expert disclosures with reasonable limits on the production of their working files and the length of expert discovery depositions, to facilitate the efficient presentation and cross-examination of expert testimony during the evidentiary hearing.
- ▷ stipulated fast track prehearing procedures to resolve discovery disputes without the time and expense of protracted and costly motion practice.
- ▷ stipulated procedures and limits on dispositive motions, which are rarely granted by experienced judges and arbitrators.
- ▷ convenient arrangements to assist with the arbitrator's preparation for and the parties' presentations during the evidentiary hearing, including such things as the coordination of legal briefs and other helpful prehearing submittals; a site visit when appropriate; joint exhibits to simplify the admission of paper and electronic evidence; the need and parameters for opening statements; and advanced

notice of the authorized hearing attendees, the parties' "will call" and "may call" witnesses, and any need for sequestration of potential witnesses; the sequence of live and remote testimony; and any intended use of technology to present the evidence.

- ▷ convenient arrangements for any necessary post-hearing submissions to encourage the efficiency and economy of the evidentiary hearing while providing all parties a fair opportunity to address, among other things, any appropriate requests for prevailing party or statutory attorney fees, or pre- and post- award interest, arbitration fees, and costs.
- ▷ entry of well-reasoned interim and final arbitration awards as needed.
- obtain a final, enforceable award. Some parties and counsel believe there is a need to prepare a stipulated official record of the evidentiary hearing in the form of a court reporter's transcript, but this is seldom a good investment. Experience suggests that there is little value in the preparation of a costly official record due to the finality inherent in final arbitration awards as a matter of law and the extremely high rate of voluntary compliance with final awards.
- preserve the parties' valuable business relationships. The personal participation of the party decision makers should be encouraged from the beginning to the end of the arbitration process. A proactive, personal approach frequently allows valuable client insight into the arbitrator's role and recommendations for the consensual procedures that will govern throughout the administration of the proceeding. Experience also suggests that early client participation may help the parties avoid the suspension or termination of the disputed business transaction while their dispute is being resolved.

Adopting a Mandatory Binding Arbitration Strategy

By recognizing the compelling results of Microeconomics' research and embracing the best

practices highlighted in this article, industry leaders can benefit from the financial and practical advantages that a mandatory binding arbitration strategy offers them, including, most notably, a proven method of managing the considerable direct and secondary costs and economic losses that are inherent in every dispute resolution approach.

For decades, seasoned business professionals have embraced risk management strategies that rely on prudent contract provisions to minimize the enterprise risks that are inherent in large, complex commercial transactions. Carefully drafted provisions that address liability limitations, liquidated damages, mutual waivers of consequential damages, insurance, additional named insureds, waiver of subrogation, and prevailing party attorney fee shifting are now commonplace in commercial transactions conducted throughout most industries.

Mandatory binding arbitration agreements are created by written contract and are typically prospective in nature; the terms of the arbitration agreement are included in the parties' underlying contract documents before a known business dispute exists. Thus, it is critical for the arbitration agreement to anticipate and define the scope of future claims and other disputed matters that the arbitrator is authorized to decide; identify the applicable law and administrative rules and procedures that will govern any future binding arbitration proceeding between the parties; and finally, address any other reasonably foreseeable issues, circumstances, or risks that may be unique to the parties' commercial transaction.

An arbitration agreement should include the adoption of the court-tested rules of one of the nationally recognized professional ADR organizations.²² This will provide clear guidelines and best practices, defining the powers and authority of the arbitrator(s) while establishing a comprehensive baseline of flexible procedural and administrative rules that the arbitration professionals can implement to fit just about any circumstance that might arise from a business dispute.

Because of the uncertainty about the nature and extent of any potential commercial dispute that may arise between the parties, it is common


practice for businesses to incorporate perceived safeguards into their arbitration agreements in the form of state and federal rules of civil procedure and state and federal rules of evidence. However, most ADR commentators now recognize that this approach defeats the purpose of choosing a simplified and flexible mandatory binding arbitration process.

When making the informed decision to choose mandatory binding arbitration and waive the right to judicial dispute resolution with its concomitant formal procedural, evidentiary, and appellate rules, businesses and their counsel must fully embrace both the limitations and advantages that are inherent in mandatory binding arbitration.

Where to Draw the Line?

When deciding between civil litigation and mandatory binding arbitration, the question is whether to choose a traditional civil litigation strategy with its attendant uncertainties or a risk management strategy that relies on mandatory binding arbitration, with its quantifiable objective and subjective benefits. Arbitration seems to provide clear financial advantages

in most cases and the opportunity to put the final decision in the hands of an experienced arbitrator or three-member panel.

Experience suggests that a customized mandatory binding arbitration strategy will offer industry leaders better value for their dispute resolution dollars when facing commercial disputes. 



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NOTES

1. Weinstein et al., "Efficiency and Economic Benefits of Dispute Resolution through Arbitration Compared with U.S. District Court Proceedings," Micronomics Economic Research and Consulting (Mar. 2017), www.micronomics.com/articles/Efficiency_Economic_Benefits_Dispute_Resolution_through_Arbitration_Compared_with_US_District_Court_Proceedings.pdf.
2. www.micronomics.com/index.shtml.
3. Pearsall et al., "Economic Impact of Reduced Judiciary Funding and Resulting Delays in State Civil Litigation," Micronomics, Inc. (Mar. 2012), www.micronomics.com/articles/Economic_Impact_of_Reduced_Judiciary_Funding_and_Resulting_Delays_in_State_Civil_Litigations.pdf.
4. Weinstein and Porter, "Economic Impact on the County of Los Angeles and the State of California of Funding Cutbacks Affecting the Los Angeles Superior Court," Micronomics, Inc. (Dec. 2009), www.micronomics.com/articles/LA_Courts_Economics_Impact.pdf.
5. Weinstein et al., *supra* note 1 at 8.
6. *Id.*
7. *Id.* at 2.
8. *Id.*
9. *Id.*

10. *Id.* at 8.
11. *Id.*
12. *Id.*
13. *Id.* at 3.
14. *Id.* at 16.
15. *Id.* at 4.
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.* at 3.
20. *Id.*

21. ADR commentators and counsel have questioned the value of the sliding-scale filing fee and administrative fee schedules charged by national arbitration administrators, and this has caused some arbitrators to offer negotiated discounts under appropriate circumstances. Nonetheless, those seemingly shortsighted concerns should give way in most cases to the sound reasoning and economic findings set forth in Micronomics' 2017 report, particularly when all of the financial advantages and other practical benefits of mandatory binding arbitration are taken into account.

22. For example, adr.org/Rules.