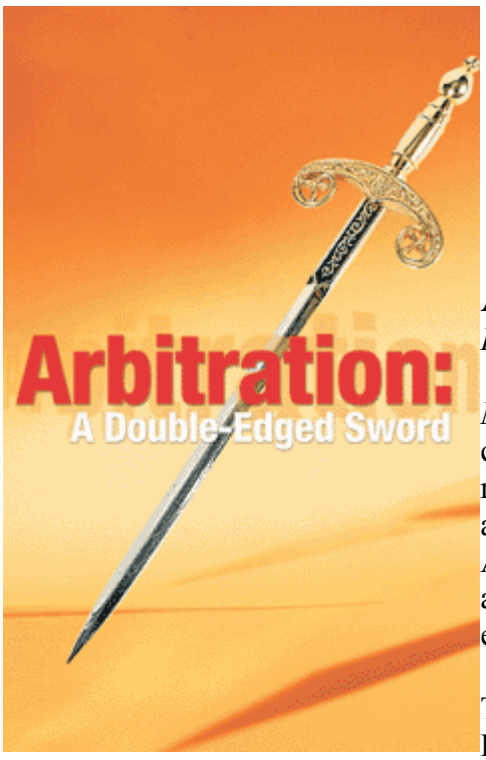

Phone Plus Magazine: Posted: 02/2005

Arbitration: A Double-Edged Sword

By Neil S. Ende

Most agreements, including most telecommunications agreements, contain language identifying the forum in which disputes will be resolved. To an everincreasing degree, telecommunications agreements require the parties to submit their disputes to arbitration. Although these provisions can be among the most important in any agreement, they are little understood, buried in the boilerplate at the end of agreements and generally ignored.

The arbitration process has grown significantly over the last decade. Proponents of that process argue arbitration is a cheaper, faster and less public way to resolve disputes.

Without doubt, the arbitration process can achieve these benefits. However, as with most things in life, the "benefits" associated with arbitration, real or not, do not come without costs to one party or the other. More importantly, benefits and costs of arbitration generally are not allocated equally among the parties. Indeed, many parties select arbitration not because they believe it to be faster and cheaper, but because they understand the process of arbitration will provide them with tactical and strategic advantages in any dispute that may arise. By the same token, while the ability to keep disputes out of the public eye can be a good thing for one party or class of parties, it also can be used to deny a party the ability to obtain critical information about a pattern of conduct or to achieve the benefits of public disclosure.

Thus depending on the nature of a party's business, arbitration can be a valuable part of a company's legal strategy or a real threat to its ability to sustain its legal rights. It is therefore critical for companies to understand fully all the costs and benefits of the arbitration process before deciding to include or agree to an arbitration clause.

IS ARBITRATION CHEAPER AND FASTER?

Advocates of arbitration argue a key benefit of arbitration is it provides a faster and less expensive method of resolving disputes. Is this really the case? The answer is yes, no and maybe. As a general matter, the empirical data tends to support this argument. Generally speaking, parties to an arbitration will have their cases heard and resolved faster, and generally at a lower out-of pocket cost, than they would through a traditional litigation before a state or a federal court.

However, these data often fail to include all applicable out-of-pocket costs and do not tell the whole story. While the greater speed and lessened formality of the arbitration process can result in lower attorney's fees and other costs to the participants, those savings may be overwhelmed by fees and other charges that must be paid to the arbitration authority and generally are not imposed by the court system. For example, under the Commercial Arbitration Rules of the American Arbitration Association, parties are subject to at least three types of fees they typically do not face in a court proceeding. These fees are an initial filing fee, a case service fee and the fees paid for the arbitrator or arbitrators who hear the case. Currently, the initial filing fee and the case service fee are based on the size of each party's claim or counterclaim and range from $500, for claims or counterclaims up to $10,000, to as much as $65,000 for certain claims greater than $10 million. The case service fee for these cases ranges from $200 to as much as $6,000.

Given the size of the claims in many telecom cases, these two fees alone can eliminate quickly any savings in attorney's fees associated with a more expeditious arbitration process. Moreover, unlike a court proceeding where a party does not need to pay a fee based on the size of its claim or counterclaim, the obligation to pay arbitration fees can present a real economic barrier to the assertion of a party's rights, especially where that party has become economically weakened by the very conduct for which it seeks redress.

Further, and ironically, the claimed savings in attorney's fees often cited by advocates of arbitration also are offset by the fees parties are required to pay to arbitrators who hear the case. Specifically, unlike a court proceeding where the parties generally do not have to pay fees to the court and never pay specifically for the judge's time, parties to an arbitration process pay the arbitrator or arbitrators an hourly fee for their services. These fees, which generally range from $150 to $400 per hour, are set by each arbitrator, who also determines how many hours to spend on the case. In a complex case, and particularly one for which three arbitrators are required, arbitrator fees can run into the tens of thousands of dollars. Additionally, a party who cannot pay these fees can be denied the right to present its claims or counterclaims or to defend against the claims or counterclaims of the other party.

One final matter must be considered with respect to cost. Arbitrations are sometimes less expensive because parties simply do not pursue their claims as aggressively as they would in court. While this may be a good thing for the party who has engaged in the wrongdoing, it also tends to diminish the importance of the proceeding, which can serve to limit one or both parties' rights. This means, before entering into an agreement to arbitrate, one really needs to understand the issues that are likely to arise and how they will need to be addressed legally. Once these issues have been properly considered, a more informed decision can be made as to whether potential speed and/or a lower cost as well as limitations on due process are truly consistent with an overall legal strategy.

IS FASTER BETTER?

The arbitration process generally is thought to be faster than the litigation process for two primary reasons. First, the waiting list in bringing a case to an arbitration hearing is shorter than the backlog in getting a trial date in court. For parties that require an expeditious proceeding, this can be an important advantage. Second, the procedures are streamlined such that many of the rules fundamental to a fair trial do not apply.

These include the rights to:

- obtain documents from the other party
- depose the other party's witnesses
- present certain evidence or witnesses
- obtain a transcript of the hearing
- present certain claims, counterclaims or legal arguments
- obtain a written decision along with any explanation of the reasons for any decision
- appeal an adverse judgment

For certain parties, the ability to preclude its opponent from asserting these rights can be a major — even overwhelming — advantage that is sufficient, standing alone, to include an arbitration clause in its agreement. For example, in many telecom disputes, the issue boils down to a fight over whether certain calls were made or completed and whether the appropriate rate was charged. In many of these cases, one party has unique access to documents and data — CDRs, switch records and billing models and data — critical to the case. If the case were brought to court, there would be no question the other party would have the right to obtain these documents and to depose witnesses who are familiar with how they were created.

In an arbitration, however, the claimed need for speed leads to a general disdain for the discovery process and thus the imposition of restrictions on document and witness discovery. This problem for parties seeking document production is only exacerbated by the absence of any governing set of rules (like the Federal Rules of Civil Procedure and the Federal Rules of Evidence in a federal court proceeding) for discovery. The result is the party who needs these documents and witnesses to prove its case is often denied access to them and, typically, suffers an adverse judgment specifically because it did not have the documents it needed to prove its case. The party who holds the documents prevails — even when it should not — merely by its ability to deny its opponent the ability to obtain critical evidence.

Needless to say, this advantage is not lost on parties who control the documents and data essential to any dispute. In the telecom world, this is generally the carrier in a carrier/reseller relationship, particularly where the reseller does not have a switch recording its traffic. And, while it is rarely admitted, this factor is one explanation for the prevalence of arbitration clauses in carrier agreements. For carriers, the arbitration

process can be a very powerful advantage. For resellers, agreeing to arbitration may be foregoing an ability to prove their claims even before they arise.

The claimed need to limit costs and/or the need for speed also can be the basis for the refusal by an arbitration authority and/or an arbitrator to provide a written decision or any other explanation for a decision. Moreover, unlike court orders that generally are appealable, arbitration awards typically are not — even in instances where the decision is clearly incorrect as a matter of law or fact.

IS PRIVACY A GOOD THING?

Another advantage touted by the advocates of arbitration is the proceeding is private and the outcome is not subject to public disclosure. As with the issues described above, the ability to keep an issue private can be a very effective part of a legal strategy for one party and a serious obstacle to another.

As a practical matter, the privacy of arbitration proceedings means it will be very difficult for parties to the arbitration proceeding to determine if the matter at issue has ever been arbitrated before and, if so, by whom. Privacy of arbitration proceedings also means it will be difficult, if not impossible, to determine the outcome of any prior arbitrations regarding the same or similar issues or parties. Finally, privacy of arbitration proceedings generally means it will not be possible to determine whether the arbitrator or arbitrators assigned to the case have heard cases involving the opponent before and, if so, how they have ruled.

Needless to say, the privacy associated with the arbitration process tends to favor parties that file, or are subject to, arbitration claims more frequently and thus have an incentive to keep these matters as private as possible. This is particularly true where a party has received adverse judgments relating to the same or similar conduct.

Privacy also can be a tool to prevent disclosure of conduct by arbitrators that would suggest a pattern of favoritism to a certain party or class of parties, particularly where such party or class of parties has designated a particular arbitration authority to hear its cases.

The American judicial system was founded on the principal of openness of proceedings and transparency of decisionmaking. To the extent the arbitration process strays from this principal, parties need to consider the privacy issue carefully in determining whether the use of arbitration meets their overall legal objectives.

Arbitration is truly a double-edged sword. While in many cases arbitration may make sense for both parties, quite often the inclusion of a mandatory arbitration provision in an agreement is a tactical and strategic move by a drafting party who understands the arbitration process will work to their unique advantage. For this reason, it is critical to carefully consider this issue both from the perspective of an overall legal strategy, and also with respect to the circumstances of each agreement drafted or signed. It will be time very well spent.

Neil S. Ende is the founder of and a partner in Technology Law Group LLC, a Washington, D.C.-based telecommunications law firm. He can be reached by phone at +1 202 895 1707 and by e-mail at nende@tlgdc.com.