

## An Introduction to Private Arbitration

---

Penned by Indiana poet James Whitcomb Riley and later used in this abbreviated form by then California Governor Ronald Regan is the phrase,

If it walks like a duck and quacks like a duck, then it must be a duck.

Although typically less formal than a trial, there are many similarities between an arbitration and a civil trial. Because of these similarities, one might believe that arbitration is the same as a trial, only more private, more expedient, and less expensive. However, private arbitration is not a civil trial and the differences, not the similarities, should be considered when determining whether a dispute should be arbitrated rather than tried. This article summarizes those differences.

### An Overview of Private Arbitration

Private arbitration is a form of alternative dispute resolution<sup>1</sup> where one or more parties agree to resolve a dispute before one or more private arbitrators rather than in a court of law.<sup>2</sup> The benefits of arbitration are that they are generally more expedient, less costly, and private.<sup>3</sup>

There are several organizations, such as the American Arbitration Association, that provide arbitration services to the public for a fee. There are also industry organizations, such as the Financial Regulatory Authority, that provide arbitration services for a specific industry. Each such organization will have their own rules of procedure on how the arbitration will be conducted. The American Arbitration Association's (AAA) *Commercial Arbitration Rules and Mediation Procedures* (hereinafter referred to as the "AAA Arbitration Rules" and can be found [here](#)<sup>4</sup>) and the Financial Industry Regulatory Authority's (FINRA) *Code of Arbitration for Industry Disputes* (herein after referred to as the "FINRA Arbitration Rules" and can found [here](#)<sup>5</sup>) are used as examples through this article.

---

<sup>1</sup> Alternative Dispute Resolution refers to a variety of methods, including arbitration and mediation, that provide for the resolution of disputes without a trial in a court of law.

<sup>2</sup> There are several variations on the composition of an arbitration panel, including a panel consisting of a single arbitrator, a panel consisting of multiple neutral arbitrators, or a panel consisting of both neutral and non-neutral arbitrators. This article is presented as if the arbitration is conducted before a single arbitrator.

<sup>3</sup> Unlike a civil trial, where the pleadings and the trial are -available to the public, private arbitration, as the name suggests, is private and not available to the public. But note that, under FINRA Arbitration Rules, Rule 13905(h), arbitration awards are available to the public.

<sup>4</sup> As of the date of this article, the AAA Arbitration Rules can be found at the following location: [https://www.adr.org/sites/default/files/Commercial\\_Rules.pdf](https://www.adr.org/sites/default/files/Commercial_Rules.pdf).

<sup>5</sup> As of the date of this article, the FINRA Arbitration Rules can be found at the following location: [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=4193](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4193).

Although parties may agree to arbitrate after a dispute arises, in many cases, the agreement to arbitrate is made before. For example, a contract may contain a provision requiring the parties to arbitrate contractual disputes before a specific organization such as the AAA.<sup>6</sup> Alternatively, industry organizations, like FINRA, as a condition of membership or registration with the industry organization, may require that industry disputes involving its members and/or registrants be arbitrated before that organization.<sup>7</sup> Courts will enforce such agreements to arbitrate as a matter of public policy, as “arbitration is a speedy and relatively inexpensive means of resolving disputes and eases court congestion.”<sup>8</sup>

As provided for in both the AAA Arbitration Rules, the FINRA Arbitration Rules, an arbitration is generally conducted as follows:

1. An arbitration proceeding is initiated by a claimant who files a “statement of claim” or “demand for arbitration” with the agreed upon arbitration forum, describing the dispute, the reasons the claimant is entitled to relief, and the relief that is being sought. This is akin to the filing of a complaint by a plaintiff in a civil trial.<sup>9</sup>
2. The respondent will then submit a response denying some or all the allegations made by the claimant and describing why the claimant is not entitled to the relief requested. This is akin to the filing of an answer by a defendant in a civil trial.<sup>10</sup>
3. Unlike a civil trial, the parties will then select an arbitrator. Unless otherwise agreed upon by the parties, the applicable arbitration rules will determine how the arbitrator is selected.<sup>11</sup>
4. As in a civil trial, the claimant and respondent will conduct discovery and make prehearing motions.<sup>12</sup>
5. As in a civil trial, there is a hearing where the parties present testimony and evidence to the arbitrator.<sup>13</sup> However, the arbitration forum will have its own procedural and evidentiary rules which are generally laxer than in a civil trial.<sup>14</sup>

---

<sup>6</sup> As of the date of this article, sample contractual arbitration clauses for AAA can be found at <https://www.adr.org/Clauses>.

<sup>7</sup> See FINRA Arbitration Rules, Rule 13200.

<sup>8</sup> See California Code of Civil Procedure, § 1281; See e.g., *Rodriguez v. Superior Court*, 176 Cal. App. 4th 1461, 1467 (2009).

<sup>9</sup> See FINRA Arbitration Rules, Rule 13302; AAA Arbitration Rules, Rule R-4.

<sup>10</sup> See FINRA Arbitration Rules, Rule 13303; AAA Arbitration Rules, Rule R-5.

<sup>11</sup> See FINRA Arbitration Rules, Rules 13400 et seq.; AAA Arbitration Rules, Rule R-12.

<sup>12</sup> See FINRA Arbitration Rules, Rules 13500 et seq.; AAA Arbitration Rules, Rules R-22, R-33.

<sup>13</sup> See FINRA Arbitration Rules, Rules 13600 et seq.; AAA Arbitration Rules, Rules R-24 through R-33.

<sup>14</sup> See FINRA Arbitration Rules, Rule 13604; AAA Arbitration Rules, Rules R-34.

6. As in a civil trial, the arbitrator will render a decision. Unlike a civil trial, that decision may not include an opinion explaining how the arbitrator reached that decision.<sup>15</sup>
7. Unlike a civil judgment, an arbitration award cannot be enforced until it is confirmed by a court of law. Only under limited circumstances, a court of law may vacate (void) an arbitration award.<sup>16</sup>

## **How Private Arbitration is Different than a Civil Trial**

There are several aspects of private arbitration, discussed herein below, that differ significantly from a civil trial. This includes, the availability of judicial review, the interaction between state or federal law and the arbitration forum's rules, the selection of the arbitrator, and the cost of arbitration.

### Judicial Review of the Arbitration Process.

During the arbitration proceedings, the arbitration forum's procedural and evidentiary rules will govern the arbitration proceedings. However, to enforce an arbitration award, the prevailing party will need to petition a court to confirm the arbitration award and, the losing party may petition a court to vacate the arbitration award. In general, the grounds to vacate an arbitration award relate more to the arbitration process and not on the accuracy of the arbitration award.<sup>17</sup> Courts have vacated arbitration awards for the arbitrator's failure to disclose information that created an impression of bias<sup>18</sup> or where the arbitrator exceeded his authority<sup>19</sup>.

Thus, an arbitrated dispute can be prolonged where the losing party moves to vacate an arbitration award based on claims of bias or misconduct on the part of the arbitrator.

---

<sup>15</sup> See FINRA Arbitration Rules, Rule 13904; AAA Arbitration Rules, Rule R-46.

<sup>16</sup> See California Code of Civil Procedure, §1286.2; 9 U.S. § 10.

<sup>17</sup> See *Moncharsh v. Heily & Blase*, 3 Cal. 4th 1, 12-14 (1992) [discussing the availability of judicial review where there are problems with the fairness of the arbitration process]; *Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 393 U.S. 145, 150, (1968) [concluding that the Federal Arbitration Act required that arbitrated disputes must be heard before neutral arbitrator and that any not before an arbitrator that "might reasonably be thought biased"].

<sup>18</sup> See *Ovitz v. Schulman*, 133 Cal. App. 4th 830, 845, 35 Cal. Rptr. 3d 117, 128 (2005) [vacating an arbitration award under California Code of Civil Procedure, § 1286.2, where the arbitrator failed to disclose that he intended to entertain offers or employment from the parties or their lawyers and that he did accept employment when he agreed to hear another dispute involving one of the party's lawyers]; *Mt. Holyoke Homes, L.P. v. Jeffer Mangels Butler & Mitchell, LLP*, 219 Cal. App. 4th 1299, 1314-15 (2013) [concluding that the arbitrator's use of one of the party's attorneys as a reference created reasonable doubt that he could be impartial].

<sup>19</sup> See *Bonshire v. Thompson*, 52 Cal. App. 4th 803, 812 (1997) [vacating an award where the arbitrator considered extrinsic evidence even though a provision of the contract prohibited the consideration of extrinsic evidence].

### Judicial Review of the Arbitrator's Decision

Unlike an arbitrator's disclosures, his or his decision is not reviewable by a court for errors of fact or errors of law or the sufficiency of the evidence.<sup>20</sup> This is the risk that the parties made when they agreed to submit to binding arbitration before an arbitrator.<sup>21</sup> There are, however, a few limited exceptions. For example, under California law, exceptions have been found on claims that a contract provision is illegal as it violates explicit public policies.<sup>22</sup> Within the jurisdiction of some but not all the federal circuit courts, including the Court of Appeals for the Ninth Circuit, "manifest disregard for the law" is grounds to vacate an arbitration award.<sup>23</sup> "Manifest disregard for the law" exists where the record shows that the arbitrator was aware of applicable law and chose to ignore it.<sup>24</sup>

Thus, except in very limited circumstances, an arbitrator's mistakes of law or fact cannot be corrected by a court of law.

### Selection of an Arbitrator.

Unlike a civil trial, parties to an arbitration have some control over the selection of the arbitrator who will decide their case. For example, AAA Arbitration Rules, Rule R-12, and FINRA Arbitration Rules, Rule 13404, provide for the striking and ranking of arbitrators from a roster of proposed arbitrators selected by the arbitration forum. Thus, a party can and should evaluate each of the proposed arbitrators. The curriculum vitae provided for each proposed arbitrator and Internet web searches are one source of information. Awards issued by FINRA are publically available and can be another source of information. Many arbitrators used by AAA are retired judges and so there may also be decisions and opinions available for them. Given that an arbitration award will be upheld even where their mistakes of fact or errors of law, the selection of a qualified and impartial arbitrator is one of the most important parts of the arbitration process.

### The Interaction of State and Federal Law and the Arbitration Forum's Rules

A party should consider, from the onset of arbitration, which laws might be applied by a court in a subsequent petition to confirm or to vacate any resulting arbitration award. For example, once an arbitrator is selected, the arbitrator is required to make certain

---

<sup>20</sup> See *Moncharsh, supra*, 3 Cal. 4th at p. 6 [stating that, with limited exceptions, "an arbitrator's decision cannot be reviewed for errors of fact or law"].

<sup>21</sup> See *ibid.* at p. 11-12 (1992) [observing that by agreeing to arbitrate, the parties accepted the risk of arbitrator error].

<sup>22</sup> See *ibid.*

<sup>23</sup> See *Ramos-Santiago v. UPS*, 524 F.3d 120, 124 n.3 (1st Cir. 2008) [noting that "manifest disregard for the law" is not a valid ground for vacating an arbitration award after the U.S. Supreme Court ruling in *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008)]; *Sutter v. Oxford Health Plans LLC*, 675 F.3d 215, 220 n.2 (3d Cir. 2012) [noting that "manifest disregard for the law" was a judicial gloss on the statutory grounds for vacating an arbitration award]; *Comedy Club, Inc. v. Improv W. Assocs.*, 553 F.3d 1277, 1281 (9th Cir. 2009).

<sup>24</sup> See e.g., *Comedy Club, supra*, 553 F.3d at p. 1281.

disclosures to the parties so they may evaluate the neutrality of the arbitrator. The information that must be disclosed include those mandated by Arbitration Forum rule<sup>25</sup>, by statute<sup>26</sup>, and by judicial precedent.<sup>27</sup>

The failure of an arbitrator to make required disclosures required by state or federal law, regardless of the Arbitration Forum's rules, could subject the resulting arbitration award to vacatur.<sup>28</sup>

Further, in California domestic arbitration, California Code of Civil Procedure, section 1281.91(a) and (b) gives a party the right to disqualify an arbitrator, without cause, once the arbitrator makes his or her required disclosures.<sup>29</sup> The failure of the Arbitration Forum to allow such disqualification, would subject the resulting arbitration award to vacatur.<sup>30</sup>

Thus, statutes and case law that might apply in post-award arbitration litigation need to be considered during the arbitration process so as not to jeopardize the finality of any resulting arbitration award.

#### Administrative Fees and Arbitrator's Compensation.

In addition to filing fees and other administrative charges paid to the forum, which are generally higher than court filing fees, the parties to an arbitration will also be required to pay for the arbitrator's compensation. These charges and compensation are hereinafter collectively referred to as "arbitration costs." It is possible that, at some point in the arbitration, a claimant may encounter a respondent who is unable or unwilling to pay for these ongoing costs. Under the AAA, where a party has not paid such costs assessed to the party, the arbitrator may prevent the non-paying party from pursuing a claim but may not prevent the non-paying party from defending against a claim. The arbitrator may also suspend and/or terminate the arbitration proceedings.<sup>31</sup> Thus, a claimant can be faced with the possibility that arbitration proceedings may be terminated unless he or she pays both parties costs to the arbitration and recoup those costs after an arbitration award, inclusive of costs, has been issued in his favor.

## **Conclusion**

---

<sup>25</sup> See FINRA Arbitration Rules, Rule 13408; AAA Arbitration Rules, Rule R-17.

<sup>26</sup> See California Code of Civil Procedure, § 1281.9; California Code of Civil Procedure, § 1297.121.

<sup>27</sup> See *Commonwealth*, *supra*, 393 U.S. at p. 149 [requiring that "arbitrators disclose to the parties any dealings that might create an impression of possible bias"].

<sup>28</sup> See *ibid.*

<sup>29</sup> See *Azteca Constr., Inc. v. ADR Consulting, Inc.*, 121 Cal. App. 4th 1156, 1168-69 (2004) [concluding petitioner had the right to remove the arbitrator within 15 days of his disclosure statement regardless of AAA rules to contrary].

<sup>30</sup> See *ibid.*

<sup>31</sup> See AAA Arbitration Rules, Rule R-57

Arbitration can be less expensive, more private, and more expeditious than a civil trial and, thus, there are situations where arbitration is the best way to settle a dispute. However, arbitration comes with a risk of arbitrator error. Further, for contentious litigants, post-award litigation to confirm or vacate an arbitration award is more likely.

Thus, for companies with an ongoing relationship within a specific industry, arbitration may be appropriate to resolve a dispute (e.g., insurance companies and hospitals resolving coverage issues), especially where the impact of arbitrator error is not significant. However, for individuals or entities involved in a life altering dispute (e.g., a dispute that might bankrupt a company, or a dispute over a shareholder buy-sell agreement which may be a person's largest asset), arbitration may not be appropriate as the impact of arbitrator error may be too great and the likelihood of protracted post arbitration award litigation is increased, both of which negate any the expected benefits of arbitration.

---

Copyright © 2017 The Law Office of Waddy Stephenson  
701 Palomar Airport Road Suite 300  
Carlsbad, CA 92011