

# Look Before You Leap: Points to Ponder Before Including an Arbitration Clause in Your Contract

Steven M. Ziegler, Esquire\*  
Law Offices of Steven M. Ziegler PA  
Hollywood, FL

Over the past decade, there has been a significant increase in the use of arbitration clauses in commercial contracts, including managed care provider/payor contracts.<sup>1</sup> The increase in the use of arbitration clauses can be attributed to several factors, including the parties' belief that arbitration will be less costly, more efficient, and result in less animosity in the contracting relationship.<sup>2</sup> Additionally, parties have favored arbitration, thinking that the proceedings would be confidential. In the context of managed care contracts, many payors have utilized arbitration provisions in provider contracts, assuming that the proceedings would not include claims for exemplary damages or class action allegations. However, experience over time has shown that arbitration does not always meet the parties' expectations or achieve the intended or expected results. In fact, arbitration can be more costly than litigation, as contentious, not confidential, and may include claims for exemplary damages and class action allegations.

Aside from the costs of arbitration, parties often fail to consider several important factors in the arbitration process that may create unintended consequences or prevent the parties from expeditiously resolving their disputes. Many of these concerns can be addressed in the arbitration clause, but even with a well-drafted arbitration clause some issues may not be avoided. Parties should carefully weigh these factors before agreeing to include an arbitration clause in their contracts.

## The Costs of Arbitration

In theory, arbitration should have limited discovery; a shorter time for final hearing than would normally be assigned to a trial date; and due to the informality of the proceedings, should be resolved in a fair and cost-effective manner. Relying on this theory, parties often believe that submitting a dispute to arbitration will yield significant cost savings. However, parties should be aware that this is not always the case. Contracting parties need to carefully consider the types of potential costs in the arbitration process. Parties will be responsible for filing fees that may vary based on the nature of the dispute and the amount of damages at issue. Filing fees may also depend on the association that is managing the arbitration (e.g. American Health Lawyers Association (AHLA), American Arbitration Association (AAA), or Judicial Arbitration and Mediation Services (JAMS)).



## Arbitrator Fees and Administrative Costs

The parties will also be responsible for the arbitrator's fees. The arbitration fees can be very high, depending on the size of the dispute and the number of arbitrators. Arbitrators are paid on an hourly basis, and there is no way to cap the time arbitrators spend on a particular matter. Parties should consider specifying in the arbitration clause that a sole arbitrator will render the decision to limit costs. For complex or large disputes however, parties may want to utilize a three-arbitrator panel.

Parties will also be responsible for various administrative fees in the process. Depending on the arbitration venue, parties may be responsible for arbitrator travel time, hearing room rental, and witness travel expenses. To avoid any additional costs for bringing in witnesses and utilizing experts, the parties should at least specify a reasonable location to minimize travel costs.

## Discovery and Evidence

Discovery and evidence often play important parts in the arbitration process. Arbitrations are intended to be a less costly and time-consuming alternative to litigation. As a result, arbitrations typically have less extensive discovery than litigation. However, the extent of discovery can depend on several factors, including the language of the arbitration clause, determinations of the arbitrator(s), and the rules of the association conducting the arbitration.

## The Arbitration Clause

The language of the arbitration clause is the first line for determining the extent of discovery. If parties are concerned about the scope of discovery and the costs involved, the arbitration clause should place acceptable limits on discovery. For example, the parties may want to limit the number of depositions that can be taken, limit experts, and provide limitations on the number of interrogatories and document requests.

## The Arbitration Association

If the arbitration agreement is silent as to the extent of discovery but the agreement adopts the rules of the association conducting the arbitration—those rules apply. All association rules provide for discovery, and limits on discovery depend on the arbitrator. However, some associations provide basic deadlines and limits on discovery. For instance, JAMS rules provide that initial document production shall occur within twenty-one days after all pleadings or notices of claims have been received.<sup>3</sup> Moreover, the parties are limited to one deposition of an opposing party, with additional depositions provided for under the discretion of the arbitrator.<sup>4</sup> Parties should familiarize themselves with the various association rules to ensure that their discovery expectations are met.

## The Arbitrator's Discretion

Where parties fail to address discovery in their arbitration clause and no association rules are selected, the extent of discovery will depend on what discovery the arbitrator deems necessary to understand and resolve the dispute. Some arbitrators tend to limit discovery, while others allow unlimited discovery. It is entirely possible that more discovery can take place in arbitration than in litigation. Additionally, while in theory there should not be lengthy discovery disputes, often arbitrators have more time than judges and are willing to conduct lengthy hearings that most judges would not allow. This raises arbitration costs considerably, particularly when there are three arbitrators hearing discovery disputes. Not only do three individuals have to participate in the hearings, but they then have to confer and agree upon a ruling, which can result in additional costs. Parties should learn as much as possible about their potential arbitrators' inclinations regarding limitations on discovery before agreeing to any arbitrator.

## The Rules of Evidence

Parties considering inclusion of an arbitration agreement in their contract need to be concerned not only with the extent of discovery but also how evidence is to be treated during the arbitration. Specifically, parties should be aware that given the informal nature of arbitration proceedings, conformance to the Rules of Evidence is not required.<sup>5</sup> In fact, none of the main association rules require that arbitrators conform to the Rules of Evidence. As a result, arbitrators generally have the sole discretion to determine the admissibility, relevance, and materiality of the evidence offered. As such, arbitrators often accept as evidence information that would not be admissible in court, or may choose to disallow evidence that would ordinarily be admissible. Under these circumstances, parties may face more extensive discovery because they may be required to produce information that would typically not be produced in litigation. The safeguard to allowing into evidence or consideration is that the arbitrator can place the weight he or she deems appropriate on evidence and disregard evidence that is admitted. However, some believe that arbitrators tend to try to find a middle ground in their decisions and potentially inadmissible evidence still plays a role in their decision making. This would not occur in a court setting, as the judge would exclude the evidence and the judge or jury would not have

the evidence while deliberating. To allay concerns about treatment and production of evidence in the arbitration proceeding, parties should specify in their arbitration clause that the Rules of Evidence apply to the dispute.

## Confidentiality

In the managed care arena, payors often prefer the utilization of arbitration clauses in contracts with the assumption that resolution of disputes will be confidential. However, both parties should be aware that while arbitration documents are generally not open to public review, arbitrations are not confidential *per se*. Confidentiality may depend on the rules of the entity conducting the arbitration. For example, AHLA arbitrations are deemed confidential unless confidentiality is waived by the parties or disclosure is required by law.<sup>6</sup> Under the AAA rules, there is no specific rule regarding confidentiality, but a presumption of confidentiality exists. However, in the context of class actions, filings and orders appear in an electronic searchable database.<sup>7</sup> Parties should also be aware that confidentiality may be lost if the courts become involved in the arbitration process. For instance, if a party seeks relief from the courts for interim relief, pleadings filed with the court may disclose the nature of the dispute. Information may also be disclosed if a party seeks to vacate an award or court action is required to confirm an award.

If parties prefer arbitration for the resolution of their disputes, the parties should ensure that they utilize an entity that extends confidentiality to their proceedings, or they should make sure that the arbitration clause contains a proper confidentiality provision.

## Causes of Action and Forms of Relief

Perhaps one of the biggest factors in determining whether disputes should be subject to arbitration is the types of actions contemplated to be resolved through the arbitration process and the available relief for those actions. Parties must ensure that they have appropriately contemplated the nature of the disputes that will be submitted to arbitration and the potential remedies to avoid additional disputes as to whether particular claims are subject to arbitration, or whether particular remedies are included or excluded from the agreement.

## The Class Action

Often payors opt for the inclusion of arbitration provisions in their provider contracts without contemplating whether a party has the right to demand arbitration on a class-wide basis. If parties have not made a class action assessment prior to including an arbitration provision in their contract, they may be faced with trying to resolve multiple claims during the arbitration process.

As a general rule, the courts have recognized the viability of class actions in the arbitration forum.<sup>8</sup> However, some courts have held that such actions are only permitted where the parties have specifically provided for such actions in their arbitration agreement.<sup>9</sup> In any event, the potential for class actions exists and most arbitration associations have rules for managing class action proceedings. Despite having rules to address the class action arbi-

tration, such actions can have a significant impact on all parties to the arbitration agreement.

As an initial factor, the class action arbitration can be detrimental to the perceived cost savings of arbitration. An increase in claims and parties/members to the dispute will likely increase an arbitrator or panel's fees exponentially. In addition, the scope and extent of discovery is likely to increase based on the number of claims. Moreover, in the class action context the goals of privacy and confidentiality are abolished. Under the AAA Supplementary Rules for Class Actions, the presumptions of privacy and confidentiality do not apply in class actions.<sup>10</sup> All filings in class actions may be public, and hearings are open to the public.<sup>11</sup> Further, due process issues may arise for absent class members. Under some procedural rules, the arbitrator determines the binding effect of any award on the class.<sup>12</sup> As such, absent class members may be bound by decisions from an arbitrator they did not choose and may potentially waive rights that exist in the litigation forum.

To prevent the potential pitfalls of class action in arbitration, the parties may take steps in drafting the arbitration provision to exclude the availability of class actions. However, if the parties chose to exclude class actions as potential actions under the arbitration agreement, the party seeking the exclusion must be sure that such exclusion does not appear to be a punishment to the other party. Exclusions that appear unfair to the other party may be held unenforceable by the courts.<sup>13</sup>

### **Injunctive Relief**

Another factor parties should consider prior to submitting claims to arbitration is whether preliminary relief will be needed pending arbitration. The need for injunctive relief can raise significant issues as to whether relief can be obtained through the arbitrator, or whether relief through the courts waives the right to arbitration.

Generally, most association arbitration rules provide an arbitrator with the power to award interim relief as necessary to preserve the status quo of the parties during arbitration.<sup>14</sup> However unless the arbitration is expedited, the time taken to select an arbitrator and start the proceedings may be too long to wait for interim relief. In those cases, parties may consider seeking relief from the court. On the other hand, pursuing interim relief through the courts may be deemed as a waiver of the arbitration right.

Interestingly, the AAA Commercial Arbitration Rules provide parties with the right to seek preliminary relief through the courts without waiving arbitration.<sup>15</sup> In conjunction with this rule, many courts have held that parties may seek preliminary relief through the courts where the arbitration award would not return the parties to the status quo.<sup>16</sup> Should a party choose to seek preliminary relief through the court, they must be careful to only seek the preliminary relief necessary to preserve the status quo. Where parties seek additional relief, the courts are likely to find that the right to arbitration has been waived.<sup>17</sup>

In other cases, courts have declined to contemplate issuance of preliminary relief and have found waiver of the right to arbitrate

where the parties' agreement did not contemplate issuance of any such relief.<sup>18</sup>

To avoid any disputes concerning preliminary relief and to protect the right to arbitration, parties should clearly specify in arbitration agreements whether preliminary remedies are available or excluded, and the venue for such requests.

### **Punitive, Exemplary, and Non-Economic Damages**

As the use of arbitration has grown, parties' desires to limit the potential damages available in the proceedings have also increased.

Generally, when contemplating arbitration and potential damages, parties seek to set specified limitations on non-economic, special, punitive damages, and attorney's fees. In terms of punitive damages, entitlement to such damages may depend on the rules of the association conducting the arbitration. For example, under the AHILA rules of procedure, the parties agree that there will be no award or claim for consequential, incidental, punitive, or special damages in any actions other than torts that are unrelated to employment.<sup>19</sup>

Entitlement to exemplary damages may also depend on the language of the arbitration provision. Parties may waive the right to receive punitive damages through an appropriately worded arbitration clause.<sup>20</sup> However, where the parties seek to limit non-economic, special, or punitive damages, care must be taken to ensure that unenforceable provisions are not created. Unenforceable provisions will be found where the arbitration clause purports to waive damages or disallow claims for attorney's fees that are otherwise provided under statute.<sup>21</sup>

In addition, questions as to the validity of arbitration provisions foreclosing damage remedies are left to the interpretation of the arbitrator.<sup>22</sup> In cases where such provisions are found to be ambiguous, the provisions may be construed against the drafter leading to a significant award for claimants.<sup>23</sup>

### **Finality of the Proceedings**

Before agreeing to submit disputes to arbitration, both parties need to ensure that they accept the finality of the proceedings. Traditional litigation often provides parties with several bites at the apple in terms of motions for rehearing and appeals. However to coincide with the goals of a cost-effective and expeditious resolution, there is very limited review or reconsideration of arbitration decisions. The right to review or appeal will depend primarily on the language of the arbitration agreement, the association rules, and the substantive law applying to the contract.

### **Internal Association Appeals**

Some arbitration associations provide the right to internal appeal of the decision. Under the JAMS rules, anytime before an arbitration award becomes final the parties have the opportunity to agree to optional arbitration appeal procedures.<sup>24</sup> In addition, under the AHILA rules parties may move for reconsideration of an award within five days after an award has been issued.<sup>25</sup>

## Judicial Review

Where the parties have not provided for appeal in their arbitration agreement and association rules have not been adopted, parties are only entitled to limited review of an arbitration decision through the courts.

In those cases governed by the Federal Arbitration Act, review of an arbitration award is limited to cases where (1) the award was procured by corruption or fraud; (2) there is evidence of partiality or corruption of the arbitrators; (3) the arbitrators were guilty of misconduct in the proceedings; (4) the arbitrators exceeded their powers; or (5) where an award has been vacated and the time for issuance of an award has not expired, a rehearing may be ordered.<sup>26</sup>

For those contracts governed by state law, most states have adopted some version of the Uniform Arbitration Act that limits review of awards to specific circumstances set forth in the various state statutes.<sup>27</sup> If review is limited to grounds set forth in statute, this is generally the exclusive means for review of an award.<sup>28</sup> If a request for review does not fall within one of the specified circumstances, the court may decline to review or vacate an award. In some cases, state statutes dictate that the merits of an arbitration award are not subject to judicial review. For example, California cases have held that under state statutes the merits of any arbitration awards are not subject to judicial review.<sup>29</sup>

Some states do provide for review of arbitration awards outside of statutory circumstances, but only where a manifest disregard of the law has occurred.<sup>30</sup> Under the manifest-disregard-of-the-law standard, significant errors in the application of the law must have occurred.<sup>31</sup> It is not enough that simple errors of the law have occurred.

## Collateral Estoppel and Res Judicata

In traditional litigation, the doctrines of res judicata and collateral estoppel preclude parties from re-litigating entire claims. In the context of arbitration, however, parties may face re-arbitration of claims and issues, as the above doctrines are not applied to arbitration awards with consistency.

Given the informal nature of arbitration proceedings, some courts are not inclined to offer collateral effect to any decisions or awards, absent an indication in the arbitration agreement that such decisions have a preclusive effect on subsequent litigation.<sup>32</sup> However, some courts are willing to apply the doctrines of res judicata and collateral estoppel where a party voluntarily submitted claims to arbitration and the award was confirmed, or where a party pursued claims during arbitration and lost.<sup>33</sup>

To ensure that parties are protected from the potential re-arbitration of claims or litigation of the same claims, the arbitration agreement should include a provision that the decision is final.

In closing, as a rule of thumb, before jumping into an arbitration provision, parties should carefully weigh factors such as cost, discovery, causes of action and remedies, confidentiality, and the finality of proceedings to ensure that their expectations and goals of arbitration will be met. If the parties desire to utilize arbitration

as their method of dispute resolution, they should carefully draft the arbitration agreement provisions to adequately address their needs and limit foreseeable disputes concerning the application of the arbitration provision.

\* *Steven M. Ziegler is the founder of the Law Offices of Steven M. Ziegler PA, a healthcare law firm located in Hollywood, FL, that has specialized in representing managed care organizations for twenty-five years. Ziegler represents managed care organizations nationwide on litigation, regulatory, and legislative matters. He is a frequent lecturer and author on issues facing the managed care industry, and is National Managed Care Claims and Risk Counsel for Lexington Insurance Company.*

- 1 Stephen K. Huber & Wendy E. Tracht-Huber, *Top Ten Developments in Arbitration in the 1990s*, Nov. 2000-Jan., 2001 *DISP. RESOL. J.*
- 2 Merton E. Marks, *New Trends in Domestic and International Commercial Arbitration and Mediation*, (2003), available at [www.cidra.org/articles/newtrends.htm](http://www.cidra.org/articles/newtrends.htm).
- 3 JAMS Comprehensive Arbitration Rules & Procedures, Rule 17.
- 4 *Id.*
- 5 See JAMS Comprehensive Arbitration Rules & Procedures, Rule 22(d).
- 6 AHLA Code of Ethics for Arbitrators, Rule 3.03.
- 7 See AAA Searchable Class Arbitration Docket, available at [www.adr.org/sp.asp?id=25562](http://www.adr.org/sp.asp?id=25562).
- 8 *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003).
- 9 *Champ v. Siegel Trading Co.*, 55 F.3d 269 (7th Cir. 1995).
- 10 AAA Supplementary Rules for Class Action Arbitrations, Rule 9.
- 11 *Id.*
- 12 AAA Supplementary Rules for Class Action Arbitrations, Rule 6(b)(6).
- 13 *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862 (Cal. Ct. App. 2002).
- 14 See AHLA Rules of Procedure for Arbitration, Rule 4.14; AAA Commercial Rules for Arbitration, Rule 34.
- 15 AAA Commercial Arbitration Rules and Mediation Procedures, Rule 36.
- 16 See *Drago v. Holiday Isle, L.L.C.*, 2007 WL 2683675 (S.D. Ala. 2007).
- 17 See *Johnson Resources, Inc. v. La Vallee*, 271 A.D.2d 832, 835 (N.Y. 2000).
- 18 See *Rath v. Network Management, L.C.*, 790 So. 2d 461 (Fla. Dist. Ct. App. 2001); *Structured Capital Resources Corp. v. Arctic Cold Storage, L.L.C.*, 237 S.W.3d 890 (TX. App. 2007).
- 19 AHLA Rules of Procedure for Arbitration, Rule 6.06.
- 20 *Benoay v. E.F. Hutton & Co.*, 699 F. Supp. 1523, 1528 (S.D. Fla., 1988) (citing *Baseliski v. Paine Webber*, 514 F. Supp. 535 (N.D. Ill. 1981); *Baravati v. Josephthal, Lyon & Ross, Inc.*, 28 F.3d 704, 709 (7th Cir. 1994).
- 21 *Booker v. Robert Half Intern., Inc.*, 413 F.3d 77 (D.C. Cir. 2005).
- 22 *MCI Telecomm. Corp. v. Matrix Communications, Corp.*, 135 F.3d 27, 33 (1st Cir. 1998); *Hawkins v. Aid Ass'n for Lutherans*, 338 F.3d 801, 807 (7th Cir. 2003).
- 23 *Stark v. Sandberg, Phoenix & Von Gontard, P.C.*, 381 F.3d 793, 797 (8th Cir. 2004), *reh'g denied*, and *cert. denied*, *Stark v. EMC Mortg. Corp.*, 544 U.S. 1000 (2005), and *cert. denied*, 544 U.S. 1027 (2005).
- 24 JAMS Comprehensive Arbitration Rules and Procedures, Rule 34.
- 25 AHLA Rules of Procedure for Arbitration, Rule 6.08.
- 26 9 U.S.C. § 10 (2006).
- 27 See *Bankers & Shippers Ins. Co. v. Gonzalez*, 234 So. 2d 693, 695 (Fla. Dist. Ct. App. 1970); *Foust v. Aetna Cas. & Ins. Co.*, 786 P.2d 450, 451 (Colo. Ct. App. 1989).
- 28 See *Lackman v. Long & Foster Real Estate, Inc.*, S.E.2d 818 (Va. 2003).
- 29 *Siegel v. Prudential Ins. Co. of Am.*, 79 Cal. Rptr. 2d 726 (1998).
- 30 *Sanderson Group, Inc. v. Smith*, 809 So. 2d 823 (Ala. Civ. App. 2001); *Lauro v. Visnapuu*, 570 S.E.2d 551 (S.C. Ct. App. 2002), *cert. denied*.
- 31 See *City of Fairbanks Municipal Utilities Sys. v. Lees*, 705 P.2d 457, 459 (Alaska 1985).
- 32 *Buchner v. Kennard*, 99 P.3d 842 (Utah 2004).
- 33 See *Serafin v. Connecticut*, 2005 WL 578321 (D. Conn. 2005); *Richard B. Le Vine, Inc. v. Higashi*, 32 Cal. Rptr.3d 244 (Cal. Ct. App. 2005).