Why Businesses Should NOT Use Arbitration Clauses

Mark Cohen, J.D., LL.M.
mark@cohenslaw.com
www.cohenslaw.com
Plain English Consulting
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Many businesses include an arbitration clause in their contracts. I believe this is a mistake. I explain why below.

An arbitration clause prohibits the disgruntled party (often your customer) from filing suit against you or your company. Instead, the unhappy party must commence an arbitration action with the arbitrator specified in the contract, if it specifies one at all. Many contracts require arbitration through the American Arbitration Association (AAA).

The theory behind including an arbitration clause in your contract is that by removing a party's right to sue and forcing that party to initiate costly arbitration, you will deter that party from pursuing claims against you. An arbitration clause may deter some small claims, but it won't deter a party asserting a claim for significant damages.

So what happens if a party commences arbitration against you? You may not like the answer.

First, if your contract requires arbitration through the AAA, you will be stuck with an arbitrator selected by the AAA. Some AAA arbitrators are not even lawyers and are not likely to understand the language in the contract intended to protect you. Judges in civil suits, on the other hand, are all lawyers, normally appointed by the governor after a screening process to make certain they are competent. Because your defense is likely to hinge on language in the contract that protects you, you want the person deciding your case to understand contract law.

Second, arbitrators normally charge about $300.00 to $400.00 per hour, with the parties splitting the cost. In addition, if you use the AAA, you will pay a fee to the AAA for its administration of the case. The AAA charges more than the filing fee for the filing of a typical civil suit. Judges and court staff, on the other hand, are paid by tax dollars. Once you pay a filing fee to the Court, if any, you do not have to pay any additional money to the court, except small fees for electronic filing.

Third, you generally do not get to conduct discovery in arbitration. This means your lawyer can't take depositions and may not even be able to subpoena documents without the arbitrator's

consent. Some lawyers think this benefits you because your legal fees will be less. That may be true, but it means you will go into your arbitration hearing blind – with little information about what evidence the other party intends to present. However, if the other party instead files a civil suit against you, your lawyer can depose that party and other relevant witnesses. Often your lawyer can use these depositions to convince the court to dismiss the lawsuit on a motion for summary judgment.

Fourth, the arbitrator's decision is final. There is no appeal. Even if the arbitrator gets it wrong on the law or facts, you are stuck with the decision. Arbitrators know this and sometimes try to do what they think is fair rather than what the law requires. In a civil suit, the judge knows that if he or she makes an error you can appeal the judge's decision.

Fifth, if your contract requires you to use the AAA, you will have to use the AAA's arbitration rules. These rules may be just as complex as the rules of civil procedure you hoped to avoid by requiring arbitration.

Sixth, an arbitration clause works both ways. Suppose the other party bounces a check to you. You are not going to start an arbitration to recover such a small amount. Without the arbitration clause, you could file suit in small claims court and in many states you could get treble damages and attorney's fees. Or suppose the unhappy party goes online and posts false statements about you or your business. If your contract includes an arbitration clause, you would be unable to sue for defamation and potentially for punitive damages. The arbitration clause would bind you.

Taking all this into account, and based on my nearly forty years of litigation experience, I prefer to include a three-step dispute resolution process in the contracts I draft. The first step requires that unhappy party to provide you with notice of that party's claim "in sufficient detail and with sufficient supporting documents" that you can intelligently evaluate it. If the other party provides notice and you are unable to resolve the matter within thirty days, the next step is non-binding mediation. If the mediation is not successful, only then may the unhappy party file suit. (I also include a provision stating that all parties waive trial by jury).

If I have not persuaded you and you still want an arbitration clause in your contract, don't just cut and paste from the Internet. And don't let your lawyer do that either. Consider specifying the name of the arbitrator right in the contract. That way you pick the arbitrator in advance and you can be sure the arbitrator is competent. You do not have to use the AAA. You may use any person willing to serve as an arbitrator and avoid the AAA's administrative charges. Also, consider limiting the arbitration clause to claims in excess of a specified amount. That way if the other party bounces a check to you, you will still have the ability file suit in small claims court.

Only you can decide whether to include an arbitration clause in your contract. I hope you find this article useful.

Mark Cohen is an AV-rated Super Lawyer with 37 years of experience as a lawyer. He earned a B.A.in Economics at Whitman College and earned his law degree at the University of Colorado in Boulder. He earned an LL.M. Agricultural and Food Law from the University of Arkansas, where he also taught advanced legal writing. His diverse legal career includes service as an Air Force JAG, a Special Assistant U.S. Attorney, a prosecutor, a municipal

judge for Boulder, six years on the Advisory Board of The Colorado Lawyer (including one as chairperson), and service on the Executive Board of the Colorado Municipal League.

Mark wrote six articles in the Am.Jur. Proof of Facts series, including the seminal article on piercing the corporate veil. He wrote several articles and book reviews for The Colorado Lawyer. In 2004, he won 2nd prize in the SEAK National Legal Fiction Writing Competition. He wrote two mysteries published by Time Warner, and his first mystery, The Fractal Murders, became a Book Sense ® mystery pick and was a finalist for the Colorado Book of the Year. His non-legal articles have appeared in magazines such as *Inside Kung Fu*, *Camping & RV*, and *Modern Dad*. He is a member of the Institute of General Semantics and the Mystery Writers of America.

Mark's practice focuses on drafting and reviewing all types of legal documents including contracts, corporate documents, real estate documents, employment documents, intellectual property documents, motions, pleadings, and briefs. He also litigates cases arising out of poorly drafted documents. He enjoys helping businesses and other lawyers improve their legal and non-legal documents by translating them from Legalese into plain English. Learn more at Plain English Consulting.

Mark also serves as an arbitrator by agreement of the parties. He devised a set of Arbitration Rules he believes are simpler and more flexible than the AAA's rules. He also offers arbitration services online or via Skype by agreement of the parties. Learn more at Colorado Arbitration.

Mark lives in Nederland, Colorado. (Elevation 8,236 feet). He holds a black belt in karate and serves on the board of directors of non-profit that offers training in personal safety, violence prevention, and appropriate dating relationships.