

**THE ADVANTAGES AND DISADVANTAGES OF ARBITRATION
AS COMPARED TO LITIGATION**

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1. ADVANTAGES OF ARBITRATION

1.1 The following are said to be advantages of arbitration over court litigation:

- A. Speedier resolution; however, there can be exceptions due to multiple parties, arbitrators, lawyers and litigation strategy.
- B. Less costly; however, there can be exceptions due to multiple parties, lawyers, arbitrators and litigation strategy.
- C. Exclusionary rules of evidence don't apply; everything can come into evidence so long as relevant and non-cumulative.
- D. Not a public hearing; there is no public record of the proceedings. Confidentiality is required of the arbitrator and by agreement the whole dispute and the resolution of it can be subject to confidentiality imposed on the parties, their experts and attorneys by so providing in the arbitration agreement.
- E. From defense point of view, there is less exposure to punitive damages and run away juries;
- F. A party may record a lis pendens even if there is an arbitration pending by filing a law suit and then holding the case in abeyance until the arbitration is resolved.
- G. The ability to get arbitrators who have arbitrator process expertise and specific subject matter expertise.
- H. Limited discovery because it is controlled by what the parties have agreed upon and it is all controlled by the arbitrator.
- I. Often, the arbitration process is less adversarial than litigation which helps to maintain business relationships between the parties.
- J. The arbitration is more informal than litigation.

- K. The finality of the arbitration award and the fact that normally there is no right of appeal to the courts to change the award.

2. DISADVANTAGES OF ARBITRATION

2.1 The following have often been said to constitute the disadvantages of arbitration:

- A. There is no right of appeal even if the arbitrator makes a mistake of fact or law. However, there are some limitations on that rule, the exact limitations are difficult to define, except in general terms, and are fact driven.
- B. There is no right of discovery unless the arbitration agreement so provides or the parties stipulate to allow discovery or the arbitrator permits discovery.
- C. The arbitration process may not be fast and it may not be inexpensive, particularly when there is a panel of arbitrators.
- D. Unknown bias and competency of the arbitrator unless the arbitration agreement set up the qualifications or the organization that administers the arbitration, has pre-qualified the arbitrator.
- E. There is no jury and from the claimant's point of view that may be a serious drawback.
- F. An arbitrator may make an award based upon broad principles of "justice" and "equity" and not necessarily on rules of law or evidence.
- G. An arbitration award cannot be the basis of a claim for malicious prosecution.
- H. Except in certain circumstances, non-signatories of the arbitration agreement cannot be compelled to arbitrate. (An arbitration clause in a lease can be enforced against an assignee or sublessee in possession and also be enforced by such persons. Kelly v. Tri Cities Broadcasting (1983) 147 CA 3d 666; Melchor Investment Co. v. Rolm Systems (1992) 3 CA 4th 587.)
- I. The possibility of compromise or splitting of baby awards.

3. THE ADVANTAGES OF A LAWSUIT OVER ARBITRATION

3.1 When the advantages and disadvantages of the arbitration process are discussed what is being weighed is the advantages and disadvantages over a lawsuit which litigates the dispute between the parties at the public courthouse.

3.2 The advantages of a lawsuit over arbitration are:

- A. There is a large body of substantive law and procedure that exists which automatically controls the lawsuit and the parties don't have to create the rules that will govern the lawsuit;
- B. The judge, by law, must be impartial and the judge's paycheck is not dependent upon whether the parties ever use that particular judge in another matter. The judge is not personally affected by the outcome of the case;
- C. The place of the trial is in the courthouse and therefore neutral territory;
- D. If a litigant is unhappy with a decision of the judge or the jury the possibility of an appeal exists;

4. THE DISADVANTAGES OF A LAWSUIT OVER ARBITRATION

4.1 Anyone who has been involved in litigation has war stories as to how terrible it was. Some of mine are:

- A. The time that it takes to get to trial, which while much better than the five years that it used to take, can still take a substantial time;
- B. The fear of lawyers of being accused of malpractice by their clients in not being 100% prepared, leaving nothing to chance, and thus have a possible liability for not taking the deposition of everyone who ever touched a piece of paper in the litigation all of which leads to overkill and abuse of the discovery process; this is commonly referred to as the scorched earth approach to litigation.
- C. The paper war between lawyers relating to motions on an infinite variety of topics;
- D. The large cost of legal fees in litigating a dispute.
- E. The reasonable probability that you will not be able to go to trial on the date that is set by the judge because the judge's prior case is not over, or there is no courtroom available due to the priority of criminal

matters, all of which results in the trial of the case being continued from time to time;

- F. The ability of parties to appeal to a higher court after losing at the trial court level and the lack of finality;
- G. The fact that neither the jury or the judge may not have any knowledge nor experience with the subject matter of the dispute between the parties which results in the parties having to educate the judge as to the law and custom and practice.
- H. The ability to appeal to a higher court adverse rulings on procedural issues.

5. THE PROBLEM THAT CREATED THE NEED FOR ARBITRATION

5.1 Litigation can be considered the nightmare of the real estate industry. It impacts the real estate broker, the seller, buyer, lessor, lessee and their respective lawyers.

5.2 The specific difficulties that litigation creates for everyone are:

- A. The large legal fees and out of pocket expenses of litigation.
- B. If counsel for a party undertakes to utilize all of the sophisticated discovery processes that are permitted under the laws governing litigation there is almost no end to the amount of lawyer time that can be devoted to that process. It is the discovery wars. In the March 23, 1983 edition of the New York Times an experienced lawyer was explaining to young potential lawyers what they can expect in litigation practice. He said, "You spend years and years in pretrial motion practice. I smother the other side with papers and they smother me with papers until we wear each other out and the judge knocks my head against his head and we settle. It takes around three or four years."
- C. The time expended by the parties themselves in the litigation in terms of the time devoted to preparation and educating their own lawyers concerning the facts as well as the amount of time spent in studying documents produced by the other side. The time and efforts spent by the parties could be spent more productively in their business.
- D. The uncertainty of the judge's decision or the jury verdict.

5.3 When dealing in real property litigation there is always the strong possibility of a wrong decision being reached by judges and juries as a result of the following realities:

- A. The lack of commercial real estate experience by most judges. A large number of persons who are being appointed to the bench have had their primary experience in the district attorney's office, the U.S. attorney's office, the public defender's office and various public agencies. For the most part, that work experience did not involve real estate matters. In some cases the only experience with real estate that the judge has had is in the first year of law school and the purchase and sale of their own home.
- B. The lack of commercial real estate experience of most jurors.
- C. If there are claims of fraud, actual or constructive, the possibility that punitive damages may be assessed against a party.
- D. The time it will take to get to trial on the merits of the dispute taking into consideration the fact that criminal trials have a priority over civil trials.
- E. The hesitancy of the state legislature to create more judges and courtrooms to deal with civil trials because of the expense.

5.4 The unique concerns of the real estate broker.

- A. There are thousands of appellate cases involving claims against real estate brokers and it is a fair statement to say that there is a bias against the real estate broker in the law when there is a dispute with the broker's principal. That bias arises as a result of a number of considerations including:
 - (1) The difference between the law imposed fiduciary responsibilities of real estate brokers and the marketplace custom and views of the function of a broker. The brokerage community may think that in the event a claim is made against a broker that the broker will be gauged by the standard of the custom and usage in the marketplace but that is not the case. The real estate broker has fiduciary obligations which are substantially the same as the fiduciary obligations owed by a lawyer to the lawyer's client and the broker's conduct or lack thereof will be measured against the broker's fiduciary obligations. That fiduciary obligation is the highest form of obligation in our system of law.
- B. The predisposition of the courts to find that a real estate broker is "an agent" automatically brings into the law suit the concept of the fiduciary responsibility of the broker which also includes the theory

that errors by the broker can be considered “constructive fraud”. In addition, in some states, as in California, the burden of proof then shifts to the real estate broker to show that the broker did not violate the broker’s obligations as opposed to the principal having the obligation to prove that the broker breached an obligation.

5.5 The unique concerns of the seller of real estate.

- A. A seller of real property has many of the same concerns as a real estate broker. However, the seller also has the fear that a suit for specific performance will be filed by a buyer who will also record a lis pendens. The lis pendens has the practical effect of preventing the real property from being sold, financed or leased while the litigation is pending. That is one risk that sellers try to avoid by not signing anything but a full and complete final document.

5.6 The unique concerns of the buyer of real estate.

- A. A buyer also has the same general concerns about litigation but in addition has to be concerned about the length of time that the litigation will continue and the very real possibility that even if the buyer wins the litigation that the seller can take an appeal which will further lengthen the time to final judgment.

5.7 The unique concerns of the lessor of real estate.

- A. The lessor of commercial property has the same concerns about litigation as any other owner in real estate, however there is one distinct advantage that a lessor of property has over other people involved in real estate disputes and that is a summary procedure that in California is referred to as an “unlawful detainer” action. An unlawful detainer action is summary in nature and is entitled to a priority on the calendar because it involves the possession of real estate. Usually the trial of an unlawful detainer action takes place within forty-five days of the filing of the lawsuit. However, there are some issues that a lessor would prefer not to litigate in the court system where the proceedings and documents are open to the public. Such an area of dispute oftentimes concerns the amount and allocation of common area maintenance charges which also impacts other tenants of the project who may learn of the issues after the trial.

5.8 The unique concerns of the lessee of real estate.

- A. The lessee under a lease likewise has concerns about litigation and is at a distinct disadvantage against the lessor in an unlawful detainer action. That distinct disadvantage is that the obligation of the tenant

to pay rent is considered by the courts as an independent obligation the payment of which is unrelated to whether the lessor performs its obligations under the lease. This means that even if the lessor is in default of its obligations under the lease the lessee must still pay the rent. This rule is a very old common law concept and is not applicable in residential leases and is not applicable in almost any other contractual relationship. I know of only one state, Utah, that has expressly held that the obligation to pay rent in a commercial lease is a conditional covenant and not an independent covenant and the condition is that the lessor performs its obligations under the lease.

5.9 The unique concerns of the real estate lawyer for the parties.

- A. The inability to have a peer group determine if the lawyer committed legal malpractice in performing legal work in a real estate matter.

6. LEGISLATION ENFORCING MANDATORY PRIVATE ARBITRATION AGREEMENTS.

- 6.1. In 1925 Congress enacted the Federal Arbitration Act which gave the legal basis to the federal court system for the enforcement of commercial arbitration agreements (9 USC §§1-14)
- 6.2 In 1955 the Uniform Arbitration Act was adopted by the National Conference of Commissioners on Uniform State Laws and, in one form or another, has been adopted, to a greater or lesser extent, in all States.

7. A REVOLUTION HAS OCCURRED

7.1 The rise in the use of mandatory arbitration in real estate agreements has been a revolution comparable to photocopy machines, voice mail, facsimile transmission, e-mail, word processing, computers, search engines, text retrievable systems, scanning and automatic redlining.

7.2 Mandatory arbitration will continue to expand because:

- A. Public policy that favors arbitration of disputes.
- B. The legislative shift of the expense of court house civil trials to the litigants similar to the shifting of the cost of cleanup of contaminated property to the property owners or lessees.
- C. The advantages of arbitration are too great to ignore.

8. ROLE OF THE TRANSACTIONAL REAL ESTATE LAWYER

8.1 The transactional real estate lawyer can no longer simply ignore the issues of how disputes that arise subsequent to execution of the document are handled because that is a “litigation” matter. Transactional real estate lawyers will have to place mandatory arbitration provisions in the agreements and, at the minimum, there will have to be mediation. The process has to be given a chance to work and that process begins with mediation.

8.2 It has been suggested in some of the literature written about mediation and arbitration that the failure of a lawyer to suggest to the client that the client consider either or both of those processes could constitute legal malpractice.