

2.4: Arbitration

The American Bar Association (ABA) defines arbitration as the “private process where disputing parties agree that one or several individuals can make a decision about the dispute after receiving evidence and hearing arguments.” Arbitration is overseen by a neutral **arbitrator**, or an individual who is responsible for making a decision on how to resolve a dispute and who has the ability to decide on an **award**, or a course of action that the arbiter believes is fair, given the situation. An award can be a monetary payment that one party must pay to the other; however, awards need not always be financial in nature. An award may require that one business stop engaging in a certain practice that is deemed unfair to the other business. As distinguished from mediation, in which the mediator simply serves as a facilitator who is attempting to help the disagreeing parties reach an agreement, and arbitrator acts more like a judge in a court trial and often has legal expertise, although he or she may or may not have subject matter expertise. Many arbitrators are current or retired lawyers and judges.

Types of Arbitration Agreements

Parties can enter into either voluntary or involuntary arbitration. In **voluntary arbitration**, the disputing parties have decided, of their own accord, to seek arbitration as a way to potentially settle their dispute. Depending on the state’s laws and the nature of the dispute, disagreeing parties may have to attempt arbitration before resorting to litigation; this requirement is known as **involuntary arbitration** because it is forced upon them by an outside party.

Arbitration can be either binding or non-binding. In **binding arbitration**, the decision of the arbitrator(s) is final, and except in rare circumstances, neither party can appeal the decision through the court system. In **non-binding arbitration**, the arbitrator’s award can be thought of as a recommendation; it is only finalized if both parties agree that it is an acceptable solution. This fact is why non-binding arbitration can be useful for what the American Arbitration Association describes as “disputes where the parties may be too far apart in their viewpoints to mediate or are in need of an objective evaluation of their respective positions.” Having a neutral party assess the situation may help disputants to rethink and reassess their positions and reach a future compromise.

Issues Covered by Arbitration Agreements

There are many instances in which arbitration agreements may prove helpful as a form of alternative dispute resolution. While arbitration can be useful for resolving family law matters, such as divorce, custody, and child support issues, in the domain of business law, it has three major applications:

- **Labor.** Arbitration has often been used to resolve labor disputes through interest arbitration and grievance arbitration. **Interest arbitration** addresses disagreements about the terms to be included in a new contract, e.g., workers of a union want their break time increased from 15 to 25 minutes. In contrast, **grievance arbitration** covers disputes about the implementation of existing agreements. In the example previously given, if the workers felt they were being forced to work through their 15-minute break, they might engage in this type of arbitration to resolve the matter.
- **Business Transactions.** Whenever two parties conduct business transactions, there is potential for misunderstandings and mistakes. Both business-to-business transactions and business-to-consumer transactions can potentially be solved through arbitration. Any individual or business who is unhappy with a business transaction can attempt arbitration. Jessica Simpson recently won an arbitration case in which she disputed the release of a fitness video she had made because she felt the editor took too long to release it.
- **Property Disputes.** Business can have various types of property disputes. These might include disagreements over physical property, e.g., deciding where one property ends and another begins, or intellectual property, e.g., trade secrets, inventions, and artistic works.

Typically, civil disputes, as opposed to criminal matters, attempt to use arbitration as a means of dispute resolution. While definitions can vary between municipalities, states, and countries, a **civil matter** is generally one that is brought when one party has a grievance against another party and seeks monetary damages. In contrast, in a **criminal matter**, a government pursues an individual or group for violating laws meant to establish the best interests of the public. While the word **crime** often invokes the idea of violence, there are many crimes, such as embezzlement, in which the harm caused is not physical, but rather monetary.

Ethics of Commercial Arbitration Clauses

As previously discussed, going to court to solve a dispute is a costly endeavor, and for large companies, it is possible to incur millions of dollars in legal expenses. While arbitration is meant to be a form of dispute resolution that helps disagreeing parties find a low-cost, time-efficient solution, it has become increasingly important to question whose expenses are being lowered, and to what

effect. Many consumer advocates are fighting against what are known as **forced-arbitration clauses**, in which consumers agree to settle all disputes through arbitration, effectively waiving their right to sue a company in court. Some of these forced arbitration clauses cause the other party to forfeit their right to appeal an arbitration decision or participate in any kind of **class action lawsuit**, in which individuals who have a similar issue sue as one collective group. For example, in 2006, Enron investors initiated a class action lawsuit against executives who hid the company's losses and were awarded \$7.2 billion dollars. While this example represents a case where the company being sued was clearly in the wrong, it is important for large companies to be ethical in their use of arbitration clauses. They should not be used as a way to keep wrongdoings "quiet" or to limit consumers' abilities to obtain rightful retribution for products and services that do not perform as promised.

Arbitration Procedures

When parties enter into arbitration, certain procedures are followed. First, the number of arbitrators is decided, along with how they will be chosen. Parties that enter into willing arbitration may have more control over this decision, while those that do so unwillingly may have a limited pool of arbitrators from which to choose. In the case of willing arbitration, parties may decide to have three arbitrators, one chosen by each of the disputants and the third chosen by the elected arbitrators.

Next, a timeline is established, and evidence is presented by both parties. Since arbitration is less formal than court proceedings, the evidence phase typically goes faster than it would in a courtroom setting. Finally, the arbitrator will make a decision and usually makes one or more awards.

Not all arbitration agreements have the same procedures. It depends on the types of agreements made in advance by the disputing parties. Consider the following scenario: the owner of a large commercial office building uses a lease agreement, which stipulates that arbitration will be used to settle the renewal terms of a lease. For example, the lease may state that, at the end of year one, the second year's lease payment will be at current market value, and if the tenants cannot agree on that value, they will then allow an arbitrator to decide. If the building owner feels that the renewal rate should be \$40/square foot and the tenant feels it should be \$20/square foot, an arbiter who may not be an expert in local real estate values might decide to resolve the dispute by using a rule of thumb, such as "splitting the difference." In this case, the arbiter might decide that \$30/square foot represents a fair lease renewal rate.



Figure 2.4.1: Various types of arbitration can be employed depending on what the parties think is best for their situation. (Credit: Tim Eiden/ pexels/ License: CC0)

To overcome this shortcoming, the building owner could write a lease agreement that stipulates that the parties use binding **baseball arbitration** and use subject matter experts as arbitrators. In this case, that might include real estate attorneys or commercial real estate investors. In baseball arbitration, each party would submit a lease renewal figure to an arbitrator. For example, imagine that the renewing tenant submits an offer of \$10/per square foot, which is very much under market value, while the building owner submits an offer of \$35/square foot. In this scenario, the arbitrator chooses one offer or the other, without

modification. This type of arbitration incentivizes both parties to be fair in their dealings with one another because to do otherwise would be to their own detriment.

Arbitration Awards

An arbiter can issue either a “bare bones” or a reasoned award. A **bare bones** award refers to one in which the arbitrator simply states his or her decision, while a **reasoned** award lists the rationale behind the decision and award amount. The decision of the arbitrator is often converted to a judgement, or legal tool that allows the winning party to pursue collection action on the award. The process of converting an award to a judgement is known as confirmation.

Judicial Enforcement of Arbitration Awards

While it might seem that the party that is awarded a settlement by an arbitrator has reason to be relieved that the matter is resolved, sometimes this decision represents just one more step toward actually receiving the award. While a party may honor the award and voluntarily comply, this outcome is not always the case. In cases where the other party does not comply, the next step is to petition the court to enforce the arbitrator’s decision. This task can be accomplished by numerous mechanisms, depending on the governing laws. These include writs of execution, garnishment, and liens.

- **Writ of Execution.** Cornell Law School defines a writ of execution as “A court order that directs law enforcement personnel to take action in an attempt to satisfy a judgment won by the plaintiff.”
- **Garnishment.** A garnishment refers to a court order that seizes the money, typically wages, to satisfy a debt. A myriad of laws apply to wage garnishment, e.g., certain types of income, such as Social Security Disability Income (SSDI), cannot be garnished. In addition, depending on state laws, sometimes only debtors who make over a certain amount, e.g. \$1,600 gross/month, are subject to wage garnishment.
- **Liens.** A lien gives the entitled party in a judgement the right to seize the property of another to satisfy a debt. Commonly, liens can be placed on real estate and personal property, such as automobiles and boats. Property that has a lien cannot be sold because the title is encumbered and often cannot be legally transferred until the lien is satisfied, or paid. Depending on state laws, only certain property is subject to a lien. For example, the winning party in an arbitration case may only be able to place a lien on the other party’s vehicle if it has a market value of over \$7,500.

The enforcement of arbitration awards is governed by a number of laws, such as Federal Arbitration Act and Uniform Arbitration Act.

Summary

Negotiation, mediation, and arbitration are alternatives form of dispute resolution that attempt to help disagreeing parties avoid the time and expense of court litigation. While negotiation is involved in all three forms, mediation and arbitration involve a neutral third party to help the parties find a solution. Frameworks that consider self-interest, as opposed to interest in the other party, can help negotiators craft successful negotiation approaches. Mediators, arbitrators, and groups of arbitrators all follow certain steps and play in important role in trying to help parties reach common ground and avoid court proceedings. Mediators who establish rapport with disputing parties can facilitate dispute resolution, as mediation is very much solution-focused. Arbitrators must often decide upon awards when parties cannot reach an agreement. Even when an aggrieved party attains an arbitration award, it may still have to pursue the other party by using a variety of legal techniques to enforce the payment or practice stipulated by the award. Staying current with federal and state laws associated with negotiation proceedings is essential for businesses looking to maximize their relational and outcome goals.

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