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Hospitality Law

Best Practices in Arbitration for Hospitality Cases

Pros and Cons of Arbitration Compared to Mediation, Expert Determination and Litigation

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In my two prior articles on alternative dispute resolution, I discussed mediation and expert resolution. In ascending order in terms of "severity" of the matter in dispute, the next alternative for resolving disputes is arbitration. By "severity", I am referring to the either the complexity of the question to be resolved where legal interpretations, document discovery and witness testimony, even expert witness testimony, may be utilized by the parties to present their side of the dispute. In short, the matter to be arbitrated typically is not unlike matters over which parties go to court, but for reasons we will explore, arbitration may be preferable.

As with expert resolution, in arbitration, a neutral third party, or, more commonly, a panel of three parties, the "arbitrators", are called upon to resolve the issue, to render a binding decision, as a judge might render, after a process that is similar to a court proceeding

The question to be decided should be carefully crafted by the parties by means of an agreed "terms of reference" submitted to the arbitrators. The parties in their agreement to arbitrate may empower the arbitrators to make pre-decision orders (interim relief) as a court would do by issuing an injunction whereby the parties are ordered to do or refrain from doing certain acts pending the outcome of the arbitration.

In the early stages of the arbitration, the parties may request that the arbitrators make decisions about the scheduling of witness depositions, the production of documents and the details (time, place) of the arbitration hearing before the arbitrators.

If the dispute is monetary, the parties may also agree to 'baseball arbitration' whereby the expert is required to choose the position of one of the parties as correct or left free to determine the correct remunerative value. In any case, the parties should agree either in the contract calling for expert resolution or in their subsequent agreement that the expert's decision is binding and unappealable, except for 'manifest error'.

Selecting the Arbitrator(s)

Obviously, the arbitrators should have no preexisting relationship so that all judgments are objective and impartial.

Arbitrators may be chosen from a list of arbitrators who have been certified by arbitration-sponsoring organizations.

The question of how many arbitrators poses some consideration. While the perception is that a panel of three arbitrators will likely result in a decision that is more balanced and not subject to an individual's whim, the process of selecting the three arbitrators can dilute this advantage. In many arbitration agreements, each party appoints an arbitrator, typically after interviewing candidates, and then the two party-appointed arbitrators select the third or "neutral" arbitrator. That word "neutral" may have more meaning than is intended because there may be a tendency on the part of the party-appointed arbitrators, if not to advocate for the party that appointed them, at least they may be a bit biased toward that party. In addition, having three arbitrators, typically experienced lawyers with expertise in the field or retired judges, who are paid handsome hourly rates, can be very expensive for the parties who must also pay their own legal counsel. Two-to-one decisions by the arbitrators may indicate that in their closed sessions, the winning party's appointed arbitrator may have been more persuasive toward the neutral arbitrator than was the losing party's appointed arbitrator. Three good arbitrators should avoid the temptation of any bias toward either party.

Administrative Organizations

While arbitration may be conducted by the parties in accordance with their own agreed rules or available rules of recognized bodies such as the United Nations Commission on International Trade Law ("UNCITRAL") and arbitrators may be selected without any particular "certification" or other qualification except as the parties may impose, there are many agencies that facilitate arbitration through the publication of rules, the qualification of arbitrators, management of scheduling and other services, these agencies also charge a fee, typically based upon the amount in controversy. The two agencies frequently chosen in hotel-related agreements are the American Arbitration Association ("AAA") and the International Court of Arbitration established by the International Chamber of Commerce ("ICC").

Types of Hotel Industry Disputes Suitable for Arbitration

Arbitration can involve many different types of disputes in the hotel industry, but the following are typical of disputes involving the degree of "severity" for which arbitration is suitable as an alternative to expert determination (discussed in a prior article) and judicial resolution:

- The scope and validity of a significant agreement;
- Claims of wrongful termination of a significant agreement;
- Owner claims of mismanagement by the management company;
- Owner-contractor disputes regarding the construction of a new hotel;
- Interpretation of collective bargaining agreements;
- Franchisor claims that the hotel fails to comply with mandated standards.

Primary Benefits of Arbitration

There are numerous advantages to arbitration as a way to resolve a case.

- The parties to the dispute usually agree on the arbitrator, so the arbitrator will be someone that both sides have confidence will be impartial and fair.
- The dispute will normally be resolved much sooner, as a date for the arbitration can usually be obtained a lot faster than a court date.
- Arbitration is usually a lot less expensive. Partly that is because the fee paid the arbitrator is a lot less than the expense of paying expert witnesses to come and testify at trial. (Most of the time the parties to arbitration split the arbitrator's fee equally). There are also lower costs in preparing for the arbitration than there are in for preparing for a trial. Partly this is due to the fact that the rules of evidence are often more relaxed than in a trial, so that documents can be submitted in lieu of having a witness come to trial and testify. For instance, if a claimant has several doctors who are out-of-state, the cost of bringing them to trial or going out-of-state to take their depositions may be prohibitive for trial, but in arbitration you can usually use just their records and reports.
- Unlike a trial, arbitration is essentially a private procedure, so that if the parties desire privacy then the dispute and the resolution can be kept confidential.
- If arbitration is binding, there are very limited opportunities for either side to appeal, so the arbitration will be the end of the dispute. That gives finality to the arbitration award that is not often present with a trial decision.
- Arbitration is appropriate where the parties are in different countries - i.e., in an "international dispute" - and none of the parties is willing to submit to the jurisdiction of the courts of another party's country.

Disadvantages of Arbitration

There are, however, also some disadvantages to arbitration as a method of resolving a dispute.

- If arbitration is binding, both sides give up their right to an appeal. That means there is no real opportunity to correct what one party may feel is an erroneous arbitration decision.
- If the matter is complicated but the amount of money involved is modest, then the arbitrator's fee may make arbitration uneconomical. Remember that the parties may be paying fees of an administrative agency, hourly rates of each of three arbitrators, their own counsel fees and expert witness fees.
- Rules of evidence may prevent some evidence from being considered by a judge or a jury, but an arbitrator may consider that evidence. Thus, an arbitrator's decision may be based on information that a judge or jury would not consider at trial.

- If certain information from a witness is presented by documents, then there is no opportunity to cross-examine the testimony of that witness.
- Discovery may be more limited with arbitration. In litigation, discovery is the process of requiring the opposing party -- or even a person or business entity who is not a party to the case - to provide certain information or documents. As a result, many times arbitration is not agreed to until after the parties are already in litigation and discovery is completed. By that time, the opportunity to avoid costs by using arbitration may be diminished.
- If arbitration is mandatory or required by a contract, then the parties do not have the flexibility to choose arbitration only when both parties agree. Mandatory arbitration allows one party to force the other party to use arbitration. In situations where the arbitrator is reliant on one party for repeat business, then the potential for abuse is present and the advantage of impartiality is lost.
- The standards used by an arbitrator are not clear, although generally the arbitrator is required to follow the law. However, sometimes arbitrators may consider the "apparent fairness" of the respective parties' positions instead of strictly following the law, which could result in a less favorable outcome for the party who is favored by a strict reading of the law. This consideration is often overlooked in evaluating the applicability of arbitration.

Sample Arbitration Clause for Inclusion in a Contract

"All claims and disputes arising under or relating to this Agreement are to be settled by binding arbitration in [insert place where parties agree to arbitrate] or another location mutually agreeable to the parties. The arbitration shall be conducted on a confidential basis pursuant to the Commercial Arbitration Rules of the American Arbitration Association. Any decision or award as a result of any such arbitration proceeding shall be in writing and shall provide an explanation for all conclusions of law and fact and shall include the assessment of costs, expenses, and reasonable attorneys' fees. Any such arbitration shall be conducted by an arbitrator experienced in [insert industry or legal experience required for arbitrator] and shall include a written record of the arbitration hearing. The parties reserve the right to object to any individual who shall be employed by or affiliated with a competing organization or entity. An award of arbitration may be confirmed in a court of competent jurisdiction."

Case Illustration (Based Upon an Actual Case)

Owner claims that Management Company has mismanaged the hotel for the past X years resulting in losses to Owner of $Y; moreover Management Company has failed the performance test. Owner has terminated the management agreement based on the alleged mismanagement and the performance test failure and seeks $Y from Management Company as damages. Manager claims that Owner has refused to make required capital expenditures to comply with brand standards and has repeatedly interfered with Management Company's right to exclusive operational control by issuing its orders to hotel personnel and seeks $Z for damages resulting from wrongful termination, recognizing that under the "agency theory" overlaying management contracts, Management Company cannot be reinstated. The matter is well-suited for three arbitrators, all lawyers, experienced in the hotel industry to read the correspondence that went

back and forth between the parties about the many allegations, hear witness testimony and cross examination and issue a reasoned opinion (a written opinion setting forth the arbitrators' reasons) as to the monetary damage claims of both parties. The decision may be enforced in court and is not appealable (1).

References

(1) *Arbitration Appeals - see Aaron Bayer, The National Law Journal, June 28, 2004.*

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