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## The Special Master Solution To The Hall Street Blues: The Use Of Special Masters As An Alternative To Arbitration

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Virtually every seasoned litigator has anecdotal information about arbitration: it is less expensive, more expensive, faster, slower, fairer, arbitrary, final, and never-ending. There are, in short, about as many opinions as there are experiences from which they are derived. Few litigators base these opinions upon more than personal experience.

Some years ago, however, a group called Public Citizen founded by Ralph Nader turned an analytical eye to the subject of arbitration. The research confirmed the views of practitioners who reject the dominant orthodoxy that exalts the assumed virtues of alternative dispute resolution over a litigated resolution.

Any comparative analysis of arbitration to litigation should begin, understandably, at the beginning. The deterioration of the assumption of arbitration's inherent superiority over litigation begins as soon as the assumption is analyzed. Arbitration nearly always costs more to commence than litigation. This truth is both inescapable and understandable for a simple reason: courts are subsidized by the state and, therefore, can absorb the transactional costs related to the filing of a new matter. Arbitration providers, on the other hand, are invariably businesses, and whether for profit or not, they cannot absorb or spread the transactional cost associated each new matter.

Consequently, the filing fees charged in arbitration are, therefore, by necessity higher than court filing fees; in some cases those filing fees can be as much as five times higher in arbitration. Of course, such fees are a *de minimis* differentiator when compared to the fees charged by arbitrators. In complex commercial cases, the three-arbitrator panel is typical, and those panels are stocked with lawyers who generally charge as much as \$2,000 to \$3,000 or more per day. Arbitration's cost multiple is further increased when various add-on fees with which arbitration burdens claimants are considered - fees for subpoenas, discovery requests, continuances, hearing rooms, and the like. In the final analysis, according to Public Citizen, "in the vast majority of cases, arbitration will necessarily *increase* the transaction costs of litigation."

Public Citizen also reported this paradoxical fact: The cost of arbitration is higher for volume users of arbitration services because volume users benefit from higher costs. Many parties pursue arbitration because they are compelled to do so by a contractual pre-dispute arbitration provision. Those provisions are found, sometimes hidden, in the boilerplate bowels of standard form agreements authored by parties who have a substantial interest in creating barriers to entry to any dispute resolution forum.

Dispute resolution providers have little interest in introducing competitive pricing or any other mechanism to reduce transactional costs of dispute resolution because their principle business sources - the companies that write the arbitration clauses - benefit from higher transactional costs. The higher the transactional cost of arbitration, the lower the probability that arbitration claims will be asserted against them. Competitive pricing is an anathema to the primary purpose of arbitration provisions for certain parties to an agreement - to stop any form of dispute resolution.

As for the promise of savings borne of efficiency, lawyers have found a way to stop that as well. The introduction of wide-ranging discovery, the use of three arbitrators, each with a schedule that must be accommodated, and the use of a litigation template for all that occurs in arbitration has substantially increased the cost and lengthened the time to complete the hearing and issue an award. According to the Federal Mediation and Conciliation Services ("FMCS") in 2004, the average time for an arbitration to reach resolution was 476.08 days. While the stopwatch may produce different results in different venues, it is unlikely that complex commercial disputes will be more briskly disposed of through arbitration than through closely monitored and managed litigation.

#### **Standard Of Review: *Hall Street Blues***

Sections 10 and 11 of the Federal Arbitration Act ("FAA") provide the exclusive grounds for vacating and modifying arbitration awards. Section 10(a) of the FAA empowers a court to vacate or modify an arbitration award where (1) the award was procured by corruption, fraud, or undue means; (2) there was evident partiality or corruption in the arbitrators, or either of them; (3) the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or (4) the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

In short, a court cannot review an arbitrator's award for legal errors, except those specified in the FAA. For many years, practitioners and the courts had accepted as an article of faith that the courts could undo rogue arbitration awards through the application of the "manifest disregard of the law" standard of review. The Supreme Court has recently called that view into question in *Hall Street Associates, LLC v. Mattel, Inc.*, 128 S.Ct. 1396 (2008). The *Hall Street* Court announced that the "manifest disregard" standard can be read merely to refer to the § 10 grounds collectively, rather than adding to them. In other words, unless the arbitration award is subject to challenge under the standards listed above, the award is not subject to challenge.

Even more importantly to parties who value predictability more than finality was the *Hall Street* Court's holding that the parties to a contract may not require the courts to employ a more rigorous standard of review than the statutory standards. As Justice Souter explained, § 9 carries no hint of flexibility: "On application for an order confirming the arbitration award, the court 'must grant' the order 'unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title. . . .' Instead of fighting the text, it makes more sense to see the three provisions, §§ 9-11, as substantiating a national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straightaway." *Id.* at 1405.

If arbitration's essential virtue is "resolving disputes straightaway," perhaps litigation's essential virtue is resolving disputes predictably and in a manner more consistent with the desires of the parties. Indeed, the central holding in *Hall Street* is that the parties may not hold an arbitrator to a higher standard, even if they want to. Although arbitration generally occurs only at the instance of the parties, the FAA does not permit the parties to insist that their arbitrator follow the law - or, at least, so says the Supreme Court.

#### **And Now For Something Completely Different**

How can one get the benefits of arbitration with the predictability and structure of litigation? Use a special master. The appointment of a special master is like placing an arbitration overlay upon a judicial proceeding. The appointment of a special master delivers all of the benefits of arbitration with none of the drawbacks.

Federal Rule of Civil Procedure 53(a)(1) provides that the court may appoint a special master to "perform duties consented to by the parties." Nothing in the Rule suggests that the consent must occur after the filing of the dispute, and nothing in the Rule forbids the parties from agreeing to the appointment of a special master in a pre-dispute agreement. So, instead of an agreement to arbitrate, the parties could include in their agreements language requiring the appointment of a special master:

In the event of any dispute arising between the parties relating to this Agreement, the terms thereof, or matters arising therefrom, the parties agree that the case shall be heard in a court of competent jurisdiction. The parties agree to move the court jointly in any such proceeding for the appointment of a special master to (i) conduct all pretrial proceedings, supervise discovery, rule on all dispositive motions and prepare the case for trial; and (ii) hold the non-jury trial proceedings and make findings of facts and conclusions of law.

The parties shall request that the court enter a referral order in the form of the model referral order then available from the Academy of Court Appointed Masters, subject to any revisions required by the court, agreeable to the parties or required by law.

The special master shall make a report to the court, which shall become the final judgment of the court, absent a timely filed appeal to the court. The standard of review applicable to an appeal of a final judgment by the trial court shall apply to any appeal of the special master's findings. The parties agree that neither will appeal the final judgment of the Court; the trial Court's decision in the matter shall not be subject to any appellate review. The parties, or if there are more than two parties to an action, shall equally share the cost of the special master.

This language, of course, is offered merely for illustrative purposes. The practitioner can customize the provision to meet the specific needs and goals of the parties to a particular transaction. Some areas of potential customization are: (i) the parties might wish to have the special master only oversee discovery; (ii) conversely, the parties might wish for the special master to try the case; or (iii) the parties might prefer no appeal rights, full appeal rights or only appeals to the trial court.

There are many benefits to this approach. First, the use of a special master in lieu of arbitration will deliver costs savings to litigants from the commencement of the dispute resolution through the end of the process. The use of a special master in the context of litigation will allow litigants to avoid the substantial filing fees arbitration providers charge and the ongoing administrative fees that accumulate as the process moves forward. This cost savings will in no way affect the quality of services delivered to the parties as the courts presumably will appoint special masters drawing on a similar, but larger, pool of qualified practitioners to serve. Indeed, courts, unlike arbitration services, can draw on a vast pool of qualified practitioners, not only those on the approved list of the particular provider.

In addition to the financial benefits, the special master solution can deliver a more predictable outcome without sacrificing finality. This is true for a number of reasons: First, because special masters are adjuncts of the court, they must behave like courts. In other words, they must follow the law. Special masters need not guess about the law that governs the transactions or the procedure they will use. The applicable rules of civil procedure and evidence, to the extent not affected by the court's referral Order, will govern the proceedings. The substantive and procedural law that will govern a dispute will be the same as that which would govern a judicial proceeding.

In terms of delivering a customizable dispute resolution approach, the special master solution also avoids the problem of unintended finality that the Federal Arbitration Act creates as explained in *Hall Street*. With a contract dictating both the scope of the special master's duties and the nature of the parties' appeal rights, litigants would be free to enjoy the finality of no appeal or the security of unrestricted appeals - as they choose. Rule 53, unlike the Arbitration Act, does not purport to restrict the parties' options.

In the final analysis, the special master solution, created through a customized contract provision, would allow parties to create an alternative dispute resolution process that fits their needs and delivers a more predictable outcome through a less expensive process.

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