New American Arbitration Association Rules for Accounting and Related Services Arbitrations—An Emphasis on Management by the Panel, Efficiency and Proportion

By Barbara Mentz and Dan Kolb

Introduction

While arbitration should provide a simpler, less expensive and more expeditious form of dispute resolution, too often the arbitration process has become essentially the same as a court proceeding. Recognizing that, in its adoption of both its New Commercial Rules, which became effective on October 1, 2013, and its New Rules for Accounting and Related Services Disputes, which became effective on February 1, 2015, the American Arbitration Association (AAA) has focused on the importance of the Arbitrator or Arbitrators (the "Panel") managing the arbitration process and including steps in the process that should, if adhered to, make an arbitration far more efficient and cost-effective.

Focusing in this writing just on the New Rules for Accounting and Related Services Disputes, we think it is important for practitioners to understand and embrace the new approach. Both accounting firms and their clients are keenly aware of the costs of litigation and should appreciate the substantial improvements directed at efficiency and proportion in the New Rules.

Although we focus here on the New Rules for Accounting and Related Services Disputes, the discussion of arbitration management should also benefit those engaged in the arbitration of other types of commercial cases. That should be true especially of the discussion of the fully developed Rules for managing the discovery process with an emphasis on a more detailed approach to managing E-discovery, production of documents and depositions.

A Presumption in Favor of Mediation

Just as in the New Commercial Rules, the New Rules for Accounting and Related Services adopt a novel approach to encourage the parties to mediate their dispute before and, if need be, during arbitration. It is presumed in the New Rules that the Parties will mediate either with a mediator nominated by the AAA or a mediator they select privately, unless they take the initiative and opt out of mediation. This, by design, puts the weight on the scale in favor of mediating rather than, as in the past, just providing it as an option the Parties could select. Mediation, if effectively conducted and embraced by the parties, can lead either to an early resolution and significant cost savings or can assist the Parties in focusing on the real issues early so that, if the arbitration process continues, they may have a better appreciation of those steps in preparation for and presentation at the hearing that are necessary.

If the mediation is not immediately successful in bringing about a settlement, the Rules provide that it can continue while the arbitration process moves forward, without delaying the arbitration. Often that can mean that as the Parties learn more as their cases develop they can better assess their strengths and weaknesses and, in time, return to the mediation better equipped to resolve the matter before the hearing. While that will not spare them all the costs of the process it holds the promise of reducing the burden and costs materially.

It is too early to determine how well the presumption in favor of mediation will work but initial indications are that the use of mediators under the New Commercial Rules has increased significantly since those Rules were adopted in 2013. The new presumption in favor of mediation is a novel way to promote increased efficiency that many Parties and their counsel should value.

The Preliminary Hearing

As in the New Commercial Rules, the new Accounting and Related Services Rules adopt important changes in how the preliminary hearing is to be conducted. They are designed to promote efficiency by, among other things, encouraging stronger management of the arbitration process by the Panel at the hearing. The Rules include a useful checklist of matters to cover at the preliminary hearing that should lead to development of a comprehensive plan for the arbitration by the Panel and Parties. Stress is placed in the Rules on not importing into the arbitration and the preparatory work for it, procedures from court systems which can expand the work that must be done without commensurate benefits for the parties. After directing the process at the preliminary hearing and getting the Parties focused on a plan to get through the preliminary steps before the arbitration, the Panel will typically issue its first Pre-Hearing Order enumerating the anticipated steps leading to the hearing accompanied by dates by which each step is to be taken. That order and such modifications as may be made to it in subsequent Pre-Hearing Orders should serve as the framework for the Parties and counsel as they proceed.

To promote proportion and cost saving in the steps taken at the preliminary hearing, the New Accounting Rules specifically require—to the extent possible—the presence of client representatives at the Preliminary Hearing. Because the client may have a greater sensitivity to litigation costs and the values in close management of the process than counsel, it is hoped that the presence of

client representatives will be a further spur to efficiency. While many litigators embrace efficiency many also see their role as obtaining all the facts so they can do the best job. That may be a worthy goal but it also may be more than the client wants or may need. The client can elect to take the risk of not seeking everything, and that may be harder for counsel.

To promote success in the efforts to have the Panel manage the process for both efficiency and fairness, the New Accounting Rules—just as the New Commercial Rules—provide the Arbitrator with specific enforcement authority. They permit a series of specific directions by the Arbitrator that can, among other things, set search parameters and allocate costs of discovery in order to keep the process in measure. They provide specifically for enforcement orders that can serve as encouragement for the efficiency that will benefit most Parties.

New Disclosure Rules

Consistent with the emphasis on efficiency as well as proportion, the new Rules for Pre-Hearing Disclosure have been designed based on the conviction that in disputes where professional accounting and related services firms are Parties it is very often in the mutual interest of the Parties to avoid steps in disclosure that can, if not controlled, needlessly inflate the time and cost required to resolve the issues. They afford the Panel the authority, the responsibility and the duty to manage the exchange of information among or between the Parties so as to reduce cost and increase the focus on the central issues in dispute. The Panel is to do so with due consideration for proportionality both as to the scope of any request for information in relation to the likely relevance and materiality of the requested disclosure and the amount at stake in the arbitration. Expressly rejected by the New Disclosure Rules is the dragnet approach, where the objective is to sweep in anything and everything that can be thought of as conceivably relevant.

If the basic concepts embodied in the New Disclosure Rules are understood and guide the Panel and Parties, each decision as to appropriate disclosure will be made with efficiency, proportionality and focus in mind, with the almost certain result that the discovery process will be limited either to or close to all that is really necessary.

If the New Disclosure Rules are not followed and the Parties and their counsel instead proceed with disclosure that is as unrestricted as it can be in court proceedings, they will likely lose many of the significant benefits of efficiency, proportionality and focus that arbitration can provide.

As required by the New Disclosure Rules, the Panel and the Parties should, in addition, adopt the following specific practices.

Preservation

While, under the New Disclosure Rules the Parties are responsible for preservation of all files and documents that are relevant and material to the Parties' claims and defenses, the Parties would also be expected to identify for discussion with the Panel and other Parties any issues as to preservation that could result in significant and potentially unreasonable burdens for them.

If preservation issues are discussed openly at the first preliminary conference or as soon thereafter as practicable, with the express encouragement of the Panel, the Parties may well reach agreement as to a reasonable scope for preservation by both sides that will eliminate the need to preserve vast bodies of irrelevant electronically stored information ("ESI") and hardcopy documents.

As and when necessary, the Panel should issue preservation orders, with due consideration for proportionality and the importance of avoiding unnecessary delay and expense to the Parties.

Production of Documents

The New Disclosure Rules provide that with direction from the Panel, the Parties would take a number of practical steps that should serve to limit significantly the burden of document production.

(1) The Parties would be directed to exchange early and to update at set intervals the production of documents, including ESI, upon which they intend to rely. Strategic efforts to hold back evidence for either side often lead to no more than unnecessarily extended efforts to discover such evidence and prolong a proceeding that otherwise may be resolved early if the most significant evidence is known to both sides;

(2) Document requests would be tailored not to sweep in any conceivable evidence but instead to specifically describe what is sought with express indication of how and why the documents sought are likely to be "relevant and material" to the Parties' claims and defenses. To assure focus on what is material and relevant broad language such as "all documents directly or indirectly related to" would be avoided;

(3) All requests would be limited to files that are directly relevant and material to the Parties' claims and defenses. If, for example, the search required is for the files of individual employees, the search would be confined to the files of those employees of the Parties who are identified as spending time of significance, not measured alone by the number of hours spent, working in the areas directly relevant and material to the Parties' claims and defenses. Sweeping requests that all the files be searched for specific evidence—including files

where there is little or no likelihood at all that material information would be found—would be disallowed. Such limitations will be beneficial because at both accounting and related service firms and their clients, it is often the case that copies of ESI and hard copies of documents are received by many individuals who have limited or no involvement at all in the matter in issue;

(4) Where a Party has extensive files, the Panel may direct that an index or description of the documents be made available to the requesting Party in order to facilitate a focused description of relevant and material documents as to which production may reasonably be requested. In the absence of an adequate index or other such written description of file contents, the Panel may direct that a Party produce a knowledgeable witness to provide in a limited deposition a description of the contents of files. After that the Parties should be expected to focus their requests for disclosure;

(5) The Parties would avoid, and the Panel would deny, blanket requests for "all drafts" because for most documents in a production the content of drafts is of no moment; instead the Panel and Parties would limit production of drafts to those actually sent to third Parties, or, on good cause shown, drafts that would likely be material to an identified, significant issue raised by the claims and defenses of the Parties. Examples would be the draft language of a contract where the contract's proper interpretation is in issue or drafts of a working paper with respect to a key audit procedure. As with requests for documents, an application for such drafts would be limited to those files that are directly relevant and material to the Parties' claims and defenses and searches of files of individuals would be limited to the files of those who spent time of significance, not measured alone by the number of hours spent, working on matters relevant and material to the Parties' claims and defenses. The fact that documents are not in the possession of the requesting Party should not in itself be sufficient to establish that there is good cause for production;

(6) To avoid concerns about confidentiality, the Panel may issue appropriate orders protecting confidentiality or proprietary information; otherwise Parties may be forced to work through extensive document reviews looking for the usually very limited number of documents requiring confidential treatment. Such orders are often especially helpful with respect to privileged documents.

Electronically Stored Information

Of course, the greatest single cost concerns today are usually as to the vast array of ESI that most organizations have in their possession and control. ESI can be particularly problematic where the dispute is between accounting firms and their clients, each of which can have ESI spread among large numbers of employees, officers and directors. Audits can involve many professionals at an accounting firm and many officers, employees and even directors of a client corporation. If an employee's hard drive contains 200 gigabytes it may contain the equivalent of 13 million pages of documents, 20 million pages of e-mails or 33 million pages of spreadsheets.[1] And ESI may be stored in both workplace locations, such as laptops, voicemails, shared systems, file shares, cloud accounts, third party storage, archives and personal locations, such as personal laptops, iPhones, iPads, Facebook and other social media.

Duly recognizing the extent of the ESI problem, in addition to the kind of focused discovery requests outlined above, the New Disclosure Rules include the following additional limitations on the production of ESI: (1) The Party in possession of ESI should be allowed to make it available in a readable form most convenient and economical for it, subject to a showing of good cause that there is a compelling need for access to the documents in a different form; very much as with drafts this will serve to limit special production requirements to instances of genuine need:

(a) The Panel should direct that requests for ESI be narrowly focused and structured to assure that a search will not be unduly burdensome;

(b) Production of categories of ESI such as those below should be allowed only if the Panel determines, on application and for good cause shown, that there is a compelling need for such access:

(i) "deleted," "slack," "fragmented," or "unallocated" data on hard drives;

(ii) random access memory (RAM) or other ephemeral data;

(iii) on-line access data such as temporary internet files, history, cache, cookies, etc.;

(iv) metadata, with the exception of header fields for email correspondence, including fields that are frequently updated automatically, such as last-opened dates;

(v) backup servers, tapes, backup data that is substantially duplicative of data that is more accessible elsewhere or not reasonably accessible or other media data;

(vi) other forms of electronically stored documents that would require extraordinary affirmative measures that are not utilized in the ordinary course of business;

(vii) archives, except as that term may be used by the accounting firm to refer to the filing of its final electronic and manual working papers;

(viii) obsolete media or legacy data.

It is a rare instance when production of such forms of ESI will unearth truly relevant and material evidence. Again, the fact that documents are not in the possession of the requesting party does not itself establish a compelling need.

Key to the discussions with Parties and the determinations made by the Panel may well be knowledge and understanding of the technological challenges that face each of the Parties. Such challenges will not be the same in every arbitration. Therefore, the New Disclosure Rules make it clear that if the Panel would benefit from technical assistance to aid it and the Parties in resolving ESI issues before deciding the application, the Panel should require the attendance of an IT, CIO or other individual who is knowledgeable about the Party's electronic systems and capabilities, including electronic document storage, organization, format issues, relevant information retrieval technology and search methodology, in order to explain those systems and address any questions that the Panel may have.

Depositions

Although controlling document production can often be the most important step in assuring efficiency in an arbitration, controlling the scope of deposition testimony can also make a significant difference. Accordingly, the New Disclosure Rules provide the following:

(1) Absent an agreement of the Parties with respect to depositions, the Panel should direct that no more than three merits depositions per Party be taken. The New Disclosure Rules permit an exception if, upon application for good cause shown, the Panel determines that an additional deposition or depositions are warranted. They also afford the Parties the option of agreeing on a limited number of depositions that is not inflated but is instead consistent with the scope and importance of the issues in dispute.

(2) Depositions should be limited to witnesses who will testify as to matters that are "relevant and material" to the Parties' claims and defenses and should be limited to no more than two days per deponent, with seven hours per day, not including breaks.

(3) Any order with respect to depositions should include a statement that, except to preserve privilege, no speaking objections should be made.

(4) Where the Panel determines that it is necessary to have a limited deposition or depositions in advance of document requests for the purpose of focusing and restricting the scope of document discovery, such limited depositions should not count against a Party's total number for merits depositions.

Interrogatories and Requests for Admission

The New Disclosure Rules provide generally that interrogatories and requests for admission should not be used because they are often not cost-efficient. Their use is provided for only in those very limited situations where a Party can demonstrate that it is highly likely that such discovery will significantly narrow the issues or provide a necessary clarification.

Among other things, this approach permits the Parties to avoid the usually fruitless process of calling upon the other side to explain its position on various issues through use of "contention interrogatories" that are often answered in so guarded a way that they become no more than a test of the skills of counsel in avoiding anything harmful.

Experts

The New Disclosure Rules provide that, absent a showing of good cause, expert testimony will be confined to written reports that can be submitted to the Panel, with cross-examination conducted at the hearing and not before. The Panel may determine that, in some cases, it would be a cost effective procedure to have the experts exchange their opinions on key issues and discuss them directly. Often such steps can result in the narrowing of the issues.

Costs and Compliance

Parties may seek discovery that is burdensome, time consuming and costly either in and of itself or in proportion to the issues in the arbitration. In deciding the disclosure issues, the New Disclosure Rules provide that the Panel should focus on the time involved, the cost of obtaining the discovery, the issue of proportionality, and whether such discovery will serve the goal of a cost-effective and efficient arbitration. Where appropriate, the Panel may condition granting a request on the requesting Party paying costs. The practical effect of such a condition is often that the Parties confronted with bearing the actual cost of disclosure may be driven to work all the harder to promote efficiency. Similarly, where a Party fails to comply with a discovery order, the Panel may take such failure into consideration when allocating costs and may draw an adverse inference.

The Importance of Creativity

Because the variation in possible disclosure situations is endless, the New Disclosure Rules encourage the Panel to address situations not otherwise covered by being proactive and creative in seeking realistic and creative ways to avoid needless cost and delay.

Conclusion

The New Disclosure Rules offer the Parties and the Panel a balanced, focused approach to the management of disclosure. If adopted in drafting an arbitration clause, the new Rules for Arbitration of Accounting and Related Services Disputes, through the New Disclosure Rules, should serve to inform the Parties of what they may expect with respect to disclosure in an arbitration.

Endnote

1. *See, e.g.*, lexisnexis.com (use search term "How Many Pages in a Gigabyte?").

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