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## An Alternative For Righting The Wrongs Of An Arbitration Panel In IP Disputes

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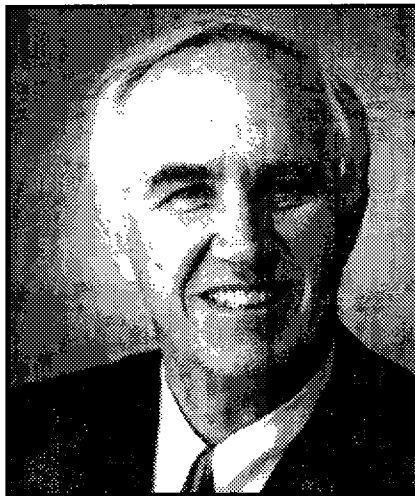
On April 25, 2002, a trial team of McAndrews, Held & Malloy, led by Timothy J. Malloy, won a patent infringement arbitration award of \$158 million. News of the arbitration award arrived while this same senior partner was conducting a jury trial in San Francisco on behalf of a different client, defending against a charge of patent infringement. One week later, the San Francisco jury returned a favorable verdict holding the asserted patent invalid on multiple grounds.

These back-to-back results from different litigation forums have caused us to reflect on the dramatic differences between arbitrations and court trials. Mr. Malloy has spent the majority of his career litigating intellectual property (IP) disputes before juries in federal court. However, in more recent years, he has also conducted numerous IP arbitrations. These two vehicles for dispute determinations are vastly different, although the use of arbitrations for patent infringement cases is a relatively new method of resolving such disputes.

### Genesis Of Arbitration In Patent Actions

It was not until 1982 that Congress

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Timothy J. Malloy

opened the door to arbitrate patent infringement cases with the passage of 35 U.S.C. § 294. This statute provides that a "contract involving a patent or any right under a patent may contain a provision requiring arbitration of any dispute relating to patent validity or infringement arising under the contract."

Before section 294, the general rule was that patent infringement cases could not be arbitrated. As one court explained, "[q]uestions of patent law are not mere private matters....[They] grant limited monopolies to inventors..., render[ing] them inappropriate for determination in arbitration proceedings." As a result, arbitrations of patent infringement disputes were almost nonexist-

ent before 1982. And although patent infringement arbitration is relatively more prevalent in 2002 than it was in the '80s, it is not appropriate in every case. The advantages and disadvantages of using arbitration must therefore be evaluated in light of the particular dispute.

### Pros Of Arbitration

A myriad of theoretical reasons has been given for choosing arbitration over traditional litigation. These include the speed at which a resolution might be reached, cost savings, confidentiality, quality of the outcome, and the level of control afforded the arbitrating parties. We say "theoretical" because in actual practice, and with a sufficiently experienced trial team, many of these goals can be achieved with the traditional jury trial.

Patent litigation can last for years, due in large part to the tremendous backlog in a number of districts in the federal court system. In contrast, patent disputes submitted to arbitration may be resolved in considerably less time, sometimes in as little as six months. Further, traditional patent litigation may cost millions of dollars. In contrast, arbitrating a patent dispute is said by one advocate to be less than 85 percent of the cost of taking the same dispute to trial.

Arbitral proceedings are generally private in nature. As most proceedings are not published, parties have greater assurance that they will obtain private justice without putting trade secrets or other confidential information at risk.

Finally, the arbitrating parties may spec-

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ify virtually all aspects associated with the dispute resolution proceedings, from the specific arbitrators who will settle the dispute, to the remedies that will be available to the prevailing party, to the location of the proceeding and timing of the resolution.

### Cons Of Arbitration

Arbitrating parties forgo substantial rights. They forgo the right to trial by jury, the right to an Article III judge, the right to discovery under the Federal Rules of Civil Procedure, and the right to appeal. A discussion of the benefits of these rights is beyond the scope of this article.

It is not the purpose of this article to advocate for one form of patent dispute resolution over another. There are substantial rights which are waived by selecting arbitration over a jury trial in our fine federal court system. These are rights not to be lightly dismissed. Instead, this article assumes the litigants have chosen to arbitrate. It then recommends a small change in arbitration procedures which can bring a big change in their reliability.

One of the most significant drawbacks of arbitration is the virtual waiver of the right to appeal. Parties who arbitrate have the prospect of having to "live with" the arbitration panel's decision, the right to appeal being available in only a limited number of circumstances.

### Limited Bases For Appeal Of An Arbitration Award

Some of the narrow bases for vacating an arbitration award are found in § 10 of the Federal Arbitration Act ("FAA"):

- (1) corruption, fraud, or undue means in procuring an award;
- (2) evident partiality or corruption on the part of the arbitrators;
- (3) arbitrator misconduct; or
- (4) arbitrator conduct beyond the powers granted by an arbitration agreement.

For numerous reasons, it is very difficult to establish any of these bases. First, each basis typically has an evidentiary requirement of "clear and convincing evidence." The petitioner may be required to show both improper conduct by the arbitrators and direct evidence linking such conduct to the award. Second, the stark reality is that courts affirm a vast majority of challenged awards, estimated at over 90%. Finally, courts have been inconsistent in determining what grounds are required to vacate an arbi-

tration award. In general, the arbitrator's conduct must have approached a level of fraud for the award to be vacated. Under no circumstances may an award be appealed simply based on a party's disagreement with the arbitrator relating to any substantive issue in the case, or for minor errors in fact or law. Rarely will mistakes of law or fact be valid grounds for vacation of the award.

### A Solution To The Limited Appeal Problem

With such limited bases for appealing the decision of an arbitration panel, how can you increase the likelihood of a correct result in arbitration while accepting the waiver of an appeal inherent in most arbitrations?

Our recommendation is to impose four requirements upon the arbitration panel in the arbitration agreement:

- (1) Insist on at least a three-member arbitrator panel. The dynamics of a three-member panel allow for discussion and exchange of ideas and perspectives.
- (2) Require an initial, written decision setting forth the facts and law supporting the award. Giving an arbitration panel the right to send your client's case up or down with a figurative "thumbs up or down" grants too much discretion to reside within the panel.
- (3) Require the initial decision of the panel to be in "draft" form only. This places the panel in the proper mindset: their task is to render a decision but only insofar as the facts and law support that decision.

(4) Permit either party to criticize and comment on the draft opinion in writing, before a final decision is awarded. This allows errors to be exposed and provides for corrections of the decision. Most importantly, comments on the draft opinion allow the panel to change its collective mind.

The criticisms of the parties are not taken simply as a request for reconsideration. On the contrary, they are a required part of the process before the panel is allowed to make a final decision. When the panel expects to have its reasoning criticized before "going to press" with a final decision, two things tend to happen. First, the panel tries harder to get it right the first time. Second, the panel is likely to be more open to criticism in the interests of justice.

### Anecdotal Experience

We used this very technique with great success in one of our earlier arbitrations.

When we received the draft opinion in that case, we had lost on every issue. However, the draft opinion revealed that the logic upon which the opinion was based was fatally flawed. It was 2-1 decision so we knew there was one panel member on the draft opinion who understood our theories. However, the basic rationale of the majority's draft was fundamentally in error. It espoused a theory of our case that we had expressly rejected. We felt that the author of the draft opinion had simply not carefully reviewed our submissions or understood our arguments.

Had this been a conventional arbitration, without the inclusion of the draft opinion provision, the "award" would have been final. Because of the limited right of appeal, it is doubtful that the fundamental errors in the opinion could have been corrected. Fortunately, we implemented the "draft opinion" provision required in the arbitration agreement. In the final opinion, the results were vastly different after the errors of the draft decision were brought to light. The end result was a 2-1 decision in our favor. We had pulled a victory from the jaws of defeat.

How likely is a result like this? In our view, it is substantially more likely where you have the dynamics of a three-member panel than would be the case with a single judge or panel member. Though some practitioners favor a single arbitrator over a multi-member panel, the likelihood that a single panel member would go back and "second guess" his decision is far less likely than it is in the case of a multi-member panel. The dynamics of a three-member panel, for example, invariably result in back-and-forth communications between members and an exchange of ideas between and among panel members when an error occurs. Such error will usually have been generated by a single panel member. If significant error is brought to light, it is harder to ignore when two other panel members are there to discuss it.

According to Frank Zotto, the American Arbitration Association's Vice President for Case Management, use of "draft opinions" is an "unusual" practice, in both patent arbitrations and the approximately 200,000 other arbitrations each year. However, as clearly evidenced by our experience, such a technique can provide a highly effective means for review of a seemingly unappealable arbitration outcome.