Commercial Dispute Resolution in the United States

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Introduction

An analysis of commercial dispute resolution in the United States must focus, in large part, on the American court system. This does not mean, however, that all, or even most, commercial disputes are resolved in the courts. Resort to the courts is expensive and time-consuming for the litigants. Honest disputes between parties who interact for commercial purposes are inevitable. Often, such disputes arise out of business relationships which are long-standing, and in which continuing business relations are contemplated and desired. How can the disputants best accomplish these goals?

Given the premium which must be placed upon the peaceful and efficient resolution of commercial disputes, a conciliatory and measured approach to commercial dispute resolution is appropriate. The parties to the dispute will typically work hard to reach a negotiated solution. Failing that, they may engage a mediator (a third-party neutral), often trained in the art of facilitation, to assist the parties in attempting to reach a negotiated resolution which, without the intervention of the third party, had proven unattainable. If mediation fails, the parties might consider arbitration, in which the neutral third party has the ability, and the mandate, to render a binding decision with regard to the dispute. Such a decision can be enforced just as a court decision, but has a number of advantages, including the fact that it is generally cheaper and faster than obtaining a judgment through litigation. If all else fails, the parties may resort to court, and even once the dispute has been reduced

to a lawsuit, the American court system employs a number of strategies which are intended to speed and simplify the process.

This analysis covers both judicial and non-judicial methods of commercial dispute resolution. The non-judicial mechanisms often work, in part, because the parties know that if their efforts fail, and if the matter is eventually brought to court, the system has strong mechanisms for enforcement. It is therefore expected that just debts can, for the most part, be collected from a solvent debtor. The analysis of commercial dispute resolution begins, therefore, with some broad observations about the nature of the American judicial system.

Sources of American Judicial Power

Constitutional Separation of Powers. American courts have the ability to declare legislative enactments unconstitutional, either on their face, or as applied. The power, and in fact the duty, to subject such legislative enactments to constitutional scrutiny, is interwoven throughout our unified court system (we do not have a separate constitutional court). Citizens have the right to be free from legislation which violates either their state constitution or the United States Constitution. Determinations of this nature by lower courts are, of course, subject to review on appeal, but consistency throughout both the state and federal court systems is guaranteed through the unification of both systems under the ultimate authority of the United States Supreme Court.

The judicial power of constitutional review is recognized by the general population as an important characteristic of a democratic society. Sometimes, the legislative branch will enact a new piece of legislation for the purpose of attempting to accomplish an objective which, under prior legislation, was deemed to be unconstitutional. Of course, such replacement legislation can again be

subjected to judicial review, and perhaps, repeated rejection. The executive branch must follow the rulings of the court, both through enforcement of legislation which has been determined to be constitutional, and by refusing to enforce legislation which has been held unconstitutional.

Public Trust. The American public tends to take the authority of the judicial system as a given. This popular confidence is not innate, however, and must be earned by the judicial system through its actions. Just as this public trust and confidence must be earned, it can be lost, and there are historical periods when public confidence in the American judicial system was shaken. Fortunately, these periods have been few and far between, and have never dramatically eroded the overall functionality of the system.

Enforcement Powers. Constitutional authority and public trust make it possible for the court to make binding rulings which have presumptive validity in the eyes of the general public. In order to give the judicial system "teeth", however, especially in the context of the resolution of economic disputes and the rebalancing of economic rights, it is critical that the judicial system have effective enforcement powers. Without them, a judgment is merely a "right without a remedy".

One of the fundamental differences between the enforcement powers of Russian and American courts stems from the greater degree of privatization of real property in the United States. Real property constitutes a large percentage of the property which, in the aggregate, is privately held. As such, the "pledging" of real property as collateral plays a critical role in the functioning of our economic system. In the attached hypothetical, the developer is able to pledge its leasehold interest in the land, as well as its interest in the structure as it is completed, as collateral for the construction financing. Similarly, when the construction phase is completed, the permanent loan is collateralized

by the leasehold interest and that portion of the building which remains under the ownership of the developer after the sale of the residential condominium units on the second floor.

The prioritization of interests in the real property is further illustrated in the hypothetical by the assumption that the commercial tenant on the first floor has negotiated for, and documented, the fact that its interest in the leasehold is superior to that of the bank which is providing the permanent financing. In this way, if the developer defaults on the permanent loan, the bank can foreclose the developer's interest, but cannot oust the commercial tenant. The same is not true of the residential condominium owners on the second floor, whose interest in the ground lease is subordinate to that of the permanent lender. All of these rights are enforced by the court (if necessary) in a manner which is relatively predictable. Therefore, those who place themselves in positions of financial risk can know, with a reasonable degree of certainty, how, and to what extent, they can protect those financial positions through court-assisted resort to collateral. This is one of the fundamental ways in which the court has the power to give force and effect to its judgments.

The Adversarial System

The reader should keep two other fundamental characteristics of the American court system in mind. The first is that our system is highly adversarial. The burden falls on the opposing lawyers (or in the absence of lawyers, upon the opposing parties) to develop the evidence which is necessary to support their positions, and to carry out their burdens of proof. The American judge is much less judicially active (both during the trial and during the pre-trial proceedings). Instead, the attorneys are much more active. In this respect, it is interesting to compare the "judge to lawyer" ratios in Vermont and Karelia. In Vermont, we have approximately 40 judges and 1500 lawyers. This number

of lawyers includes the Russian equivalents of prosecutors, advocates, notaries, legal consultants and others, but even so, the ratio in Russia is dramatically different, reflecting the greater degree of judge-intensiveness which is characteristic of an "inquisitorial" system.

Precedent as Law

A second important distinction between the American and Russian systems is the common law notion of precedent. In the United States, precedent unquestionably constitutes a type of law. Our law is not as highly codified as the Russian law (although it is becoming increasingly codified over time). In the substantive areas in which there are few, if any, statutes, the law is based largely upon precedent. Many legal treatises compile those precedents, and organize them by subject matter, in order to create a distillation of the precedential law. In some cases, those distillations are eventually adopted as legislative enactments. This is one way in which the codification of the American legal system is evolving. Even in statutory areas of the law, however, judges are regularly called upon to interpret statutes. We therefore develop case law concerning the interpretation of statutes, further illustrating the role of precedent, even in an area which is primarily governed by legislative enactments.

Alternative Dispute Resolution

Litigation is expensive and time consuming. As a result, when commercial disputes arise, business people increasingly resort to "alternative" forms of dispute resolution. This process has several distinct components.

Negotiated Problem Solving. In commercial endeavors, disputes inevitably arise. It is human nature to attempt to resolve these disputes quickly, and directly between the principals. In this way, the parties can continue to work together, reaping the benefits of their economic relationship, and not wasting time and resources on non-productive endeavors. If direct negotiated settlement does not work, the parties may resort to mediation.

Mediation. Dispute resolution is a bit of an art, and a bit of a science, and not everyone is good at it. There are individuals who are trained, however, to facilitate dispute resolution. If direct negotiation fails to produce a resolution, commercial disputants will sometimes engage the services of a trained mediator who tries to help the parties agree upon a solution. The mediator does not have the authority to bind the parties, and for this reason, efforts at mediation will sometimes fail. In that case, the parties may submit their dispute to arbitration.

Arbitration. This is another method whereby a third party is used to resolve the commercial dispute. The arbitrator, however, is given authority to issue a binding ruling. The arbitration decision can simply be converted into a court judgment, and enforced as such. Since arbitration is voluntary, there are two ways in which it arises. The first is that the parties agree to submit a matter to arbitration after the dispute has arisen. The second, and perhaps more common, is that the parties stipulate in their contract that arbitration will be used as a means of dispute resolution in the event that a dispute arises during the course of the performance or non-performance of the contract.

In a contractual arbitration clause, it is common to find a provision that the arbitrator has the discretion to award the costs of the arbitration, including attorney's fees, to one party or the other. This is sometimes known as a "loser pays" provision, and has the effect of discouraging litigation positions taken in bad faith for the purpose of economic gain. It is also wise, in an arbitration clause,

to designate the forum in which the arbitration will occur. Many international business contracts provide for the submission of disputes to arbitration in a particular city pursuant to the international arbitration rules of the International Chamber of Commerce. At the same time, the parties often designate the country whose substantive law will apply. The parties are free to design the arbitration process in any way that suits their needs. It is in the parties' interest to design a dispute resolution mechanism which is both efficient and non-destructive. After all, in the past, the parties have worked together toward shared economic goals, and may hope to continue to do so in the future.

Litigation

If all forms of alternative dispute resolution fail, or if parties are unwilling to voluntarily subject themselves to it, and are not contractually bound to do so, litigation looms as the last alternative. Again, because of its cost and its propensity to cheat normal business endeavors of their full potential, litigation should be viewed as a last resort. Space only permits me to deal superficially with the American commercial litigation system, and I will address some of the characteristics which differentiate it from the Russian system.

Subject Matter Jurisdiction in Commercial Matters. Subject matter jurisdiction over commercial matters in the American court system is shared, in large part, by the state and federal court systems. Each state has its own court system, with similarities and differences from state to state, and all state court systems, as well as the federal court system, afford an eventual right to petition for appeal to the United States Supreme Court.

Bankruptcy is the only commercial area which, by mandate of the United States Constitution, falls exclusively within federal subject matter jurisdiction. With respect to other types of commercial

litigation, as a general rule, those involving smaller disputes, and those arising between parties of the same state, must be litigated in state court. Others may be brought in the federal court of first instance, and in some cases, the plaintiff may have the option of filing a commercial action in either state or federal court.

Some cases can be resolved purely by application of federal statutes and/or caselaw. Others can be resolved purely on the basis of state statutes and/or caselaw. Some cases require the application of legal principles from both state and federal law. At times, one or more aspects of a case can turn on the application and construction of state and/or federal constitutional provisions. As long as the case is properly before a given court, the court can (and in fact, must) apply all such sources of law which are applicable. The state and federal court systems have separate, although similar, rules of procedure. Enforcement of state and federal judgments is functionally equivalent.

Pleadings. The American system has rather minimal requirements for the court-filed documents which set forth the parties' claims and counterclaims. It is generally considered sufficient if the pleadings make clear the nature of the claim, including a conclusory summary of the facts. Fraud claims must be supported with pleadings which are somewhat more factually particularized.

Pre-Judgment Remedies. Pre-trial remedies are, in a sense, the first stage of enforcement. Obviously, enforcement of judgments does not occur until a final judgment has been rendered, but given the understandable incentive which the eventual judgment debtor might have to dispose of, or otherwise encumber, potentially attachable property, the court will, under some circumstances, preserve the status quo during the litigation. Such a pre-judgment attachment is only granted on a preliminary showing of likelihood of success on the merits, and upon a representation that the defendant is not insured for liabilities of the sort which are contemplated. If, for example, a claimant

were to prove a reasonable likelihood of success, and if the defendant were to be uninsured but the owner of a piece of real property, the court would probably issue, on application of the plaintiff, a "pre-judgment attachment" against the real property. The attachment would take the form of a written notice, which would be recorded in the land records, and which would create a situation in which a subsequent purchaser of that property, or for that matter, anyone who were to obtain a subsequent interest in the property after the recording of the court notice, would have an interest which would be inferior to that of the judgment creditor, should the judgment creditor eventually receive a final judgment.

Since the granting of a pre-judgment attachment is conditioned upon a showing of a reasonable likelihood of success on the merits, a hearing must be held for this purpose. Under most circumstances, the defendant will receive notice of this hearing. However, if there are facts to suggest that the defendant will dispose of, secrete, or otherwise encumber, attachable assets prior to a determination even of the motion for pre-judgment attachment, such a decision can be made by the court, in the first instance, without notice to the defendant. In such cases, constitutional principles of due process require a follow-up hearing in a very short period of time, to allow the defendant to present evidence which might defeat the attachment application.

Discovery. There are a number of important mechanisms through which the parties can learn additional information about the case, and obtain relevant documents, through the "discovery" process. Written questions may be posed to an opposing party, and must be answered under oath. The penalties for perjury or false statement are severe. Similarly, the oral statements of opposing parties and witnesses may be obtained, again under oath, before trial, with a verbatim record being kept either stenographically, or by video tape, or both. Compliance with discovery can be compelled

by the court, subject to reasonable limitations as to scope, privilege and the like. The court has a number of mechanisms through which to enforce compliance with discovery, for example, through "issue preclusion", wherein a material fact may be deemed admitted as against a party who refuses to comply with a reasonable relevant discovery request directed to that fact.

Pre-Trial Motions. The main goal in the filing of pre-trial motions is to limit the issues which are before the court during the course of the trial. It might be expected that the defendant (or at least the party against whom a particular claim is being made), would be more likely to file a pre-trial motion to dismiss one or more or all claims of the opposing party, or to file a motion for a pre-trial judgment in its favor with respect to one or more or all of its own claims. While this is true, the filing of pre-trial motions can be an effective tool for either party, and if properly handled by the court, can have a positive effect on judicial efficiency.

Trial. A detailed description of the trial process is far beyond the scope of this article. Reference is hereby made to the attached materials of Judge Mary Teachout. One important point deserves mention here, however, and that is the Rules of Evidence. In an adversarial system, the parties may seek to introduce evidence which, for any number of reasons, would be partly or wholly inappropriate. The judge has ultimate control over what evidence may and may not be introduced, subject of course, to appeal. An article on the Rules of Evidence, which was prepared in connection with an earlier Vermont/Karelia rule of law program, is attached to these materials. The Rules of Evidence apply, with some variation, to both non-jury and jury trials.

Enforcement of Judgments. After judgment is rendered, and any appeals exhausted, the successful party resorts to enforcement. Some judgments are simply paid when final, such as those for which there is undisputed insurance coverage. In the absence of a voluntary satisfaction of the

judgment, however, assets of the judgment debtor may be executed upon, except for a list of statutory exemptions. These exemptions allow the debtor to keep that property which is generally considered to be necessary for subsistence.

The debtor's assets can be seized from him personally, or from others who hold assets for him (such as banks). The creditor can even reach assets which are nominally titled to another individual, if the assets were transferred by the debtor to the third party for little or no consideration, and if the surrounding circumstances suggest that the debtor is, in fact, the equitable owner of the property.

Recourse may be had to real or personal property, with the former (when available) often affording a greater likelihood of success in collection. The execution against the debtor's property is performed, if necessary, by a sheriff (in the state system) or a marshal (in the federal system), each of whom is charged, in a broad sense, with the duty to enforce court orders, in whatever form. When non-liquid assets are to be executed upon, they are typically sold at auction, with the proceeds being first used to pay the expenses of the sale, and with the balance being distributed to the judgment debtor, and/or to creditors who have prior interests in the property in question. After satisfaction of all of the debts, if a portion of the proceeds remains, it is returned to the debtor. If, on the other hand, there is a shortfall, the judgment creditor may proceed against other property, if available. If sufficient assets to pay the judgment are not disclosed by the debtor, or otherwise known to the judgment creditor, post-judgment discovery can be directed to the debtor, and the answers thereto will be compelled by the court if necessary. Of course, any property which was subjected to a pre-judgment attachment will have been preserved, and will be capable of being subjected to all of these various procedures.

Judicial Formalization of Settlements. If all law suits were to require trials in America, the system as we know it would break down. Fortunately, however, because the system is relatively predictable, negotiated settlements are quite common. Such a settlement does not result in a dismissal of the lawsuit. Quite to the contrary, the parties enter into a written settlement agreement, which is then submitted to the court for approval. As eventually approved, the settlement is then embodied into a court judgment, which can be enforced through any of the mechanisms by which a fully-contested judgment could be enforced.

Conclusion

An important goal of commerce is to avoid conflict. When disputes arise, they should be resolved efficiently. This can be accomplished through the proper securitization of business transactions (so that risk can be quantified, and knowingly undertaken or avoided), in the context of a legal system which will recognize and enforce those rights. The American system is benefitted, in this respect, by a high degree of privatization of property.

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