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New York Dispute Resolution Lawyer

A publication of the Dispute Resolution Section
of the New York State Bar Association

Message from the Chair

Jonathan Honig

It has never been clearer that alternative dispute resolution is going to play an increasing role in the future. Examples abound in all different spheres of activity. In connection with the events of September 11, a compensation plan was devised that avoided litigation with respect to thousands of victims. In connection with the recent collapse of the automobile industry, a government intervention replaced years of litigation over the failures of Chrysler and GM. In connection with a foreclosure crisis that is affecting millions of homeowners, there has been a search for solutions, including New York's own mandatory settlement conferences, because the courts simply cannot deal with this magnitude of litigation. There are countless other examples.

In the Supreme Court of the United States, there has been a clear focus on the importance of arbitration, with the last 30 years having witnessed a departure from the hostility of the Court to arbitration evidenced in *Wilko* to a succession of decisions allowing arbitration in connection with securities fraud, RICO, antitrust and employment issues.

Recently, the Supreme Court has addressed a variety of important arbitration issues. The perennial battle between speed of result and accuracy of result caused many parties to seek to craft appellate review provisions in contracts providing for arbitration. The Supreme Court addressed this in *Hall* and denied enforcement to provisions for Court appellate review of arbitration awards leaving the parties free to provide for arbitral appellate processes in their contracts, and arbitration providers have established appellate panels to meet this need. In its decision in the Spring in *Vaden*, the Court refused to find federal jurisdiction for purposes of an FAA motion to compel arbitration in circumstances in which the initial complaint in state court had no federal claim but the counterclaim was predicated on federal law, with the result that a party was encouraged to arbitrate the entire dispute rather than litigate and arbitrate at the same time. And most recently, the Court has agreed to address a question of great importance relating to arbitration, namely the ability of parties to engage in class actions in arbitration. In *Stolt-Nielsen*, the Second Circuit upheld a decision by an arbitration panel that an arbitration clause permitted class arbitration, finding that the panel's decision was not in manifest disregard of law. The outcome of this case will have a significant impact for litigation and the drafting of arbitration clauses.

The Dispute Resolution Section has been and will continue to be involved in this evolving future of expanded

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Message from the Editor

Edna Sussman

We were thrilled by the warm reception of the last issue of *New York Dispute Resolution Lawyer* which contained a special round-up from around the world on med-arb and arb-med, a subject of continuing interest. We would like to publish an issue on the many forms of ADR and include some of the less used techniques such as early neutral evaluation, mini-trials, dispute boards, settlement counsel, deal mediation, online dispute resolution, and ombudsman. If you have experience with any of the less frequently used ADR modalities and might be interested in writing an article about it, please contact me at esussman@sussmanadr.com. We continue to invite you to submit letters to the editor, articles and article proposals on all aspects of dispute resolution.

Section Reports

Discovery in arbitration and arbitration management issues have been the subject of extensive discussion and debate in recent years. The Dispute Resolution Section prepared a report, approved by the NYSBA Executive Committee and House of Delegates, containing precepts which, if followed, it is hoped will help arbitrators effectively handle discovery in domestic, commercial cases in a manner which is both cost-effective and fair, and that—with due regard to freedom of contract—is consistent with the expectations of the counsel and parties who selected the arbitration process. The report, entitled *Guidance for Arbitrators in Finding the Balance Between Fairness and Efficiency,* is reproduced in full on p. 69 in this issue.

The Arbitration Fairness Act introduced in the 110th Congress has been reintroduced in the 111th Congress in the House of Representatives and would invalidate arbitration agreements in, *inter alia,* consumer, employment and franchise disputes and by virtue of certain broad provisions, threatens to cripple all domestic and international business arbitration. The Dispute Resolution Section prepared a report, approved by the NYSBA Executive Committee and House of Delegates, discussing the unintended troublesome ramifications of the legislation. The report is reproduced in full on p. 76 in this issue. Following the preparation of the report, a parallel bill was reintroduced in the U.S. Senate which addressed and corrected many of the problems identified. The Section is preparing a supplemental report highlighting remaining problems with the Senate version of the Arbitration Fairness Act of 2009.

Section Activities

We report on the forthcoming review of the issue of mediator certification and the Section's launch of a new subcommittee for international arbitration.

ADR News

It seems there is always a lot to report in the ADR world. In this issue, we include (i) a discussion of Justice Sotomayor's record on arbitration, (ii) President Obama's orders directing transparency, public involvement and collaboration, (iii) a review of the changes at FINRA, (iv) a short news roundup on the new compensation rules in the Eastern District, the National Arbitration Forum's withdrawal from consumer arbitration, and New Hampshire's recently enacted legislation providing for the court's mediation office to facilitate **pre-suit** ADR.

Our own Ethical Compass discusses the challenges of following the New York State Rules of Professional Conduct for Lawyers that became effective April 1, 2009, while at the same time adhering to the relevant dispute resolution ethical guidelines. A discussion of diversity in ADR follows.

Case Law Developments

We start with a review of the arbitration decisions issued by the Supreme Court in the term commencing in October 2008: *Vaden v. Discover Bank*, *14 Penn Plaza v. Pyett* and *Arthur Andersen LLP v. Carlisle.* We follow with an analysis of the *Stolt-Nielsen SA v. AnimalFeeds Int'l Corp.* Second Circuit decision in which the Supreme Court granted *certiorari* and which raises for resolution the question of class actions in arbitrations and provides another opportunity for the Supreme Court to further clarify its position on manifest disregard. The question of the authority of the arbitrator to impose sanctions is the subject of the discussion of the Second Circuit decision in *Relia-Star Life Insurance Co. of New York v. EMC National Life Co.* In response to the current economic conditions, we cover the subject of what happens to an arbitration agreement when a bankruptcy is filed. Finally, we cover the ever-present question of whether you really agreed to arbitrate.

International Developments

We continue with our coverage of international ADR issues and especially invite articles in this arena to support the work of the new International Arbitration Subcommittee. In this issue we are fortunate to have an article by Professor Bermann, the Chief Reporter for the work being done by the American Law Institute to prepare a

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use of alternative dispute resolution. In its inaugural year, the DR Section crafted a report on potential national legislation that would have substantially restricted arbitration; that proposed legislation has now been altered reflecting our concerns. In addition, the Arbitration Committee of the DR Section crafted a report on discovery in domestic commercial arbitration that dealt with the critical issue of the balance between swift, cost-efficient arbitration and the need for discovery.

In the upcoming year, the DR Section will take on three demanding projects that relate to the expansion in the use of alternative dispute resolution. First, with respect to mediation, there has long been an issue as to whether there should be training or certification requirements for people to function as mediators. This issue will be addressed in a report that is being prepared by the mediation committee.

Second, there has long been a division in the New York courts as to whether and how to use alternative dispute resolution. The result has been an *ad hoc* approach involving magistrates and hearing officers, compulsory arbitration of certain claims in the Eastern District of New York and in certain small New York State court claims, selective mediation with respect to cases in the commercial division of the New York State Supreme Court, and the foreclosure settlement conferences referred to earlier. The ADR in the Courts Committee will address this issue in a systematic way.

Third, a new international arbitration subcommittee has been established in the Arbitration Committee and it will prepare a report focusing on New York's role in international arbitration.

In addition, a number of legislative proposals relating to arbitration, mediation and collaborative law will be the subject of DR reports and legislative activity.

The DR Section is also looking forward to an exciting meeting in the upcoming year. At the Annual Meeting, late January 2010 at the Hilton Hotel in New York City, we will put on a number of programs dealing with cutting-edge mediation and arbitration issues, including issues relating to the timing of mediation and class action arbitration. There will be additional joint programs with the International Practice and Entertainment, Arts and Sports Law sections and we look forward to collaboration with other sections in the future.

In short, this is a very dynamic area and we are fortunate to have many of the most prominent practitioners among the DR Section membership. There is room for a great number of people to participate and we look forward to the continued involvement of the current membership and new involvement by the thousands of NYSBA members who indicate that a significant part of their practice involves alternative dispute resolution.

Jonathan Honig

Message from the Editor *(continued from page 2)*

Restatement of the U.S. Law of International Commercial Arbitration. The *West Tankers* decision, which deals with anti-suit injunctions in the European Community, has created quite a stir across the pond and is discussed, along with its possible impact on arbitration in New York. As the Section's Mediation Committee embarks on its review of mediator certification, we include an article about the International Mediation Institute, which after several years of preparation has recently launched its certification platform for international mediators. Bringing back memories of the strong reactions to the New York *Hauzinger* decision last year, we discuss a case from England which is of considerable interest on the subject of mediator testimony. Finally, as a prelude to the discussion in our next issue in the Ethical Compass of the extent of the obligation of a New York attorney to advise on ADR and whether such obligations should be imposed, we include an article on recent parallel developments requiring solicitors in England and Wales to consider ADR with clients in disputes.

Mediation

Mediation has particular application and utility in different areas of practice for reasons related to the unique nature of each. This issue discusses mediation's special utility in resolving business divorces and insurance matters. We include a wonderful description of some creative non-monetary resolutions that truly accomplished the win-win objective of mediation and another example of a successful med-arb combination.

Much has transpired in recent months relevant to ADR and undoubtedly much will transpire in the coming months that will affect our ADR world. We look to all of you to keep us current by contributing to this publication and by alerting us to subjects you think we should cover. Please e-mail me with your input at esussman@SussmanADR.com and help make this publication a success.

Edna Sussman

Mediator Certification

The IMI Certification initiative (described in Michael Leathe's article) is an example of the mushrooming "quality control" or "branding" efforts of the mediation community, intended to bolster consumer confidence in mediators' competence and integrity. The question is whether certification is a good idea, and whether these efforts will be or should be left to individual organizations, like the IMI, or required by law as pre-requisites to mediating. The Mediation Committee has been asked to study this important issue and to report its findings and recommendations to the Section at the 2010 Annual Meeting. Readers are encouraged to share their views on mediator certification with the Committee by e-mail abigail@pessenadr.com.

International Arbitration Subcommittee

The Section has established a new subcommittee of the Arbitration Committee for international arbitration, an area with issues and concerns that differ in some ways from domestic arbitration. The new subcommittee, which will be chaired by John Fellas, is considering the preparation of a paper on international arbitration in New York State, a focus about which little has been written in recent years. The subcommittee is always interested in new members and invites all to join and contribute to its work.

Dispute Resolution Section Schedule of Executive Committee Meetings 2009-2010

All meetings, except the January meeting, will be held at:

Paul Hastings
75 East 55th Street, New York, NY
Conference Rooms 701/702
8:30 a.m.–10:00 a.m.

You can call into the meeting from wherever you are.

Please RSVP to Susan Fitzpatrick at sfitzpatrick@nysba.org if you plan to attend. She will send you the call-in number if you will not be attending in person.

November 19th	(Thursday)
December 17th	(Thursday)
January 28th	(Thursday—Annual Meeting at Hilton)
February 11th	(Thursday)
March 17th	(Wednesday)
April 15th	(Thursday)
May 19th	(Wednesday)

Please come—You are all invited to our meetings from all over the state

The Ethical Compass

The Jelly Beaner Challenge: How Attorneys Serving as Neutrals Identify and Coordinate the Ethical Mandates of the 2009 Rules of Professional Conduct with the Ethical Mandates of Dispute Resolution

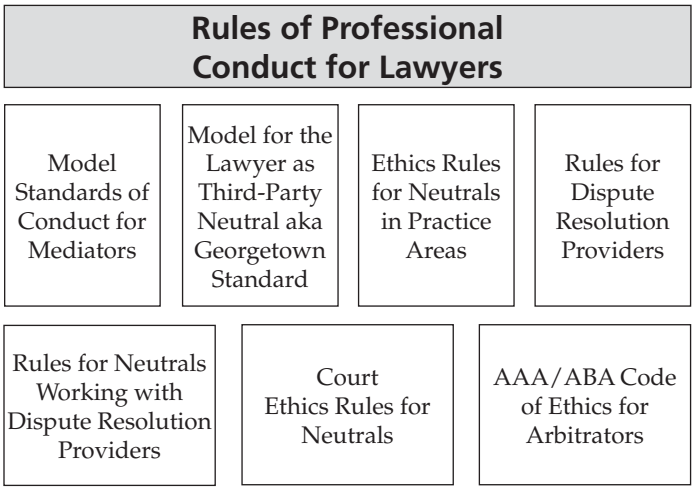
By Elayne E. Greenberg

Many of us may remember as children trying to master the coordination game Jelly Beaner, a joust in which the player is challenged to pat his or her head up and down with one hand while simultaneously rubbing his or her belly in a circular pattern with the other hand.

"[W]hen lawyers serve as third-party neutrals, we may be unnerved to discover that in addition to the Professional Rules for lawyers, multiple dispute resolution ethical codes are also applicable."

Competing movements, but with practice even those less coordinated can master how to synchronize their hands and play the game. So, too, those of us who are lawyers serving as neutrals are now engaging in a variant of the Jelly Beaner Challenge when it comes to discerning ethical behavior. How do we as third-party neutrals simultaneously follow the newly issued ethical mandates of the New York Part 1200 Rules of Professional Conduct for Lawyers that became effective April 1, 2009, while at the same time adhering to the relevant dispute resolution ethical guidelines? This column will elucidate the implications of three rules in the 2009 Rules of Professional Conduct that are applicable to third-party neutrals: conflicts, clarification of attorney/neutral role and confidentiality.[1] Then we will discuss how ethical practitioners may coordinate the mandates of the Professional Rules with the Model Standards of Conduct for Mediators, a representative ethics code for third-party neutrals.[2] We'll start off easy and progress to the greater challenges. Let's learn how to play.

Some fundamental background information may be helpful. Of course, first and foremost, we are lawyers, and as lawyers we are obligated to follow the Rules of Professional Conduct. What is sometimes forgotten is that our ethical obligations as lawyers remain with us even while we are serving as third-party neutrals. Moreover, when lawyers serve as third-party neutrals, we may be unnerved to discover that in addition to the Professional Rules for lawyers, multiple dispute resolution ethical codes are also applicable (*see diagram below).* Even more confounding, although each of these dispute resolution ethical codes offers its own brand of ethical wisdom, they fail to guide about how to interface with each other. The scale of this article requires that we limit our discussion to how the 2009 Rules of Professional Conduct affect neutrals' conduct and how these rules interface the Model Standards of Conduct for Mediators.



To begin, one of the ever-important issues, conflicts of interest, is addressed in Rule 1.12 of the 2009 Rules of Professional Conduct as it applies to *subsequent* employment limitations for those who have judged, arbitrated, mediated or served as another type of third-party neutral.[3] Rule 1.12 has economic implications not only for neutrals, but also for the firms that employ them.[4] As we may well appreciate, the integrity of dispute resolution processes is judged by the fairness of its procedures and the impartiality of its neutrals. Rule 1.12 seeks to preserve the integrity of dispute resolution processes proactively by signaling that while lawyers are serving as neutrals, they shall not conduct themselves in any way that garners future employment from one of the parties, and possibly taints the dispute resolution process as a whole.[5] Specifically, Rule 1.12 provides:

> (a) A lawyer shall not accept private employment in a matter upon the merits of which the lawyer has acted in a judicial capacity.

(b) Except as stated in paragraph (e), and unless all parties to the proceeding give informed consent, confirmed in writing, a lawyer shall not represent anyone in connection with a matter in which the lawyer participated personally and substantially as:

(1) An arbitrator, mediator or other third-party neutral; or

(2) A law clerk to a judge or other adjudicative officer or an arbitrator, mediator or other third-party neutral.

(c) A lawyer shall not negotiate for employment with any person who is involved as a party or as lawyer for a party in a matter in which the lawyer is participating personally and substantially as a judge or other adjudicative officer or as an arbitrator, mediator or other third-party neutral.

(d) When a lawyer is disqualified from representation under this Rule, no lawyer in a firm with which that lawyer is associated may knowingly undertake or continue representation in such a matter unless the firm acts promptly and reasonably to:

(1) notify, as appropriate, lawyers and nonlawyer personnel within the firm that the personally disqualified lawyer is prohibited from participating in the representation of the current client;

(2) implement effective screening procedures to prevent the flow of information about the matter between the personally disqualified lawyer and the others in the firm;

(3) the disqualified lawyer is apportioned no part of the fee therefrom;

(4) written notice is promptly given to the parties and any appropriate tribunal to enable it to ascertain compliance with the provisions of this Rule; and

(5) there are no other circumstances in the particular representation that create an appearance of impropriety.

(e) An arbitrator selected as a partisan of a party in a multimember arbitration panel is not prohibited from subsequently representing that party.[6]

A careful reading of the rule alerts that lawyers serving as neutrals may be precluded from subsequent employment with any of the parties in a matter that the lawyer personally and substantially had participated in as a neutral.[7] The rule distinguishes different neutral roles. For example, lawyers who were former judges are not allowed to subsequently represent a client on a matter in which that judge was involved in on the merits.[8] However, lawyers who have served as arbitrators, mediators, third-party neutrals, law clerks to a judge, other adjudicative officers and arbitrators, other than a partisan arbitrator, are precluded from representing anyone in a matter in which they participated personally or substantially in the aforementioned roles *unless* they have all parties' informed consent that is confirmed in writing.[9] Note that partisan arbitrators are allowed to subsequently represent a party.[10] Supposedly, it is understood that there is no expectation that partisan arbitrators are selected for their neutrality.

Of economic interest to firms that have members serving as neutrals, when a lawyer is disqualified from representation under this rule, the firm may also be precluded from representing the party *unless* it implements the specified safeguards.[11] The firm needs to construct a screen that prevents the transmission of any information between legal and non-legal employees of the firm and the attorney disqualified under Rule 1.12.[12] Expectedly, the disqualified attorney is prohibited from receiving any fees from this matter. Moreover, the firm must notify the tribunal and parties involved *in writing* about the screening procedures that have been instituted to ensure that they are able to monitor the firm's compliance with those procedures.

Rule 1.12 may have reverberating financial impact on neutrals and the firms that employ them as lawyers. As increasing numbers of attorneys foray into the dispute resolution practice while maintaining their existing legal practice, this will become a growing problem. Initially, many firms may have encouraged their members to expand their skills to include dispute resolution, believing that such diversification may open up economic opportunities for the firm. However, Rule 1.12 raises the possibility that this practice may in fact be an obstacle to overcome.[13] Rule 1.12 also leaves some questions unanswered. Is a former employee of a law firm who leaves the firm, but still leases space from that firm to conduct the dispute resolution business, still creating the appearance of being a member of the firm for Rule 1.12 purposes? Do the issues addressed in Rule 1.12 have a statute of limitations or do they exist in perpetuity?[14]

When we turn to the Model Standards of Conduct for Mediators, we see that the topic of conflicts of interest is also a focus, but with a different emphasis. Standard III, CONFLICTS OF INTEREST, addresses the subject matter in a broader time frame including: prior to, during and subsequent to the conclusion of the mediation. Let's see

how the Model Standards address conflicts of interest compared to Rule 1.12.[15]

Standard III (a) states,

> a mediator shall avoid a conflict of interest or the appearance of a conflict of interest during and after a mediation. A conflict of interest can arise from involvement by a mediator with the subject matter of the dispute, or from any relationship between a mediator and any mediation participant, whether past or present, personal or professional, that reasonably raises a question of a mediator's impartiality.[16]

Then, Standard III (f) instructs,

> Subsequent to a mediation, a mediator shall not establish another relationship with any of the participants in any way that would raise questions about the integrity of the mediation. When a mediator develops personal or professional relationships with parties, other individuals or organizations following a mediation in which they were involved, the mediation should consider factors such as time elapsed following the mediation, the nature of the relationships established, and services offered when determining whether the relationships might create a perceived or actual conflict of interest.[17]

We see that the Model Standards prohibit mediators from engaging in any relationship with any of the participants subsequent to the mediation if it would call into question the integrity of the mediation.[18] According to the Model Standards, the characterization of a conflict of interest may be subject to interpretation based on the criteria delineated.[19]

Getting back to our challenge of coordinating ethical codes, we see both the Professional Rules and the Model Standards attend to the management of conflicts of interest as vital to preserving the integrity of dispute resolution. However, Rule 1.12 delineates with greater specificity how mediators, arbitrators and other third-party neutrals and the law firms that employ them should address these conflicts.[20] Lawyers serving as third-party neutrals, aware of the broader focus of the Model Standards of Conduct for Mediators and the specific edicts of Rule 1.12, can integrate both codes' guidance into their ethical practice, knowing they have passed level one of the Jelly Beaner Ethical Challenge.[21]

Another issue of welcomed elucidation for third-party neutrals is the 2009 Rules of Professional Conduct Rule 2.4, which clarifies the distinction between the role of lawyers and lawyers serving as third-party neutrals.[22] Rule 2.4 provides:

> (a) A lawyer serves as a "third-party neutral" when the lawyer assists two or more persons who are not clients of the lawyer to reach a resolution of a dispute or other matter that has arisen between them. Service as a third-party neutral may include service as an arbitrator, a mediator or in such other capacity as will enable the lawyer to assist the parties to resolve the matter.
>
> (b) A lawyer serving as a third-party neutral shall inform unrepresented parties that the lawyer is not representing them. When the lawyer knows or reasonably should know that a party does not understand the lawyer's role in the matter, the lawyer shall explain the difference between the lawyer's role as a third-party neutral and a lawyer's role as one who represents a client.[23]

Rule 2.4 explains that lawyers who serve as third-party neutrals are helping parties resolve a dispute but they are *not* the attorney's clients.[24] Rule 2.4 makes a point of saying that lawyers serving as a third-party neutral have an ongoing obligation to inform unrepresented parties of this distinction.[25] The neutral is just the neutral, not their lawyer, too. Parties are not getting "two for the price of one" and lawyers may need to repeatedly dispel this commonly held, mistaken belief of *pro ses*. Such *pro se* statements to a third-party neutral as "I'm so glad you're working with me. You'll protect me"; "I don't know the law, but I'm sure you're not going to let me make a bad deal"; and "What do you think about that legal proposal?" are representative statements that call into action the Rule 2.4 requirements.

Rule 2.4 suggests that lawyers serving as third-party neutrals may need to review the frequency in which they clarify their role.[26] Many lawyers serving as third-party neutrals report that they always begin mediation and include in their Agreement to Mediate a statement that they are not the parties' lawyer. However, Rule 2.4 makes it clear that the responsibility to clarify may be ongoing, and once may not be enough.[27] Ethically conscious attorneys will have to vigilantly listen to *pro ses* to ensure that *pro ses* have a clear understanding of the third-party neutral's role.

Implicit in Rule 2.4 is a third-party-neutral's obligation to refrain from a conduct that might be misconstrued to be lawyerly.[28] If you say you are not acting as the parties' lawyer, then don't. This calls into question whether controversial practices such as evaluation and agreement

drafting by third-party neutrals might be in contravention of this rule. Moreover, this is another factor to be included in the ongoing debate that seeks to clarify the murkiness that sometimes exists between the role of a lawyer and the role of a neutral.

Although the Model Standards don't address the issue of clarification of roles with the specificity of Rule 2.4, the Model Standard VI(5), QUALITY OF THE PROCESS, addresses the issue in a more generic way. According to Standard VI(5):

> The role of a mediator differs substantially from other professional roles. Mixing the role of a mediator and the role of another profession is problematic and thus, a mediator should distinguish between the roles. A mediator may provide information that the mediator is qualified by training or experience to provide, only if the mediator can do so consistent with the standard.[29]

With a cautionary note, Standard VI(6) warns:

> A mediator shall not conduct a dispute resolution procedure other than mediation but label it mediation in an effort to gain the protection of rules, statutes, or other governing authorities pertaining to mediation.[30]

Again, ethically minded lawyers who also serve as third-party neutrals may breathe a sigh of relief to find that the Professional Rules and Model Standards both address clarification of roles. However, we see that the Professional Rules impose a greater obligation on lawyers to ensure that *pro ses* understand the distinction between the role of lawyer and the role of a lawyer who is serving as a third-party neutral.[31] Another Jelly Beaner Ethical Challenge met!

Finally, the thorniest issue we are going to tackle is how lawyers serving as third-party neutrals balance their ethical obligation to report professional misconduct of their colleagues with their ethical obligation to maintain the confidentiality of the dispute resolution process. This is the ultimate Jelly Beaner Ethical Challenge.

According to Rule 8.3 of the 2009 Professional Code, REPORTING ETHICAL MISCONDUCT:

> (a) A lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer shall report such knowledge to a tribunal or other authority empowered to investigate or act upon such violation.
>
> (b) A lawyer who possesses knowledge or evidence concerning another lawyer or a judge shall not fail to respond to a lawful demand for information from a tribunal or other authority empowered to investigate or act upon such conduct.
>
> (c) This Rule does not require disclosure of:
>
> (1) information otherwise protected by Rule 1.6; or
>
> (2) information gained by a lawyer or judge while participating in a bona fide lawyer assistance program.[32]

Thus, Rule 8.3 obligates a lawyer to report another lawyer that "has committed a violation of the Rules . . . that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer. . . ."[33] As a reminder, lawyers serving as neutrals are included among the lawyers that *shall* report misconduct of another lawyer in a mediation or arbitration they are conducting.[34] Disclosure is exempted if the information is otherwise protected by Rule 1.6 or because it was made while the "judge or attorney was participating in a bona fide lawyer assistance program."[35]

One rule that third-party neutrals are likely to see violated in the dispute resolution context is Rule 4.1, TRUTHFULNESS IN STATEMENTS TO OTHERS. Rule 4.1 informs, "In the course of representing a client, a lawyer shall not knowingly make a false statement of fact or law to a third person.[36] Interestingly, Rule 4.1 prohibits false statements of fact or law that are *intentionally* made, not those out of ignorance.[37] Rule 4.1 is particularly noteworthy because the prohibition found in the rule covers any statement of fact, not just material statements as previously required.[38] Moreover, Rule 4.1 calls into question the accepted negotiation behavior by those who frequently make false statements as part of a negotiation strategy.[39] Is it possible that the 2009 Rules are raising the bar of truthfulness to a higher level than previously required? Connecting the dots, lawyers serving as third-party neutrals are obligated to report any false statements knowingly made by their colleagues in a mediation or arbitration.[40]

You may be wondering how this ethical mandate comports with the ethical mandate of the Model Standards of Conduct for Mediators on confidentiality. Closer examination of the Model Standards of Conduct for Mediators in Standard V, CONFIDENTIALITY, offers a helpful way for lawyers serving as mediators to address the issue.[41] The relevant parts instruct:

> A. A mediator shall maintain the confidentiality of all information obtained by

the mediator in mediation, unless otherwise agreed to by the parties or required by applicable law.

1. If the parties to a mediation agree that the mediator may disclose information obtained during the mediation, the mediator may do so.

* * *

D. Depending on the circumstance of a mediation, the parties may have varying expectations regarding confidentiality that a mediator should address. The parties may make their own rules with respect to confidentiality, or the accepted practice of an individual mediator or institution may dictate a particular set of expectations.[42]

We see that lawyers serving as third-party neutral may still honor the their ethical obligation to report the misconduct of our colleagues, which is required by Rule 8.3 of the Professional Rules, while preserving the confidentiality of mediation.[43] As explained in the Model Standards, at the onset of mediation the mediator may, in consultation with the parties, clarify which mediation communication will remain confidential and which will not.[44] If a lawyer serving as a mediator clarifies prior to the commencement of mediation that attorney statements that are a violation of the Professional Rules and will not receive the mediation confidentiality protection, parties will have a clearer expectation of what is able to remain under the mediation confidentiality umbrella.[45] Moreover, it will signal to attorneys participating in mediation to be more vigilant about the accuracy of the statements they utter in mediation.[46] Of curiosity, informal surveys conducted by this author of several hundred practicing neutrals at annual Bar Association meetings and dispute resolution trainings reveal that not one—yes, not one—neutral has ever reported a colleague for such false statements. Possibly this speaks to individual's personal ethical codes that are ever-present, but have not been explicitly discussed in this column. Another Jelly Beaner Challenge mastered!

As we are experiencing, the ethical landscape for lawyers serving as third-party neutrals is neither clearly defined nor internally consistent. Moreover, the context, values, and guidance offered by the 2009 Rules of Professional Conduct are different than the context, values, and guidance offered by such dispute resolution codes as the Model Standards of Conduct for Mediators. The Rules of Professional Conduct for Lawyers were reasoned from an adversarial paradigm in which lawyers function as zealous advocates in the context of litigation. Tenets of that code are zeal, client loyalty, partisanship, individual gain and non-accountability.[47] In direct contrast to the adversarial-based paradigm of the Professional Rules, the Model Standards of Conduct for Mediators, like other ethical codes for third-party neutrals, were promulgated to guide neutrals functioning in a non-adversarial context. The values reinforced in these non-adversarial ethical codes include: problem-solving, party self-determination, confidentiality, trust, openness and creativity.[48] Thus, there is no surprise that these foundational distinctions between the ethics codes for lawyers and the ethics codes for neutrals result in areas of convergence and divergence.

"[T]he ethical landscape for lawyers serving as third-party neutrals is neither clearly defined nor internally consistent."

Noted ethical commentators such as Julie MacFarlane,[49] Carrie Menkel-Meadow,[50] and Jacqueline Nolan-Haley[51] have raised the inadequacies of existing ethical codes for lawyers now practicing in more collaborative and non-adversarial ways and have called for a revamping of existing codes. Until then, as lawyers serving as third-party neutrals we need to be aware of the applicable ethical codes that may be relevant to our practice, vigilant about the differences, and decipher ways to integrate their mandates into a coordinated ethical practice.

Endnotes

1. 22 N.Y.C.R.R. Part 1200 R. 1.12 (2009); 22 N.Y.C.R.R. Part 1200 R. 2.4 (2009); 22 N.Y.C.R.R. Part 1200 R. 8.3 (2009).
2. *See* Model Standards of Conduct for Mediators Standard III (2005); *see* Model Standard of Conduct for Mediators Standard VI (5) (2005); *see* Model Standards of Conduct for Mediators Standard V (2005).
3. *See supra* note 1, at R. 1.12 (2009).
4. *Id.*
5. *Id.*
6. *Id.*
7. *Id.*
8. *Id.* at R. 1.12 (a).
9. *Id.* at R. 1.12 (b).
10. *Id.* at R. 1.12 (e).
11. *Id.* at R. 1.12 (d).
12. *Id.*
13. *Id.*
14. *Id.*
15. *See supra* note 2, at Standard III (2005).
16. *Id.* at III (a).
17. *Id.* at III (f).
18. *Id.*
19. *Id.*
20. *See supra* note 1, at R. 1.12 (2009).

21. *Id.*
22. *See supra* note 1, at R. 2.4 (2009).
23. *Id.*
24. *Id.*
25. *Id.* at R. 2.4 (b).
26. *Id.*
27. *Id.*
28. *Id.*
29. *See supra* note 2, at Standard VI (5) (2005).
30. *Id.* at VI (6).
31. *See supra* note 1, at R. 2.4 (2009).
32. *See supra* note 1, at R. 8.3 (2009).
33. *Id.* at R. 8.3 (a).
34. *Id.*
35. *Id.* at R. 8.3 (c) (1).
36. *See supra* note 1, at R. 4.1 (2009).
37. *Id.*
38. *Id.*
39. *Id.*
40. *See supra* note 1, at R. 4.1 (2009).
41. *See supra* note 2, at Standard V (2005).
42. *Id.*
43. *Id.*; *see also supra* note 1, at R. 8.3 (2009).
44. *See supra* note 2, at Standard V (2005).
45. *See id.*
46. *See id.*
47. *See, e.g.,* Carrie Menkel-Meadow, *When Dispute Resolution Begets Disputes of Its Own: Conflicts Among Dispute Professionals*, 44 UCLA L. REV. 1871, 1913–14 (Aug. 1998).
48. *Id.*
49. *See, e.g.,* Julie MacFarlane, *The Evolution of the New Lawyer: How Lawyers are Reshaping the Practice of Law*, 2008 J. DISP. RESOL. 61, 80 (2008) (noting the rise of adversarialism is at odds with many significant changes occurring in the legal practice).
50. *See, e.g.*, Carrie Menkel-Meadow, *Ethics in ADR Representation: A Road Map of Critical Issues*, DISP. RESOL. MAG., Winter 1997, at 3–4; *see also* Menkel-Meadow, *supra* note 47, at 1911–22.
51. *See, e.g.,* Jacqueline Nolan-Haley, *Informed Consent in Mediation: A Guiding Principle for Truly Educated Decisionmaking*, 74 NOTRE DAME L. REV. 775, 799–804 (1999).

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Diversifying the ADR Field

By Erin Gleason Alvarez

Introduction

Law firms and corporate law departments have undertaken numerous efforts to diversify their ranks. These efforts to diversify the practice of law are well known and well advertised. Many firms and in-house law departments have instituted initiatives to encourage "minority" inclusion. The efforts include establishing diversity officers/departments, recruitment and retention programs, mentoring and training programs. While these plans are generally positive steps toward including underrepresented ethnic and racial minorities, women, persons with disabilities, lesbian, gay, bisexual, and transgender (LGBT) people, and other diverse groups ("underrepresented groups" or "minorities") into the practice of law, the initiatives have had varying degrees of success.

Efforts to promote diversity among mediators and arbitrators are more limited. Dispute resolution provider organizations ("ADR providers"),[1] Bar Associations, and other organized efforts have promoted Alternative Dispute Resolution (ADR) diversity programs but it is difficult to gauge the level of success achieved through these programs. Very few studies have been conducted on underrepresented groups' involvement in ADR. Mentoring and training programs for members of these groups have not been well-received by ADR users. Selection criteria for mediators and arbitrators often fail to include issues related to diversity. A perusal of ADR provider rosters demonstrates that these lists are not diverse.

This article will make recommendations as to how the ADR field can build on law firm and law department models for promoting diversity among mediators and arbitrators. The first section will outline ways that underrepresented groups are excluded from ADR, while the following section will analyze how law firms and corporations have encouraged diversity in their ranks and review how some of these efforts can be adapted for the ADR field.

Diversity and ADR

Diversity is a crucial element to any field. In dispute resolution, it is essential to have mediators and arbitrators with many different perspectives to handle the plethora of claims needing resolution. A diverse pool of ADR professionals also provides the field with the ability to connect with diverse populations through varied problem-solving techniques. Diversity in ADR fosters the development of more creative negotiations and ways to identify party interests. Moreover, many "corporate law departments say they need no convincing that diversity in ADR is a business necessity. They say it is self-evident to any business that has a diverse customer base, has a diverse vendor list, or is growing in a diverse market, that they need counsel with diverse viewpoints, advisors from diverse backgrounds, and problem-solvers with diverse perspectives."[2]

One recent study examined "factors affecting participation, or lack thereof, by underrepresented racial and ethnic groups in the 'supply' side of the dispute resolution field, which includes practitioners, educators, administrators, and trainers."[3] Here, researchers found three general categories of barriers to the ADR field. These include:

- ***Universal barriers:*** This category includes obstacles experienced by many people who are interested in the ADR field. However, the study found that universal barriers are even more difficult for minorities to overcome. The lack of access to information about the field, the need for a clearer entry point and career path, ambiguity over acceptable credentials, and limited access to compensated rosters all inhibit diversity in ADR.
- ***Specific barriers for minorities to enter the field:*** The study also found that members of certain underrepresented groups had formidable constraints in attempting to enter the ADR field. This includes limited opportunities for ADR work, a lack of role models, challenges for people with accents—or where English is the second language, prejudice, and difficulty in achieving financial gains through work as a mediator or arbitrator.
- ***Barriers for minorities in ADR:*** Members of underrepresented groups already participating in the ADR field complained that they are often isolated and fear retribution or elimination for promoting other minorities.[4]

By looking at existing practices for encouraging diversity, the ADR field can work to support more inclusion and participation by underrepresented groups. These practices include re-thinking methods for recruiting and selecting ADR professionals, professional development strategies, appointing committees to promote diversity in ADR, and collecting data on minority performance and inclusion in ADR. Each of these factors is analyzed in the following discussion.

Recommendations

Many law firms began to adopt comprehensive diversity programs within the past decade.[5] In developing these initiatives, firms have focused on the following criteria for their diversity programs:

- They are used to eliminate imbalances in traditionally segregated positions.
- They do not unnecessarily inhibit the interests of non-minority workers or create a barrier to advancement of non-minority employees.

- They are viewed as temporary measures to eliminate an imbalance and are not intended to sustain balance.[6]

In-house law departments have also developed mandates for their law firms, requiring that firms prove their commitment to diversity. In 2004, Roderick Palmore, who served as general counsel of Sara Lee, released the Call to Action document, which urges corporations to commit to diversity. Approximately 100 general counsels signed the Call to Action, which obligates corporations to:

- Make a binding commitment to diversity within their legal departments;
- Actively look for opportunities with law firms that distinguish themselves in diversity issues;
- End relationships with firms whose record of accomplishment reflects a lack of meaningful interest in diversity.[7]

The ways law firm and in-house programs encourage diversity include the following examples. Each of these programs can be leveraged by the ADR field to develop a more inclusive community of practitioners.

Recruiting

These efforts can take many different forms. Firms and law departments offer internships to minority students, encouraging them to consider legal careers. Many participate in minority law student recruiting programs. However, the most recent Minority Corporate Counsel Association's (MCCA) report on law firm diversity determined that law firms limit opportunities for recruiting highly qualified and diverse lawyers by "staying frozen in historical recruiting models, instead of broadening the recruiting pool."[8] In fact, the report found that the standards for recruiting minorities were higher than the standards for whites. Instead of focusing so much on law school, school ranking, and grade point average, the study suggested that firms should focus more on "reality-based" hiring criteria. In the hiring process, firms should focus on criteria that are proven to lead to success.

While the ADR field continues to grow exponentially, minority mediators and arbitrators continue to be underrepresented. "Not only have minorities been disproportionately excluded from ADR rosters and panels, they are often not selected as trainers in a myriad of training programs provided by colleges and universities, private training organizations and governmental agencies."[9] In 2004 and 2005 surveys, minority ADR neutrals identified selection practices and processes as the main obstacle to gaining access to work in the field.[10] This continues to be true today, though studies show that individuals involved in ADR processes are more comfortable "when they share some aspect of their identity with those guiding the process."[11]

Similar to the hiring processes for attorneys, the neutral roster appointment and party selection processes can depend on factors that do not necessarily focus on success. Parties may rely on big names, hefty prices, and prestigious backgrounds in determining the "best" mediators and arbitrators. However, these are not true measures of a neutral's ability to problem solve effectively, facilitate negotiations, or draft a sound award. ADR providers, law firms, and corporations should look at individual achievements when selecting ADR professionals for their panels. While experience, negotiation style, and reputation are clearly important factors in considering ADR professionals, current selection practices should be evaluated to ensure that diversity is achieved. An ADR professional's capabilities should be assessed according to "reality-based" criteria.

Professional Development

Law firms and law departments encourage the professional development of minority lawyers though various measures, including mentoring and training programs. Attorney mentoring programs have been created externally, to introduce students to the practice of law or, internally, to encourage the professional development of associate attorneys and new partners. Special mentoring programs have also been established for minority students and lawyers. Other programs have been established for minority lawyers to assist them in networking, client development, and relationship building.

ACCESS ADR is one example of a professional development program that was designed to promote minority ADR professionals. Three experienced ADR professionals were selected to serve as ACCESS ADR fellows in 2005. Fellows were to be "exposed to a group of ADR service-users by mediating cases provided by those users for a period of about 18 months."[12] During this time, fellows would be evaluated by the parties and the ACCESS ADR advisory board was to provide fellows with feedback on their performance.[13] "At the end of the fellowship period, the fellow would be expected to have developed a reputation for excellence among those users with whom he or she would have had experience and exposure."[14] However, fellows were not selected often by participating ADR users. Between June 2006 and June 2007, ACCESS ADR received several serious case inquiries, but only two case assignments.[15] In 2008, ACCESS ADR changed its focus to a "micro-user" of ADR in order to obtain cases for the fellows.[16]

Mentoring programs for minority ADR professionals could be an ideal way to introduce new mediators and arbitrators to the field. However, the task of securing a committed mentor is a challenge for any ADR professional and can be particularly difficult for minorities. ADR organizations offer an ideal environment for mentoring minority ADR professionals. Tenured mediators and arbitrators could agree to work with minorities who are trying to break into the field for a designated period of time. During the mentorship, the mentee should shadow the mentor in mediations or arbitrations, attend networking events with

the mentor, speak on panels before potential clients with the mentor, and seek guidance from the mentor on how to develop his or her practice.

Law firms might also encourage their successful litigators from underrepresented groups to cultivate dispute resolution practices. This would not only boost diversity in the ADR field, but also provide security to minority lawyers who would like to explore work as a mediator or arbitrator.

Diversity Committees and Diversity Officers

Many firms and law departments have created diversity committees and/or hired diversity officers to oversee efforts to help the organization become more inclusive. Members of senior management often participate in these commissions, helping to stress leadership's commitment to becoming more diverse and inclusive. Committee and/or officer efforts include sponsorship of programs or events that promote diversity, collection and analysis of data on diversity, and adoption of standards for hiring and promoting minority lawyers.

Most ADR providers have made efforts to be more inclusive and to promote diversity in the dispute resolution field. Nonetheless, most of their rosters continue to lack diversity. ADR provider organizations, law firms, and corporations could develop similar committees or specialists to promote diversity among mediators and arbitrators with whom they work. The purpose of these groups would be to affirm the organization's commitment to diversity, not only within its own ranks, but also among those with which it does business. The ADR diversity committees' and/or officers' efforts would focus on the development of programs to promote diversity in ADR, collection and analysis of data on the usage of minority ADR professionals, and development of suggestions that encourage the selection of minority mediators and arbitrators.

Data Collection

Law firms, corporations, legal publications, and other organizations now closely track the level of minority penetration among lawyers. However, it is extremely rare to find any statistical information about the work performed by minority ADR professionals. One recent survey of minority ADR professionals in the New York City area found that minorities perceive their barriers for entering the ADR field much higher than that experienced by whites.[17] But it is difficult to obtain any information on how many minority ADR professionals are affiliated with ADR providers, how often they work, or whether they have successful practices. This information would be very helpful to the ADR community for evaluating the causes for disparity in the field and developing solutions for increased diversity.

Conclusion

While efforts to diversify the practice of law are still evolving, attempts at bringing diversity to ADR are more limited and less successful. While law firms and corporations have committed to promoting diversity within their own ranks, there is more work to be done in promoting diversity among the mediators and arbitrators with whom they work. This article has offered some suggestions for ADR providers, law firms, and organizations to consider in order to be better sponsors of diversity in ADR.

Endnotes

1. ADR providers are those organizations that facilitate mediation, arbitration, and other dispute resolution mechanisms by providing rules and a roster of mediators and arbitrators.
2. F. Peter Phillips, *Diversity in ADR: More Difficult to Accomplish than First Thought*, 15 No. 3 Disp. Resol. Mag. 14 (2009).
3. Maria R. Volpe, *et al., Barriers to Participation: Challenges Faced by Members of Underrepresented Racial and Ethnic Groups in Entering, Remaining, and Advancing in the ADR Field*, 35 Fordham Urb. L.J. 119, 123 (2008).
4. *Id.* at 136.
5. Minority Corporate Counsel Association, *The Next Steps in Understanding and Increasing Diversity & Inclusion in Large Law Firms, available at* http://www.mcca.com/_data/global/images/Research/5298%20MCCA%20Pathways%20final%20version%202009.pdf, stating, ". . . in 2002, most law firms were not actively pursuing diversity programs. They had not organized firm-wide diversity committees. No law firm had a dedicated professional serving as a diversity director or chief diversity officer. Many were debating whether collecting data regarding the firm's diversity progress was legal . . ." (last visited June 20, 2009).
6. *See United Steelworkers v. Weber*, 443 U.S. 193, 197 (1979).
7. Call to Action, *available at* http://clocalltoaction.com/ (last visited June 20, 2009).
8. MCCA Study, *supra* note 5.
9. Floyd D. Weatherspoon, *Eliminating Barriers for Minority ADR Neutrals*, *available at* http://www.law.capital.edu/Faculty/Publications/ACResolution_Weatherspoon.pdf (last visited June 20, 2009).
10. *Id.*
11. Volpe, *supra* note 3, citing Gary LaFree & Christine Rack, *The Effects of Participants' Ethnicity and Gender on Monetary Outcomes in Mediated and Adjudicated Civil Cases,* 30 Law & Soc'y Rev. 767 (1996).
12. Marvin E. Johnson and Homer C. La Rue, *The Gated Community: Risk Aversion, Race, and the Lack of Diversity in Mediation in the Top Ranks*, 15 No. 3 Disp. Resol. Mag. 17, 18 (2009).
13. *Id.*
14. *Id.*
15. *Id.*
16. *Id.* at 19.
17. *See* Volpe, *supra* note 3, at 136–142.

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The opinions expressed in this article are that of the author and should not be attributed to Chartis Insurance or practices regarding the resolution of any claim.

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The Obama Administration Establishes a New Era of Transparency, Public Involvement and Collaboration

By Joseph A. Siegel

Dispute resolution is a phrase that is often associated with matters involving disputes that have already been joined. Resolution of those disputes can take place using neutrals, as in the case of mediation and arbitration. However, many dispute resolution professionals also act as neutrals when disputes are not yet joined. For example, neutrals may be called upon to facilitate collaborative processes designed to resolve important public policy decisions in a collaborative manner. Success in collaborative processes requires, among other things, engagement of the appropriate stakeholders and buy-in from those stakeholders. Another important element of most collaborative processes, particularly those involving government, is transparency. The Obama administration, in its first half-year, has begun to build a framework for transparency, collaboration and citizen engagement in order to address many of the important policy issues facing our nation.

On his first day in office, President Obama issued the Transparency and Open Government Memorandum for the heads of federal executive departments and agencies.[1] The Memorandum ushered in a new era in which the federal government is charged with being transparent, participatory, and collaborative. This new approach to governing is intended to promote accountability and engage citizens in the work of their government with the goal of fostering increased effectiveness and improved decision-making. The Memorandum also instructs federal departments and agencies to use "innovative tools, methods, and systems to cooperate among themselves, across all levels of government, and with organizations, businesses, and individuals in the private sector."[2]

In the Transparency and Open Government Memorandum, the President directed the Office of Management and Budget (OMB), together with the Chief Technology Officer and General Services Administration, to make recommendations within 120 days regarding issuance of an Open Government Directive. As a result, OMB launched the Open Government Initiative on May 21, 2009 to involve the public in making the recommendations.[3] The Open Government Initiative consists of three phases. The first phase, called the Open Government Dialogue, ran from May 21 to May 29, 2009 and asked citizens to answer the question, electronically, "How can we strengthen our democracy and promote efficiency and effectiveness by making government more transparent, participatory, and collaborative?" The second phase consisted of an online discussion that began on June 3, 2009, and the third phase, which ran from June 15 to July 8, 2009, was a public electronic drafting of recommendations for the Open Government Directive.[4] The draft recommendations are currently being reviewed by government officials in order to prepare for the next steps in implementing the President's Transparency and Open Government Memorandum.[5]

In another move to increase involvement in the federal government, on May 11, 2009 the President launched a new Office of Public Engagement "to engage as many Americans as possible in the difficult work of changing this country. . . ."[6] This office replaced the Office of Public Liaison and will have a new focus on obtaining ideas and information from the American people through public events and online interaction.[7]

"The Obama administration . . . has begun to build a framework for transparency, collaboration and citizen engagement . . ."

In addition to actively engaging the public in the business of the federal government, President Obama, on his first day in office, issued a Memorandum regarding the Freedom of Information Act (FOIA).[8] The FOIA Memorandum requires the federal government to return to the Clinton-era presumption in favor of disclosure.[9] This approach had been reversed by President Bush in the wake of the September 11 attacks.[10] President Obama's FOIA Memorandum goes further than the Clinton approach in that it calls upon federal departments and agencies to take "affirmative steps to make information public" and not "wait for specific requests from the public."[11] On March 19, 2009, Attorney General Eric Holder issued a Memorandum for Heads of Executive Departments and Agencies implementing the President's FOIA Memorandum.[12] In keeping with the President's philosophy, the Attorney General Memorandum indicates that "agencies should readily and systematically post information online in advance of any public requests."[13]

The Obama Administration's early and decisive departure from the previous Administration's philosophy on transparency and public involvement signals a new era of open government. It is now up to the federal departments and agencies to implement President Obama's agenda. There is reason to expect that we will see many interesting developments in the coming months and years as the federal government becomes more transparent, participatory and collaborative.

Endnotes

1. http://www.whitehouse.gov/the_press_office/TransparencyandOpenGovernment/.
2. *Id.*
3. http://www.whitehouse.gov/open/.
4. http://blog.ostp.gov/.
5. *Id.*
6. http://www.whitehouse.gov/the_press_office/President-Obama-Launches-Office-of-Public-Engagement/.
7. *Id.*
8. http://www.whitehouse.gov/the_press_office/FreedomofInformationAct/.
9. http://www.usdoj.gov/oip/foia_updates/Vol_XIV_3/page3.htm.
10. http://www.doi.gov/foia/foia.pdf.
11. http://www.whitehouse.gov/the_press_office/FreedomofInformationAct/.
12. http://www.usdoj.gov/ag/foia-memo-march2009.pdf.
13. *Id.*

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Justice Sotomayor's Position on Arbitration: A Survey of Past Cases and a View to the Future

By Quinn Smith

President Obama's decision to nominate Sonia Sotomayor to the Supreme Court has created the usual buzz of publicity and review of her work, experience, and character. While many commentators have focused on such hot button issues as abortion, gay rights, or allegations of "judicial activism," other important topics need to be addressed. Specifically, it is important to note Judge Sotomayor's position on arbitration. Not all of the current justices have been completely supportive of arbitration, and recent opinions have illustrated a divide in the Court over arbitration-related issues. With potential changes to the Federal Arbitration Act (FAA) and the constant shifting of a diverse field of case law, Judge Sotomayor's decisions could be important.

To understand Judge Sotomayor's position on arbitration, this article will briefly look at a few significant, recent decisions involving her. First, the article will look at a recent case invalidating a class action waiver in the commercial context. Second, the article will study her decision in a case related to electronic commerce. Then the article will discuss an opinion focusing on the principle of separability. Finally, the article will note a few other decisions of interest to arbitration practitioners, students, and scholars. In general, these narrowly crafted and careful opinions reflect a nuanced view of arbitration and opinions carefully written to arrive at their conclusion.

In perhaps the most recent, notable case dealing with arbitration, Judge Sotomayor sat on a panel charged with deciding the validity of a class action waiver for commercial plaintiffs. In *In re American Express Merchants Litigation*,[1] the Second Circuit reversed the district court's decision to compel arbitration of the claims of a putative class of commercial entities and uphold the class action waiver. The plaintiffs had alleged violations of the Clayton Act. The Second Circuit declined to enforce the waiver because it found that cost constraints would preclude individual plaintiffs from bringing their claims without the class action device. While reiterating the court's strong support for the liberal federal policy favoring arbitration, the court provided a lengthy overview of the competing positions regarding class action waivers, noting the importance of class actions for remedying small claims. In an interesting twist, the court invalidated the arbitration clause not on unconscionability grounds, as had several other courts, but on a finding that under § 2 of the Federal Arbitration Act (FAA) valid grounds existed for revocation of that contractual clause because it denied the plaintiffs practical access to the courts.[2]

In the battle over class action waivers, the case made waves. Even though the court classified the case as one of first impression, it invalidated the class action waiver despite decisions by district courts and other courts of appeal upholding class action waivers. Potentially, the decision jeopardizes a number of other arbitration clauses. But the case shows a style of decision-making characteristic of Judge Sotomayor.

The decision is exceedingly narrow. The court went out of its way to limit its holding to a narrow set of facts, ruling it did not invalidate class action waivers *per se* and requiring a case-by-case showing of the substantive impossibility of bringing an individual claim. The opinion did not contain sweeping pronouncements on the freedom of contract or the protection of parties with unequal bargaining power. In fact, the opinion forswears any reasoning based on the size of the plaintiffs, and it rejects any potential hostility towards arbitration. In sum, the opinion is neither a victory for plaintiffs nor a stinging rebuke to corporate defendants. It is a narrow ruling balancing competing interests.

Judge Sotomayor's other representative cases demonstrate a similar tendency. In *Specht v. Netscape Communications Corp.*,[3] Judge Sotomayor wrote an opinion affirming the decision of the district court denying the defendants' motion to compel arbitration and stay court proceedings. The court found the plaintiffs could not be bound to the arbitration clause because a reasonable Internet user would not have had the chance to read the arbitral clause prior to downloading the program at the core of the lawsuit.

Similar to *In re American Express Merchants Litigation*,[4] the case turned largely on its facts. Judge Sotomayor was meticulous, carefully noting how each plaintiff accessed the program in a step-by-step description. She also invested significant time reviewing case law from around the country, noting the development of law in the field of electronic commerce. And she thoroughly discussed the underlying law governing contract formation, citing a variety of California cases and statutes.

But this is not a case striking at the heart of arbitral clauses in electronic commerce. She demonstrates no hostility to arbitration and does not quarrel with other controversial cases, such as *ProCD v. Zeidenberg*[5] and *Hill v. Gateway 2000*.[6] She does not create a new test for defining arbitration in electronic commerce or raise the bar for defendants to an unreasonable level. Rather, the opinion shows a great willingness to delve into the many issues surrounding electronic commerce and grapple with the emergence of law in this field in a full and complete manner.

Lest readers assume Judge Sotomayor only sides with plaintiffs seeking to avoid arbitration, she also authored an

opinion reversing the district court's decision to deny a defendant's motion to compel arbitration. The district court found the arbitral clause too narrow to encompass claims of fraud. The Second Circuit did not agree in *ACE Capital Re Overseas Ltd. v. Central United Life Ins. Co.*[7] In this case, decided before the Supreme Court's further clarifications in *Buckeye Check Cashing v. Cardegna*,[8] Judge Sotomayor reviewed the principle of separability. Relying on *Prima Paint v. Flood & Conklin Mfg. Co.*,[9] she wrote that a party claiming fraudulent inducement can only succeed in avoiding arbitration if the claim is directed at the arbitration agreement itself, not the contract as a whole.

Having decided that the arbitration clause could not be challenged in court based on the claim of fraudulent inducement of the contract as a whole, applying her consistent method Judge Sotomayor carefully reviewed the language of the arbitration agreement to see if it was written broadly enough to encompass claims of fraudulent inducement and thus provide for arbitral jurisdiction over that issue. She concluded that it was. Her decision reinforced the limitation to "its precise facts" of the earlier Second Circuit decision in *In re Kinoshita & Co.*,[10] which had found a claim of fraud to be outside the arbitration agreement. The Sotomayor decision leaves open arguments as to the scope of an arbitration agreement, and contentions as to the limitations on the scope of arbitrator authority particularly where it is limited to disputes "arising under" the agreement. But the court's detailed analysis provides a good roadmap for analyzing the likelihood of success of any attempt to assert that particular claims are not arbitrable because they fall outside the scope of the arbitration agreement.

The opinion also contains a footnote discussing the relationship between the FAA and the New York Convention. Oddly, the footnote refers to the New York Convention by the acronym CREFAA (Convention on the Recognition of Foreign Arbitral Awards). While the acronym correctly describes the convention, perhaps it does not demonstrate a familiarity with the international arbitration community's reference to the convention. But the footnote does appear to demonstrate the correct interpretation of the New York Convention in relationship to the FAA.

There are other notable opinions by Judge Sotomayor or by panels on which she sat. These opinions appear to carry the themes discussed above: careful adherence to precedent and an unwillingness to make sweeping pronouncements on arbitration jurisprudence. For example, in two recent decisions Judge Sotomayor sat on panels[11] applying the manifest disregard of the law standard without mentioning the effect of *Hall Street Assocs. v. Mattel, Inc.*[12] While the Second Circuit seems to have continued to apply the manifest disregard doctrine,[13] these two opinions do little to clarify the Second Circuit's decision in *Stolt-Nielsen SA v. Animal Feeds Int'l*.[14] Again, it appears Judge Sotomayor is not anxious to draft opinions dramatically changing arbitration jurisprudence.

In light of the foregoing opinions, it is also important to note Judge Sotomayor's experience outside of the judiciary. A search for articles written by her does not note anything on the topic of arbitration. Instead, her writings focus more on the nature of being a judge and the practice of law generally. But Judge Sotomayor does have practical experience in the field of international litigation. She worked at a law firm representing international clients and traveled extensively in her work. Her biographies do not make clear whether this work involved arbitration.

In sum, Judge Sotomayor does not appear to be a Supreme Court justice who would be hostile to arbitration. Her opinions do not reveal a particular theory of analyzing arbitration issues, and she appears unwilling to make broad statements regarding arbitration. While she has found in favor of plaintiffs on some important issues, she is not a judge who rules for consumers by default or imposes insurmountable bars to enforcing an arbitral clause. At this point, it does not appear that a reading of her opinions should give either arbitration plaintiffs or defendants cause to cheer or fear her appointment. Of course, the Supreme Court is a different place, and her background in international litigation and experience handling such issues on the Second Circuit may make her a more imposing force when arbitration issues arise in the Supreme Court.

Endnotes

1. 554 F.3d 300 (2d Cir. 2009). See also discussion of this case in James Benjamin Gwynne, *Class Action Waivers in Arbitration Agreements: The Second Circuit Speaks,* Vol. 2, No. 1, New York Dispute Resolution Lawyer (Spring 2009).
2. *See also Homa v. American Express Co.* 558 F.3d 225 (3d Cir. 2009), issued shortly after *In re American Express Merchants Litigation*, a class action waiver was invalidated on grounds of unconscionability.
3. 306 F.3d 17 (2d Cir. 2002).
4. *See supra* note 2.
5. 86 F.3d 1447 (7th Cir. 1996).
6. 105 F.3d 1147 (7th Cir. 1997).
7. 307 F.3d 24 (2d Cir. 2002).
8. 546 U.S. 440, 126 S. Ct. 1204 (2006).
9. 388 U.S. 395, 87 S. Ct. 1801 (1967).
10. 287 F. 2d 951 (2d Cir. 1961).
11. The cases are cited as follows: *Macromex Srl. v. Globex Intern, Inc.*, No. 08-2255-CV, 2009 WL 1448999 (2d Cir. May 26, 2009); *Dupont v. Tobin, Carberry, O'Malley, Riley, Selinger, PC*, No. 08-1414-CV, 2009 WL 1015340 (2d Cir. Apr. 16, 2009).
12. 552 U.S. 576, 128 S. Ct. 1396 (2008).
13. For a discussion of the continued viability of manifest disregard, see Sherman Kahn, *Manifest Disregard of the Law After* Hall Street*: A Continued Role for an Extra-Statutory Doctrine?,* Vol. 2, No. 1, New York Dispute Resolution Lawyer (Spring 2009).
14. 548 F.3d 85 (2d Cir. 2008). The Supreme Court granted *cert.*, 08-1198 (June 15, 2009), in this case for the 2009–2010 term.

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Recent FINRA Dispute Resolution Initiatives

By Avi Rosenfeld

FINRA, the Financial Industry Regulatory Authority, is the largest non-governmental regulator for all securities firms doing business in the United States. Created in 2007 through the consolidation of NASD and NYSE Member Regulation, FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complementary compliance and technology-based services. FINRA touches virtually every aspect of the securities business—from registering and educating industry participants to examining securities firms; writing rules; enforcing those rules and the federal securities laws; informing and educating the investing public; providing trade reporting and other industry utilities; and administering the largest securities dispute resolution forum in the world.

FINRA Dispute Resolution facilitates the efficient resolution of monetary, business, and employment disputes among investors, securities firms, and employees of securities firms by offering both arbitration and mediation services through a network of 72 hearing locations across the United States and abroad. It also maintains a diverse roster of approximately 6,500 arbitrators and 1,000 mediators.

To maintain its position as the world's largest and most effective securities dispute resolution forum and to accommodate changing and diverse cases, FINRA continually adjusts its procedures. In 2008 and 2009, FINRA launched numerous initiatives and rule changes to adapt to market changes, to curb arbitration abuses, and to meet the needs of its constituents.

Below are highlights of recent case filing activity, FINRA's Public Arbitrator Pilot Program, several important recent rule changes, as well as other initiatives to improve the forum.

Recent Case Filings

After a long-term decline, arbitration case filings have increased significantly. Through May, parties filed 3,163 cases, which represents an 85% increase in cases filed over the same time period in 2008, and projects to 7,600 case filings for 2009. Claims relating to subprime mortgages and auction rate securities account for a significant part of this increase.

Public Arbitrator Pilot Program

On October 6, 2008, FINRA launched a voluntary two-year Public Arbitrator Pilot Program that gives investors greater choice when selecting an arbitration panel. The Pilot Program will allow FINRA to determine whether a change in the way arbitration panels are selected is a better way to serve and protect the interests of investors.

The Pilot Program allows investors in some three-arbitrator cases to have a panel consisting of three public arbitrators, instead of two public arbitrators and one non-public arbitrator. Parties in Pilot Program cases will continue to receive the same three lists of arbitrators—one chair-qualified list, one public list, and one non-public list. Parties may strike up to four of the arbitrators from the chair-qualified and public arbitrator lists for any reason, then rank the remaining arbitrators on those lists according to preference, as is the current rule.

Under the Pilot Program, however, if a party does not want a non-public arbitrator to serve on the case, then the party may strike all proposed arbitrators on the non-public list. When that occurs, FINRA appoints an additional public arbitrator, thus resulting in an all-public panel.

Rule Change to Significantly Curtail Motions to Dismiss in Arbitration

On December 31, 2008, the United States Securities and Exchange Commission (SEC) approved a rule change to adopt Customer Code Rule 12504 and Industry Code Rule 13504 to limit significantly dispositive motions filed in the arbitration forum and to impose strict sanctions against parties who engage in abusive motion practices.[1]

Under the new rule, if a party (typically a respondent firm) files a dispositive motion before a claimant finishes presenting its case, the arbitration panel will be limited to three grounds on which to grant the motion: (1) the parties previously settled their dispute in writing; (2) factual impossibility, the party was not associated with the accounts, securities or conduct at issue, or (3) the existing six-year time limit on the submission of arbitration claims.[2] The rule also requires that arbitrators hold a hearing on such motions and that any decision to grant a motion to dismiss be unanimous and be accompanied by a written explanation.

The changes also require the panel to assess against the moving party all forum fees associated with hearings on dispositive motions if the panel denies the motion and require the panel to award costs and attorneys' fees to the opposing party if the dispositive motion is deemed frivolous. Under the new rule, when a respondent files a dispositive motion after the conclusion of the claimant's case, the provisions above do not apply. However, the rule does not preclude the arbitrators from issuing an explanation or awarding costs or fees.

Rule Change to Address Expungement Procedures

On October 30, 2008, the SEC approved a rule change to adopt Customer Code Rule 12805 and Industry Code Rule 13805 to establish specific procedures for arbitrators to follow before recommending expungement of information related to customer complaints from a registered person's Central Registration Depository (CRD) record.[3] The new rule is designed to ensure that expungement occurs only when one of the narrow grounds specified in the FINRA rules—factual impossibility, no involvement by the registered person, or falsity—is determined and specifically articulated by the arbitrators.[4]

Since 2004, FINRA's rules have required that arbitrators affirmatively find one of the three grounds set forth above when they order expungement of customer claims. The new rule established procedures arbitrators must follow when evaluating expungement relief requests. Specifically, arbitrators must:

- hold a recorded hearing session by telephone or in person;
- provide a brief written explanation of the reasons for ordering expungement;
- in cases involving a settlement, review the settlement documents to evaluate culpability by examining the amounts paid to any party and any other terms and conditions of the settlement; and
- assess all forum fees for hearing sessions in which the sole purpose is to determine the appropriateness of expungement against the parties requesting expungement relief.

Rule Change to Raise the Amount in Controversy Heard by a Single Chair-Qualified Arbitrator to $100,000

On February 2, 2009, the SEC approved a rule change to amend Customer Code Rule 12401 and Industry Code Rule 13401 to raise the amount in controversy that will be heard by a single chair-qualified arbitrator to $100,000 from $25,000.[5] By raising the threshold, the rule restores the proportion of cases heard by a single arbitrator to what it was when the single arbitrator threshold was last increased in 1998 (about one-third of cases). The rule also removes the option for one party unilaterally to require three arbitrators in cases with claims for more than $25,000. If all parties agree in writing, however, FINRA will appoint a three-person panel in cases with claims of less than $100,000. Parties will benefit from the new rule by reduced (1) case processing times; (2) time in the arbitrator selection process, and (3) hearing session fees.

Rule Change to Require Arbitrators to Provide an Explained Decision Upon the Joint Request of the Parties

On February 4, 2009, the SEC approved amendments to Rules 12214, 12514 and 12904 of the Customer Code and Rules 13214, 13514 and 13904 of the Industry Code relating to explained decisions.[6] The new rule requires arbitrators to provide an explained decision at the parties' joint request and specifies that the explained decision will be a fact-based award stating the general reasons for the arbitrators' decision. Parties are required to submit any joint request for an explained decision at least 20 days before the first scheduled hearing date. The chairperson will write the explained decision and will receive an additional honorarium of $400 for doing so. The panel will allocate the cost of the additional honorarium to the parties as part of the final award.

Constituent Education

On December 8, 2008, FINRA posted on its Web site separate Webcasts for investors and firms that explain in plain English what to expect from FINRA's arbitration and mediation processes.

In 2007, FINRA launched its own Arbitration Awards Online database, replacing the system launched in 2001 which used an outside vendor. The database is available on FINRA's Web site at www.finra.org. Through the database, parties can access FINRA arbitration awards from January 1989 through the present. In addition, parties can access all NYSE arbitration awards, plus the awards of all arbitration programs absorbed by NASD and NYSE over the years.[7] The database provides users with instantaneous access to awards and the ability to search for awards by using multiple criteria. The enhanced search capability enables users to search for awards by case number, keywords, arbitrator names, date ranges set by the user, and any combination of these features. Through this database, users can obtain an unlimited number of FINRA arbitration awards free of charge, 24 hours a day, seven days a week. The database receives over 200,000 "hits" a month and has had over three million hits since inception.

Law School Clinics

FINRA's Investor Education Foundation (Foundation) on May 4 announced the Investor Advocacy Clinic Grant Program to provide start-up funding for investor advocacy clinics at law schools in the United States. In December 2009, the Foundation will award up to three grants to law schools committed to launching and supporting a new clinical education program that will provide legal advice and other help to underserved investors in the com-

munity. The grant amount is up to $250,000 per award over a three-year period. Investors with relatively small claims—usually under $100,000—often find it difficult to identify lawyers willing to represent them. The Foundation aims to help fill this gap in legal representation by funding clinics that allow supervised law students, pursuant to state practice orders, to represent small investors. Proposals are being solicited from law schools in five geographic regions[8] identified as "high need" by the Foundation, including:

- Boston, Massachusetts
- Los Angeles, California
- Miami, Florida
- Philadelphia, Pennsylvania
- Washington, D.C.

Conclusion

Consolidating the NASD and NYSE arbitration programs into FINRA Dispute Resolution created a forum with a shared background of more than 100 years of experience in arbitration and mediation. Over the past 10 years alone, FINRA Dispute Resolution has helped resolve over 70,000 disputes and returned billions of dollars to investors through settlements and arbitration awards. As described above, we have significantly improved our program, and will continue to make further enhancements in the future. You can learn more about FINRA's arbitration and mediation processes, case statistics, and other FINRA initiatives by visiting FINRA's Web site at www.finra.org.

Endnotes

1. See Release No. 34-59189, published in the Federal Register on January 7, 2009 (Vol. 74, No. 4, p. 731). FINRA published Regulatory Notice 09-07 in January 2009.
2. See Customer Code Rule 12206 and Industry Code Rule 13206.
3. See Release No. 34-58886, published in the Federal Register on November 6, 2008 (Vol. 73, No. 216, p. 66086). FINRA published Regulatory Notice 08-79 in December 2008.
4. See FINRA Conduct Rule 2130.
5. See Release No. 34-59340, published in the Federal Register on February 6, 2009 (Vol. 74, No. 24, p. 6335). FINRA published Regulatory Notice 09-13 in February 2009.
6. See Release No. 34–59358, published in the Federal Register on February 11, 2009 (Vol. 74, No. 27, p. 6928). FINRA published Regulatory Notice 09-16 in March 2009.
7. This includes arbitration awards from the following SROs: American Stock Exchange, International Stock Exchange, Philadelphia Stock Exchange, and Municipal Securities Rulemaking Board.
8. Several existing law schools in California, Illinois, New York, and Pennsylvania currently provide legal representation through securities arbitration clinics.

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ADR News Updates

New Hampshire Adopts Pre-Suit, Court-Sponsored ADR

On June 29, 2009 New Hampshire Gov. John Lynch (D) signed legislation (SB 70) authorizing the state Office of Mediation & Arbitration (OMA) to offer pre-suit alternative dispute resolution (ADR) services in civil cases. The legislation, developed at the request of the judiciary, adds to the duties of that office to "facilitate voluntary pre-suit mediation or arbitration services, in accordance with rules adopted by the supreme court, as an option in cases which would otherwise be filed in the trial courts." Truly a multi-door courthouse.

New Eastern District Rules on Mediator Compensation

The U.S. District Court for the Eastern District of New York issued a new rule in July of 2009 to bridge two competing concerns: (1) that an indigent or unwilling party should not be required to pay the cost of court-ordered mediation, and (2) that mediators be compensated for their professional time and significant efforts to settle civil cases currently in litigation. The new rule provides:

> *83.11 (f) (1)Services of Mediators*
>
> (1) Participation by mediators in the program is on a voluntary basis. Each mediator shall receive a fee of $600 for the first four hours or less of the actual mediation. Time spent preparing for the mediation will not be compensated. Thereafter, the mediator shall be compensated at the rate of $250 per hour. The mediator's fee shall be paid by the parties to the mediation. Any party that is unable or unwilling to pay the fee may apply to the referring judge for a waiver of the fee, with a right of appeal to the district judge in the event the referral was made by a magistrate judge. Each member of the panel will be required to mediate a maximum of two cases pro bono each year, if requested by the Court. Attorneys serving on the Court's panel will be given credit for pro bono work. [Amended: July 7, 2009].

NAF Drops Out of Consumer Arbitration

The Minnesota Attorney General filed a lawsuit in July of 2009 against the National Arbitration Forum alleging that it misrepresented its independence and hid from consumers and the public its extensive ties to the collection industry. NAF was the largest arbitration company in the country for consumer credit disputes and processed over 214,000 consumer collection arbitration claims in 2006. NAF announced shortly after the suit was filed that it would "voluntarily cease to administer consumer arbitration disputes as part of a settlement agreement with the Minnesota Attorney General." In its statement, NAF emphasized that "notably, nothing in the Minnesota Attorney General's complaint alleges that arbitration proceedings administered by the FORUM are unfair." Subsequently the American Arbitration Association announced its decision not to accept new consumer debt collection arbitration cases and stated that this policy "will be in effect until such time as the AAA determines that adequate and broadly acceptable due process protocols specific to these cases are in place." Hearings on the subject were held on July 22, 2009 in Congress before the Domestic Policy Subcommittee of the Oversight and Government Reform Committee.

Developments in Arbitration: Arbitration at the United States Supreme Court—October Term 2008

By Sherman Kahn

During its 2008 term (commencing in October 2008 and extending until June 2009), the United States Supreme Court decided three cases focusing on arbitration, suggesting that the Court has a strong interest in developing arbitration jurisprudence. The subject matter was wide-ranging—stretching from the intersection of FAA jurisdiction and the well-pleaded complaint rule[1]; to the rights of non-signatories to arbitration agreements to compel arbitration[2]; to the enforceability of arbitration clauses in collective bargaining agreements over civil rights claims by covered workers.[3] The Supreme Court's decisions this year are discussed in more detail below in chronological order.[4]

A. *Vaden v. Discover Bank*

The first arbitration decision handed down by the Supreme Court this year was *Vaden v. Discover Bank*.[5] In *Vaden,* the Supreme Court confronted the intersection between § 4 of the Federal Arbitration Act and the well-pleaded complaint rule familiar to all United States practitioners from first-year civil procedure. Section 4 of the FAA provides that a party seeking arbitration can seek an order compelling arbitration from:

> . . . any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties.[6]

The question in *Vaden*, brought about by the procedural circumstances of the case, was whether the district court would, but for the arbitration clause, have had jurisdiction over the subject matter of the controversy. A majority of the Court determined that it would not.[7]

The dispute in *Vaden* originated as a debt collection action in which Discover Bank sought to recover in Maryland state court $10,610.74 in past due credit card charges, plus interest and counsel fees, from credit card holder Betty Vaden.[8] *Vaden* responded to Discover's Maryland state court complaint with a counterclaim alleging that Discover's finance charges, interest and late fees violated state law.[9] Vaden's counterclaims were styled as class actions.[10]

Although Discover had chosen to sue *Vaden* in court to recover the past-due amount, the credit card agreement included a clause providing for arbitration of "any claim or dispute between [Discover and Vaden]."[11] Like Discover, Vaden also did not invoke the arbitration clause in the Maryland state action— choosing instead to bring her counterclaims and class allegations in court.[12] However, when faced with Vaden's counterclaims, Discover petitioned the United States District Court for the District of Maryland under § 4 of the FAA to compel arbitration of Vaden's counterclaims.[13]

In support of its position, Discover argued that Vaden's counterclaims were completely preempted by § 27(a) of the Federal Deposit Insurance Act (FDIA).[14] The district court granted Discover's petition.[15] Vaden's initial appeal resulted in a remand by the Fourth Circuit which instructed the district court to "look through" the Section 4 petition to find the substantive controversy between the parties.[16] On remand, during which Vaden conceded that the FDIA completely preempted her state court counterclaims, the district court again ordered arbitration.[17] The Fourth Circuit affirmed.[18]

The Supreme Court granted *certiorari*[19] to examine the Courts of Appeals' conflicting decisions regarding whether it is appropriate to "look through" a Section 4 petition to determine jurisdiction and to examine Vaden and Discover's dispute to determine whether jurisdiction was proper.[20] The majority held that it is indeed proper to "look through" but that, applying the well-pleaded complaint rule, the controversy between Vaden and Discover did not give rise to jurisdiction.

In ruling that it is proper to "look through" a Section 4 petition to determine federal question jurisdiction, the Supreme Court overruled the majority of the circuit courts of appeal which had decided the issue.[21] However, the Supreme Court majority opinion added the important caveat that, although it may "look through" a Section 4 petition to assess whether it is predicated on an action that arises under federal law, the federal court may not entertain a Section 4 petition based upon the contents, actual or hypothetical, of a counterclaim.[22]

Based upon this caveat, the Supreme Court held that Discover's petition should be denied as Discover alleged jurisdiction based on the contents of Vaden's counterclaim—not Discover's original Maryland state court claim.[23] The majority stated:

> Under the well-pleaded complaint rule, a completely preempted counterclaim

remains a counterclaim and thus does not provide a key capable of opening a federal court's door.[24]

The dissent agreed that it is proper to look through the Section 4 petition to determine the underlying dispute but disagreed with the majority about how that dispute should be characterized. According to the dissent, the dispute the court should examine should be framed by the Section 4 petition itself.[25] Thus, according to the dissent, because Discover requested arbitration as to Vaden's counterclaims, the original collection claim on which Discover sued Vaden should not be considered part of the controversy.[26]

"[O]ther parties in Discover's position will be armed with the knowledge of the Vaden *decision. The* Vaden *decision thus makes the situation it resolved unlikely to repeat itself."*

The dissent also pointed out that in most cases under Section 4, no complaint will have been filed.[27] The dissent characterized this as a problem with the majority's reasoning.[28] However, this point also underscores that the differences between the majority and the dissent are not particularly significant. Discover, of course, could have decided to enforce its collection action against Vaden through arbitration. Having done so, it would have left Vaden with the choice of raising her counterclaims in the arbitration or raising them as an original complaint in court—which would have provided Discover with a valid Section 4 petition. Going forward, other parties in Discover's position will be armed with the knowledge of the *Vaden* decision. The *Vaden* decision thus makes the situation it resolved unlikely to repeat itself.

B. *14 Penn Plaza LLC, et al. v. Pyett*

In *14 Penn Plaza LLC v. Pyett*,[29] the Supreme Court addressed whether arbitration clauses in collective bargaining agreements can be enforced to compel arbitration of civil rights claims asserted by individuals covered by the collective bargaining agreement.[30]

The facts of *14 Penn Plaza* are as follows: The Service Employees International Union, Local 32BJ ("the Union") is the representative of building services employees in New York City.[31] In that role, the Union entered into a collective bargaining agreement with the Realty Advisory Board on Labor Relations, which is a multi-employer bargaining association for New York City contractors and building owners.[32] The collective bargaining agreement explicitly required Union members to submit any claims of employment discrimination to binding arbitration under the collective bargaining agreement's grievance and dispute resolution procedure.[33]

The specific dispute at issue arose between the owners of a New York City office building at 14 Penn Plaza and a group of building employees who held positions such as lobby night watchmen.[34] 14 Penn Plaza Management engaged a new unionized security services contractor to staff the building lobby and entrances and transferred the existing employees to other, less lucrative, jobs in the building.[35] The Union filed grievances on behalf of the employees alleging a variety of claims, including a claim for age discrimination.[36] However, after an initial arbitration hearing the Union withdrew the age discrimination claims—because the Union had agreed to the new security contract for the building, the Union did not believe it could object to the reassignment as discriminatory.[37]

After exhausting administrative remedies, the employees sued the building for violation of the Age Discrimination in Employment Act (ADEA).[38] The building filed a motion to compel arbitration.[39] The district court denied this motion because under Second Circuit authority "even a clear and unmistakable union-negotiated waiver of a right to litigate certain federal and state statutory claims in a judicial forum is unenforceable."[40] The Second Circuit affirmed.[41] The Supreme Court granted *certiorari* and reversed.[42]

The Second Circuit based its decision on the Supreme Court's decision in *Alexander v. Gardner-Denver Co.*,[43] which the Second Circuit interpreted to hold that a collective bargaining agreement could not waive a worker's right to a judicial forum for causes of action created by Congress.[44] The Second Circuit observed a tension between *Gardner-Denver* and the Supreme Court's later decision in *Gilmer v. Interstate/Johnson Lane Corp.*,[45] in which the Court held that an individual employee who had agreed individually to waive rights to a federal forum could be compelled to arbitrate an age discrimination claim, but resolved the tension by interpreting the *Gardner-Denver* rule to apply only to collective bargaining.[46]

Justice Thomas' majority opinion disagreed with the Second Circuit's interpretation of *Gardner-Denver,* interpreting the case to hold only that arbitration of discrimination claims is precluded only where a collective bargaining agreement does not explicitly give the arbitrator authority to resolve statutory claims.[47] In the majority's view, *Gardner-Denver* and the line of cases following it do not address the arbitrability of statutory claims but rather whether arbitration of contract claims precluded subsequent judicial resolution of statutory claims.[48] Accordingly, the Court held that the *Gilmer* Court's interpretation of the ADEA to allow claims to be submitted to arbitration applies in a collective bargaining context.[49]

Perhaps the most interesting aspect of the opinions in *14 Penn Plaza* is the exchange between the majority opinion and Justice Stevens' dissent regarding the federal policy toward arbitration. The majority characterizes

the *Gardner-Denver* line of cases as being founded in a now-antiquated antipathy to arbitration.[50] In support of this characterization, the majority compared *Gardner-Denver* to *Wilko v. Swan*,[51] which held that an agreement to arbitrate claims under the Securities Act of 1933 was unenforceable and which the Supreme Court had overturned, stating that it was pervaded by the old judicial hostility to arbitration.[52] In his separate dissent, Justice Stevens responds to this point by arguing that the Court was subverting precedent in support of a "changed view on the merits of arbitration."[53]

In the course of this debate the majority commented that "Congress is fully equipped to identify any category of claims as to which agreements to arbitrate will be held unenforceable."[54] Congress appears to be contemplating doing just that. The most recent Senate proposal for the "Arbitration Fairness Act," which would limit arbitrations in the consumer, employment and franchise context, has been modified to state that no arbitration provision in a collective bargaining agreement "shall have the effect of waiving the right of an employee to seek judicial enforcement of a right arising under a provision of the Constitution of the United States, a State constitution, or a Federal or State statute, or public policy arising therefrom."[55] This change appears to be a direct attempt to overrule *14 Penn Plaza.*

"[T]he majority commented that 'Congress is fully equipped to identify any category of claims as to which agreements to arbitrate will be held unenforceable.'"

C. *Arthur Andersen LLP v. Carlisle*

The Supreme Court's decision in *Arthur Andersen LLP v. Carlisle*[56] addressed whether non-parties to an arbitration agreement have the right to request a stay under § 3 of the FAA and whether § 16(a)(1)(A) provides the non-party with an interlocutory appeal of the denial of such a stay. A majority of the Supreme Court answered yes to both questions—Section 3 applications for stays pending arbitration may be sought by non-parties with a State law right to enforce a contract containing an arbitration provision and, if such a stay is denied, the non-party may immediately appeal.[57]

The respondents in *Arthur Andersen* were aggrieved investors in tax shelters which the IRS had later ruled to be illegal.[58] The investors filed suit in the Eastern District of Kentucky against the provider of the tax shelters, Bricolage Capital, LLC ("Bricolage"), Arthur Andersen, their accountant, auditor and tax advisor which had steered them to the investments, and a law firm to which Bricolage had referred them.[59] The respondents had invested in the tax shelters through LLCs which, in turn, had entered into an agreement with Bricolage containing an arbitration provision.[60] The various defendants in the investors' lawsuit moved under FAA § 3 to stay the action, claiming that equitable estoppel required that the investors arbitrate their claims under the agreement between the LLCs and Bricolage.[61] The district court denied the motions to stay and the defendants filed an interlocutory appeal in the Sixth Circuit.[62] The Sixth Circuit dismissed the appeal for lack of jurisdiction.[63] The Supreme Court granted *certiorari*, reversed and remanded the matter to the Sixth Circuit for a decision on the merits.[64]

"[T]he Court's ruling in Arthur Andersen *will lead to some purely tactical Section 3 filings by non-parties . . . with tangential relations to arbitration agreements . . ."*

The opinion of the court addressed the appealability issue first, stating that under the clear and unambiguous terms of § 16(a)(1)(A) "any litigant who asks for a stay under Section 3 is entitled to an immediate appeal from denial of that motion—regardless of whether the litigant is in fact eligible for a stay."[65] The majority rejected the notion that to determine appellate jurisdiction, courts should "look through" to the merits of the Section 3 petition, stating that courts that had declined Section 3 interlocutory appeals had conflated the merits with the jurisdictional issue.[66]

The Court also overruled the Sixth Circuit's underlying determination that non-parties to an arbitration agreement are ineligible to obtain a stay under Section 3. The Court reasoned that state contract law is applicable to determine which contracts are binding under Section 2 and enforceable under Section 3.[67] The court therefore concluded that, because traditional contract law provides non-parties with rights to enforce contracts through assumption, piercing the corporate veil, alter ego, incorporation by reference, third-party beneficiary theories, waiver and estoppel, non-parties should be able to use those grounds to bring stay motions under Section 3.[68]

Justice Souter's dissent argues that the majority had given insufficient deference to the policy against interlocutory appeals in deciding on a broad scope for § 16(a)(1)(A). The dissent also suggests that the question of whether a Section 3 applicant was a signatory would provide a bright-line rule to courts seeking to resolve Section 16 appeals and would discourage Section 3 petitions filed for dilatory reasons. It is possible, as the dissent suggests, that the Court's ruling in *Arthur Andersen* will lead to some purely tactical Section 3 filings by non-parties. It is virtually assured that the Court's opinion will lead parties with tangential relations to arbitration agreements to raise creative arguments seeking to invoke arbitration agreements to which they are not parties.

* * *

In sum, the past term was one in which the Supreme Court paid considerable attention to arbitration. It appears that we may have another interesting set of arbitration decisions in the coming term. The Supreme Court has already granted *certiorari* regarding the Second Circuit's decision in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp*.[69] The stated question presented is "[w]hether imposing class arbitration on parties whose arbitration clauses are silent on that issue is consistent with the Federal Arbitration Act, 9 U.S.C. §§ 1 *et seq.*"[70] However, the Second Circuit decided this issue in the context of the judicially created doctrine of "manifest disregard of the law," holding that the doctrine remains viable after the Supreme Court's decision in *Hall Street Assoc. LLC v. Mattel, Inc.*[71] The Supreme Court's resolution of *Stolt-Nielsen* will possibly provide further guidance on the viability of the manifest disregard standard. Bill Brown's article in this issue, "*STOLT-NIELSEN*: The Supreme Court Takes Up Issues of Class Arbitration," further discusses the implications of *Stolt-Nielsen*.

The Supreme Court has also granted *certiorari* on a case raising the question, "[D]oes a federal court have jurisdiction to determine whether a collective bargaining agreement was formed when it is disputed whether any binding contract exists, but no party makes an independent challenge to the arbitration clause apart from claiming it is inoperative before the contract is established?"[72] The decision in this case may add clarity to the question of when a court may resolve challenges to the formation of a contract containing an arbitration clause.

Endnotes

1. *Vaden v. Discover Bank,* 129 S. Ct. 1262 (2009).
2. *Arthur Andersen LLP v. Carlisle,* 129 S. Ct. 1456 (2009), 2009.
3. *14 Penn Plaza LLC, et al. v. Pyett,* 129 S. Ct. 1896 (2009).
4. The Supreme Court's decision in *Ministry of Defense and Support for the Armed Forces of the Islamic Republic of Iran v. Elahi,* 129 S. Ct. 1732 (2009) also has some bearing on arbitration. *Elahi* concerned attempts to assert a default judgment against Iran by a plaintiff who alleged that the government of Iran had unlawfully participated in the assassination of his brother. *Elahi*, 129 S. Ct. at 1735. Elahi sought to attach a judgment in favor of Iran that had resulted from an ICC arbitration award and Iran claimed sovereign immunity. *Id.* The Supreme Court held, *inter alia,* that Elahi's claim was barred by his acceptance of partial compensation from the United States government under the Victims of Trafficking and Violence Protection Act of 2000 (VPA). *Id.* The VPA offers partial compensation by the United States Government to individuals with terrorism-related judgments against Iran but requires individuals who accepted compensation under the act to relinquish "all rights to execute against or attach property that is at issue in claims against the United States before an international tribunal." *Id.* at 1741. The Supreme Court held that Elahi had relinquished his rights to attach the claimed judgment because he had accepted VPA compensation and the judgment had been asserted as a setoff in an arbitration proceeding before the Iran-U.S. Claims Tribunal—an international arbitration tribunal created under an international agreement called the "Algiers Accords to arbitrate disputes between Iran and the United States." *Id.* at 1741–45.
5. 129 S. Ct. 1262 (2009).
6. 9 U.S.C. § 4.
7. *Vaden* at 1278. *Vaden* was a 5-4 decision but did not divide the Court along familiar ideological lines. Justice Ginsburg delivered the opinion of the Court, joined by Justices Scalia, Kennedy, Souter and Thomas. Chief Justice Roberts concurred in part (to the extent that the majority endorsed that courts should "look through" the pleadings to find the controversy) and dissented in part, joined by Justices Stevens, Breyer and Alito.
8. *Vaden* at 1268.
9. *Id.*
10. *Id.*
11. *Vaden* at 1268–69.
12. *Id.*
13. *Vaden* at 1269. Discover was likely motivated by a class action prohibition in the arbitration clause. *Vaden at* 1269, n.2. The Supreme Court noted this alleged motivation but expressed no opinion as to the validity or enforceability of this clause.
14. *Vaden* at 1269 (*citing* 12 U.S.C. § 1831d(a)).
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.*
19. *Vaden v. Discover Bank,* 128 S. Ct. 1651 (2008).
20. *Vaden,* 129 S. Ct. at 1270.
21. The Second, Fifth, Sixth and Seven Circuits had ruled that looking-through the petition was improper. *Wisconsin v. Ho-Chunk Nation,* 463 F. 3d 655, 659 (7th Cir. 2006) (court may not look through Section 4 petition and focus on underlying dispute); *Smith Barney, Inc. v. Sarver,* 108 F.3d 92, 94 (6th Cir. 1997) (same); *Westmoreland Capital Corp. v. Findlay,* 100 F.3d 263, 267-68 (2d Cir. 1996)(same); *Prudential-Bache Securities, Inc. v. Fitch,* 966 F.2d 981, 986-989 (5th Cir. 1992) (same). The Fourth and Eleventh Circuits had ruled that the court may look through the petition and assess the underlying dispute. *Discover Bank v. Vaden,* 396 F.3d 366, 370 (4th Cir. 2005) (an earlier proceeding in the case reviewed); *Community State Bank v. Strong,* 485 F.3d 597, 605–06 (11th Cir. 2007), *vacated, reh'g en banc granted,* 508 F.3d 576 (11th Cir. 2007).
22. *Vaden,* 129 S. Ct. at 1273. The majority focused on the Supreme Court's decision in *Holmes Group, Inc. v. Vornado Air Circulation Systems, Inc.,* 535 U.S. 826 (2002) in which the Court held that the Federal Circuit Court of Appeals' exclusive jurisdiction over patent appeals did not apply where the claims at issue under the patent laws were in a counterclaim. *Vaden,* 129 S. Ct. at 1272, n. 10.
23. *Vaden,* 129 S. Ct. at 1275–76.
24. *Id*. at 1276.
25. *Id.* at 1279–80.
26. *Id.*
27. *Id.* at 1281.
28. *Id.*
29. 129 S. Ct. 1456 (2009).
30. *14 Penn Plaza,* 129 S. Ct. at 1474. *Penn Plaza* was, like *Vaden*, a 5-4 decision. Unlike in *Vaden* the justices in *Penn Plaza* were divided along ideological lines, with Justice Thomas delivering the opinion of the Court joined by Chief Justice Roberts and Justices Scalia, Kennedy and Alito. Justices Souter and Stevens delivered dissenting opinions, with Justices Stevens, Ginsburg and Breyer joining Justice Souter's dissent.
31. *Id.* at 1461.
32. *Id.*
33. *Id.*

34. *Id.* at 1461–2.
35. *14 Penn Plaza*, 129 S. Ct. at 1462.
36. *Id.*
37. *Id.*
38. *Id.*
39. *Id.*
40. *14 Penn Plaza*, 129 S. Ct. at 1462–3.
41. *Pyett v. Penn. Building Co.*, 498 F.3d 88 (2d Cir. 2007), *rev'd, 14 Penn Plaza v. Pyett*, 129 S. Ct. 1456 (2009).
42. *14 Penn Plaza*, 129 S. Ct. at 1463.
43. 415 U.S. 36 (1973).
44. *Id.*, *citing decision below,* 498 F.3d at 92, 91, n.3.
45. 500 U.S. 20 (1991).
46. *14 Penn Plaza*, 129 S. Ct. at 1463, *citing decision below,* 498 F.3d at 93–94.
47. *14 Penn Plaza* at 1467.
48. *Id.* at 1468. Justice Souter's dissent takes issue with this characterization of *Gardner-Denver*, asserting that the case held that "an individual's statutory right of freedom from discrimination and access to court for enforcement were beyond a union's power to waive." *Id.* at 1478 (Souter J. dissenting).
49. *Id.* at 1465.
50. *Id.* at 1469–72.
51. 346 U.S. 427 (1953).
52. *Id.*, *citing Rodriguez de Quijas v. Shearson/American Express, Inc.,* 490 U.S. 477, 480 (1989).
53. *14 Penn Plaza,* 129 S. Ct. at 1474–75 (Stevens J. dissenting).
54. *Id.* at 1472.
55. S.931 proposed "Arbitration Fairness Act of 2009." Previous versions of the proposed Arbitration Fairness Act had completely exempted collective bargaining agreements from the proposed legislation. *See, e.g.,* H.R. 1020; S. 1782. Thus, this change in the Senate proposal appears to be a response to the Supreme Court's decision in *14 Penn Plaza.*
56. 129 S. Ct. 1896 (2009).
57. *Arthur Andersen,* 129 S. Ct. at 1903. Justice Scalia delivered the opinion of the Court, joined by Justices Kennedy, Thomas, Ginsburg, Breyer and Alito. Justice Souter filed a dissenting opinion, which was joined by Chief Justice Roberts and Justice Stevens.
58. *Arthur Andersen,* 129 S. Ct. at 1899.
59. *Id.* at 1899–1900.
60. *Id.* at 1899.
61. *Id.* at 1900. Bricolage also moved to stay, but its motion was denied as moot after it declared bankruptcy. 129 S. Ct. at 1900, n.2.
62. *Id.*
63. *Id.*; *Carlisle v. Curtis, Mallet-Prevost, Colt & Mosle, LLP*, 521 F.3d 597, 602 (2008).
64. *Arthur Andersen,* 129 S. Ct. at 1900, 1902.
65. *Id.* at 1900.
66. *Id.* This holding creates an interesting counterpoint with the holding in *Vaden,* decided less than one month earlier, in which a majority including many of the same justices held that it is appropriate for courts to look through to the merits in determining jurisdiction under FAA § 4. *Vaden,* 129 S. Ct. at 1273. It is also worth noting that one of the opinions criticized by the majority was written by Chief Justice Roberts when he was on the D.C. Circuit. *See DSMC Inc. v. Convera Corp.*, 349 F.3d 679, 682-85 (D.C. Cir. 2003).
67. *Arthur Andersen,* 129 S. Ct. at 1902.
68. *Id.*
69. No. 08-1198 (June 15, 2009). The Supreme Court also granted *certiorari* earlier this year in *Union Pacific Railroad Co. v. Bhd. of Locomotive Eng'rs and Trainmen Gen. Comm. of Adjustment, Central Region,* 522 F.3d 746 (7th Cir. 2009). The question presented is whether the Seventh Circuit erroneously held that arbitration awards in Railway Labor Act arbitrations can be set aside for violation of due process. Petition for *Certiorari*, Supreme Court Docket No. 08-604, Nov. 5, 2008.
70. *Id.*
71. 128 S. Ct. 1396 (2008). *Stolt-Nielsen,* 548 F.3d at 90–102.
72. *Granite Rock Co. v. Int'l Brotherhood of Teamsters*, No. 08-1214 (June 29, 2009).

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In *ReliaStar* the Second Circuit Confirms That Arbitrators Have Inherent Authority to Sanction

By Jordan Nodel

The U.S. Court of Appeals for the Second Circuit recently decided a significant issue regarding an arbitrator's power to sanction a party's conduct.[1] In a 2-1 decision, the Court held that a broad arbitration clause confers upon an arbitrator the inherent authority to award attorney's and arbitrator's fees as a sanction against a party who acted in bad faith during the arbitration proceeding.[2] The Court found this authority notwithstanding a special clause in the arbitration agreement providing the parties would bear their own costs and fees. The Court's decision, written by Circuit Judge Reena Raggi and joined by David G. Trager (District Judge for the Eastern District of New York, sitting by designation), was met with a strong dissent from Circuit Judge Rosemary S. Pooler, who wrote that the parties' contractual language divested the arbitral panel of any authority to award fees.[3]

The majority's reasoning set forth two significant principles for understanding the scope of an arbitrator's inherent power and the limitations that the parties' express language may place on this: first, the Court clearly established that an arbitrator has authority to sanction the parties when considering a dispute pursuant to a broad arbitration clause; and second, the Court concluded that the arbitration agreement's express language on costs and attorney's fees only applied in the presumptive good faith context. This means an arbitrator has inherent power to sanction bad faith conduct unless authority to sanction is explicitly withheld in the arbitration agreement.

Procedural Background

EMC National Life Company (known as "National Travelers") and ReliaStar Life Insurance Company of New York ("ReliaStar") entered into two coinsurance agreements, which contained an arbitration provision providing that any dispute arising under the agreements would be submitted to arbitration and—notably in this case—included a fee clause that "[e]ach party shall bear the expense of its own arbitrator . . . and related outside attorneys' fees, and shall jointly and equally bear with the other party the expenses of the third arbitrator."[4]

When various disputes arose between the parties, National Travelers initiated arbitration proceedings. In May 2006, an arbitration panel conducted a two-week hearing. Later in August, the panel entered an interim award, finding that the disputed coinsurance agreements remained in force and directing National Travelers to pay a $21 million past-due balance under the agreements' terms. Further, a majority of the panel, without any explanation, directed National Travelers to pay ReliaStar's attorneys' and arbitrators' fees and costs. After extended briefing on the issue of fees and costs, the arbitration panel finalized its order, explaining that it viewed National Travelers' conduct during the arbitration "as lacking good faith."[5]

Thereafter, ReliaStar petitioned the district court to confirm the arbitration award, and National Travelers filed a counter-petition to vacate the award to the extent that it granted ReliaStar fees and costs. National Travelers argued that the panel exceeded its authority in awarding fees and costs in light of the arbitration agreement's provision for each side to bear its own expenses. The district court agreed with National Travelers and, accordingly, vacated the part of the arbitration decision that granted fees.[6] On appeal, the Second Circuit considered this issue, and reversed.

The Second Circuit's Decision

This case presented another opportunity for the Second Circuit to address the innate tension between, on one hand, limits placed on arbitral authority in a mutually agreed upon arbitration agreement, and on the other hand, an arbitrator's need to fashion "awards or remedies to ensure a meaningful final award."[7] The Court acknowledged that the scope of an arbitrator's authority "generally depends on the intention of the parties to an arbitration, and is determined by the agreement or submission."[8] Mindful of this limitation, the Court described its task as considering "whether the arbitrator's award draws its essence from the agreement to arbitrate, since the arbitrator is not free merely to dispense his own brand of industrial justice."[9]

The fee clause presented the most challenging issue for the Court. After all, the parties' arbitration agreement provided that each side would pay their own fees, and yet the Court held that in the context of a broad arbitration agreement, this provision did not preclude an arbitrator from awarding a party fees for the other side's bad faith conduct. The Court held that a broad arbitration provision "confers inherent authority on arbitrators to sanction a party that participates in the arbitration in bad faith," and "such a sanction may include an award of attorney's or arbitrator's fees."[10]

National Travelers argued, unsuccessfully, that the parties' fee clause expressly limited the arbitration panel's ability to award such a sanction.[11] The Court disagreed, finding that the fee clause simply reiterated the default American Rule that parties to a dispute pay their own costs and fees *subject to a bad faith exception*. National

Travelers submitted that because the American Rule is presumed to apply to all disputes, reading the section as a simple articulation of the American Rule would render it superfluous.[12] The Court again disagreed, saying that parties to commercial arbitration may explicitly reference the American Rule for a number of reasons unrelated to the scope of the arbitrator's authority to sanction bad faith conduct—for example, as an instructive clause directed toward an arbitrator who is not an attorney or as a reminder to arbitrators who come from jurisdictions that employ the "English Rule" (where the unsuccessful party generally pays the other party's fees).[13]

A Broad Arbitration Clause Confers Inherent Authority to Sanction

The Court concluded that where the scope of an arbitration clause is sufficiently broad to cover all of the parties' disputes arising under the agreement, "arbitrators have the discretion to order such remedies as they deem appropriate."[14] The Court relied on several cases, both within the Second Circuit and from other courts, in support of its conclusion. For instance, the Court cited *Synergy Gas Co. v. Sasso*, where the Second Circuit held that an arbitrator had inherent authority to award attorney's fees after the parties were brought to arbitration a second time in order to secure the losing party's compliance with the initial arbitration award.[15] In that case, the arbitrator explained that he had decided to award attorney's fees to one of the parties, in part because the other side acted in bad faith.[16]

ReliaStar also looked to the Ninth Circuit's decision in *Todd Shipyards Corp. v. Cunard Line, Ltd.*, in which the Court rejected a challenge to an arbitrator's authority to award attorney's fees and applied the bad faith exception to the American Rule in the arbitration context.[17] *Todd Shipyards* concerned a commercial contract for the repair and refitting of cruise ships. The parties agreed to a broad arbitration clause which incorporated the American Arbitration Association (AAA) Commercial Rule 43: "The arbitrator may apportion such fees, expenses, and compensation among the parties in such amounts as the arbitrator determines is appropriate." The arbitrator awarded punitive damages and attorney's fees to the plaintiff because of the other party's bad faith.[18] The Ninth Circuit held "that the expansive view that has been taken of the power of arbitrators to decide disputes, coupled with the incorporation of AAA Commercial Arbitration Rule 43 by the parties, provided the arbitration panel here with authority to make the punitive damage award."[19]

While National Travelers argued that this case is distinguishable because *Todd Shipyards* specifically incorporated Rule 43, the Court said that it did not "consider a reference to Rule 43 to be essential where, as in this case, the parties' arbitration clause applies broadly to every dispute arising under their agreement. . . ."[20] However, in another part of its opinion, the Court indicated that it did not view the authority to sanction as expansively as the Ninth Circuit, which permits punitive sanctions, noting that the award, here, "did not contravene New York's public policy against punitive arbitration awards because the fees were compensatory, not penal, in nature and, thus, an appropriate form of damages granted to the aggrieved party."[21]

The Dissent

In her dissent—nearly the length of the majority's opinion—Judge Pooler argued that the arbitration award squarely contradicted the parties' agreement to pay their own costs and fees, and thus "the arbitral award could not properly include an award of attorney's fees to ReliaStar, even if that award was based upon the arbitral panel's reasonable conclusion that [National Travelers] should be sanctioned for bad faith conduct."[22] Judge Pooler interpreted the fee clause in the parties' arbitration agreement to preclude an attorney's fee award for *any* reason.[23]

Judge Pooler said that the majority's reliance on *Synergy Gas* and *Todd Shipyards* was misplaced because in neither case was there any indication that the award of attorney's fees was in conflict with any contractual provision dealing with such an award. Judge Pooler further noted the unclear basis for applying the American Rule's bad faith exception to the arbitration context, citing as support a 2005 decision by the Southern District of New York, where the district court judge concluded that there was not "any authority that supports an arbitrator's ability to award attorney's fees against an attorney appearing before him."[24]

* * *

While the dissent focused on the restricting impact that the parties' fee clause had on the arbitrator's authority, Judge Pooler shared one important nexus with the majority—she said that it was "an interesting question as to whether or not the arbitral panel might have awarded a sanction against [National Travelers] other than the award of attorney's fees."[25] This implies that Judge Pooler disagreed with the majority's opinion more narrowly on the issue of interpreting the fee clause, while remaining amenable to the idea that an arbitrator otherwise has inherent authority to sanction.

ReliaStar bolsters the Second Circuit's approbative view on the sanctioning of bad faith conduct in commercial arbitration proceedings. Parties who wish to limit an arbitrator's ability to sanction should explicitly say so in their agreement.[26] Otherwise, the Court's holding leaves no doubt that it wishes to promote the effective and disciplined arbitration of commercial disputes by empowering arbitrators with authority to sanction.

Endnotes

1. *ReliaStar Life Insurance Co. of New York v. EMC National Life Co. (aka "National Travelers Life Co.")*, No. 07-0828-cv, 2009 U.S. App. LEXIS 7647 (2d Cir. April 9, 2009).
2. *ReliaStar*, 2009 U.S. App. LEXIS 7647, at *19–20.
3. *Id.* at *21 (Pooler, J., *dissenting*).
4. *Id.* at *3–4.
5. *Id.* at *5.
6. *Id.* at *6.
7. *Id.* at *9 (citing *Banco de Seguros del Estado v. Mut. Marine Office, Inc.*, 344 F.3d 255 (2d Cir. 2003)).
8. *Id.* at *6–7 (citing *Synergy Gas Co. v. Sasso*, 853 F.2d 59, 63–64 (2d Cir. 1988)).
9. *Id.* at *7–8 (citation and internal quotation marks omitted).
10. *Id.* at *10. In a footnote, the Court clarified—in response to the dissent's contention—that by noting the arbitrator's "inherent authority," it simply meant that the "authority to sanction inheres in the comprehensive arbitral authority." *Id.* at *10 fn. 2.
11. *Id.* at *14.
12. *Id.* at *16.
13. *Id.* at *17. In response, the dissent said that the majority's dismissive interpretation of why the parties' referenced the American Rule in their agreement "must be rejected as pure surmise." The dissent continued: "On the contrary, it is easily imaginable that the explicit provision for the American Rule in an arbitration agreement might be a consideration in a party's strategic approach to an arbitration proceeding." *Id.* at * 34 (Pooler, J., *dissenting*).
14. *Id.* at *9.
15. *Synergy Gas Co. v. Sasso*, 853 F.2d 59 (2d Cir. 1988).
16. *Synergy Gas Co.*, 853 F.2d at 64–65.
17. *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991).
18. *Id.* at 1061, 1063.
19. *Id.* at 1063.
20. 2009 U.S. App. LEXIS 7647, at *13.
21. *Id.* at *11.
22. *Id.* at *20–21 (Pooler, J., *dissenting*).
23. *Id.*
24. *Id.* at *30 (citing *InterChem Asia Pte. Ltd. v. Oceana Petrochemicals AG*, 373 F. Supp. 2d 340, 355–56 (S.D.N.Y. 2005)).
25. *Id.* at *35.
26. "[O]ur holding today should not be understood to preclude parties who wish to limit the scope of an arbitrator's sanction authority to exclude attorney's fee or arbitrator's awards from doing so. We require only that they explicitly and clearly state that intent as part of their agreement to arbitrate." *Id.* at *17–18.

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Stolt-Nielsen: The Supreme Court Takes Up Issues of Class Arbitration

By William J.T. Brown

In its recent grant of *certiorari* in *Stolt-Nielsen S.A. v. Animalfeeds Int'l Corp.*,[1] the Supreme Court continues its campaign to resolve questions in the field of arbitration. To the surprise of some, however, the Supreme Court is returning to the issue that many of us thought had been resolved in *Green Tree Financial Corp. v. Bazzle*,[2] whether the arbitrator has power in a case involving a form contract with an arbitration clause that makes no mention of class arbitration but is identical to that in many other form contracts, to interpret the contracts as permitting class arbitration, and to declare that since the company that had drafted and concluded these contracts with its customers had chosen the arbitrator to act in one case against a particular customer, it should be deemed to have empowered that same arbitrator to act in a class arbitration involving all of the company's customers who might choose to join in. In *Bazzle* the form contracts and their arbitration clauses were under South Carolina state law, and the state supreme court had already determined that its law called for class arbitration in the circumstances. The U.S. Supreme Court vacated the South Carolina decision, holding that, as the parties had agreed to arbitrate their disputes, under § 2 of the Federal Arbitration Act (FAA) it was up to the arbitrator, rather than a court, to decide whether the contracts permitted or called for class arbitration. But the Supreme Court held in *Bazzle* by a plurality of four, with a fifth justice, Justice Stevens, joining in the result only, that class arbitration was indeed permissible if the arbitrator so interpreted the contracts.

Stolt-Nielsen differs from *Bazzle* in that the contracts at issue are not consumer lending contracts governed by South Carolina state law but maritime shipping contracts, concluded by a shipping company with its many customers and governed by federal maritime law (or possibly by New York law). In opposing class arbitration of the antitrust issue raised by its customers, the shipping company argued that class actions never had been used in connection with federal maritime claims, in contrast to consumer lending as in the *Bazzle* case, where litigated class actions were well known. Accordingly, the parties could never have had a tacit intention that class litigations or class arbitrations would be used to adjudicate such maritime claims. Accepting this argument, Judge Rakoff of the Southern District of New York vacated the arbitrators' decision to grant class arbitration, holding that the arbitrators' decision to do what had been permitted in *Bazzle* was in manifest disregard of law, as the arbitrators had performed only slight choice of law analysis, disregarding custom under federal maritime law and precedent under New York state law.[3]

Nearly three years later the Second Circuit reversed Judge Rakoff's decision.[4] It acknowledged the point that class action litigation was largely unknown in the maritime field, and further agreed that manifest disregard of law remained a viable ground for *vacatur* of an arbitral decision, despite the Supreme Court's recent decision in *Hall Street Associates v. Mattel*.[5] Indeed the Second Circuit stated that it held that manifest disregard was the only doctrine of law that might apply to permit *vacatur* of the arbitrators' decision, since the court felt that it could not be challenged under any of the specific grounds for *vacatur* set forth in section 10 of the FAA.[6] But the Second Circuit concluded that the arbitrators could not be faulted for a cursory choice of law analysis and held that the arbitrators' decision was not so wrong as to rise to the level of manifest disregard. As the arbitration clauses were silent as to the possibility of class arbitration, it was possible to interpret them as permitting it, just as in *Bazzle*.

> *"[W]e need to go back to the* Bazzle *case itself, consider the evolution of the Supreme Court's arbitration canon since* Bazzle *and also gauge the significance of changes in Supreme Court personnel . . ."*

In seeking *certiorari*, the shipping company asked the Supreme Court to revisit *Bazzle*, arguing that the case had not been decided by a clear majority, as Justice Stevens joined in the result only; that the Court had held that the arbitrator should be allowed to decide whether class action arbitration was called for but had not articulated the standards under which such a decision should be reviewed; and it also sought to demonstrate a significant split in decisions of the federal courts as to whether class arbitration was permissible where the arbitration agreement was silent in this regard. As noted above, the Supreme Court granted *certiorari*.

The *Bazzle* Decision and the Constitution of the Court

As we seek to understand the legal issues involved in this controversy and predict how the Supreme Court may decide it, we need to go back to the *Bazzle* case itself, consider the evolution of the Supreme Court's arbitration canon since *Bazzle* and also gauge the significance of changes in Supreme Court personnel since that time.

The four justices who constituted the plurality in *Bazzle*, Justice Breyer speaking for himself and Justices Souter, Scalia and Ginsburg, were able to point out that the form agreement and arbitration clause in that case were governed by South Carolina law and the South Carolina Supreme Court, in applying that law to the terms of the clause, had already determined that, though the clause was silent as regards class arbitration, South Carolina law did permit class arbitration in such circumstances, and indeed that court had ordered class arbitration to proceed. It was therefore sufficient for the Supreme Court plurality to hold that the Federal Arbitration Act did not forbid class arbitration if that was what the parties had implicitly agreed to, and they voted to vacate the decision of the South Carolina Supreme Court only because they considered that the Federal Arbitration Act required that the arbitrator, rather than a court, should be permitted to decide the class arbitration issue where the parties had agreed that all issues were to be decided by arbitration. Justice Stevens indicated he joined in the judgment only to achieve a majority decision and that, while it was arguable that the South Carolina court should have allowed the arbitrator to decide whether the matter would proceed as a class action, the decision of the plurality would in substance allow the class arbitration to proceed as apparently reflecting the independent intention of the arbitrator.

"Can it be argued . . . that the decision of an arbitrator, named by agreement of the parties to serve in one case, to expand his jurisdiction to cover the many other cases of class arbitration, is, if erroneous, a matter of exceeding the arbitrator's powers rather than a matter of erroneous legal interpretation?"

In dissent, Chief Justice Rehnquist spoke for himself and Justices O'Connor and Kennedy in emphasizing the importance of § 2 of the FAA as a source of substantive federal law for the interpretation of arbitration clauses, arguing that the parties' agreement should be enforced as written and that, despite the significance of South Carolina state law in defining the agreement, federal law should prevent the arbitrator from imposing on the parties an obligation to participate in class arbitration that the dissenters felt they had not truly accepted. Thus, although state law governed the interpretation of the terms of the arbitration clause, there was enough substance in § 2 of the FAA to trump this interpretation of South Carolina law. To some, this argument coming from Chief Justice Rehnquist, the author of the decision in *Volt Information Sciences v. Board of Trustees of Leland Stanford Junior University*,[7] where the parties' choice of California law was deemed to trump the application of the federal policy favoring arbitration over litigation, may have seemed paradoxical. Certainly it did not win the approval of the Court. Justice Thomas, in his own terse dissent, reasserted his own now lonely view that the FAA does not apply to proceedings in state courts, and accordingly held that there was no basis for reversal of the South Carolina Supreme Court, a decision that would have allowed class arbitration to continue as ordered by that court.

As we consider the material differences between *Bazzle* and *Stolt-Nielsen*, we can observe that federal law governs the interpretation of the arbitration clauses in *Stolt-Nielsen's* maritime contracts, as the clause makes specific reference to the FAA as governing law. Thus, while federal courts must refer interpretation of such clauses to an arbitrator and give greater or lesser deference to the arbitrator's interpretation, federal courts have ultimate responsibility for application of federal principles of construction to clause interpretation. The Second Circuit acknowledged that the arbitrators' decision of the issue was a break with precedent in the maritime field, but held it could only be set aside if it constituted manifest disregard of law. However, if we accept the Supreme Court's suggestion in *Hall Street Associates v. Mattel* that the manifest disregard standard could be seen as a shorthand reference to all the more specific grounds upon which arbitral decisions may be vacated under FAA § 10, then we might ask if the standards of manifest disregard must really be applied to review of all the potential arbitral faults listed in that section on a one-size-fits-all basis. The Section 10 grounds for *vacatur* include such grounds as corruption, fraud, partiality, and misconduct in rejecting a meritorious request for adjournment of the hearing. In considering a request for *vacatur* on such grounds a court would doubtless give some deference to the arbitrator's own analysis and decision on the point, but the court's decision would nonetheless most likely be on an independent or even a *de novo* basis. However, Section 10 also includes a more anodyne and potentially broader ground for *vacatur*—the argument that the arbitrator exceeded his powers. This most typically includes the conduct of arbitration against a party who never agreed to arbitrate or the exercise of jurisdiction over claims that the parties had not agreed to submit to the arbitrator. Can it be argued, however, that the decision of an arbitrator, named by agreement of the parties to serve in one case, to expand his jurisdiction to cover the many other cases of class arbitration, is, if erroneous, a matter of exceeding the arbitrator's powers rather than a matter of erroneous legal interpretation? In the former case it might be reviewable on a *de novo* basis, in the latter, reviewable for manifest disregard or possibly not at all if manifest disregard is only a shorthand reference to the specific grounds of Section 10. Does the arbitrator who expands his or her jurisdiction from a single case to arbitration of a class of

cases without substantial authority under the state or other law governing the arbitration clauses exceed his or her proper powers? Under what standard should a court review such a decision?

Recent changes to Supreme Court personnel do not seem to provide a basis for prediction. Chief Justice Roberts and Justice Alito would seem likely to align with their predecessors, Chief Justice Rehnquist and Justice O'Connor. The views of Justice Sotomayor in this regard could resemble those of Justice Souter. Thus a close decision seems likely, and the future of class arbitration may be at issue, at a time when use of arbitration in consumer disputes, the main subject matter of class arbitration, is itself under challenge by proponents of the Arbitration Fairness Act,[8] who seek to invalidate all agreements for consumer arbitration, and when a principal provider of arbitration services for consumer disputes, National Arbitration Forum, has already abandoned the field.

"Grant of certiorari *in* Stolt-Nielsen *gives the Supreme Court an opportunity to speak out on the future of class arbitration at a crucial moment . . ."*

Arbitration Clauses That Specifically Forbid Class Arbitration

What of arbitration clauses that are not silent as to class arbitration but specifically forbid it? Since decision of the *Bazzle* case, numerous banks, credit card companies and others who offer their customers form contracts with arbitration clauses have sought to amend those clauses to specifically rule out class action arbitration. In cases in the state and federal courts it has been contended that it is unconscionable under applicable state law to seek to preclude class action treatment in circumstances where the small size of typical individual claims means that effective vindication of rights can only be achieved through aggregation of claims in a class action. Some courts have rejected this argument, while others have accepted it, notably the Supreme Judicial Court of Massachusetts in the recent case of *Feeney v. Dell, Inc*.[9] In that case the court argued persuasively that so long as applicable state law makes it unconscionable in consumer contracts in general to exclude the right to participate in a class action, it may also be held unconscionable to exclude class action treatment in arbitration. The remedy in the *Feeney* case was to invalidate the entire arbitration clause, not just the portion forbidding class arbitration. In other cases the remedy could be to force the bank or credit card company to accept class arbitration even though it had specifically refused its consent to such procedure. The Supreme Court's ultimate decision in *Stolt-Nielsen* seems unlikely to shed much light on these related controversies, which are also being played out in the impending shadow of the Arbitration Fairness Act.

Conclusion

Grant of *certiorari* in *Stolt-Nielsen* gives the Supreme Court an opportunity to speak out on the future of class arbitration at a crucial moment when other forces, including Congress, the state courts and state attorneys general, are also beginning to have a major impact on consumer arbitration. We can expect that the landscape of this type of arbitration may have taken on a new shape in a year's time.

Endnotes

1. 548 F.3d 85 (2d. Cir. 2008), *cert. granted*, 129 S. Ct. 2793 (2009).
2. 539 U.S. 444 (2003).
3. 435 F.3d 382 (S.D.N.Y. 2006).
4. *See supra* note 1.
5. 128 S. Ct. 1396 (2008).
6. *See supra* note 1, 548 F. 3d at 95–96.
7. 489 U.S. 468 (1989).
8. *See* Arbitration Fairness Act of 2009, S. 931, H.R. 1020.
9. 454 Mass. 192 (2009). *See also In re American Express Merchants' Litigation*, 554 F.3d 300 (2d Cir. 2009), and *Homa v. American Express Co.*, 558 F.3d 225 (3d Cir. 2009) and the discussion of class action waivers in New York Dispute Resolution Lawyer, Vol. 2, No. 1 at 60–61 (Spring 2009), a publication of the New York State Bar Association.

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Did You Agree to Arbitrate?

By Laura A. Kaster

The most basic concept in arbitration law is that arbitration is voluntary. It requires the agreement of two or more parties: "A party cannot be required to submit to arbitration any dispute which he has not agreed so to submit."[1] Under the Federal Arbitration Act, the agreement must be in writing.[2] And an award may not be enforced without providing the arbitration agreement to the court.[3] Under the Revised Uniform Arbitration Act (RUAA) Section 6, the arbitration agreement must be "contained in a record."[4] But what at first blush appears to be a simple threshold issue often requires more searching analysis by the advocate, arbitrator, or judge. Whether a party is bound to arbitrate or may invoke the right to arbitrate requires examination of at least the following questions:

- What documents govern?
- What is a writing or a record?
- Who is party to the writing or record?
- What law applies?
- Who decides?

Several recent cases illustrate a few of the nuances that may be involved in examining what is often thought to be a straightforward starting point for issues of arbitrability.

What Documents Govern

Be thoughtful about the potential documents that may impact claims.

Your client tells you that she has discovered evidence that her wages and those of other women with her job title have been consistently lower than men to whom her employer gives identical job titles and who have the same seniority. You think she and others may have a statutory claim. There is no contract of employment. Where else do you need to look?

The U.S. Supreme Court has just informed us that you must also ask your client if she is a member of a labor union, and, if so, you must examine the collective bargaining agreement. In *14 Penn Plaza v. Pyett*[5] the Court held that if the collective bargaining agreement clearly specifies that claims under the statutes you deem to be applicable must be arbitrated, your client has been bound by someone else to arbitrate. Similarly, 14 Penn Plaza was itself bound to arbitrate by a multi-employer bargaining association.

A claim by a partner or member of a law firm would require examination of the bylaws of the incorporated firm to determine whether there is specific agreement to arbitrate the claim. The nature and degree of proof required may be governed by state law. In *Kirleis v. Dickie McCarry & Chilicote, PC* [6] the Court held that the bylaws of the law firm could control but that there must be express and unequivocal agreement to arbitrate under Pennsylvania law, and finding the expression insufficient, it denied arbitration. The federal court held that as a matter of first impression under Pennsylvania law, a shareholder could not be compelled to arbitrate claims against the firm under corporate bylaws to which she did not explicitly consent.

The ruling in *Kirleis* is somewhat at odds with the comments to RUAA § 6 that note that as an agreement between the corporation and its members and among its members, bylaws are enforceable. The RUAA, like the Uniform Arbitration Act, was intended to include arbitration provisions contained in the bylaws of corporate or other associations as valid and enforceable arbitration agreements.[7] In any case, under both the decision in *Kirleis* and the RUAA, bylaws must be evaluated in assessing whether arbitration is available or may be ordered.

Your client may also be bound by a writing or record that he or she has not signed, and arguably not received if the seller can show it has a routine practice of transmitting the contract. For example, noting the full performance under the contract and the seller's evidence that buyers are routinely mailed an arbitration agreement as part of a standard credit materials package, a Minnesota federal district court held that a computer buyer was bound to arbitrate claims under a "'shrinkwrap' accept-or-return" agreement. In *Wold v. Dell Fin. Servs., L.P.*,[8] the shrinkwrap "accept or return" contract sent as part of credit materials in connection with the purchase of a Dell computer bound the purchaser even after the loan was paid off. When Wold sued for violations of the Fair Credit Reporting Act and for credit defamation, Dell Financial Services successfully moved to compel arbitration. The court rejected Wold's argument that he had never received the agreement in light of the business practice and noted that so-called "shrinkwrap" agreements, sent to a remote buyer for review after the sale with an opportunity to reject within a reasonable time, are generally considered enforceable.[9]

What Is a Writing or a Record

As *Wold* illustrates and *Kirleis* and *14 Penn Plaza* make clear, issues of agency, authority, alter ego, and third-party beneficiary may yield controlling documents that will impact the right to arbitrate and the parties who enjoy that right. A writing need not be signed, but there must be evidence of a binding agreement; the standard of required proof varies according to state law.

Who Is Bound to Arbitrate

The parties to the agreement are not the only ones who may be bound or take advantage of an arbitration agreement. In *Idearc Media Corp v. Encore Marketing Group*,[10] Idearc contracted with Encore to sell Internet advertising on Superpages.com to small and medium-sized companies. Encore's commission was based on monthly net sales. Encore cooked the books, creating fictitious sales to generate commissions. Idearc alleged that the president and other officers of Encore were personally involved and it sued alleging fraud, unjust enrichment, conspiracy to defraud and other claims, many of which overlapped with claims against the corporation. The contract between Idearc and Encore contained an arbitration provision and Encore successfully moved to compel arbitration. The Encore executives who were not party to the agreement then moved to compel arbitration of the claims against them. Relying on an earlier Fifth Circuit decision,[11] the court noted that there are two circumstances under which nonsignatories can compel arbitration under the doctrine of equitable estoppel: (1) when a signatory to the agreement must rely on the terms of that written agreement to assert its claims against the nonsignatory; or (2) when a signatory to the contract raises allegations of substantially interdependent and concerted misconduct by the nonsignatory and one or more of the signatories to the contract.

In *Idearc,* the first test did not apply, because many of the claims were not dependent upon the contractual duties. But the court held that the second test did apply because Idearc generally alleged acts against the defendants as a group, intermixing allegations against signatory and nonsignatories to a degree that made arbitration appropriate in light of the fact that the conduct was committed by the Encore employees as a result of the agreement signed by Encore. For that reason, the nonsignatories were permitted to compel arbitration of their claims.

The Second Circuit provided a detailed examination of the estoppel analysis in *Sokol Holdings, Inc. v. BMB Munai, Inc.*,[12] making clear that the fact that the subject matter of the dispute was intertwined with the contract providing for arbitration was a necessary but insufficient basis for finding a matter arbitrable. There must also be a relationship among the parties that supports an implied factual conclusion that the party against whom enforcement is sought consented to extend its agreement to arbitrate beyond the initial parties or that it would be inequitable not to do so.

What Law Applies

Although state law (usually the law of the state specified in the contract that contains the arbitration agreement) typically governs issues of contract formation, it should be noted that the Supreme Court in *14 Penn Plaza* applied federal law to construe the Federal Arbitration Act and to determine that collective bargaining agreements could establish a binding obligation for union members to arbitrate statutory claims. The equitable estoppel arguments reflected in *Idearc* and *Sokol Holdings* allude to basic equity principles without specifying state law. The advocate is well-advised to think about this issue and the consequences for the case.

Who Decides

The cases discussed here are court decisions. Under longstanding principles, *Buckeye Check Cashing, Inc. v. Cardegna*[13] and *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*,[14] the formation of the contract as a whole is for the arbitrator. But the issue of whether an arbitration agreement has been formed is for the court unless the rules adopted by the parties, such as the Rules of the American Arbitration Association, specify that the issue is for the arbitrator. Under the Federal Arbitration Act, when a party seeks to compel arbitration, the court must satisfy itself as to the existence of an arbitration agreement.[15] Therefore, while the validity or existence of an arbitration agreement is for the arbitrator, whether a given party is bound by or may invoke the arbitration clause will likely be for the court.

All of these issues arose out of the ostensibly simple question—did you agree to arbitrate?

Endnotes

1. *AT&T Techs, Inc. v. Communication Workers of Am.*, 475 U.S. 643, 648 (1968).
2. 9 U.S.C. § 2.
3. 9 U.S. C § 13.
4. The RUAA definition section provides: "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form. RUAA § 1.
5. 128 S. Ct. 1233 (2009).
6. 2009 WL 750415 (3d Cir. March 24 2009).
7. Comment 1 to Section 6 of the RUAA provides: "Subsection (a), being the same as Section 1 of the Uniform Arbitration Act (UAA), is intended to include arbitration provisions contained in the bylaws of corporate or other associations as valid and enforceable arbitration agreements. Courts that have addressed whether arbitration provisions contained in the bylaws of corporate or other associations are enforceable under the UAA have unanimously held that they are."
8. 2009 WL 397235 (D. Minn. Feb. 17, 2009).
9. *See, e.g., Hill v. Gateway* 2000*, Inc.*, 105 F.3d 1147 (7th Cir. 1997).
10. 2009 WL 129379 (N.D. Tex. Jan. 20, 2009).
11. *Grigson v. Creative Artists Agency L.L.C.*, 230 F.3d 524, 527–28 (5th Cir. 2000).
12. 532 F.3d 354, 361–62 (2d Cir. 2007).
13. 546 U.S. 440 (2006).
14. 388 U.S. 395 (1967).
15. 9 U.S.C § 3.

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Arbitration Agreements and Bankruptcy—Which Law Trumps When?

By Edna Sussman, with the assistance of Osata Tonia Tongo

As reported by the Office of Administration of the U.S. Courts, in the 12-month period ending June 30, 2009, there was a 35% increase in bankruptcy filings compared to the 12-month period ending June 30, 2008. Business bankruptcy filings rose 63% while non-business filings rose 34%. Chapter 11 filings rose 91% during that period.[1] In light of these statistics and recent economic conditions, we review the principal cases that address what happens to arbitration agreements in the context of a bankruptcy proceeding. The short answer: there is no bright line.[2]

The Competing Policies

The Federal Arbitration Act (FAA) provides that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon grounds as exist at law or in equity for the revocation of any contract." [3] The Supreme Court has repeatedly stated that questions of arbitrability must be addressed with a "healthy regard for the federal policy favoring arbitration."[4] To accomplish the goals of the FAA, "the enforcement of private agreements to arbitrate and encouragement of efficient and speedy resolution," the courts must "rigorously enforce agreements to arbitrate even if the result is piecemeal litigation, at least absent a countervailing policy manifested in another federal statute."[5]

A principal purpose of the Bankruptcy Code[6] is to allow the bankruptcy court to centralize all disputes concerning all property of the debtor's estate so that the reorganization can proceed efficiently, protecting creditors and reorganizing debtors from piecemeal litigation and supporting the power of the bankruptcy court to enforce its own orders.[7]

The Second Circuit recognized the inherent tension between these statutes in commenting that there will be occasions where a dispute involving the Bankruptcy Code and the Arbitration Act presents "a conflict of near polar extremes" as "bankruptcy policy exerts an inexorable pull towards centralization while arbitration policy advocates a decentralized approach towards dispute resolution."[8]

Case Law Developments

The first significant case to deal with the tension between the FAA and the Bankruptcy Code was the Third Circuit's decision in *Zimmerman v. Continental Airlines*.[9] The court recognized that both the FAA and the Bankruptcy Reform Act represented important congressional concerns. Following a careful analysis, the court placed greater emphasis on the bankruptcy laws and stated that the intention of Congress would be better realized if the bankruptcy laws were read "to impliedly modify the Arbitration Act."[10] The court concluded that while the bankruptcy court could stay proceedings in favor of arbitration, the use of the power was to be left to the sound discretion of the bankruptcy court and established a series of considerations for the exercise of that discretion

"[I]n the 12-month period ending June 30, 2009 . . . business bankruptcy filings rose 63% while non-business filings rose 34% [and] Chapter 11 filings rose 91% . . ."

Subsequent to the *Zimmerman* decision, in *Shearson/American Express Inc. v. McMahon*,[11] the Supreme Court addressed the question of whether a claim brought under § 10(b) of the securities laws and under RICO must be sent to arbitration in accordance with the terms of an arbitration agreement. In its review the court established the test to be used to review challenges to an arbitration clause based on another statutory imperative. The Court held that, to overcome the federal policy favoring arbitration, the burden is on the party opposing arbitration to show that Congress intended to limit or prohibit waiver of a judicial forum for a particular claim. The Court said that this intent will be "deducible from the statute's text or legislative history . . . or from an inherent conflict between arbitration and the statute's underlying purpose."[12]

There is general agreement in the case law that there is no indication of a congressional intent to override the FAA in the text or legislative history of the bankruptcy laws, although as discussed below, this conclusion has been questioned by some courts. Accordingly, the third prong of the Supreme Court test—whether there is "an inherent conflict between arbitration and the statute's underlying purpose"—has been the test applied by the courts.

In the wake of the *McMahon* decision, a series of other Supreme Court decisions strongly supporting arbitration, and the 1984 amendments to the Bankruptcy Code which scaled back the jurisdiction of the bankruptcy courts,[13] the Third Circuit revisited the issue in *Hays and Co. v. Merrill Lynch Pierce Fenner & Smith Inc.*[14] The court found an arbitration agreement to be a non-executory contract, which like other contracts cannot be rejected by a trustee in bankruptcy. The court held that the trustee is "bound to arbitrate all of its claims that are derived from the rights of the debtor" as of the commencement of the case, but

not bound to arbitrate other claims that are not derivative but are rather statutory rights created by the bankruptcy code.[15] The court then considered whether, having found that the trustee is bound, the court had discretion to refuse to enforce the arbitration clause. Guided by the developments in the Supreme Court and in Congress, the court held that an arbitration clause should be enforced for a non-core proceeding unless "it would seriously jeopardize the objectives of the [Bankruptcy] Code."[16] Where a trustee seeks to enforce a claim inherited from the debtor in court, the court "perceived no adverse effect on the underlying purpose of the Code from enforcing arbitration."[17] The *Hays* decision has been cited often for the proposition that where a party seeks to enforce a non-core pre-petition debtor derivative contract claim, a court does not have discretion to deny enforcement of an otherwise valid arbitration clause.[18]

As courts generally begin by determining whether the proceeding is core or not non-core in deciding whether to compel arbitration or stay the bankruptcy proceeding, a brief explanation of that dichotomy is necessary. The core/non-core distinction derives from the Supreme Court decision in *Northern Pipeline Construction Company v. Marathon Pipeline Company*,[19] in which the Court struck down the provision of the 1978 Bankruptcy Act which gave broad powers to the bankruptcy courts. The Court found that the statute vested authority in Article I bankruptcy courts to decide cases that, without party consent, constitutionally could only be heard by Article III courts. To address this issue, Congress in the amendments to the Bankruptcy Code in 1984 divided claims into core and non-core, 28 U.S.C. § 157, giving bankruptcy judges authority to hear and determine "all core proceedings arising under title 11 or arising in a case under title 11." Non-core matters are only "related to" the bankruptcy proceeding. With respect to non-core matters, the bankruptcy judges can only recommend findings of fact and conclusions of law to the district court. The Bankruptcy Code provides a non-exclusive list of core proceedings.[20] As the list is not exclusive, the courts have developed additional frameworks for the core/non-core analysis.

Extensive case law and confusion over the distinction between core and non-core have followed. Indeed, the difficulties in deciding whether a matter is core or non-core have been described by one commentator as a "most difficult area of constitutional law," in which "the precedents are horribly murky, doctrinal confusion abounds, and the constitutional text is by no means clear."[21]

In *In re U.S. Lines Inc.*[22] the Second Circuit stated that whether a proceeding is core depends on whether "(1) the contract is antecedent to the reorganization petition; and (2) the degree to which the proceeding is independent of the reorganization."[23] Proceedings can be core by "virtue of their nature if either (1) the type of proceeding is unique to or uniquely affected by the bankruptcy proceedings, or (2) the proceedings directly affect a core bankruptcy function. . . ."[24] Other circuits have their own variations on the test to be applied to the core/non-core determination. A review of the cases demonstrates the difficulties the courts have with this issue as decisions by both the bankruptcy courts and the district courts are often reversed upon review.

"[T]he difficulties in deciding whether a matter is core or non-core have been described . . . as a 'most difficult area of constitutional law,' in which 'the precedents are horribly murky, doctrinal confusion abounds, and the constitutional text is by no means clear.'"

The Fifth Circuit in *In re National Gypsum*[25] dealt with the question of how arbitration agreements in core proceedings should be handled. The court was urged to adopt a position that categorically found arbitration of core proceedings to be inherently irreconcilable with the Bankruptcy Code. The court refused, finding that doing so "conflates the inquiry" required by *McMahon* and is "too broad."[26] The court stated that not all core proceedings are premised on provisions of the code that inherently conflict with the FAA or jeopardize the objectives of the Bankruptcy Code. The court held that "non-enforcement of an otherwise applicable arbitration provision turns on the underlying nature of the proceeding, i.e. whether the proceeding derives exclusively from the provisions of the Bankruptcy Code and if so whether arbitration of the proceeding would conflict with the purposes of the Code."[27]

The Second Circuit's decision in *In re United States Lines, Inc.*[28] similarly concluded that arbitration of core proceedings does not necessarily conflict with the Bankruptcy Code. The case involved P&I insurance policies issued by several carriers that were the only source for payment of claims by thousands of employees for asbestos-related injuries. The Trust, as successor in interest to the debtor, began an adversary proceeding in bankruptcy court for a declaratory judgment on the insurance coverage. The bankruptcy court held that the proceeding was core and denied the motion to compel arbitration. The district court reversed both determinations.

The Second Circuit looked first to whether the proceeding was core or non-core as a non-core proceeding is "unlikely to present a conflict sufficient to override by implication the presumption in favor of arbitration."[29] The court held that the matter was a core proceeding. The court further held that the mere fact that a proceeding is core will not automatically give the bankruptcy court discretion to stay arbitration. On the facts before it con-

cerning insurance coverage which the court found to be integral to the bankruptcy court's ability to preserve and equitably distribute the assets, the Second Circuit found the bankruptcy court's refusal to refer the proceeding to arbitration to be proper.[30]

In *MBNA American Bank, N.A. v. Hill,*[31] the Second Circuit reiterated its position that bankruptcy courts generally do not have discretion to refuse to compel arbitration of non-core bankruptcy matters or matters that are simply "related to" rather than "arising under" bankruptcy cases. Nor do bankruptcy courts have absolute discretion to refuse to compel arbitration of core proceedings. Rather that determination requires "a particularized inquiry into the nature of the claim and the facts of the specific bankruptcy."[32] Although finding the action before it to be a core proceeding, the court concluded that arbitration of the dispute would not jeopardize the objectives of the Bankruptcy Code and that the bankruptcy court did not have discretion to deny the motion to stay the proceeding in favor of arbitration.

"[T]here will be little certainty in some cases as to whether an arbitration agreement will be enforced in a bankruptcy."

Some years later, in *In re Mintze,*[33] the Third Circuit clarified its holding in *Hays,* stating that the decision applied equally to core and non-core proceedings and that the analysis requires a review under the *McMahon* standard for both. The analysis as to the arbitration clause thus raises both the complexity of deciding whether the proceeding is core or non-core and the complexity of deciding whether referring the proceeding to arbitration would jeopardize the objectives of the bankruptcy code.

Complicating the situation further, some courts have challenged the basic premise that the Bankruptcy Code does not itself evidence congressional intent to override the FAA. For example, in *In re White Mountain Mining Company*[34] the Fourth Circuit followed the precedents discussed above in reaching its holding. However, the court suggested, without deciding the point, that, at least with respect to core proceedings, it could be argued from the statutory text that in granting bankruptcy courts jurisdiction over "core proceedings arising under title 11" Congress "reveal[ed] a Congressional intent to choose those courts in exclusive preference to all other adjudicative bodies, including boards of arbitration, to decide core claims."[35]

In a recent decision, *In re Payton Construction Company*,[36] the court's discussion also questioned the prevailing analysis of congressional intent and urged a presumption that Congress "intended for the bankruptcy courts to be the principal and usual, if not exclusive, forum for most matters in bankruptcy."[37] The court cited the creation by Congress of bankruptcy's "centralized, collective proceeding to facilitate the expeditious and relatively inexpensive resolution of all matters relating to bankruptcy so as to make reorganization possible, enable the debtor's fresh start and maximize value and expedite recovery of creditors."[38]

Conclusion

The case-by-case approach in the case law and the difficult analysis required where the matter is not clearly core and integral to the bankruptcy have led to a lack of predictability and costly and time- consuming litigation. Indeed, the extensive litigation that can take place over the enforceability of arbitration clauses in bankruptcy can deprive the parties of the common goals of both legal regimes: efficiency, speed, and avoidance of costs.

The Supreme Court has dealt with the interplay of several statutory claims and the FAA but has not yet directly provided guidance to the courts by addressing the tension between the Bankruptcy Code and the FAA. Many commentators have urged that the Supreme Court or Congress should step in to clarify this area of the law.[39] Commentators have expressed various views as to how the question should be resolved. One commentator suggests that arbitration of core claims should be precluded by the Bankruptcy Code, argues against a *per se* rule in favor of arbitration for non-core proceedings, and urges that debtors be permitted to reject the arbitration agreement[40] pursuant to § 365 of the Bankruptcy Code.[41] Another commentator urges that the filing of a proof of claim in the bankruptcy should be deemed to be a waiver of the contractual right set forth in the arbitration clause.[42] Yet others favor a more nuanced approach that creates presumptions but allows exceptions for both core and non-core proceedings.[43]

The correct solution requires careful thought and analysis and must continue to give due deference not only to the needs of the debtor and the creditors but also to the contractual choice made by the parties to have any disputes resolved in the forum selected by the parties, a choice that can have significant impact on whether a deal is struck and on the economics of the transaction.[44]

The case-by-case analysis of the facts and of the impacts on the bankruptcy in each proceeding in which the enforceability of the arbitration clause can in good faith be debated has created a fertile field for arguments by both those who seek to enforce an arbitration agreement and those who seek to block it. Creative litigants will doubtless find many arguments to support their position.[45] Until such time as Congress or the Supreme Court steps in to simplify the task and create a more predictable litmus test, there will be little certainty in some cases as to whether an arbitration agreement will be enforced in a bankruptcy.

Endnotes

1. Administrative Office of the U.S. Courts, News Release August 13, 2009, *available at* http://www.uscourts.gov/Press_Releases/2009/BankruptcyFilingsJun2009.cfm.
2. For an overview on the subject, see 8 Norton Bankr. L. & Prac. 3d § 169:4 (2009).
3. Federal Arbitration Act, which comprises Chapter 1 of Title 9, is codified at 9 U.S.C. §§ 1-16 (2000). *See* § 2.
4. *See, e.g., Gilmer v. Interstate Johnson Lane Corp.*, 500 U.S. 20, 26 (1991).
5. *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221 (1985).
6. 11 U.S.C. §§ 101 *et seq.*
7. *See, e.g., In re United States Lines*, 197 F. 3d 631, 640 (1999).
8. *Id.* at 640 (citations omitted).
9. 712 F.2d 55 (3d Cir. 1983).
10. *Id.* at 56.
11. 482 U.S. 220 (1987).
12. *Id.* at 227.
13. See discussion in *Hays and Co. v. Merrill Lynch Pierce Fenner & Smith Inc.*, 885 F.22d 1149, 1157 (1989) of the scope of the bankruptcy court's jurisdiction.
14. *Id.*
15. *Id.* at 1154.
16. *Id.* at 1161.
17. *Id.*
18. *See, e.g., In re Crysen/Montenay Energy Co.* 226 F.3d 160, 166 (2d Cir. 2000) ("Bankruptcy courts generally do not have discretion to decline to stay non-core proceedings in favor of arbitration"); *In re Electric Machinery Enterprises Inc.*, 479 F.3d 791 (11th Cir. 2007).
19. 458 U.S. 50 (1982).
20. *See* 28 U.S.C. § 157 (b)(A)-(O).
21. Jason C. Matson, *Running Circles Around Marathon: The Effects of Accounts Receivable as Core or Non-core Proceedings in Article III Courts*, 20 Emory Bankr. Dev. J. 451, (2004).
22. *Supra* note 7.
23. *Id.* at 637.
24. *Id.*
25. 118 F. 3d 1056 (5th Cir. 1997).
26. *Id.* at 1067.
27. *Id.*
28. *Supra* note 7.
29. *Id.* at 640.
30. However, the Second Circuit did not look to whether the claim derived exclusively from the provisions of the Bankruptcy Code as seems to be required by the *In re National Gypsum* decision. See discussion of this point in *Jurisdiction in Bankruptcy Proceedings: A Test Case for Implied Repeal of the Federal Arbitration Act*, 117 Harv. L. Rev. 2296 (2004).
31. 436 F.3d 104 (2d Cir. 2006).
32. *Id.* at 108.
33. 434 F.3d 222 (3d Cir. 2006).
34. 403 F.3d 164 (4th Cir 2005).
35. *Id.* at 168.
36. Bnkrtcy No. 07-11522-HB, Adv. No. 08-1173, 2009 WL 86968 (Bkrtcy. D. Mass., Jan 13, 2009); there is no First Circuit precedent on this issue.
37. *Id.* at 8.
38. *Id.*
39. *See, e.g.*, Mette H. Kurth, *Comment: An Unstoppable Mandate and an Immovable Policy: The Arbitration Act and the Bankruptcy Code Collide*, 43 UCLA L. Rev. 999 (1999); Matthew Dameron, *Stop the Stay: Interrupting Bankruptcy to Conduct Arbitration*, 2001 J. Disp. Resol. 337 (2001).
40. The arbitration agreement is viewed in the case law as a separate agreement from the rest of the contract. *See, e.g., Prima Paint v. Flood & Conklin*, 388 U.S. 395 (1967).
41. *Note: Jurisdiction in Bankruptcy Proceedings: A Test Case for Implied Repeal of the Federal Arbitration Act*, 117 Harv. L. Rev. 2296 (2004).
42. Michael Fielding, *Elevating Business Above the Constitution: Arbitration and Bankruptcy Proofs of Claim*, 16 Am. Bankr. Inst. L. Rev. 563 (2008).
43. Alan Resnick, *The Enforceability of Arbitration Clauses in Bankruptcy*, 15 Am. Bankr. L. Rev. 183 (2007).
44. *14 Penn Plaza LLC v. Pyett*, 129 S. Ct. 1456, 1464 (2009); *Bremen v. Zapata Off-Shore Company*, 407 U.S. 1, 14 (1972); *Roby v. Corporation Lloyd's*, 996 F.2d 1353, 1363 (2d Cir. 1993).
45. For a discussion of some of the strategies for avoiding arbitration in bankruptcy, see Michael Fielding, *How to Avoid Arbitration in Bankruptcy*, 26-6 American Bankruptcy Institute Journal 24 (July 2007).

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The Restatement (Third) of the U.S. Law of International Commercial Arbitration: Some Questions Along the Way

By George A. Bermann

The American Law Institute's project on a Restatement of the U.S. Law of International Commercial Arbitration is decidedly underway. To get to this point, two basic questions had to be answered in the affirmative: Is the state of the law within the field such that the field stands to benefit from the assumed contributions of a Restatement? And is the magnitude of that benefit such as to justify the evident magnitude of the effort that a proper Restatement requires? These are questions particularly worth asking whenever the ALI steps—as it is increasingly doing—out of the classic and paradigmatic terrain of restatements, that is to say, fields of common law falling within the remit of state law.

Most persons working in the field of international arbitration would agree that a proper Restatement would—or at least could—bring real benefits to the field. Even if the field is not composed chiefly of state common law, as were virtually all the early Restatements, it nevertheless requires clarification and consolidation, due mainly to its multiplicity of sources and its contradictory judicial decisions. International commercial arbitration consists of both statute and common law, both state and federal law, considerable treaty law, and an enormous quantity of "soft law," in the sense in which that term is used today. The central federal legislation (the Federal Arbitration Act) by no means answers all pertinent questions clearly and well. Nor is its relationship to the New York and Panama Conventions and the multitude of investment treaties, on the one hand, or to state statutory and case law, on the other, sufficiently well understood. For these and other reasons, the case law in the field presents far from a coherent picture.

Among my favorite examples of problems to whose solution a Restatement might contribute is one that we have reason to believe courts today find themselves inadequately equipped to address, or at least in an uncomfortably improvisational mode. Consider the following. In time I, Court A is asked to refer the parties to arbitration and, in doing so, makes certain determinations about the meaning, the scope, the validity and the enforceability of the arbitration agreement (not to mention about who is bound by it). In time II, the arbitrators may be called upon to revisit some or all of the same questions. In time III, Court B, in the place of arbitration, is invited by a disappointed party to annul the reward on recognized grounds, some of which closely echo challenges to the arbitration agreement that not only the arbitrators, but also the court that compelled arbitration in the first place, will or may have addressed. Of course, if the action before Court B is unsuccessful and the award survives, the award may well be brought for recognition or enforcement in yet another court, Court C. Once again, very similar if not identical grounds may be advanced for denying the recognition and enforcement that is sought.

Should any of these courts feel bound by the prior determinations? Should they at least show them deference? Or are these the "hallmark" issues that every court in the chain of courts should, if asked, answer for itself. Scenarios for preclusion abound. So, too, do questions of waiver. If the disappointed party has failed to contest the arbitration agreement or the award either at the time that arbitration was compelled, or when the arbitration was underway, or upon *vacatur*, is it too late to do so at a later point in time? This question, too, may arise throughout the length of the procedure. Arbitrations can enjoy long and interesting life cycles, with numerous points of intersection with the courts and numerous opportunities for parties to question the validity and enforceability of the arbitration agreement or award.

"Most persons working in the field of international arbitration would agree that a proper Restatement would—or at least could—bring real benefits to the field."

Should the answer depend upon the specific challenge to the agreement or award (lack of consent to arbitrate?, dispute beyond the scope of the arbitrators' authority?, procedural irregularity or partiality of the tribunal?, etc.) that is being raised at these multiple moments in time? Should the answer depend on the court's assessment of the choice of law properly to be applied to each of these challenges? Similarly, with waiver, might the answer depend on the nature of the particular objection being raised or upon the substantive law that a court chooses to apply to the challenge? These are merely examples of the very real scenarios to which a judge may well lack a ready and settled response.

While the Reporters are now already knee-deep in the substance of at least one Restatement chapter—on the recognition and enforcement of international commercial arbitral awards—they first had to resolve a number of conceptual questions. Space limitations allow me to evoke only the most salient of these questions, and to do so all too briefly.

First, should this be a restatement of the *U.S.* law of international commercial arbitration or a more "a-national" elaboration? The Reporters have resolved this question in favor of the former. We propose to be anchored, throughout the project, in U.S. law, with a special eye on the issues likely to confront courts and parties in the United States in the course of or in relation to an arbitration. Of course, that statement requires immediate qualification, for international arbitration by definition interfaces with foreign arbitral systems, and does so in many and complex ways. Clearly, any given arbitration might spend part of its life cycle in the courts and other institutions of other countries, and arbitrations begun in other countries may spend part of their life cycle in courts and institutions in the U.S. But there are also larger and more cosmopolitan reasons for taking arbitral and judicial practice abroad into account. We accordingly expect our Reporters' notes to be suitably rich in allusions to foreign law and practice.

Second, what of alternative dispute resolution forms other than arbitration? The palette of arbitral forms is rich and new manifestations are always occurring. (Even "hot-tubbing" has become an arbitral form or at least an arbitral device.) But at some point, we think, you cross the line into another form of ADR, be it mediation or conciliation or any number of other processes. It is not the purpose of this Restatement to deal with these; were we to do so, we would risk a very serious loss of focus.

Third, should a Restatement of *international* commercial arbitration take into consideration arbitration that is merely domestic, within the meaning of U.S. law, including the 1958 New York Convention? We think it should, if only because the Federal Arbitration Act applies to both. After all, as we consider the landmark Supreme Court rulings that have profoundly affected international arbitration law and practice, we find that a great number—*Mastrobuono*, *Volt*, *Southland v. Keating*, *First Options*, *Hall Associates*, to name just a few—have arisen out of domestic, albeit interstate, arbitration. So, while we focus on the phenomenon of international commercial arbitration (a sphere to be defined, of course), we need to embrace all the relevant learning to be drawn from the purely interstate cases.

Fourth, to what extent does a Restatement of the U.S. Law of International Commercial Arbitration purport to restate rules of arbitral procedure as such? This is a difficult question. One could envision a comprehensive code for the conduct of international commercial arbitrations in the United States, covering all manner of issues, from service of pleadings, to the conduct of hearings, to provisional relief, to discovery, to the form of the award. A comprehensive *lex arbitri* could well go deeply into such issues of arbitral procedure; while the FAA as currently drafted does not do so, the arbitration laws of certain other countries do.

But the Reporters do not conceive of this project as the drafting of a new Federal Arbitration Act, however useful the eventual Restatement might be were Congress ever to undertake a comprehensive revision of the FAA. A Restatement speaks first and foremost to U.S. courts, and indirectly to persons whose affairs may some day come before the U.S. courts. The procedural conduct of arbitrations is not fundamentally a question for judicial determination—not, at least, until we have before us a *lex arbitri* that goes deeply into matters of arbitral procedure, which is not the case.

"[T]he Reporters do not conceive of this project as the drafting of a new Federal Arbitration Act . . ."

Moreover, if there is any overriding principle of the U.S. (and most other countries') law of arbitration, it is the principle of party autonomy in the design of arbitral process. The law should take care not to prescribe the ways in which an arbitration should unfold; among the very purposes of arbitration is to give the widest scope possible to the parties' freedom in this regard. For this reason, even if a Restatement were to venture far into arbitral procedure, the vast majority of its prescriptions would take the form of default rules, from which the parties would remain perfectly free to derogate. The aspects of arbitral procedure that are properly regarded as legally "mandatory" are few.

Finally, there exists a plenitude of excellent model rules, as well as institutional rules, of arbitral procedure that parties may—and commonly do—adopt as part of their arbitration agreement. These rules are highly detailed and represent procedural choices that the parties may fairly be deemed to have made when they incorporated the rules into their arbitration agreement. The quantity and quality of such rules, and the frequency with which arbitration agreements embrace them, suggest that prescribing arbitral procedure in a complete and comprehensive fashion should not be regarded as the Restatement's mission.

This is not to say that issues of arbitral procedure will not figure importantly in the Restatement. They assuredly will, if only because such issues do come before the courts on all the occasions identified above when arbitration agreements, arbitral proceedings and arbitral awards themselves come before the courts. Courts neither compel arbitration, nor intervene in arbitral proceedings, nor scrutinize awards upon their rendition, recognition or enforcement, without issues of arbitral procedure coming to the fore. But it is one thing for a Restatement to address these critical scenarios in their litigation context and another for it to presume to dictate rules of arbitral pro-

cedure, even default rules, irrespective of whether courts themselves will ever have occasion to address them.

Surely, however, the most challenging question of scope facing the Reporters is whether investor-state arbitration belongs in this Restatement. Clearly, the Restatement governs disputes, even if investor-related, that grow out of a contract between an investor and a foreign state that contains an arbitration clause. I doubt anyone would contest that proposition. But we all know only too well that investment arbitration disputes arise out of contracts between states and foreign nationals that contain no arbitration clause, because there is in effect a bilateral investment treaty (BIT) in effect between the investor's state and the host state. We know further that investment disputes may implicate a foreign state even where it is not a party to the underlying contract, for the simple reason that a BIT or a regional trade agreement so provides. The question arises whether the distinctive features of investor-state arbitration of the latter sort counsel their inclusion or exclusion in the Restatement project, or some intermediate solution.

"It may well be that some of the judgments of scope . . . described here will come to be revisited as the process of drafting this ambitious Restatement continues to unfold."

If this Restatement were proposing, as it is not, to move heavily onto substantive law terrain—that is to say, the law governing the substantive rights and obligations at issue in the arbitration—then we would be faced, once we had brought investor-state disputes into the mix, with the challenge of defining and operationalizing most favored nation (MFN), national treatment, expropriation, and "fair and equitable treatment." That is not what we contemplate doing, any more than we contemplate addressing, in the case of commercial arbitration generally, the substance of the United Nations Convention on Contracts for the International Sale of Goods (CISG) or the Unidroit Principles or, heaven help us, the domestic contract law of the state to whose law the choice of law instincts of an arbitration panel may point.

Of course, even on purely institutional and procedural issues, the terrain is not entirely level as between investor-state arbitration and the rest. There are distinctive ground rules and institutional expectations that will complicate the inquiry, once the Restatement embraces this species of arbitration. But though we may have perhaps erred on the side of caution in respect of the other decisions about project scope that I have mentioned, when it came to this one, we have succumbed, preliminarily of course, to the urge to err on the side of inclusion. If, as I expect, we maintain this course, we will continue to find ourselves jostled, to put it mildly, by the particularities of investor-state arbitration—and this, even if we rigorously confine ourselves to international arbitration's institutional and procedural aspects.

* * *

To be sure, the Reporters have by now moved beyond these abstract questions of scope. We have made great progress in rigorously examining and reformulating principles of law in the area of recognition and enforcement of awards, and will next venture into the principles governing *vacatur* of awards. We will eventually turn to the enforcement of the arbitration agreement, to issues of arbitral procedure (within the limits sketched above), to judicial assistance in the form of provisional relief both in local and foreign arbitrations and, as noted, to the particularities in all respects of investor-state arbitration. It may well be that some of the judgments of scope I have described here will come to be revisited as the process of drafting this ambitious Restatement continues to unfold. But it is critical to have guiding principles on large issues even as one gets underway. I hope this brief account provides some understanding of those issues that the Reporters have addressed and at least provisionally resolved. There remains the arduous multi-year task, rich in perspiration and inspiration alike, of actually producing the Restatement whose articulation these principles are meant to guide.

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A Farewell to Arms? *West Tankers* and the Demise of the Anti-Suit Injunction in Europe

By Timothy G. Nelson and Colm P. McInerney

In February 2009, the European Court of Justice (ECJ) decided *Allianz SpA v. West Tankers Inc.* (*"West Tankers"*),[1] a case that arguably delivered the death-knell to "anti-suit injunctions" in cases between European parties, particularly in cases where English courts may wish to enjoin foreign court proceedings to protect a pending London arbitration. As a result of the ECJ's holding that such injunctions were incompatible with European Union (EU) law, some even predicted that the *West Tankers* decision would see parties fleeing to alternative, non-European venues such as New York, whose courts remain able to issue anti-suit injunctions to stop foreign litigation from interfering with a pending arbitration.[2]

1. The Nature and Purpose of Anti-Suit Injunctions

An anti-suit injunction is a form of court order that commands a party to refrain from pursuing, or continuing to pursue, litigation in a foreign forum. This remedy was developed by the common law courts to prevent parties from engaging in foreign proceedings that are vexatious, harassing or otherwise improper. Such relief is generally regarded as a remedy that should be used sparingly, in order to avoid disrupting the working of other countries' courts. Nevertheless, courts in common law countries, including England and the United States, have historically been willing to enjoin parties from pursuing foreign proceedings brought in breach of a specific forum selection clause—be it a choice-of-court clause or an arbitration clause.[3] For example, until *West Tankers*, English courts had repeatedly granted anti-suit injunctions restraining parties from pursuing foreign proceedings that violated their promise to arbitrate disputes in London.[4] Now, the power of English courts to issue such relief has been significantly curtailed.

2. The Role of the ECJ and European Law in Limiting Anti-Suit Relief

That the ECJ has power to review the permissiblity of anti-suit injunctions in *West Tankers* is a reflection of the growing absorption of the United Kingdom's (U.K.) legal system into the broader framework of European law. Since 1968, the UK has been party to European treaties—and, more recently, EU regulations—governing issues of jurisdiction in civil cases. The most recent iteration of these measures is known as the "Brussels Regulation."[5]

In the 2004 *Turner* case, the ECJ held that the common law anti-suit injunction (as practiced in the courts of England and Ireland), if utilized to restrain court proceedings in another EC Member state, is inconsistent with Article 27 of the Brussels Regulation, which states that where proceedings involving the same parties and causes of action are first brought in one EC Member state court, *any* other EC Member State court must stay its action until the first-seized court decides whether it has jurisdiction. Thus, in *Turner*, an anti-suit injunction by an English court, restraining the pursuit of earlier-filed litigation in Spain, was incompatible both with Article 27 and the general principle of "mutual trust" between EU Member States.[6]

> *"[U]ntil* West Tankers, *English courts had repeatedly granted anti-suit injunctions restraining parties from pursuing foreign proceedings . . ."*

Of course, the concept of anti-suit relief is not widely accepted within the "civil law" world, and many civil lawyers are vociferously hostile to this remedy. Indeed, in lamenting the *Turner* decision, Professor Adrian Briggs ascribed the ECJ's antipathy toward anti-suit relief to the "peculiar hostility" that "continental lawyers" harbor toward the anti-suit injunction—even though "[a]s an antidote to jurisdictional shenanigans its usefulness is second to none."[7] In place of this remedy, he wrote, English courts were now required to "repos[e] trust in the other states' legal systems and judicial institutions."[8]

Even after *Turner*, however, hopes persisted that anti-suit injunctions *in aid of arbitration* remained valid, by reason of Article 1(2)(d) of the Brussels Regulation—which excludes arbitration-related proceedings from the scope of the regulation. Early ECJ case law had held that not only was arbitration itself excluded from the Brussels Regulation, but so was "a measure [that] comes within the sphere of arbitration."[9] But, in the 1998 case of *Van Uden*, the ECJ held that proceedings before a Dutch court to seek injunctive relief in aid of arbitration did *not* fall within the arbitration exception[10]—thus indicating that the ECJ would henceforth interpret the "arbitration exception" narrowly.

3. The *West Tankers* Decision

West Tankers dates back to an August 2000 collision between a vessel, *The Front Comor*, chartered by West Tankers, Inc. (WTI) to Erg Petroli SpA ("Erg"), with Erg's oil jetty on the Ionian Sea near the coast of Syracuse, Italy. Erg successfully claimed against its insurers and simultaneously initiated arbitration proceedings in London against WTI to recover the excess insurance pursuant to the terms of the charter party. In July 2003, having paid Erg's claim, the insurers sought to recover these sums by commencing court proceedings in Italy against WTI before the *Tribunale di Syracuse* in Italy.

In September 2004, WTI applied to the English High Court for an anti-suit injunction to restrain the insurers from continuing the Italian proceedings, on the basis that, as subrogees, they were bound by the arbitration agreement. The Court agreed, stating that "this is a clear case for an anti-suit injunction."[11] On appeal, the House of Lords upheld the decision but referred to the ECJ the issue of whether the injunction was compatible with the Brussels Regulation.[12]

"[I]nitial fears that the West Tankers *decision might cause a mass exodus of arbitration from London may have been overstated."*

In a February 2009 decision that essentially reversed the English courts' rulings, the ECJ held that the controversy was covered by the Brussels Regulation, notwithstanding the arbitration exception.[13] It held that the critical issue was not whether the English proceedings were related to arbitration, but whether the court proceedings that the anti-suit injunction *was directed at*—the first-filed Italian proceedings—fell within the Brussels Regulation (which they plainly did).

As to the propriety of anti-suit relief, the ECJ held that:

> [A]n anti-suit injunction … is contrary to the general principle which emerges from the case-law of the Court . . . that every [EU] court seised itself determines, under the rules applicable to it, whether it has jurisdiction to resolve the dispute before it.
>
> * * *
>
> [A]n anti-suit injunction also runs counter to the trust which the Member States accord to one another's legal systems and judicial institutions and on which the system of jurisdiction under [the Brussels Regulation] is based.[14]

Thus, it held, the English courts should not have enjoined the Italian proceedings.[15]

4. Future Implications of the *West Tankers* Decision

The loss of this long-standing remedy has caused some disappointment within U.K. and Irish legal circles and has also provoked lively debate within the international arbitration community.[16] Yet, initial fears that the *West Tankers* decision might cause a mass exodus of arbitration from London may have been overstated. After all, Paris, Geneva and Stockholm all enjoy prominent positions as European arbitration venues, and yet their courts rarely issue such injunctions.

Moreover, *West Tankers* does not purport to alter the power of *non-EU* courts to grant anti-suit relief, even where the restrained proceedings are located in the EU. For example, the courts of the British Virgin Islands (BVI) (which is not part of the EU) have granted anti-suit relief to restrain BVI-incorporated companies from pursuing improper foreign proceedings, including in EU Member States—even where the underlying dispute had no connection with the BVI.[17] On its face, *West Tankers* does not alter the power of the BVI or other non-European courts to grant such relief in the future.

In the same vein, *West Tankers* arguably leaves English and Irish courts free to grant anti-suit relief to restrain proceedings in non-European states.[18] Under this analysis, several English courts have recently issued anti-suit injunctions to enjoin parties from litigating in India and Tunisia respectively, regarding the Brussels Regulation as inapplicable in such circumstances.[19]

Separate altogether is the ability of the *arbitrator* itself to issue an anti-suit order. For purposes of European law, an arbitrator is not "a court or tribunal of a Member State,"[20] and thus is not constrained by the Brussels Regulation. Furthermore, courts in England (as in the United States) have recognized the power of arbitrators to issue anti-suit relief and/or award damages for breach of an arbitration agreement.[21]

In summary, although *West Tankers* has removed the protective umbrella of the English anti-suit injunction, this is unlikely to dilute the efficacy of London arbitration clauses for mainstream commercial transactions, especially those involving countries with a long record of deference to arbitration (e.g., France, Switzerland and the Benelux countries). The position may be different for transactions that involve exposure to "high-risk" jurisdictions—i.e., countries whose courts may prove hospitable to "spoiling" actions intended to derail arbitration. In such cases, *West Tankers* may persuade contracting parties to either explore alternative arbitral venues in countries whose courts still permit anti-suit injunctions (e.g., New York or Singapore), or to consider modifications to their standard London arbitration clauses to offset "spoiling"

actions (e.g., by providing that arbitral tribunals may act with greater than usual expedition or providing expressly for an award of damages for any breach of the arbitral agreement).[22]

Endnotes

1. Case C-185/07, *Allianz SpA v. West Tankers Inc. ("West Tankers")*, 2009 ECJ EUR-LEX-LEXIS 113 (Feb. 10, 2009).
2. *See, e.g.*, Alex Spence, *Lawyers fear West Tankers ruling could harm London*, TimesOnline, Feb. 10, 2009, *available at* http://business.timesonline.co.uk/tol/business/law/article5703346.ece (last visited July 9, 2009) (quoting the Law Society, which remarked in the wake of the ECJ's ruling: "'Today's ruling does Europe no favors as a place to do business, not to mention London. We will have to ensure today's ruling does not push arbitration to New York or Singapore, rather than European arbitral seats such as London.'").
3. *See, e.g., Paramedics Electromedicina Comercial Ltda. v. GE Med. Sys. Info. Techs., Inc.*, 369 F.3d 645, 654 (2d Cir. 2004) (holding that Brazilian litigation should be enjoined because it was a "tactic to evade arbitration," and the strong U.S. policy which favored enforcement of arbitration clauses supported issuance of anti-suit injunction); *cf. LAIF x SPRL v. Axtel, S.A. de C.V.*, 390 F.3d 194, 2000 (2d Cir. 2004) (refusing to issue anti-suit injunction to restrain litigant from continuing Mexican proceedings where the respondent had commenced this action not "as an evasion of the arbitral forum or 'an attempt to sidestep arbitration,'" but rather to have the Mexican court determine the standing of petitioner (citation omitted)).
4. *See, e.g., Pena Copper Mines Ltd. v. Rio Tinto Co.*, (1911) 105 L.T. 846 (Eng.) (holding anti-suit injunction would be available against foreign proceedings in breach of arbitration agreement); *Aggeliki Charis Compania Maritima SA v. Pagnan SpA ("The Angelic Grace")*, [1995] 1 Lloyd's Rep. 87 (Eng.) (upholding anti-suit injunction against Italian court proceedings on basis of arbitration agreement); *Navigation Maritime Bulgare v. Rustal Trading Ltd. ("The Ivan Zagubanski"*) [2002] 1 Lloyd's Rep. 106, 113-14 (Eng.) (English court held it would grant anti-suit injunction to restrain proceedings in Marseille, France, if the claimant could demonstrate the existence of an arbitration clause and there were no exceptional circumstances which militated against the granting of the requested relief).
5. Official Journal of the European Communities, *Council Regulation (EC) No 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters (entered into force March 1, 2002)*, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2001:012:0001:0023:EN:PDF (last visited July 9, 2009). Prior to the Regulation, the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters of 27 September 1968 (the "Brussels Convention") was in effect. Thus, some of the ECJ case law refers to the Brussels Convention rather than the Regulation. All of the Brussels Convention articles that are referenced in this article are now found in the Brussels Regulation. In addition, a sister convention known as the "Lugano Convention" (Convention of 16 September 1988 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters) applies similar rules between EU Member States and the members of the European Free Trade Area (EFTA), *i.e.*, Switzerland, Iceland and Norway, as well as Poland.
6. Case C-159/02, *Turner v. Grovit*, 2004 E.C.R. I-3565, at 31; *see also* Case C-116/02, *Erich Gasser GmbH v. MISAT Srl.*, 2003 E.C.R. I-14693, at 54 (holding that a court first-seised of a case must *always* be allowed to decide its jurisdiction before a latter-seised court could rule on this issue, even where the parties' contract had provided a choice-of-forum clause in favor of another jurisdiction). Brussels Regulation, Article 27 states in full:

   "1. Where proceedings involving the same cause of action and between the same parties are brought in the courts of different Member States, any court other than the court first seised shall of its own motion stay its proceedings until such time as the jurisdiction of the court first seised is established. 2. Where the jurisdiction of the court first seised is established, any court other than the court first seised shall decline jurisdiction in favour of that court."
7. Adrian Briggs, *Anti-Suit Injunctions and Utopian Ideals*, 120 L.Q.R. 529, 530 (2004).
8. *Id.*
9. Case C-190/89, *Marc Rich & Co. AG v. Societa Italiana Impianti P.A. ("Atlantic Emperor")*, 1991 E.C.R. 3855, at 19 (holding that the appointment of an arbitrator by the English court was a measure that came within the sphere of arbitration and thus was covered by the exception and therefore the English proceeding was outside the scope of the Convention).
10. Case C-391/95, *Van Uden v. Kommanditgesellschaft In Firma Deco-Line*, 1998 E.C.R. 7091, at 26, 33. The ECJ's reasoning was that such proceedings were intended to ensure performance of the contractual obligation itself, and so the proceedings were not "bound up with the subject-matter of arbitration" or "ancillary" to it.
11. *West Tankers Inc. v. Ras Riunione Adriatica di Sicurta, ("Front Comor")*, [2005] 2 Lloyd's Rep. 257, 273 (Eng.).
12. *See West Tankers Inc v. Ras Riunione Adriatica di Sicurta SpA ("Front Comor")*, [2007] 1 Lloyd's Rep. 391 (H.L.)(U.K.).
13. *West Tankers*, at 26.
14. *Id.* at 29–30.
15. Domestic anti-suit injunctions are possible in certain instances in the U.S. The Anti-Injunction Act, 28 U.S.C. § 2283 (1958), provides that a federal court may enjoin state proceedings where such relief "is expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect and effectuate its judgments." "The Second Circuit has repeatedly affirmed district court decisions that compel arbitration and stay state court actions." *Ferrari N. Am., Inc. v. Ferrari of Los Gatos*, LLP, No. 99 Civ. 4537 (MBM), 1999 WL 1711081, at *3 (S.D.N.Y, Sept. 13, 1999) (citing *Pervel Indus., Inc. v. T M Wallcovering, Inc.*, 871 F.2d 7, 9 (2d Cir. 1989)); *see also Doctor's Assocs., Inc. v. Hamilton*, 150 F.3d 157, 164 (2d Cir. 1998) (affirming order compelling arbitration and enjoining state court litigation initiated in violation of arbitration agreement). Additionally, a state court may enjoin another state court. *See Cole v. Cunningham*, 133 U.S. 107 (1890) (holding that a Massachusetts state court could constitutionally enjoin a pending suit in the state of New York). However, state courts are generally without power to enjoin proceedings in federal court. *See Donovan v. City of Dallas*, 377 U.S. 408, 413 (1964) ("state courts are completely without power to restrain federal-court proceedings in in personam actions . . ."); *accord Gen. Atomic Co. v. Felter*, 434 U.S. 12 (1977).
16. Separately, the European Community has raised the possibility of reforming the Brussels Regulation or other European laws to address arbitration issues, including a proposal to create uniform rules for determining whether cases should be referred to arbitration. *See* Commission of the European Communities, *Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the application of Council Regulation (EC) No 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, COM (2009) 174 final*, at 9, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0174:FIN:EN:PDF (last visited July 9, 2009).
17. *See Finecroft Ltd. v. Lamane Trading Corp.*, Claims No. BVIHCV2005/0264 & BVIHCV2005/0265 (Eastern Caribbean Sup. Ct., British Virgin Islands High Ct., Jan. 6, 2006) (restraining a BVI company from initiating proceedings in New York, Cyprus

and Russia in breach of a London arbitration clause); *see also* Paul Mitchard, *Anti-Suit Relief—An Imperfect World*, 2 Global Arb. Rev. 33, 34 (2007).

18. However, it remains possible that the ECJ may curtail such injunctions. The Irish Supreme Court recently asked the ECJ whether it could stay proceedings before it on the grounds of *lis alibi pendens* where one of the parties had previously commenced litigation in the U.S., a non-EU Member State, or whether Article 27 of the Regulation precludes such relief. *See Goshawk v. Life Receivables Ireland Ltd.*, [2009] I.E.S.C. 7, at 13 (Ir. Sup. Ct.). Conceivably, the outcome of this case may impact the English and Irish courts' ability to issue anti-suit relief to enjoin proceedings in non-European venues.

19. *See Shashou v. Sharma*, [2009] EWHC (Comm.) 957 (Eng.) (English High Court held that it could issue an injunction restraining a party from continuing litigation in India challenging the English court's confirmation of a London-venued International Chamber of Commerce award on costs); *see also Midgulf Int'l Ltd. v. Groupe Chimiche Tunisien*, [2009] EWHC 963 (Eng.) (English High Court issued an injunction restraining a party from litigating in Tunisia pending the court's determination of whether the parties' agreement contained a valid London arbitration clause.).

20. *See* Case 102/81, *Nordsee Deutsche Hochseefischerei GmbH v. Reederei Mond Hochseefischerei Nordstern AG & Co. KG*, 1982 E.C.H.R. 1095 (held that arbitrator called on by the parties under an arbitration clause to decide a dispute was not a "court or tribunal of a member state" within the meaning of Article 177 (now Article 234) of the Treaty Establishing the European Community, Nov. 10, 1997, 1997 O.J. (C 340) 3); *see also* Case 125/04, *Denuit v. Transorient-Mosaïque Voyages et Culture SA*, 2005 E.C.R. I-923 (same holding).

21. *See, e.g.*, *Telenor Mobile Commc'ns AS v. Storm LLC*, 587 F. Supp. 2d 594 (S.D.N.Y. 2008) (imposing contempt sanctions against four foreign corporations for failing to comply with UNCITRAL arbitral award rendered in New York; noting that UNCITRAL tribunal had issued an anti-suit injunction prohibiting the prosecution of any existing litigations in the Ukraine); *CMA CGM SA v. Hyundai Mipo Dockyard Co.*, [2009] 1 Lloyd's Rep. 213 (Eng.) (endorsing an English-venued tribunal's award of damages against a party that had obtained a judgment in France contrary to the parties' arbitration agreement; tribunal awarded damages in an amount equal to the amount the party had obtained from the French judgment); *MWN Group, Inc. v. MAG USA, Inc.*, No. 3:06-MC-47 (Phillips), 2007 U.S. Dist. LEXIS 57979, at *11 (E.D. Tenn. Aug. 8, 2007) (upholding arbitrator's award of damages incurred by prevailing party arising from opponent's actions in "filing suit in Michigan rather than instituting arbitration proceedings").

22. For further discussion on the possible implications of the *West Tankers* decision on European arbitration, see Colm P. McInerney and John P. Gaffney, *West Tankers: Fuelling the Debate on the Position of Arbitration Under European Union Law*, ABA Section of Litigation, International Litigation Quarterly, Vol. 25, Issue 3 (2009).

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Our next Ethical Compass will consider the question of what attorneys are ethically required to do in New York State with regard to discussing dispute resolution options with clients and what they should be required to do. This article provides some perspectives on the issue from a sister common law jurisdiction.

Advising Clients on ADR: Professional Conduct Obligations for English Solicitors

By Alexander J. Oddy

Since 2007 solicitors[1] in England and Wales[2] have been subject to professional conduct obligations to consider Alternative Dispute Resolution (ADR) with clients in disputes. That recent development has reinforced the series of measures put in place progressively since 1999 as part of the reforms to the English Civil Procedure Rules (CPR)—widely known as the "Woolf Reforms" after their architect, Lord Woolf of Barnes—which have moved ADR to the heart of the civil justice system.

Introduction

Two features of the English civil justice system bear mention by way of introduction. First, in a discussion of practice in England and Wales the term ADR will only infrequently be considered to include arbitration, in contrast to the view commonly held in the U.S. The term ADR as used in this article includes the full range of processes, of which mediation is overwhelmingly the most popular, but all of those are perceived as alternatives to litigation or arbitration, both being formal processes delivering binding adjudicated outcomes.[3]

Secondly, it should be noted that the costs of civil litigation in England and Wales are, subject always to the Court's discretion, awarded according to the "loser pays" rule.[4] A successful party (whether claimant or defendant) will usually recover in the region of 60-70% of the costs of the action from the unsuccessful opponent. Under limited circumstances, higher levels of recovery are possible.[5]

The Civil Procedure Rules

The CPR govern procedure for cases in the civil courts and came into force in April 1999 following Lord Woolf's root and branch review of the English civil justice system. One of the key recommendations in Lord Woolf's *Access to Justice* report was that the range and availability of ADR processes should be increased as one of a series of measures to improve the efficiency and effectiveness of civil procedure, thereby reducing the cost and time spent resolving disputes. The CPR's approach is one of "carrot and stick." The "carrot" is the encouragement and facilitation of ADR by the courts. The "stick" is that a successful party that fails unreasonably to comply with the various obligations of the CPR that encourage parties toward ADR risks having its usual entitlement to costs reduced in part or whole.

The Pre-Action Protocols

The CPR introduced a set of codes, called Pre-Action Protocols, with a view to regulating the conduct of prospective litigants prior to commencing proceedings to try to ensure that litigation was truly a matter of last resort. There are currently ten specific Protocols which guide the conduct of certain types of civil disputes, including professional negligence disputes, construction and engineering disputes, personal injury claims, and disease and illness claims.[6] Even where no specific Protocol applies (as in many commercial disputes), a Protocols Practice Direction dictates the way in which the parties should engage constructively prior to the commencement of proceedings. Whilst the Protocols focus on practical measures requiring parties to articulate their cases clearly and to exchange relevant documents, all of them require parties to consider ADR processes prior to the commencement of proceedings. Whilst pre-action ADR is not mandatory,[7] the Protocols make clear that if they are not followed then the Court *must* have regard to that conduct when determining costs.

Consequently, a solicitor is obliged to inform the client that a failure to comply with the Protocols and at least consider ADR risks prejudicing the recovery of costs (or exacerbating an adverse costs award).

The Overriding Objective

The CPR introduced a guiding principle for the conduct of civil litigation—the overriding objective—that the Court must deal with cases "justly." To further the overriding objective, the Court has a duty to manage cases actively.[8] Active case management includes *"encouraging the parties to use an alternative dispute resolution procedure if the court considers that appropriate and facilitating the use of such procedure."*[9] Furthermore, litigants are required to help the Court further the overriding objective and so must necessarily be given advice on ADR procedures by solicitors advising them to assist with the Court's encouragement of ADR.[10] As officers of the Court, solicitors have an obligation to assist the Court in the same way.

Active Case Management

Once litigation is under way and the parties have exchanged statements of case (pleadings), they are required to complete an Allocation Questionnaire, which assists the Court in managing the dispute appropriately.[11] The

Allocation Questionnaire includes as its first section a series of questions on settlement. It alerts parties to the fact that the Court will want to know what steps have been taken toward settlement and requires legal representatives to confirm *personally* that they have explained to their client the need to try to settle, the options available, and the possibility of costs sanctions if the client refuses to try to settle.

At the allocation stage, any of the parties may seek a stay of proceedings to attempt settlement through ADR[12] or the Court may order a stay of one month or more for that purpose of its own volition.[13] A solicitor will need to have discussed carefully the suitability of the matter for ADR with the client, not only for this allocation exercise but also so that the pre-trial timetable can be discussed with the Court at the first Case Management Conference (CMC). At the CMC, the Court will engage in robust discussion as to the suitability of the matter for ADR, the extent to which ADR has been discussed or considered and the time by which an ADR process—usually mediation—will have been attempted. Whilst the approach of the English Courts has not been to mandate ADR,[14] a range of interlocutory orders are employed to encourage the use of ADR which, at their most robust, will require the parties (through solicitors) to write to the Court explaining why ADR either has not been attempted or, subject to confidentiality issues, has failed.[15]

Costs Sanctions for an Unreasonable Refusal to Consider ADR

The award of costs according to the "loser pays" rule is subject to the Court's discretion and, in assessing costs, the Court must take in to account the conduct of the parties, which includes conduct before proceedings, and the efforts made, if any, during proceedings to resolve the dispute.[16] The first case in which the Court showed that the costs rules in relation to an unreasonable refusal to attempt ADR had teeth was *Dunnett v Railtrack Plc*,[17] in which a wholly successful (on appeal) defendant was nevertheless deprived of its costs of the appeal for refusing the unsuccessful claimant's proposal of mediation. The Court of Appeal expressly warned lawyers that a dismissal of mediation "out of hand" risked uncomfortable costs consequences.

The leading decision is the Court of Appeal decision in *Halsey v Milton Keynes General NHS Trust*,[18] in which the Court issued guidance on the relevant factors to consider in determining whether a party has acted unreasonably in refusing ADR. The burden of proof will be on the unsuccessful party (and thus the payer of costs) to show that the successful party's refusal of ADR was unreasonable. Factors relevant to that assessment include (but are not limited to): (1) the nature of the dispute; (2) the merits of the case; (3) whether other settlement methods have been attempted; (4) whether the costs of ADR would be disproportionately high; (5) whether ADR will delay a trial; (6) whether ADR has a reasonable prospect of success; and (7) whether the Court has encouraged the parties to attempt ADR. Lord Justice Dyson made clear that *"all members of the legal profession should now routinely consider with their clients whether their disputes are suitable for ADR."*

Halsey has been followed and applied in practice in a number of decisions since 2004, and certainly in too many cases to review in this article. What is notable is the "creep" by the Courts in the application of the *Halsey* principles, beyond an unreasonable refusal to mediate, which illustrates the potential risks for solicitors that do not explain to clients the nature and advantages of ADR processes.

In *Nigel Witham Ltd v Robert Smith and others [No.2]*,[19] it was held that a successful party might[20] receive an adverse costs order if it agreed to mediate but delayed unreasonably in doing so. The judgment highlighted the tension between claimants proposing early mediation and defendants delaying until they know the case against them. Whilst it is likely that costs sanctions would be imposed only in cases where the delay was on its face wholly unreasonable, solicitors must now warn their clients that the difficult question of when to mediate (as opposed to whether to mediate) itself carries with it the risk that delays may attract criticism from an unsuccessful paying party and find a sympathetic hearing with the Court.

Even conduct at the mediation itself may, occasionally, come under the Court's scrutiny. In *7th Earl of Malmesbury v Strutt & Partner*[21] the Court held that if a party appears at mediation and conducts itself in such a way as to make successful mediation all but impossible, that behaviour is similar to simply refusing to mediate altogether and, accordingly, that party can be penalized in costs. The facts of *7th Earl of Malmesbury* are highly unusual in that the parties chose to waive privilege over their settlement communications at the mediation specifically to enable the Court to undertake this assessment of their conduct.[22] The decision illustrates the risks to litigants (and potentially their legal advisers) in adopting such a course but, it is suggested, does not signal any trend on the part of the English Courts more generally to seek to lift the veil of confidentiality over the mediation process which is so essential to its success.

Solicitors' Code of Conduct

The current Solicitors' Code of Conduct, which came in to force on July 1, 2007, sets out the professional conduct obligations on English solicitors. Rule 2.02(1)(b), dealing with standards of client care, requires that a solicitor must *"give the client a clear explanation of the issues involved and the options available to the client*.[23] The guidance to that rule provides that where the matter relates to

a dispute between the client and a third party the solicitor *"should discuss whether mediation or some other alternative dispute resolution (ADR) procedure may be more appropriate than litigation, arbitration or other formal processes."* It further reminds solicitors of the potential costs consequences of an unreasonable refusal to attempt ADR. Although the guidance is not strictly binding, a solicitor not complying with the guidance must nevertheless be able to demonstrate how the client care rule has been complied with. Given the obligations imposed by the CPR and through the case law reviewed above, there is in practice no scope for a solicitor conducting civil litigation to avoid discussing with a litigation client ADR processes. The client must be able to take an informed decision as to whether an ADR process is appropriate in a particular matter, understanding the risks (as to costs) of an unreasonable refusal to attempt it.

Conclusion

The CPR have just passed their 10th anniversary and their impact on the conduct of civil litigation has been profound in terms of promoting the use of ADR and obliging solicitors to do the same. The professional conduct obligations now reflect those obligations. Of course, litigants and their legal advisers can still, in appropriate cases, refuse to engage in ADR processes and occasionally it will be right to do so. The more usual question—and it is a measure of how the English litigation landscape has changed—is not *whether* to engage in an ADR process, but *when* to do so most effectively.

Endnotes

1. The legal profession in England and Wales is split into two: solicitors and barristers. Whilst historically the distinction was based upon the fact that only barristers enjoyed rights of audience in the higher courts, solicitors now enjoy the same rights of audience such that the distinction is less significant than was historically the case. It should be noted in the context of this article that solicitors will, in general, have day to day conduct of civil litigation from pre-contentious matters, through the commencement of proceedings to trial.
2. The U.K. comprises three separate jurisdictions (with three corresponding systems of law): England and Wales, Scotland and Northern Ireland. This article considers only the obligations upon solicitors of the Supreme Court of England and Wales (and it may be observed that England and Wales is by some way the most advanced in terms of the role that ADR plays in the conduct of civil litigation).
3. This distinction is reflected in the Solicitors' Code of Conduct, guidance paragraph 15 to rule 2.02(1)(b).
4. CPR 44.3(2).
5. Costs awarded on the "standard" basis will usually yield a recovery at 60-70%; the Court may award costs on the "indemnity basis" yielding a recovery of 70-80% (or more) where the conduct of the losing party is considered unreasonable.
6. In addition there are Protocols for defamation, judicial review, housing disrepair, clinical disputes and rent arrears matters.
7. All but two of the Protocols currently state that parties cannot and should not be forced to mediate or enter into any form of ADR.
8. CPR 1.4(1).
9. CPR 1.4(2)(e).
10. CPR 1.3.
11. In summary terms, the small claims track is for claims of up to £5,000 (say $7,500); the fast track is for claims of up to £25,000 (say $37,500); and the multi-track is for all other claims (including all larger claims).
12. CPR 26.4(1).
13. CPR 26.4(2)(b). In practice stays are uncommon in civil matters of any significant size or complexity.
14. There is an on-going debate as to whether the English Court has the jurisdiction to mandate participation in ADR, which is beyond the scope of this article. The current prevailing view is that such jurisdiction exists, but the Courts recognize that parties attending mediations voluntarily are more likely to settle than those compelled to attend against their will.
15. See Appendix 7 of the Commercial Court Guide. Orders known as "Ungley Orders," after Master Ungley of the Queen's Bench Division that devised it, require evidence to be filed with the Court pre-trial "without prejudice save as to costs" as to why the case is unsuitable for ADR (if that is said to be so).
16. CPR 44.3(4) and (5).
17. [2002] EWCA Civ 303; [2002] 2 All ER 850.
18. [2004] EWCA Civ 576; [2004] 1 WLR 3002.
19. [2008] EWHC 12 (TCC).
20. But did not on the facts, the defendant having indicated its willingness to mediate upon being provided with sufficient information to enter into the process, which position the Court did not criticize.
21. [2008] EWHC 424 (QB).
22. Ordinarily mediation is a confidential process and communications are subject to the "without prejudice" privilege. The only situations where the Court is usually entitled to consider conduct at mediation is when there is a dispute as to whether in fact a settlement was reached or there is conduct at a mediation which is said to form the basis of an estoppel in a subsequent dispute. See *Brown v Rice & Patel* [2007] EWHC 625 (Ch). For a discussion of recent developments on mediation confidentiality under English law, see Hew Dundas, *Mediation Confidentiality and the Mediator as Witness: An English Case Development*, New York Dispute Resolution Lawyer, Vol. 2, No. 2 (Fall 2009), a publication of the New York State Bar Association.
23. Rule 2.02(1)(b).

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Alex was assisted in preparing this article by associate Mike McClure.

Editor's Note: As the NYSBA Dispute Resolution Section embarks this year on a study of mediator credentialing, we thought IMI's recently launched Web-based open access platform for credentialing international mediators would be of interest.

International Mediator Certification and Expanding the Mediation Pie

By Michael Leathes

Over the years there has been a great deal of discussion about the pros and cons of mediator credentialing, a discussion which continues in various venues to date. However, there is a growing sense among many in the field that credentialing is critical if the field is to grow. To foster the growth of mediation the International Mediation Institute (IMI) was set up as a foundation in 2007.[1] IMI does not compete in the marketplace, is funded by donations, and its initial role is to credential quality mediators worldwide, enabling them to be easily identified through its search engine. IMI launched its Web-based certified mediator database, open to those seeking mediators without charge, in June of 2009. IMI's wider mission is to promote and encourage the field and help the mediation pie to expand on a global basis for the benefit of all stakeholders.

"Mediators need to adopt and support the credentialing process and focus on the enlargement of the overall pie—mediation as a practice—and not merely on their own slice sugared by vested networks."

Why Do We Need Mediator Credentialing?

Companies and professional firms often do not fully appreciate the value mediation can deliver to them. It has been estimated that the total billings of all U.S. mediators in a single year approximates $500 million—roughly the same level of billings as the 50th largest U.S. law firm. Mediation is a small pie even in the country where its progress has been greatest. In my career as an in-house counsel, I have proposed mediation to many opponents. Most were rejected. I estimate that only one in 50 to 100 proposals was accepted. The counter-parties just did not understand what was involved. Mediators see the tail of cases that come to them; they rarely see or hear of those that don't.

Mediators need to adopt and support the credentialing process and focus on the enlargement of the overall pie—mediation as a practice—and not merely on their own slice sugared by vested networks. Although they compete head-to-head for business with the next mediator, if they fail to collaborate in the task of authenticating and validating the mediation field as a whole, their piece of the pie will not enlarge.

Qualifications are essential in the mediation field to foster the growth of the field. People can practice as a mediator almost everywhere without having been trained, possessing a license, having to improve their skills or being independently tested or vetted, without being regulated and without the impetus to improve their own delivery. Although the top mediators voluntarily seek to constantly improve their skills, their example is not followed by everyone in the field, robbing it of professional integrity. As a result, the standards set by some—perhaps many—are often variable or opaque.

Around the world there are few Codes of Ethics or Codes of Conduct applying to mediators. Where they do exist, as they do in the United States, they are largely aspirational, unsupported by disciplinary processes and lacking real sanctions for the few unprofessional enough to transgress.

Another factor driving the need for certification is that some providers of mediation services in the international arena have low or undisclosed standards for admitting mediators to their panels and rosters. This forces users of mediation services to rely too often on hearsay, reputation, word-of-mouth and gossip, backed up where available by references, to decide who in this field is a high quality provider or mediator. The lack of a credible high-level qualification in most countries inhibits mediation being widely regarded as a true profession.

One reason that it has been difficult to achieve a consensus that credentialing is useful is that mediators have resisted defining their role. Many see mediation as a creative form that transcends categorization. Many think of themselves as artists, magicians, free spirits, a unique case, and that there is no yardstick that can be applied to measure competency. Mediator practices may indeed be widely divergent, but this resistance among mediators has resulted in mediation practice in most countries being balkanized into groups populated by competing providers. Ironically, for people skilled in the art of convening warring parties and getting them to communicate positively, mediators often do not apply among themselves the very skills they employ with their clients to arrive at a credentialing process that works for a variety of mediation styles.

In short, absence of recognition as a profession restrains the field's growth. This can be changed, but acceptance and support by mediators, who have so far hesitated to drive that change themselves, is necessary.

IMI Certification

IMI has stepped up to the plate to fill this need and provide a set of international standards for mediators. IMI's credentialing function is a user-driven initiative. It emerged from 18 months of consultations with hundreds of users, mediators and providers of dispute resolution services worldwide. Patterns emerged that were remarkably common and consistent around the world—though different countries were inevitably at different stages in the mediation development cycle. One of the most consistent issues to emerge was that IMI found that users want a reliable, impartial and credible mechanism to find quality mediators. They also need more reliable information to guide them in selecting suitable mediators. Providers and mediators want to give that information with the minimum bureaucracy and cost. These needs—from the demand and supply sides of the field—were not linked up on a single international platform. IMI's scheme focused on addressing both needs, internationally.

IMI convened an Independent Standards Commission of over 50 international thought leaders (www.imimediation.org/isc_list.html). The ISC is independent of the IMI Board and establishes the conditions, standards and criteria for IMI certification. It represents all stakeholders—users, providers, mediators, judiciaries, educators, trainers and regulators. All dedicate their time and expertise pro bono. For a limited period, the experienced mediators on panels of carefully selected leading provider and professional bodies have been admitted to IMI certification without undergoing a competency assessment. Thereafter, mediators can only become IMI-certified by being approved by an assessment body having a program that determines competency based on criteria established by the ISC. These criteria are applicable irrespective of a mediator's preferred mediation styles and the techniques employed to mediate.[2]

IMI's Wider Mission

IMI's overriding vision is to stimulate positive change in the dispute resolution field. Establishing criteria for certifying the competency of mediators is an early element of the mission because without mediator quality at the delivery end, further change will be unattainable and not worth the effort. But, given an established mechanism for determining minimum quality standards for mediators, there are other critical parts of IMI's mission that must be deployed:

Promoting to users (a) mediation, and (b) how to find competent mediators. IMI can use its position as an independently funded non-profit body to promote both the practice and the professionals in credible ways directly with users and relevant user groups, professional bodies, government agencies and judiciaries, articles and editorials, interactive channels and other strong media. This will help mediators and providers by growing awareness and understanding of mediation among more users and avoiding duplication of effort. IMI will seek to promote mediation in collaboration with government and intergovernmental agencies, all of which can make a dramatic difference by being seen to support, encourage and fund a faster uptake while striving for high standards and quality.

An Inter-Cultural Mediator Certification is also being developed aimed at IMI-certified mediators involving advanced knowledge and skills for handling disputes and negotiating deals involving people and issues with different cultural influences.

Providing impartial guidance and information to users of mediation services, including links to IMI qualifying institutions (providers, trainers and other bodies). As IMI will not provide mediation services, or benefit from mediations, IMI can be a credible source of objective information for the field.

Making available informative downloadable material about mediation, assisted negotiation and dispute resolution to assist and inspire users.

Providing support for the creation and advancement of mediation bodies in countries where mediation is unknown or poorly practiced.

Encouraging experience-generation schemes for newly qualified mediators and those with limited experience and untried skills—providing links to those schemes worldwide.

A Scholarship Program designed to enable aspiring mediators to be properly trained, gain experience and qualify for IMI Certification.

A convening and referral function to help bring disputing parties together. Because IMI will not itself deliver mediations, it is in a unique position to propose to parties whose dispute has become a matter of public record that they consider mediation.

A leadership role to help drive mediation into new fields. Examples include deal-making and negotiation, the relationships between regulators and those regulated, class action and mass tort mediation, the use of mediation in WTO disputes and other inter-nation disputes, and online mediation.

The Road Ahead

Mediation has come a long way, but still has a long way to go. And in many places it really is on the starting blocks, with tremendous potential. Setting high, visible, credible and consistent standards, everywhere, is a vital step, already achieved by some institutions but not by all. Once done and more widely appreciated, mediation will become more respected and its practitioners will accede to true, independent professional status as mediators. The mediation pie will then expand.

Bringing mediation out of its closet is one of the most exciting and important developments of our time. All stakeholders, including users, providers, mediators, judiciaries, educators, trainers and regulators, can play a critical role in this endeavor. If they choose to do so, they will practice an important principle preached by Mahatma Gandhi: You must be the future you wish to see in the world.

Endnotes

1. IMI's founders and fund providers are the American Arbitration Association/International Center for Dispute Resolution, Netherlands Mediation Institute, Singapore Mediation Centre and Singapore International Arbitration Centre. IMI is registered as a Foundation in The Hague. IMI's Chairman is Michael McIlwrath, Senior Counsel—Litigation, GE Oil & Gas.
2. The Criteria for Assessment Programs qualifying Mediators for IMI certification are *available at* http://www.imimediation.org/criteria-programs.html.

Michael Leathes spent his career as an in-house lawyer for a number of multi-national corporations. Over the past 20 years he has been a strong promoter of mediation for achieving business outcomes. He retired in 2007 to become IMI's first executive director. All comments on this article are welcome at: http://www.imimediation.org/?cID=contact_imi.

Mediation Confidentiality and the Mediator as Witness: An English Case Development

By Hew R. Dundas

1. Introduction

Previous articles in this publication have discussed the *Hauzinger* decision by the New York courts[1] and its implications for the assumptions that everything in a mediation is confidential and that confidentiality in mediation is both fundamental to the process and an ethical obligation on the mediator. Those comments expressed concern about the New York courts' refusal to quash a subpoena served on the mediator to give testimony about the mediation.[2] These same assumptions have come under examination in England in a number of cases of which a key one was *Rice v Patel*[3] where a dispute arose as to whether an agreement in fact had been reached in the mediation.[4] The learned judge considered it necessary to go behind the cloak of confidentiality to decide this question.

A further inroad into the key assumptions has been made in a recent English case, *Farm Assist Ltd (in liquidation) v Secretary of State for the Department of Environment, Food and Rural Affairs,*[5] where the court rejected an application by the mediator[6] to set aside a court order to appear as a witness in litigation arising in connection with the settlement agreement reached in the mediation in 2003. The judgment is notable for its careful consideration, by the highly respected Ramsey J, of the recent authorities.[7]

2. The Facts

Farm Assist Ltd. (FAL) sought to set aside a mediated settlement agreement entered into with the U.K. Department of Environment, Food and Rural Affairs (DEFRA) on the grounds that the settlement had been entered into under economic duress. The parties agreed that they wished the Mediator to give evidence and that she should be free to give evidence about the entire conduct of the mediation, including her private conversations with DEFRA and FAL and their advisers. The parties jointly wrote to her, with court approval, to ask what she could recall from 2003, to which she replied (in effect) "very little"[8] and her file contained only administrative details concerning the mediation. In later correspondence, she reminded the parties that the terms of their 2003 Mediation Agreement provided that both parties had agreed not to call her as a witness. A witness summons was subsequently issued, to which she responded by applying to have it set aside on the grounds that (i) her evidence was subject to express provisions of confidentiality and non-attendance pursuant to the Mediation Agreement and (ii) in any event the evidence was confidential and/or legally privileged and/or irrelevant.

3. The Relevant Law in England and Wales

There are three separate (if related) concepts of confidentiality, privilege and "without prejudice" communications that describe the status of communications made or information provided in relation to the mediation. It was therefore necessary for the court to consider these concepts and how far they gave the Mediator and the parties rights or imposed obligations which were relevant to the question of whether a mediator should be called as a witness.

The court noted that the fact that parties agree that something is to be confidential does not, in itself, prevent a party from giving evidence of such matters in court or prevent the court from ordering that evidence of such matters to be disclosed.[9] One of the exceptions to that principle is "without prejudice" communications and communications to mediators and conciliators.

"[T]he court rejected an application by the mediator to set aside a court order to appear as a witness . . ."

However, there was a further obligation of confidentiality which arose expressly in the case by virtue of the tripartite confidentiality agreement. While it was possible for confidentiality to be waived, it had to be with the consent of all parties so that FAL and DEFRA could not waive confidentiality in the mediation so as to deprive the Mediator of her right to have the confidentiality of the mediation preserved.

The question of privilege in mediation has much exercised the minds of mediators, academics and the judiciary in recent years, and Ramsey J gave a scholarly summary worthy of careful consideration. He concluded that the relevant principles provided sufficient guidance but that there was also the need for a further "privilege" which arose other than the Mediator's right to confidentiality in relation to the mediation proceedings.

The learned Judge concluded his analysis:

(i) Confidentiality: the mediation proceedings are confidential both as between the parties and as between the parties and the mediator. As a result, even if the parties agree that matters can be referred to outside the mediation, the mediator can enforce the confidentiality provision. The court will generally uphold that confidentiality, but where it is necessary in the interests of

justice for evidence to be given of confidential matters, the courts will order or permit that evidence to be given or produced.

(ii) Without Prejudice Privilege: the proceedings are covered by without prejudice privilege, a privilege which exists as between the parties and is not a privilege of the mediator. The parties can waive that privilege.

(iii) Other Privileges: if another privilege attaches to documents which are produced by a party and shown to a mediator, that party retains that privilege and it is not waived by disclosure to the mediator or by waiver of the without prejudice privilege.

The court looked to the language of the Mediation Procedure annexed to the mediation agreement as part of its analysis of whether the Mediator could be called as a witness. The document referred to her not being a witness in any litigation or arbitration "in relation to the Dispute." After considering whether that provision meant that DEFRA should not be entitled to call the Mediator as a witness in the proceedings, the Judge concluded that the parties' agreement not to call the Mediator as a witness "in relation to the Dispute" was limited to litigation or arbitration in relation to the underlying dispute, defined as that dispute which "*relates to work performed by [FAL] on behalf of [DEFRA] during . . . 2001.*" Since the dispute before the court was not that dispute but a separate dispute as to whether the settlement agreement had been entered into under duress, the Judge found that that the phrase "in relation to the Dispute" had been chosen to be narrow and did not prevent the testimony.

4. The Decision

Should the witness summons be set aside? The Judge considered several factors: first, in this case the parties had waived the without prejudice privilege and the Mediator had provided the parties with her [limited] documentation. Second, FAL had pleaded and relied on what had occurred in the mediation both in its pleadings and in the witness statements which it had served. Third, the Mediation Agreement's term precluding the parties from calling the Mediator as a witness did not apply to the present dispute. Fourth, the Mediator had stated that she had no recollection of the mediation. Fifth, the Mediator had an enforceable right to confidentiality under the express terms of the Mediation Agreement unless it is in the interests of justice that she should be called as a witness.

In these circumstances, balancing the various considerations, the Judge concluded that it was in the interests of justice that she should give evidence as to what was said and done in the mediation, for the following reasons:

(i) The issue in this case was whether the MSA should be set aside for economic duress; the allegations concerned what had been said and done in the mediation and this necessarily involved evidence of what FAL asserts was said and done by the Mediator. This evidence formed a central part of FAL's case and the Mediator's evidence was necessary for the Court properly to determine what had been said and done.

(ii) Whilst the Mediator may have no recollection of the mediation, this did not prevent her from giving evidence. Provided that the summons was issued *bona fide* to obtain such evidence, then as a general rule, it will not be set aside because the witness says he/she cannot recall matters.[10]

(iii) Calling the Mediator to give this evidence would not be contrary to the express terms of the mediation agreement which, in this case, addressed only her appearance to being a witness in proceedings concerning the underlying dispute.

(iv) The parties had waived any without prejudice privilege in the mediation which, being their privilege, they were entitled to do.

(v) Finally, whilst the Mediator has a right to rely on the confidentiality provision in the Mediation Agreement, this was a case where, as an exception, the interests of justice lay strongly in favour of evidence being given of what was said and done.

This was therefore a case where the Mediator should give evidence in response to the witness summons and the Judge therefore dismissed her application to set aside that witness summons.

5. Conclusions

This case is unquestionably fact-specific but is of considerable value in its summary of the authorities. However, it leaves certain issues open, not least that, with the growing complexity of the law in this area, the authoritative guidance of the Court of Appeal is going to be needed shortly, particularly on the unresolved question of mediation privilege.

It can be assumed that confidentiality clauses in mediation agreements will now be rewritten to cover every aspect "under, arising out of or, without limitation, otherwise in connection with" the underlying dispute but the Judge's analysis will likely render such rewriting ineffective.[11]

While it appears questionable that no protection was granted to private conversations between the mediator and one party, the Judge had only to deal with the consequences of the parties' agreement concerning the witness summons, so he was not called upon to address whether a court could, absent such agreement between the parties, compel a mediator to give evidence about such private meetings.

It has been suggested that Article 7 of the EU Mediation Directive (not yet enacted in the U.K.), and which will in any event not apply to domestic mediation, would have, in principle, affected the result of this case, but this is not in fact the case since the EU Mediation Directive Article prevents mediators from being compelled to give evidence only "unless the parties agree otherwise" but, here, FAL and DEFRA had so agreed.

It is self-evident that some matters arising in a mediation must be "open" to the court, e.g., if criminal matters arise, but where is the line to be drawn?

"Watch this space."

Endnotes

1. *Richard M. Hauzinger v. Aurela G. Hauzinger,* 43 A.D. 3d 1289, 842 N.Y.S. 2d 646 (4th Dep't 2007), *aff'd*, 10 N.Y.3d 923 (2008).
2. *See* Vol. 1, No. 1, New York Dispute Resolution Lawyer (Fall 2008): Robert S. Thaler, *After the New York State Court of Appeals Decision in Hauzinger: What Next?;* Leona Beane, *What Is the Extent of Confidentiality in Mediation After Hauzinger;* Richard C. Reuben, *The UMA: A Good Fit for New York.*
3. [2007] EWHC 625 (Ch); 14th March 2007**;** Stuart Isaacs QC sitting as a Deputy Judge of the High Court.
4. For a discussion of this case, see Hew Dundas, *When Does "Confidential" Mean Confidential? An Important Development in the Law of Mediation and the Without Prejudice Rule,* [2007] 73 ARBITRATION at 335.
5. *Farm Assist Ltd (in liquidation) v Secretary of State for the Department of Environment, Food and Rural Affairs* (No.2) [2009] EWHC 1102 (TCC); 19 May 2009, Ramsey J; he is Presiding Judge of the Technology & Construction Court, a division of the Commercial Court in London.
6. Miss Jane Andrewartha, a partner in the leading London law firm Clyde & Co LLP and a well-known and highly rated commercial mediator.
7. For an overview of the parallel case law in the U.S., see Edna Sussman, *A Brief Survey of U.S. Case Law on Enforcing Mediation Settlement Agreements Over Objections to the Existence or Validity of Such Agreements and Implications for Mediation Confidentiality and Mediator Testimony,* Newsletter of the Mediation Committee of the International Bar Association, Vol. 2, No. 1 (April 2006) *available at* http://www.sussmanadr.com/docs/IBA_mediation_enforcement_0406.pdf.
8. She stated that she conducted approximately 50 mediations/year.
9. The general position on confidentiality is as set out in Confidentiality by Toulson and Phipps (2nd Edition 2006) in which they state at paragraph 17-001: *"Generally speaking, confidentiality is not a bar to disclosure of documents or information in the process of litigation, but the court will only compel such disclosure if it considers it necessary for the fair disposal of the case: see British Steel Corporation v Granada Television Ltd [1981] AC 1096."*
10. *See R v Baines* [1909] 1 KB 258 at 262 per Walton J.
11. However, in *Fiona Trust* ([2007] EWCA Civ 20) the Court of Appeal rejected, in a different context, this traditional hair-splitting and the House of Lords ([2007] UKHL 40) agreed.

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International Perspectives: Arbitration Agreements and Bankruptcy

By Edna Sussman

As arbitration is of special importance for international commerce, we briefly review the relevant authorities on arbitration agreements in bankruptcy.

U.S. Bankruptcy and International Arbitration Clauses

The Supreme Court has emphasized that the deference to arbitration is particularly strong in the context of international agreements.[1] However, in deciding whether a U.S. bankruptcy court should defer to an arbitration agreement, the U.S. courts have not differentiated between agreements that are wholly domestic and those that are international.[2] As the court said in *In re United States Lines,* in addressing the question of arbitration in the context of a bankruptcy, "the Arbitration Act's mandate may be overridden by a contrary congressional command . . . even where arbitration is sought subject to an international arbitration agreement."[3] Query whether special deference should be given by the courts to the arbitration forum in the international context as there is no express Congressional command in favor of the bankruptcy court forum over arbitration and arbitration has additional unique benefits over court proceedings in international transactions.[4]

European Case Developments

Two recent cases decided in Europe reached different results in two arbitrations concerning the same debtor. The debtor, which was party to both arbitrations, was Elektrim S.A., a Polish company that was declared bankrupt in Poland after the two arbitrations were commenced. The issue in both forums was whether the impact of bankruptcy on a pending arbitration is governed by the law of the state in which the bankruptcy was declared or the law of the state in which the arbitration has its seat. It was undisputed that Polish law provides that "any arbitration clause concluded by the bankrupt shall lose its legal effect as at the date the bankrupt is declared and any pending arbitration proceedings shall be discontinued."

The first arbitration was an ICC arbitration that designated Switzerland, which is not a member of the EU, as the place of arbitration. Applying Swiss general conflict of law principles, the Swiss court held that Polish law determines the effect of the bankruptcy on a Polish company and that Polish law is applicable to determine legal capacity to be a party to arbitration proceedings. As under Polish law upon bankruptcy Elektrim lost its capacity to be a party to an arbitration agreement, the court affirmed the arbitral tribunal's decision that it had no jurisdiction over Elektrim.[5]

The second arbitration was an LCIA arbitration that designated England, which is a member of the EU, as the seat of the arbitration. The English High Court decided the matter by reference to the EU Insolvency Regulation (Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings) which is applicable to both England and Poland. The court looked to the EU provision that dealt with "lawsuits pending," such as the pending LCIA arbitration. That provision directed the application of "the law of the Member State in which that lawsuit is pending" (Art. 15 of the Regulation), which in this case was English law, and not Polish law.[6] As under English law there is no provision annulling an arbitration agreement, the court affirmed the award of the Tribunal allowing the arbitration to proceed.

Conclusion

The divergence in the viability of an arbitration agreement based on the law found to be applicable suggests that the practitioner would be wise to consider the applicable laws in selecting the seat of the arbitration and the jurisdiction for filing for bankruptcy if contracts containing arbitration clauses are of significance to the debtor's affairs.

Endnotes

1. *Scherk v. Alberto-Culver*, 417 U.S. 506, 520 (1974); *Mitsubishi v. Soler Chrysler-Plymouth Inc.,* 473 U.S. 614, 639 (1985).
2. For a discussion of U.S. law on the interplay between the Federal Arbitration Act and the Bankruptcy Code, see Edna Sussman, *Arbitration Agreements and Bankruptcy—Which Law Trumps When?,* New York Dispute Resolution Lawyer, Fall 2009, a publication of the New York State Bar Association.
3. *In re United States Lines,* 197 F. 3d 631, 639 (1999); *see also* Lindsay Besterfield, *Parties to International Commercial Arbitration Agreements Beware: Bankruptcy Trumps Supreme Court Precedent Favoring Arbitration of International Disputes*, 2006 J. Disp. Resol. 273.
4. For a discussion of the importance of arbitration in the context of international transactions, see Edna Sussman, *The Proposed U.S. Arbitration Fairness Act: A Threat to U.S. Business*, 18 Am. Rev. of Intl. Arb. 455 (2009).
5. *Vivendi and Elektrim v. Deutesche Telekom AG,* First Civil Law Department, Zurich, decided on March 31, 2009 Docket No. 4A_428.2008.
6. *Jozef Syska, as Administrator of Elektrim S.A. and Vivendi Universal* [2009]EWCA Civ. 677 decided on July 9, 2009.

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Creative Mediated Solutions

By Irene C. Warshauer

Mediation enables the parties to resolve disputes with the assistance of a mediator. Frequently, the dispute is resolved by the parties agreeing upon a sum of money which one side pays to the other. In those instances the parties reach an agreement that both sides can accept, saving time and money in the process. There are some disputes where a monetary exchange does not provide a resolution which works for one side, but is the only type of resolution that can be achieved in a judicial proceeding. Mediation presents a forum where nonmonetary solutions can be achieved. These solutions may include a payment as well. This article will discuss several creative solutions achieved through mediation. The mediator who mediated the dispute is identified in an endnote.

Death of a Baby in a Stroller

A baby fell asleep in his stroller. He was left by himself in a room while his parents worked in another room in the house. He somehow slipped and was strangled by the stroller straps. His parents sued the stroller manufacturer in court. The case was referred to mediation. The parents not only lost their child but had enormous guilt because had they not left the child alone in the stroller he probably would not have strangled. The stroller manufacturer was sympathetic, of course, but had warning labels on the stroller saying do not leave the child alone in the stroller. In American jurisprudence, the value of a life is measured, in significant part, by the earning capability of the decedent, based on his or her prior earnings. A baby's earning capacity is not great.

In mediation after opening statements and joint discussions, the stroller manufacturer offered less than $100,000, which was probably the amount of an adverse court verdict at the time. The parents were unwilling to accept that amount. In caucus the mediator asked the stroller manufacturer's attorney if the company would be willing to name a future stroller model after the child. After calling the company, counsel said yes. This was conveyed to the parents in caucus. It provided recognition of their child and their loss and enabled them to work out a resolution which included working together to contact the Consumer Product Safety Commission with ideas on how to prevent future accidents, and payment of a sum of money, which alone could not resolve the dispute.[1]

Transfer of a Government Employee

An over-40-year-old government supervisory employee was being transferred from an office near her home to an office further away, which she could reach by public bus, but would have entailed an extra hour of travel time each day. She filed a discrimination claim alleging age discrimination based upon an alleged violation of statute.

In mediation, it was agreed that she would be paid for the extra hour she was spending on the bus and that she would review files during the trip. The payment for the extra hour would continue until her retirement in less than a year.[2]

Distributor: You're Fired, Overseas

A company had an exclusive distributorship with an overseas manufacturer. The distributor had built up a successful business distributing the product and had leased many locations to sell the product. The manufacturer decided it wanted to distribute the product itself and cut off the distributor. Efforts to resolve the dispute took time, with the distributor losing money based on its inability to obtain product and its need to pay for the leases. In a mediation it was agreed that the manufacturer would immediately take over the distribution and the distributor's locations (for an agreed upon price) and that counsel would negotiate a formal agreement, terminating the distributorship, over the several months needed to cover all issues. It was further agreed that if any disputes arose out of the subsequent agreement (or during the negotiations), the mediator was designated to be the arbitrator to decide the dispute(s).[3]

Distributor: You're Fired, Domestic

A distributor had entered into a series of five-year distributorship contracts with a manufacturer. The contracts had been renewed four times so that the manufacturer and distributor had been doing business for 20 years. During that time the distributor had set up shops in malls throughout the country. At the end of the fourth contract, the manufacturer decided it wanted to cut out the middleman and sell its products directly to the consumer. It advised its distributor that it would renew the contract for another five years but the price would double. In effect, the manufacturer was only willing to ship its product to the distributor at a price the distributor could not afford to pay and still make a profit in its business, so the renewal offer, in effect, would put the distributor out of business.

The distributor sued, alleging an oral understanding with the manufacturer that it would continue to renew the same contract with a modest increase, and breach of the duty of good faith and fair dealing. The matter went to mediation and the mediator suggested that the manu-

facturer purchase distributor's business, saving itself start-up costs and giving the distributor the purchase price money. Without the purchase, the distributor would have had to close its business immediately, would have no money or merchandise, and the manufacturer would have to start from scratch and pay money to obtain leases and sales people.[4]

"Creative mediated solutions often involve something extra . . ."

A Shifty Middleman

Two parties were doing business with a middleman. The defendant had paid the middleman 50% of what was due but the middleman did not pay the plaintiff. The plaintiff commenced a lawsuit and then went to mediation. The parties and counsel got together an hour early to see if they could resolve the dispute. When the mediator arrived counsel said, "We just spent an hour and it can't be resolved." The mediator said, "I have travelled all the way here, let me try to mediate." They agreed. After hearing opening statements from both sides, she asked if the defendant was willing to pay the 50% it agreed was due to the plaintiff, and the two sides would pursue the middleman for the 50% he had been paid but not delivered to the plaintiff. They quickly agreed. The matter settled in less than an hour of mediation.[5]

Real Estate Plus

Two mediators with a lot of real estate experience co-mediated several disputes between two very affluent Orthodox Jewish families heavily involved in real estate in New York City. The monetary disputes were settled after both sides agreed to a sweetener proposed by the mediators. The mediators recommended and each family agreed to voluntarily donate several thousand dollars to their respective synagogues.[6]

Hotel Employee Begone

In a buyout of a hotel, an employee who was still on the job but to be terminated was offered a semester at an off-campus training certificate program run by a university that would give terminated employee a leg up on future jobs in the hotel industry. The mediation resulted in additional sweeteners to satisfy the unhappy employee. The semester would occur while he was on "leave" from the hotel. The leave included continuing to get his salary and insurance, even though he was to submit his resignation immediately. During the leave time, he would be allowed to return to host a large family wedding to be held at the hotel, at the employee rate, since he wanted to show off to his family how important he was at the hotel![7]

One-Time-Only Deals

In an age discrimination case, as part of the settlement, one of the perks a former employee was given was a "retiree's ID card" (invented solely for him), permitting him to enter the premises so that occasionally he could go back onto the secure workplace and kid around with his old buddies.[8]

Conclusion

Creative mediated solutions often involve something extra, often in addition to money, for the plaintiff, which has advantages for the defendant as well. Those that involve a charitable gift in addition to, or in part of payment to the plaintiff, have the advantage of the defendant not having to pay the plaintiff so much money, or any money at all, obtaining a tax deduction and doing good, all while resolving a dispute. Helping an employee deal with a transfer not only aids that person but also lifts the morale of the other employees who appreciate kindness or recognition of the employee's humanity. Other resolutions provide recognition of the plaintiff or commemorate the plaintiff's loss, such as the stroller case, or the sponsoring of a race or other event for a plaintiff with a disease or other particular type of problem.

The examples discussed in this article demonstrate the range of resolutions available through mediation. It further shows that the process can satisfy the needs of one or more parties enabling some disputes to settle or lessen hostilities between the parties when an exchange of money and a release will not be sufficient.

Endnotes

1. Irene C. Warshauer, mediator.
2. Gene Ginsburg, mediator.
3. Steve Hochman, mediator.
4. Vivian Berger, mediator.
5. Irene C. Warshauer, mediator.
6. Richard Weinberger, mediator.
7. Vivian Berger, mediator.
8. *Id*.

Insurance Company Mediations

By Peter Scarpato

Insurance is an indispensable part of our economy that pervades every facet of our professional life. No responsible business can operate without it. Dispute resolution professionals know that critical elements of every dispute—for example, who must be included to resolve the dispute and how much is available to settle and pay claims—will turn on the amount, existence and form of insurance.

When handling disputes that involve insurance, lawyers and mediators need answers to a number of questions: What kind of insurance exists? Why was it obtained? What do the parties expect the insurance to cover? Dealing with these questions in a mediation also raises procedural issues: How and when should the topic of insurance be raised? Who should raise it (the parties, the mediator)? Does the existence of insurance raise unique issues, such as multiple representation, confidentiality and conflicts of interest? What mediation best-practices apply and how should a mediator work with parties and their or the insurer's lawyers? Will insurers prefer a specific kind of mediator and will that foster resolution? Finally, how does a mediator work with an insurance adjuster?

First, some basic facts. At its core, insurance is contractual coverage (policy) where, for an agreed payment (premium), one party (insurer) agrees to indemnify or guarantee another (insured) against loss (liability) by a specified contingency or peril (risk) (Merriam-Webster's Dictionary of Law ©1996). We have all been regaled with stories about the allegedly mind-numbing pages of policy terms and conditions that provide coverage. Dissected and understood, these policy terms tell us (a) *the different forms of coverag*e: e.g., primary insurance (from dollar one of exposure), excess insurance (from some higher fixed attachment point to a maximum limit), umbrella insurance; (b) *the different levels of coverage for covered claims*: per occurrence, combined single limits, aggregates; and (c) *the different types of risk covered*: defense, indemnity, property, casualty, personal, commercial, professional, etc. Like most contracts, policies are not one-sided; they can be limited by their terms (e.g., express exclusions of specific risks, deductibles and self-insured retentions) or by their voluntary or involuntary absence (e.g., uninsured gaps or insurers becoming insolvent).

Thus, the first and one of the most important lessons about insurance for participants in mediation: Because policies contain contractual requirements for coverage, insureds and insurers have separate rights and obligations; insureds may have limited or no coverage, and may have significant uncovered self-insured financial obligations. Also, while insurers may have a duty to indemnify insureds for covered claims, they most likely have a broader duty to defend, i.e., appoint and reimburse lawyers to handle the claim. Insurers with the defense obligation occasionally have rights, obligations, goals and objectives that may differ from their insureds. For example, many medical malpractice policies have a "consent clause" which essentially forbids the insurer from settling a serious, potentially high negligence claim without the defendant-physician's consent.

"Dispute resolution professionals know that critical elements of every dispute . . . will turn on the amount, existence and form of insurance."

In these cases, mediators must deftly walk a fine line, balancing the parties' expectations of coverage against the insurers' view of their contractual rights and obligations. In essence, two mediations occur simultaneously, one dealing with the merits of the dispute, including the factual and legal elements of the parties' substantive rights and personal desire to achieve a satisfactory settlement, and a separate mediation involving the coverage—the argument over contractual rights and internal guidelines governing the timing and substance of the insurer's desire and duty to respond. The mediator must not polarize the participants by favoring or being perceived to favor one constituent over the other.

So, how and when does information about insurance come up? Absent voluntary party disclosure, the mediator should inquire as to the existence of insurance. In the initial telephone conference beginning the mediation, mediators can ask counsel outright if insurance exists or was disclosed in discovery. Although one might suspect that participants may withhold the existence of insurance, very often the lawyers on the call are insurer-appointed defense counsel who do not mind revealing their company. Nevertheless, to alleviate this concern, mediators should save further inquiry into the scope and availability of coverage until separate conference calls with each party that usually follow receipt of their mediation statements. During the initial telephone discussion, it is also proper to ask whether an adjuster, as opposed to the named party, will attend the mediation, who they are and if they will have authority. If parties appear *pro se* or are not yet in formal litigation, the mediator can also ask about insurance during the separate, post-mediation statement conferences noted above.

At the mediation, the mediator can ask if parties and their representatives have "full settlement authority." If not, who does (typically the claims adjuster's supervisor)? If not disclosed, mediators can always ask for insurance information in private caucuses at the mediation session. And, of course, if parties disclose that the mediation will be attended by claims adjusters, the answer is obvious.

Once insurance is disclosed, other questions arise. For example, how much information should be provided? Only the policy declarations page or the entire policy? Must deductibles be disclosed? Should a reservation of rights letter be produced? Is it a right to consent policy (often used in medical or professional liability policies) with a hammer clause? The hammer clause appears in a professional indemnity policy whose terms otherwise give the insured the right to consent to any settlement proposed by the carrier. The hammer clause makes an obstinate insured who refuses to consent to the carrier's proposed reasonable settlement offer liable for any amount of a subsequent judgment in excess of the proposed settlement. The mediator should know whether the insured or insurer is in control and whether a hammer clause tips the balance of power in the insurer's favor.

To fully appreciate and handle important financial and non-financial dynamics, mediators must understand the precise type and scope of coverage:

- Believe it or not, even sophisticated parties occasionally misunderstand or misinterpret their coverage.
- If a deductible applies, the mediator knows whose money is at stake and who is the decision-maker.
- Complex, multiparty cases involving several insurers are often "staged," with the mediator conducting a private, "carriers' only" session to sort out their respective rights, obligations, liabilities and allocated contributions toward a settlement. In this context, the terms and conditions of their respective policies are essential.
- An insurer and insured could decide to settle and pay an underlying third-party claim, even though the insurer fully reserved coverage defenses and a right to recoup from other insurers or the insured at the conclusion of subsequent coverage litigation. Here, the insurer simultaneously helps itself and the insured by valuing and settling the underlying claim and evaluating its own coverage exposure.
- If insurers of long tail liability (third-party exposures like pollution and asbestos where loss occurrences and damages determinations are delayed years beyond the in-force period of the policies) are presented with both actual filed claims and the certainty of future claims, they can pay a lump sum for known claims and enter into a CIP ("Coverage In Place") agreement, obligating them to pay, to a fixed cap, a certain percentage of indemnity for any future claims.
- Finally, in certain cases where only some insurers agree to mediate, the parties can single out those insurers needed to resolve at least some of the coverage disputes and negotiate payment of the unfunded balance left by the absent nonparticipating insurers.

Unquestionably, in the hands of an experienced mediator, insureds and insurers can be empowered to work together to construct unique resolutions of even the most complex insurance disputes. The amount of insurance information available will depend in part on the extent of pre-mediation discovery, timing of mediation in the case, direct involvement of claims adjusters and the mediator's ability to create an environment of trust so parties feel safe providing the information. Get as much information as you can, when you can, from whomever you can.

But getting insurance information does not always simplify the mediation. The existence of insurance can create some thorny issues. What if, for example, counsel represents multiple plaintiffs whose cases involve different facts entitling them to different or no rights to damages from the identified policies? Can the same lawyer represent these plaintiffs in the same mediation? Can confidentiality be maintained between them if, for example, the mediator needs to caucus with one and not the other, or the insurer wishes to settle claims of one without the other? Or, suppose the case involves multiple defendants, such as a corporation and its supervisors, charged with workplace discrimination. Can the lawyer appointed by the same carrier represent them if dissimilar liabilities exist? If one defendant has insurance but the other does not, should they get separate counsel? If not, can the carrier-appointed lawyer maintain the confidences of this uninsured defendant? Finally, do multiple representation consent agreements overcome conflicts?

The lesson from these questions is that mediators must understand not only the existence and scope of available insurance for each party, but also the identity and insurer-affiliation of each representative at or behind the scenes. Only with this knowledge can the mediator even begin to identify potential conflicts of interest and inequities, and conduct a fair, balanced and ultimately successful mediation.

What are some best practices that apply to mediations involving insurance? First and foremost, prepare, prepare, prepare. The mediator must help the parties to determine the merits of each claim and to assess the risk and cost of litigation. The mediator also must elicit views on the policy coverage limits and attachment level of all partici-

pating insurers and determine whether any policies have other insurance clauses that might govern the order of responding policies. Good mediators prepare an initial liability versus damages assessment and plot out steps to handle the defendant's reaction to plaintiff's demands. Often overlooked but always important is the early identification of non-monetary issues. Especially in medical malpractice claims, the plaintiff may need an apology, or at least someone's acknowledgement that something went wrong, to jump-start stalled negotiations.

"Above all else, mediators must ensure that the claims adjuster actively participates in the mediation, preferably in person . . ."

Next, mediators must understand the various roles participants play in the mediation. Insurance mediations require balancing the goals and objectives of a four-way relationship: Claims Adjuster to Insured to Counsel to Mediator, and all possible permutations. Some basic tenets about the claims adjuster: Above all else, mediators must ***ensure that the claims adjuster actively participates in the mediation, preferably in person***, or, at minimum, on the phone. Next, determine up front if the named adjusters are decision-makers or messengers? If the latter, find out who has final authority and try as hard as possible to get them involved. Third, understand that claims adjusters have institutional pressures, senior supervisors and internal guidelines to follow (e.g., reserving practices, documents and expert analyses required in file before setting settlement authority). They may evaluate the case based upon its impact on contractual rights and obligations, not necessarily the claimant's version of "true" settlement value. In fact, before the mediation, adjusters usually meet with the insured and defense counsel to discuss and evaluate: reservation of rights, deductible, allocation, covered and uncovered parties, exposures and strategy. Most importantly, mediators should watch for claims adjusters who try to isolate the insured outside the mediation loop, especially if coverage gaps or policy terms require the insured to contribute to any settlement.

In the final analysis, the mediator must build a candid, respectful relationship among the claims professional, plaintiff and defense counsel and the parties. My mantra is that all participants observe the "Four Rs": be Realistic, Reasonable, Respectful and Responsive. Open lines of communication, thorough preparation and a keen sense of timing are essential. In my experience, insurance professionals prefer mediators with the following characteristics: neutrality, credibility and integrity, significant mediation experience, subject matter expertise, negotiation skills, an eye on the settlement prize and trustworthiness.

In conclusion, to properly handle a mediation involving insurance, the mediator has a full plate. He or she must:

- Identify and understand specific types of coverage and how they work;
- Ensure that claims adjusters with authority actively participate in the mediation;
- Understand whether participants have their or their carrier's money at risk and identify the ultimate decision-makers;
- Identify and analyze how to work with hidden conflicts among parties and their legal/company representatives;
- Build candid, respectful relationships among constituents at the table: plaintiff, defendant, claims representatives and the mediator, using the "Four Rs"—realistic, reasonable, respectful and responsive;
- Ask parties in advance if they would object to your risk/benefit analysis during private caucuses;
- Identify non-monetary issues and ensure that the proper people are involved to resolve them;
- Understand the institutional pressures and internal guidelines that impact claims adjusters' participation and learn how to work with them and understand the types of mediators insurance companies prefer.

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Business Divorce Mediation

By Richard Lutringer

Lawyers often use the term "business divorce" to describe a contentious split-up of the ownership of a business. Smoldering resentments can further complicate the process in the case of family-held enterprises, particularly if a second generation is at the helm. The founders themselves can also drift apart—experienced corporate lawyers have no lack of examples from their practice of a profitable small business on a downhill trajectory as the owners struggle with each other over the allocation of assets, customer relationships and liabilities. Lawyers themselves, of course, are not immune. Many old-line New York City law firms have ended up in litigation or arbitration when partners with major clients were enticed to join other firms.

This article addresses how mediators can assist ordinary business owners and their counsel to resolve split-up issues more efficiently and fairly than litigation or arbitration.

In a seminal article, Professor Lawrence Riskin described the core concept of mediation as "a process in which an impartial third party, who lacks authority to impose a solution, helps others resolve a dispute or plan a transaction."[1] This definition, which includes the concept of transaction planning, is particularly apt in the context of many business divorces where a mediator may not only need to deal with emotional hurts and to foster an understanding of each other's interests, but also to creatively structure a business transaction to help the parties split up the business and move on.[2]

The Legal Background to Business Divorce Disputes

Litigation strategies of the parties engaged in a business divorce proceeding, whether as equal owners involved in a deadlock or a minority owner pitted against the majority, are fundamentally shaped by the underlying statutory and common law remedies. Because of their commercial importance and unique problems, this article concentrates on business divorce issues involving corporations and limited liability companies (LLCs) formed under New York law.

Shareholders of closely held corporations or LLC members are generally unable to sell their holdings because, unlike public corporations, there is effectively no third-party market and, absent agreement, there is no obligation imposed on the corporation or other shareholder to purchase their interests. To avoid uncertainty, many closely held company owners have buy-sell agreements regulating when, how and at what price their interest may be sold to the business, to another owner or a third party. Although the implementation of such agreements can also lead to litigation, this article discusses the resolution of disputes when there is no prior buy-sell agreement, so that the parties are relying solely on statutory or common law/equitable remedies.

Corporate Shareholder Disputes

Disputes between equal shareholders of a corporation can lead to deadlocks in the election of directors or in the decision-making power of the board itself. Although deadlocks provide a director, and in some cases an equal shareholder a right to request judicial dissolution of the company, courts are loathe to order dissolution if the business continues to be profitable and management isn't paralyzed in essential matters.[3]

Another type of business divorce dispute involves minority shareholders squaring off against the majority. Because shareholders don't have an automatic right to sell back shares to the corporation, the route to cashing out as a minority shareholder can only be reached under BCL § 1104-a in the form of a petition by a 20% shareholder for dissolution of the corporation based on specific misconduct of the controlling shareholders, i.e., "illegal, fraudulent or oppressive actions" or looting, wasting or diverting corporate assets.[4]

In judicial dissolution cases the court often has to weigh in on such difficult issues as the reasonableness of salaries paid and perks given to the manager/shareholders, the adequacy of consideration received or given for assets transferred to or from insiders, usurping of corporate opportunities by the majority, and similar business decisions. New York courts use a "reasonable expectations" test in determining whether the petitioner may have been oppressed. Oppression means unreasonable conduct by the majority which defeats the minority owner's expectations that "were both reasonable under the circumstances and were central to the . . . [minority shareholder's] decision to join the venture."[5]

In cases brought under BCL § 1104-a, where the petitioning minority shareholder has more than a slight chance of success, the negotiating leverage of the minority shareholder can be considerable, due to the unusual provision in the BCL entitling the corporation or another shareholder to completely eliminate the risk of dissolution by the exercise of a statutory election to purchase the dissident's shares at "fair value."[6] The election effectively converts the case into an appraisal proceeding, but the election to purchase must be made within 90 days of the date of the petition filing.[7] Such a result is usually far preferable for the majority to the downside risk of dissolution, with the likelihood of automatic defaults under lease, license, lending or other commercial agreements, as well as adverse business and tax consequences. To up the ante

even more for the majority, if they do not act within the statutory 90 days, they have to obtain court approval to make the election, which, under the statute, can be tied to the payment of the minority shareholder's legal fees.[8]

For the minority shareholder, however, even if the majority elects to purchase the minority's shares at fair value, the war is far from over, since, if the parties can't agree on a price and terms among themselves, a contested appraisal proceeding can take additional months or years of wrangling, with valuation experts hired by both sides to determine "fair value," depending as it does on the nature of the business and its prospects.[9] Thus, either of the available judicial roads for a minority shareholder—a purchase after the appraisal proceeding has determined "fair value" or an order of judicial dissolution and liquidation—may leave payment for their shares, whether for retirement or, possibly, a new business venture, far on the horizon.

Limited Liability Company (LLC) Membership Disputes

As under the BCL, discussed above, a minority member of an LLC does not have the right to withdraw and demand an in kind distribution of specific assets or a *pro rata* share of the net assets of the business. On petition, the court may dissolve the LLC if it is not "reasonably practical to carry on the business in conformity with the articles of organization or operating agreement."[10] In other words, a judge has to be convinced either that the business is no longer viable or that the controlling members have breached fiduciary duties to the minority, but without the statutory guidance provided by the BCL. A few of the reported New York cases in this area dealing with judicial dissolution of LLCs have used the BCL remedies by analogy, but, except in egregious circumstances, provide limited guidance as to the parameters of the "reasonably practical" standard.[11]

The Mediation Alternative

Given the myriad of fact patterns with respect to the management of a closely held business and the lack of easily applicable black letter law when it comes to the grounds for dissolution of either a corporation or an LLC, business divorce disputes among the owners present a compelling case for an alternative means of resolution. With the exception of the fast track of BCL § 1104-a, discussed above, providing for a statutory 90-day automatic election period, litigation involving the claims necessary to force a dissolution and liquidation is particularly prone to the uncertainties and expense of protracted litigation. Mediation, as an alternative, or even on a parallel track, can free the parties to deal confidentially and without the judicial strictures of who's "right" and who's "wrong." In mediation the parties are able to craft whatever solution makes sense to them, which may include not only such relatively simple solutions like a high-interest installment promissory note, but also more complex possibilities, such as a special class of redeemable preferred stock, personal guaranties and other security arrangements, transfer with or without separate consideration of specific assets important to the exiting owner, assumption of certain liabilities, non-compete covenants, consulting arrangements, license agreements, pension and health care benefits, and even temporary or long-term office space, among the universe of other arrangements of importance to one party or the other that allow a bargain to be made.

Guidelines for a Successful Business Divorce Mediation

1. Choice of Mediation Style for Business Divorce

Given the many possible dynamics of a relationship among co-owners of a closely held business, there is no one style of mediation that will fit each dispute or stage of dispute resolution. Professor Riskin, in his seminal 1966 article, classified mediator styles from "narrow evaluative" to "broad facilitative."[12] More recently he has modified his grid to reflect the range of mediator behavior from "elicitive" to "directive," describing typical mediator conduct during a mediation as a process of shifting from one style to another depending on the desires of the parties and the needs at the stage of the mediation.[13]

A complex business divorce involving a family business is a prime example of the necessity of mediator flexibility as it may require a mediator to use an elicitive, if not transformative, approach through much of the initial mediation sessions and caucuses in order to deal with underlying family dynamics.[14] A dispute between a minority shareholder/former employee seeking only to redeem his or her shares at fair value at an appraisal, on the other hand, may be more efficiently handled by an approach shifting between facilitative and evaluative.

2. Mediate Early

Litigators often have tactical reasons for the early commencement of a lawsuit, including statutes of limitation, forum choice or even valuation concerns in the case of a petition for dissolution under BCL § 1104-a which, when converted to an appraisal proceeding under BCL § 1118 (b), measures the value of the corporation as of the day prior to the filing of the petition. When such concerns are not primary, it should be remembered by counsel that laymen are not used to the harsh conclusory language of complaints and petitions for judicial relief. If the end goal is in fact settlement, service of process, in itself, may so polarize the parties that mediation of the dispute becomes more difficult.

By the time mediation is suggested by the court or one of the parties who has just received the first legal bill for the litigation, papers will have been exchanged, discovery may have begun and characterizations of nefarious conduct by the controlling shareholder or incompetency of

the minority shareholder/employee have all but buried a once-collegial relationship. Weeks or months have been spent preparing for document delivery, depositions and conferring with their respective litigating attorneys about strategy to "destroy" the other side's case. In many instances, formerly cordial social life has been affected as spouses are drawn in and the relationship withers. Mediators have sometimes been described as magicians in their ability to resolve difficult disputes, but the skill of resurrection is more difficult.

A pre-litigation meeting with counsel and parties on both sides, facilitated by a mediator, may pay huge dividends in the saving of time and legal expenses.

3. Build Rapport and Set Expectations

It's not unusual to talk separately with each counsel prior to the first mediation session to find out the positions of each party. If possible, after the customary conference call with the lawyers, the mediator should meet privately with each party and their counsel prior to the first session. Particularly if the mediation is court-ordered, it's possible that counsel, if not the party, may see the mediation process as merely one step in the litigation. An early meeting will give the mediator an opportunity to explain the potential benefits of mediation and respond to (and learn about) any reservations the lawyer has about the process or the other side. It will also give the mediator an opportunity to hear from the client his or her version of the facts, without the first mediation day pressure, and, incidentally, shortening the time spent in the first day's initial caucuses, when the non-caucusing party is left waiting, often for what seems like hours. By being sincerely interested and listening to the client in a more relaxed environment, the mediator will often be able to get beyond the legal rhetoric and find out what the underlying issues may be.

4. Make Sure the Necessary Parties Are at the Table

One of the primary reasons for impasse is that the right people aren't at the table.[15] In one business divorce case I mediated, three factions of shareholders of a family corporation were at the table, each represented by counsel. The matriarch of the family, still very much interested and involved in the business and who had originally doled out the shares to her children, wasn't present, but her "intentions" were regularly referred to by each of the factions. After several hours of caucuses, the mediation ended without visible progress. If I had ascertained beforehand the importance of the matriarch, even though she held no shares herself, I would have discussed with the parties the possibility of her participation at the mediation.

5. Listen for Unexpressed Needs and Interests

Business divorce disputes often are between partners who have worked together for years and who know each other's families and family problems. In one family business mediation of a litigation brought by a nephew against the family corporation, then controlled by his Uncle Joe, forcing the nephew's father Al (also in the business) into the uncomfortable position of having to take sides against his brother or his son, I was told by Al in caucus, "Joe's wife will kill him if he gives something to my son while his own kids didn't get anything." As it was, the case settled before the next session, but in the event there had been a second session, I would have asked questions of all parties in the interim period exploring tactfully with Joe and Al separately whether they thought it might be necessary to reach agreement on a family-wide basis.

6. Explore Unique Settlement Options and Tools

Sometimes a solution that had not been contemplated at the time of the initial discussions becomes obvious once tempers have calmed and options can be freely explored. It is Mediation 101 that an orange has both juice and a peel, and what may be very valuable to one party may be less valuable to the other.[16] Perhaps a consulting or carefully honed non-compete agreement can close a gap that seems unbridgeable. The parties themselves, with their deep knowledge of their own interests and the intricacies and sensitivities of the business, can come up with solutions that would not occur to third-party neutrals.

In one settlement negotiation I was involved in years ago, involving the split-up of a syndicate owning a thoroughbred stallion, the parties after many hours of negotiating agreed on a cash payment to the departing partner, but only when a certain number of annual "nominations to the stallion" (a term of art for insemination, which, under thoroughbred rules, cannot be done artificially), was at the last minute added to the mix. This is a good example of the importance of letting the parties find their own best solutions, since their proposal was not something in my toolbox.

It is a fundamental principle of mediation that the parties are in charge of the substance of their dispute, since they are best able to decide what is in their long-term interest. The mediator, however, as the one most experienced in dispute resolution techniques, has the role of guiding the parties along a road on which they may have never traveled. An important aspect of this is the suggestion by the mediator of innovative, efficient, and perhaps less emotionally charged techniques to assist in the resolution of their dispute. For example, where there are a number of definable business assets to be split up between business partners (e.g., sales regions, properties, inventories, offices, etc.), the mediator might suggest using game theory techniques designed to fairly allocate assets among competing interests. One of the most useful is the so-called "adjusted winner" technique which allows each of the competitors to use a form of weighted voting to allocate the rights/items of property in which he or she is interested.[17] Each party typically will allocate its "points" among individual items on a jointly developed list. Although one round is rarely sufficient to allocate all

the items, by repeating and rebalancing, a fair allocation can be achieved, often allowing each party to get its most valued items. These simple, yet highly sophisticated, techniques are designed for efficiency, equity and to result in an allocation that is as "envy-free" as possible. Although clearly useful in matters involving numerous items left to two or more heirs, or when a divorce settlement requires an allocation of everything from child custody to vacation homes, the technique can also be used to assist in finding a rational way to divide a closely held enterprise.

Conclusion

As with marital divorce, an area where mediation has been highly successful, the legal issues involved in business divorce litigation are often inextricably intertwined with emotional ones. The flexibility of mediation presents a unique and adaptable method to address and resolve both parts of a damaged relationship.

Endnotes

1. Lawrence Riskin, *Understanding Mediation Orientation, Strategies and Techniques: A Guide for the Perplexed*, 1 Harv. Neg. L. Rev. 7 (1966).
2. *See* Dan Krieger, *Not Just for Disputes! Mediation Techniques for Negotiation and Deal Making*, 8 JAMS Dispute Resolution Alert, No. 4, 1 (Fall, 2008); James Freund, *Three's a Crowd-How to Resolve a Knotty Multi-Party Dispute Through Mediation*, 64 The Business Lawyer 359 (February, 2009).
3. N.Y. Business Corp. Law (BCL) § 1104(a)(1) and (2); *see* 15A N.Y. Jur. 2d Sec. 1408-1409 (2009).
4. BCL § 1104-a; for holders with less than 20% of the shares, a common law right has been recognized where there has been an "egregious" breach of fiduciary duty, 15A N.Y. Jur. 2d Sec. 1378 (2009).
5. *In re Kemp & Beatley, Inc*. 64 N.Y. 2d 63, discussed in Moar, *Protecting Minority Shareholders in Close Corporation Valuation Proceedings*, 81 NYSBA Journal No. 4, p. 24 (May 2009), 15A N.Y. Jur. 2d 1416–1417 (2009).
6. BCL § 1118 (a).
7. *Id*.
8. BCL § 1118 (c) (1).
9. 15A N.Y. Jur. 2d Sec. 1428–1435 (2009).
10. N.Y. LLC Law § 702.
11. *In re Youngwall*. 2008 N.Y. Slip Op. 30811 (U) Sup. Ct., Nassau Co. 2008); discussed in Mahler and Schoenberg, *The Beat of Business Divorce Litigation Continued*, 2008, N.Y.L.J., Mar. 30, 2009.
12. Riskin, *supra* note 1.
13. Riskin, *Decisionmaking in Mediation: The New Old Grid and the New New Grid System*, 79 Notre Dame L. Rev. 1 (2003).
14. *See* Bush & Folger, The Promise of Mediation (San Francisco, Jossey-Bass 2005).
15. Lee J. Berman, *Impasse is a Fallacy*, www.mediationtools.com.
16. Fisher, Ury & Patton, Getting to Yes (2d ed. 1991) New York: Penguin Books, p. 57.
17. Brams & Taylor, The Win-Win Solution (Norton 1999); for an interesting discussion of the use of these techniques in analyzing the divorce settlement agreements of Prince Charles and Diana and Donald and Ivana Trump, as well as the negotiation of the Camp David Accords, see pp. 89–118.

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A Med-arb Variant: Binding Mediation—an Oxymoron? Yes but Doable

By Eugene S. Ginsberg

The last issue of this publication carried a series of articles on the pluses and minuses of med-arb combinations. As noted by some of the commentators, sometimes the format of traditional mediation does not suit the parties' needs. An example illustrates how a flexible approach to dispute resolution is important. Disputing parties requested "binding" mediation through the Alternative Dispute Resolution Tribunal program of the Nassau County Bar Association ("Association").

The Association has a Mediation program and an Arbitration program. They both follow their respective traditional usage. Mediation is a process whereby the goal is for the parties to voluntarily agree upon a result. The Mediator helps them to do so but does not have the power to impose a decision upon them. In arbitration the neutral or impartial arbitrator makes a decision and the award is enforceable in court. In mediation, the parties are each able to tell the mediator things that are not disclosed to the other party. If a mediation is not successful, both parties may purse other venues, including arbitration, to obtain a decision.

In this situation the parties wanted to proceed in the less formal mediation style, but in the event there was no agreement did not want to pursue a resolution in another venue. They probably chose a program of the Association because of its minimal cost. They, therefore, were willing to authorize the mediator to utilize any information disclosed in a private caucus and were willing to waive confidentiality to have a determination made by the mediator. To have the determination enforceable the mediator became an arbitrator and the determination was issued as an "Award."

Binding mediation is an oxymoron. However, converting the binding aspect into an award made what the parties desired doable. It was necessary to modify the mediation agreement to make it binding. They agreed that the impartial mediator would have "full authority to make binding decisions on any issues that are not voluntary agreed to, or otherwise resolved." They acknowledged their "desire that all disputes between them be agreed to or finally determined by the Mediation." They also agreed that "any information disclosed to the Mediator in joint or private caucus sessions may be used by the Mediator in making his final and binding determination." They expressly waived "any right or privilege that such information is confidential." They authorized the mediator to make a final and binding determination and granted him "the authority to act as an arbitrator and issue such determination in the form of a final and binding Award" and that the Award "shall be enforceable under CPLR § 7500, *et seq.*, in a Nassau County Court having jurisdiction." The arbitration opinion referenced the jurisdiction and the award resolved the issues between the parties.

This was the first time since the Tribunal Panels were established, ten years ago, by the Association that such request was received. The ADR Tribunal program accepted the challenge and accomplished the purpose desired by the disputants.

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New York State Bar Association, Dispute Resolution Section, Arbitration Committee

Report on Arbitration Discovery in Domestic Commercial Cases

This report was approved by NYSBA Executive Committee and House of Delegates, April 2009

Guidance for Arbitrators in Finding the Balance Between Fairness and Efficiency

Introduction

Arbitration has been in use for millennia,[1] and has long been on the scene in the United States. George Washington's will had an arbitration clause,[2] and some labor disputes made use of arbitration beginning in the early 1800s.[3] Over the years, arbitration has been viewed as a vehicle for the rapid resolution of disputes. In addition to the ability to select a decision maker with expertise in the pertinent field, a chief attraction of arbitration was that it dispensed with many of the expensive and time-consuming characteristics of litigation while at the same time permitting an expeditious but fair, and final, result.

More recently, as discovery proceedings have exploded in civil actions in the United States, there has been a trend to inject into arbitration expensive elements that had traditionally been reserved for litigation—interrogatories; requests to admit; dispositive motions; lengthy depositions; and massive requests for documents, including electronic data. This has particularly been the case as the use of arbitration has grown for the largest, most complex commercial cases. To an extent, this trend is understandable, since the arbitration of large commercial cases must include enough discovery to permit a fair result in a complex setting. At present, however, discovery in too many commercial arbitrations has gone far beyond a desirable expansion to accommodate increased complexity. In some cases, it has spiraled out of control and has reached a point where some users of arbitration feel that there is little difference between arbitration and litigation. Because of this, some question the need for arbitration's continued existence.

In the context of this history of arbitration as an expeditious proceeding and the recent development of complex discovery on the domestic, large case, commercial arbitration scene, advocates and parties, at times, are faced with uncertainty. Some feel stymied by an "old school" arbitrator who denies expected discovery, while others drown in full blown federal rules discovery where a more truncated proceeding is sought. This perceived need for greater predictability and for enhancement of the handling of discovery in arbitration prompted the New York State Bar Association's President, Bernice Leber, to encourage the Association's new Dispute Resolution Section to undertake a study of this issue, and, perhaps, develop some guidelines of use to counsel and arbitrators.

In charging the Section with this task, President Leber recognized that, despite the problem with discovery, arbitration can still offer many benefits: for example, confidentiality and party control not available in court and generally, a less costly, speedier, and more efficient process. Beyond this, arbitration holds great promise for the future. It represents parties' freedom of contract, the freedom to design a resolution process that fits their needs and expectations, that balances their notions of due process with efficiency, and that selects a decision-maker who they believe will best understand their custom and practice and apply the norms and standards of their field to arrive at a wise, fair, and equitable determination of their dispute.

Pursuing the goal of improving arbitration discovery, in the summer of 2008, the New York State Bar Association's Dispute Resolution Section Chair, Simeon Baum, presented this task to the Section's Arbitration Committee, which, in turn, formed a subcommittee (the "Subcommittee") to study arbitration discovery in domestic commercial cases. The Subcommittee is chaired by John Wilkinson, Carroll Neesemann and Sherman Kahn. The Subcommittee recognized that different norms and expectations might apply in the international arbitration context, in the handling of labor disputes, in small claims arbitrations, and in a wide array of other areas for arbitral resolution of disputes. Thus, it bears noting that the Subcommittee limited the scope of its study and comments to the field of domestic commercial arbitration.

In the course of its study, the Subcommittee conducted in-depth interviews with numerous leaders of the New York arbitration bar, including advocates, arbitrators, in-house counsel, and representatives of administering organizations, who brought significantly different perspectives to bear on the question of arbitration discovery. These interviews took the form of a series of in person meetings between Subcommittee members and well-known arbitration practitioners and, in addition, Subcommittee members spoke with many other knowledgeable and respected individuals in a more informal manner. The Subcommittee also studied work done by other organizations on the subject of arbitration discovery, including JAMS; the International Centre for Dispute Resolution/American Arbitration Association; the Chartered Institute of Arbitrators; the CPR International Institute for Conflict

Prevention and Resolution; the American College of Trial Lawyers; the International Bar Association; and the College of Commercial Arbitrators. The Subcommittee additionally engaged in legal research on a number of topics which related to arbitration discovery, and it reviewed numerous articles and treatises which also were relevant. Emerging from this effort was a group of Precepts which are set forth below and which, if followed, will hopefully help arbitrators effectively handle discovery in domestic, commercial cases in a manner which is both cost-effective and fair, and that—with due regard to freedom of contract—is consistent with the expectations of the counsel and parties who selected the arbitration process.

Arbitration Discovery Precepts

The Key Element—Good Judgment of the Arbitrator

- While some commercial arbitrations may have similarities, for the most part each case involves unique facts and circumstances. As a result, arbitration discovery must be adapted to meet the unique characteristics of the particular case, and there is no set of objective rules which, if followed, would result in one "correct" approach for all commercial cases.
- The experience, talent and preferences brought to arbitration will vary with the arbitrator. It follows that the framework of arbitration discovery will always be based on the judgment of the arbitrator, brought to bear in the context of variables such as the arbitrator's background, applicable rules, the custom and practice for arbitrations in the industry in question, and the expectations and preferences of the parties and their counsel. Arbitrators must exercise that judgment wisely, to produce a discovery regimen that is specific and appropriate to the given case, to ensure enough discovery and evidence to permit a fair result, balanced against the need for a less expensive and more efficient process than would have occurred if the case had gone to trial.
- Attached as Exhibit A is a list of factors which, if taken into consideration by an arbitrator when addressing the type and breadth of arbitration discovery, should assist the arbitrator in exercising judgment in a way that will limit discovery to the extent possible while taking into account all relevant factors.

Early Attention to Discovery by the Arbitrator

- It is important that the ground rules governing an arbitration be clearly established in the period immediately following the initiation of the arbitration. Therefore, following appointment, the arbitrator should promptly study the facts and the issues and be fully prepared to preside effectively over the early, formative stages of the case in a way that will ultimately lead to an expeditious, cost-effective and fair process.
- The type and breadth of the discovery regime in an arbitration is subject to applicable rules, which vary significantly with different administering organizations but lack the specificity that one finds, for example, in the Federal Rules of Civil Procedure. That being so, it is imperative for the arbitrator to avoid uncertainty and surprise by ensuring that the parties understand at an early stage what the basic ground rules for discovery are going to be. Early attention to the scope of discovery increases the chance that parties will adopt joint principles of fairness and efficiency before partisan positions arise in concrete discovery disputes.
- The type and breadth of arbitration discovery should be high on the agenda for the first pre-hearing conference at the start of the case. If at all possible, an early, formative discussion about discovery should be attended by in-house counsel or other party representatives, as well as by outside counsel. If practicable, it may also increase the likelihood of an early, meaningful understanding about discovery if the first pre-hearing conference is an in-person meeting, as opposed to a conference call.
- The arbitrator will enhance the chances for limited, efficient discovery if, at the first pre-hearing conference, he or she sets ambitious hearing dates and aggressive interim deadlines which, the parties are told, will be strictly enforced, and which, in fact, are thereafter strictly enforced.
- Where appropriate, the arbitrator should explain at the first pre-hearing conference that document requests:
  - should be limited to documents which are directly relevant to significant issues in the case or to the case's outcome;
  - should be restricted in terms of time frame, subject matter and persons or entities to which the requests pertain, and
  - should not include broad phraseology such as "all documents directly or indirectly related to."

Party Preferences

- Overly broad arbitration discovery can result when all of the parties seek discovery beyond what is needed. This unfortunate circumstance may be caused by parties and/or advocates who are inexperienced in arbitration and simply conduct themselves in a fashion which is commonly ac-

cepted in court litigation. In any event, where all participants truly desire unlimited discovery, the arbitrator must respect that decision, since arbitration is governed by the agreement of the parties. In such circumstances, however, the arbitrator should ensure that the parties have knowingly agreed to such broad discovery and that they have intentionally withheld from the arbitrator the power to limit discovery in any fashion. The arbitrator should also make sure that the parties understand the impact of an agreement for broad discovery by discussing the cost of the course on which the parties propose to embark and the benefit or negative consequences likely to be derived therefrom. The arbitrator should endeavor to have these communications with in-house counsel or other party representatives, as well as with outside counsel, to ensure that the parties, themselves, fully understand the discovery decision.

- If, after discussion with the arbitrator, the parties still wish to engage in expansive discovery, the arbitrator should, nonetheless, pursue agreement on limitations such as the number and length of depositions, and the total time period in which depositions and other forms of discovery are to be conducted.
- Where one side wants broad arbitration discovery and the other wants narrow discovery, the setting is ideal for the arbitrator to set meaningful limitations since the arbitrator has far more latitude in such circumstances than when all parties have agreed on broad, encompassing discovery.

E-Discovery

- The use of electronic media for the creation, storage and transmission of information has substantially increased the volume of available document discovery. It has also substantially increased the cost of the discovery process.
- To be able appropriately to address issues pertaining to e-discovery, arbitrators should at least familiarize themselves generally with the technological issues that arise in connection with electronic data. Such issues include the format in which documents are produced, and the availability and need (or lack thereof) for production of "metadata." A basic understanding by the arbitrator of e-discovery technology and terminology can help the arbitrator reduce discovery costs for the parties.
- While there can be no objective standard for the appropriate scope of e-discovery in all cases, an early order containing language along the following lines can be an important first step in limiting such discovery in a large number of cases:
  - There shall be production of electronic documents only from sources used in the ordinary course of business. Absent a showing of compelling need, no such documents are required to be produced from back-up servers, tapes or other media.
  - Absent a showing of compelling need, the production of electronic documents shall normally be made on the basis of generally available technology in a searchable format which is usable by the party receiving the e-documents and convenient and economical for the producing party. Absent a showing of compelling need, the parties need not produce metadata with the exception of header fields for e-mail correspondence.
  - Where the costs and burdens of e-discovery are disproportionate to the nature and gravity of the dispute or to the relevance of the materials requested, the arbitrator will either deny such requests or order disclosure on condition that the requesting party advance the reasonable cost of production to the other side, subject to further allocation of costs in the final award.

Legal Considerations

- Section 10 of the Federal Arbitration Act provides that one of the very few ways an arbitration award can be vacated is "where the arbitrators were guilty of misconduct in refusing . . . to hear evidence pertinent and material to the controversy." Some arbitrators tend to grant extensive discovery out of concern that any other approach might lead to a vacated award under Section 10. The Subcommittee believes, however, that this concern is greatly overstated and that very few arbitration awards are vacated because the arbitrator put strict limits on discovery in the interests of efficiency and cost-effectiveness.
- Some advocates fear malpractice claims if they fail to pursue scorched-earth tactics in connection with arbitration discovery. Such a concern ignores the possibility that the mindless pursuit of marginal discovery or the failure to seek reasonable limits on discovery could also lead to a claim for malpractice. In any case, there should be candid communication between attorney and client in the early stages of an arbitration with respect to the scope of discovery that is to be pursued.

Arbitrator Tools

- While arbitrators are expected to act in a deliberate and judicious fashion, always affording the parties

due process, it is also essential for the arbitrator to maintain control of the proceedings and to move the case forward to an orderly and timely conclusion. The arbitrator has many tools that can be used both to ensure the fairness of the proceedings and to prevent disruption in the rare case where one side may withhold its cooperation. Those tools may include, for example, the making of adverse factual inferences against a party that has refused to come forward with required evidentiary materials on an important issue, the preclusion of proof, and/or the allocation of costs. Depending upon the applicable institutional rules and arbitration law, it may be possible to award attorneys' fees and, in extreme cases, other monetary sanctions against an obstructing party, *Superadio Ltd. P'ship v. Winstar Radio Productions*, 446 Mass. 330 (2006) (discovery abuse in AAA arbitration); *Goldman Sachs & Co. v. Patel*, 1999 N.Y. Misc. LEXIS 681* 17-23 (S. Ct., N.Y. Co.) (NASD arbitration), and possibly even against obstructing counsel**.** On the last point, *see Polin v. Kellwood Co.*, 103 F. Supp.2d 238 (S.D.N.Y. 2000) (monetary award against counsel affirmed), *aff'd*, 34 Appx. 406 (2d Cir.), *cert. denied*, 537 U.S. 1003 (2002). *But see In re Interchem Asia 2000 PTE Ltd. v. Oceana Petrochemicals AG*, 378 F. Supp.2d 347, 355–57 (S.S.N.Y. 2005) (monetary award against counsel vacated); *see also Millmaker v. Bruso*, 2008 U.S. Dist. LEXIS 5548 (S.D. Tex. 2008).

- Sanctions may even include the resolution of a claim or defense against a party. *See First Preservation Capital, Inc. v. Smith Barney, Harris Upham & Co.*, 939 F. Supp.1559 (S.D. Fla. 1996) (NASD arbitration); *Patel*, *supra* (NASD arbitration; failure to pay monetary sanction and failure to obey arbitrator orders).

- Despite some disagreement as to the outer limits of the arbitrator's authority to impose sanctions, and the paucity of cases on the subject, the cases that do exist demonstrate the courts' generally deferential approach to review of such awards.

Artfully Drafted Arbitration Clauses

- There is significant potential for dealing with time and other limitations on discovery in the arbitration clauses of commercial contracts. An advantage of such drafting is that it is much easier for parties to agree on such limitations before a dispute has arisen. A drawback, however, is the difficulty of rationally providing for how best to arbitrate a dispute that has not yet surfaced. Thus, the use of such clauses may be most productive in circumstances in which parties have a good idea from the outset as to the nature and scope of disputes that might thereafter arise.

- In order for rational time and other discovery limitations to be effectively included in an arbitration clause, it is necessary that an attorney with a good understanding of arbitration be involved in the drafting process.

Depositions

- Because depositions have traditionally not been a major part of the arbitration process, the best exercise of an arbitrator's judgment might be to direct no depositions or the minimum number of depositions in instances, for example, where the parties' positions are already well known or are fully reflected in surrounding documents.

- However, the size and complexity of commercial arbitrations have now grown to a point where one or more depositions can serve a real purpose in many instances. In fact, at times, the absence of any depositions in a complex arbitration can significantly lengthen the cross-examination of key witnesses and unnecessarily extend the completion of the hearing on the merits. So, too, a limited deposition in advance of document requests might serve to focus and restrict the scope of document discovery and/or reduce the risk that the other party is hiding relevant evidence.

- If not carefully regulated, deposition discovery in arbitration can get out of control and become extremely expensive, wasteful and time-consuming. In determining whether and what scope of depositions may be appropriate in a given case, an arbitrator should balance these considerations, consider the factors set forth in Exhibit A, and confer with counsel for the parties. If an arbitrator determines that it is appropriate to permit depositions, it may make sense for an arbitrator to solicit agreement at the first pre-hearing conference on language such as the following:

> Each side may take #* discovery depositions. Each side's depositions are to consume no more than a total of #* hours. There are to be no speaking objections at the depositions, except to preserve privilege. The total period for the taking of depositions shall not exceed #* weeks.[4]

Discovery Disputes

- It is essential that arbitration discovery disputes be resolved promptly and efficiently since exhaustive discovery motions can unduly extend the discovery period and significantly add to the cost of the arbitration. In addressing discovery disputes, the arbitrator should consider the following practices

which can increase the speed and cost-effectiveness of the arbitration:

- Where there is a panel of three arbitrators, the parties may agree, by rule or otherwise, that the Chair or another member of the panel is authorized to resolve discovery issues, acting alone. While the designated panel member may still wish to consult the other arbitrators on matters of importance, the choice of a single arbitrator to decide discovery issues can nonetheless avert scheduling difficulties and avoid the expense and delay of three people separately engaging in the laborious tasks related to resolving discovery issues.
- Lengthy briefs on discovery matters should be avoided. In most cases, a prompt discussion or submission of brief letters will sufficiently inform the arbitrator with regard to the issues to be decided.
- The parties should be required to negotiate discovery differences in good faith before presenting any remaining issues for the arbitrator's decision.
- The existence of discovery issues should not impede the progress of discovery in other areas where there is no dispute.

Discovery and Other Procedural Aspects of Arbitration

Other aspects of arbitration have interplay with, and impact on, discovery in arbitration, as discussed below.

1. Requests for Adjournments

- Where parties encounter discovery difficulties, this circumstance often leads to a request for adjournment and the possible delay of the hearing. While the arbitrator may not reject a joint application of all parties to adjourn the hearing, the fact is that such adjournments can cause inordinate disruption and delay by needlessly extending unnecessary discovery and can substantially detract from the cost-effectiveness of the arbitration. If the request for adjournment is by all parties and is based on a perceived need for further discovery (as opposed to personal considerations), the arbitrator should ensure that the parties understand the implications of the adjournment they seek and, if possible and except for exceptional circumstances, the arbitrator should try to dissuade them from the adjournment in a way that would still accommodate their perceived needs. The arbitrator may request that the represented parties attend any conference to discuss these subjects if, in the arbitrator's judgment, the presence of clients may facilitate the adoption of a practical solution.
- If one party seeks a continuance and another opposes it, then the arbitrator has discretion to grant or deny the request. Particularly with busy arbitrators and advocates, such requests can cause long delays. In general, courts are well aware that a core goal of arbitration is speed and cost-effectiveness and will not disturb an arbitrator's rejection of an unpersuasive request for an adjournment. However, the arbitrator should carefully consider the merits of the request and the legitimate needs of the parties, as well as the proximity of the request to the scheduled hearing and any earlier requests for adjournments.
- Last-minute requests for adjournments sometimes come as a complete surprise to the arbitrator who assumed all was going well because he or she had not heard from the parties for months. In such circumstances, the arbitrator may be at least in part responsible for the breakdown of the process since the arbitrator should have scheduled periodic conference calls throughout the pre-hearing phase. When the arbitrator does this, he or she will likely get an early sense of problems in maintaining the pre-hearing schedule and will be in a much better position to deal with such problems at a relatively early stage rather than at the 11th hour.

2. Written Witness Statements

- The use of written witness statements in lieu of direct testimony ("Witness Statements") has certain benefits. Witness Statements can save considerable time at the hearing. From a discovery perspective, they can avoid or lessen the need for depositions since the cross-examining party has detailed advanced notice of the witness' direct testimony. The effectiveness of witness statements as a discovery tool is greatly increased if they are produced relatively early in the proceedings.
- The use of witness statements also has drawbacks, i.e.: (i) they are written by lawyers and often do not reflect how the witness would actually have said something; (ii) being written by lawyers, the Witness Statements can be very expensive; (iii) the witness often trusts the lawyer too much and only cursorily reviews the Witness Statement before signing it; and (iv) oral direct testimony can be a good time for an arbitrator to assess credibility from a perspective other than cross-examination.
- Thus, use of Witness Statements should be considered on a case-by-case basis, particularly in connection with secondary witnesses.

3. Discovery and Dispositive Motions

- In arbitration, "dispositive" motions can cause significant delay and unduly prolong the discovery period. Such motions are commonly based on

lengthy briefs and recitals of facts and, after much time, labor and expense, are generally denied on the ground that they raise issues of fact and are inconsistent with the spirit of arbitration. On the other hand, dispositive motions can sometimes enhance the efficiency of the arbitration process if directed to discrete legal issues such as statute of limitations or defenses based on clear contractual provisions. In such circumstances an appropriately framed dispositive motion can eliminate the need for expensive and time-consuming discovery. On balance, the arbitrator should consider the following procedure with regard to dispositive motions:

- Any party wishing to make a dispositive motion must first submit a brief letter (not exceeding five pages) explaining why the motion has merit and why it would speed the proceeding and make it more cost-effective. The other side would have a brief period within which to respond.
- Based on the letters, the arbitrator would decide whether to proceed with more comprehensive briefing and argument on the proposed motion.
- If the arbitrator decides to go forward with the motion, he or she would place page limits on the briefs and set an accelerated schedule for the disposition of the motion.
- Under ordinary circumstances, the pendency of such a motion should not serve to stay any aspect of the arbitration or adjourn any pending deadlines.

Endnotes

1. Some date arbitration back to the Phoenician merchants. Alexander the Great's father, Phillip the Second, used arbitration as a means for resolving border disputes. Barrett & Barrett, A History of Alternate Dispute Resolution: The Story of a Political, Social and Cultural Movement (Jossey-Bass) San Francisco, 2004. Elkouri & Elkouri, How Arbitration Works, Fifth Edition, 1999; Bales, Richard C., Compulsory Arbitration: The Grand Experiment in Employment, 1997. The English used arbitration for commercial disputes as early as 1224. Hill, Marvin F., Sinicropi, Anthony V., Improving the Arbitration Process: A Primer for Advocates, 1991.
2. Bales, *supra.*
3. Nellse, *The First American Labor Case,* 41 Yale L.J. 165, 1931.
4. The asterisked numbers can, of course, be changed to comport with the particular circumstances of each case.

EXHIBIT A

Relevant Factors in Determining the Appropriate Scope of Arbitration Discovery

Nature of the Dispute

The factual context of the arbitration and of the issues in question with which the arbitrator should become conversant before making a decision about discovery.

The amount in controversy.

The complexity of the factual issues.

The number of parties and diversity of their interests.

Whether any or all of the claims appear, on the basis of the pleadings, to have sufficient merit to justify the time and expense associated with the requested discovery.

Whether there are public policy or ethical issues that give rise to the need for an in depth probe through relatively comprehensive discovery.

Whether it might be productive to initially address a potentially dispositive issue which does not require extensive discovery.

Agreement of the Parties

Agreement of the parties, if any, with respect to the scope of discovery.

Agreement, if any, by the parties with respect to duration of the arbitration from the filing of the arbitration demand to the issuance of the final award.

The parties' choice of substantive and procedural law and the expectations under that legal regime with respect to arbitration discovery.

Relevance and Reasonable Need for Requested Discovery

Relevance of the requested discovery to the material issues in dispute or the outcome of the case.

Whether the requested discovery appears to be sought in an excess of caution, or is duplicative or redundant.

Whether there are necessary witnesses and/or documents that are beyond the tribunal's subpoena power.

Whether denial of the requested discovery would, in the arbitrator's judgment (after appropriate scrutinizing of the issues), deprive the requesting party of what is reasonably necessary to allow that party a fair opportunity to prepare and present its case.

Whether the requested information could be obtained from another source more conveniently and with less expense or other burden on the party from whom the discovery is requested.

To what extent the discovery sought is likely to lead, as a practical matter, to a case-changing "smoking gun" or to a fairer result.

Whether broad discovery is being sought as part of a litigation tactic to put the other side to great expense and thus coerce some sort of result on grounds other than the merits.

The time and expense that would be required for a comprehensive discovery program.

Whether all or most of the information relevant to the determination of the merits is in the possession of one side.

Whether the party seeking expansive discovery is willing to advance the other side's reasonable costs and attorneys' fees in connection with furnishing the requested materials and information.

Whether a limited deposition program would be likely to (i) streamline the hearing and make it more cost-effective; (ii) lead to the disclosure of important documents not otherwise available; or (iii) result in expense and delay without assisting in the determination of the merits.

Privilege and Confidentiality

Whether the requested discovery is likely to lead to extensive privilege disputes as to documents not likely to assist in the determination of the merits.

Whether there are genuine confidentiality concerns with respect to documents of marginal relevance. Whether cumbersome, time-consuming procedures (attorneys' eyes only, and the like) would be necessary to protect confidentiality in such circumstances.

Characteristics and Needs of the Parties

The financial and human resources the parties have at their disposal to support discovery, viewed both in absolute terms and relative to one another.

The financial burden that would be imposed by a broad discovery program and whether the extent of the burden outweighs the likely benefit of the discovery.

Whether injunctive relief is requested or whether one or more of the parties has some other particular interest in obtaining a prompt resolution of all or some of the controversy.

The extent to which the resolution of the controversy might have an impact on the continued viability of one or more of the parties.

Report of the Dispute Resolution Section on the Arbitration Fairness Act and Other Federal Arbitration Bills

The Dispute Resolution Section of the New York State Bar Association ("the DR Section") urges Congress to carefully review arbitration bills introduced in Congress to ensure that they do not interfere with general commercial arbitration. This most particularly applies in the international context where arbitration is often the only practicable choice for dispute resolution. Bills intended to protect consumers and employees, which have garnered significant congressional support, could also void pre-dispute arbitration provisions in certain additional categories of commercial disputes, and reverse decades of U.S. Supreme Court precedent relating to essential doctrines of arbitration jurisprudence. While these bills are apparently not intended to impact commercial arbitration, the unintended consequences of the bills would dramatically eviscerate the Federal Arbitration Act, lessening the efficacy of arbitration as a dispute resolution mechanism for commercial disputes and doing serious damage to U.S. businesses.

The DR Section supports many of the principles underlying the introduction of remedial arbitration legislation, including the protection of the procedural due process rights of consumers and employees. However, the DR Section opposes the enactment of such legislation as an amendment to the Federal Arbitration Act. With respect to The Arbitration Fairness Act of 2009, H.R. 1020 and the Arbitration Fairness Act of 2007, H.R. 3010 and S. 1782 (the "Arbitration Bill") the DR Section further (a) supports remedial legislation with regard to consumers but takes no position as to the optimal solution for addressing the issue; (b) opposes the overly inclusive nature of the ban on all employee arbitration and encourages the legislature to explore alternative solutions for their concerns; (c) opposes the invalidation of pre-dispute arbitration agreements in franchise contracts; (d) opposes the inclusion of vague language relating to civil rights and statutes intended to regulate transactions between parties with "unequal bargaining power";[1] and (e) opposes the overturning for all arbitrations of long-established and internationally recognized precedents as to the allocation of authority between courts and arbitrators. The DR Section is extremely concerned that in its present form the Arbitration Bill could have the unintended consequence of negatively impacting virtually all domestic and international commercial arbitration.

1. Arbitration Is the Dispute Resolution Mechanism of Choice for Many Commercial Transactions

In 1925, in response to the needs of the business community, the U.S. Congress affirmed the importance of arbitration in the promotion of commerce and trade by enacting the Federal Arbitration Act (FAA). The FAA accorded arbitration agreements the same treatment as other contracts and provided for limited judicial review of arbitration awards. As the Supreme Court stated, "[T]he central purpose of the FAA is to ensure that private agreements to arbitrate are enforced according to their terms." *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 42, 53-54 (1995).

The many benefits of arbitration have led to the extensive use of arbitration as the process of choice for dispute resolution in commercial contracts both domestically and internationally. These benefits include:

- *Flexible Process*—As arbitration is a creature of contract, the parties can design the process to accommodate their respective needs. Hearings may be set at the parties' convenience and the less formal and adversarial setting minimizes the stress to what are often continuing business relationships. In the international context, arbitration can harmonize cross-border cultural and legal differences.
- *Efficiency*—Arbitration can provide for simpler procedural and evidentiary rules than ordinary litigation (e.g., less discovery, limited motion practice, and narrower grounds for appeal) and create a mechanism whereby the parties can craft and implement a streamlined procedure.
- *Expertise*—Arbitration permits the parties to choose adjudicators with the necessary expertise to decide complex issues which often require industry-specific expertise.
- *Finality*—Judicial review of awards is restricted to a few issues primarily related to the fundamental issues of procedural fairness, jurisdiction, and public policy. The finality of awards is particularly important in business transactions. In many instances, with the cost of capital, the time value of

money and the paralysis that indecision can bring to businesses, the most important consideration in a commercial dispute is that it be quickly and definitively decided.

- *Confidentiality*—Arbitral hearings, as opposed to court trials, are generally private and confidentiality can be agreed to by the parties. Most arbitral institutions have specific rules regarding the confidentiality of proceedings and awards. This is an important feature for many corporations, particularly when dealing with disputes over intellectual property and trade secrets.
- *Neutrality*—In the international context, arbitration most importantly provides a neutral forum for dispute resolution and enables the parties to select decision-makers of neutral nationalities who are detached from the parties or their respective home state governments and courts, in a setting in which bias is avoided and the rule of law is observed.
- *Enforceability*—In the international context, a critical feature is the existence and effective operation of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (the "New York Convention") to which over 140 nations are parties, which enables the enforceability of international arbitration agreements and awards across borders. In contrast, judgments of national courts are much more difficult and often impossible to enforce abroad.

The enduring popularity of arbitration as a means of dispute resolution is reflected by the significant caseload at leading arbitral institutions. U.S. courts have repeatedly emphasized the importance of arbitration to the conduct of commercial transactions and recognized a strong federal policy favoring arbitration. *See, e.g.*, *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth*, 473 U.S. 614, 629, 631 (1985); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985).

2. The Most Significant Problems with the Arbitration Fairness Act

Several arbitration bills have been introduced in Congress, but this Report focuses on the Arbitration Bill. The Arbitration Bill is the most sweeping of these proposed bills and has garnered the greatest support in the 110th Congressional Session, with the over 100 representatives as co-sponsors and the endorsement of several prominent Senators. The discussion in this Report of the issues in the context of the Arbitration Bill is intended to be applicable to any of the same problems raised by other congressional proposals that have been or may be introduced.

The House version of the Arbitration Bill introduced in the 111th Congress (H.R. 1020) provides in relevant part as an amendment to Chapter 1, Section 2 of the FAA:

> (b) No pre-dispute arbitration agreement shall be valid or enforceable if it requires arbitration of—
>
> (1) an employment, consumer, or franchise dispute; or
>
> (2) a dispute arising under any statute intended to protect civil rights.[2]
>
> (c) An issue as to whether this chapter applies to an arbitration agreement shall be determined by Federal law. Except as otherwise provided in this chapter, the validity or enforceability of an agreement to arbitrate shall be determined by the court, rather than the arbitrator, irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement.

These provisions of the Arbitration Bill would void arbitration agreements in a broad range of business disputes. The vague statutory language of the Arbitration Bill makes it impossible to determine the full impact of the bill in this regard. The bill's proposed amendments to Section 2(c) of the FAA are not limited to the categories of parties that the bill proponents identify and seek to protect in Section 2(b), and the bill would reverse long-standing Supreme Court precedents on "separability" and "*competence-competence*" with respect to all arbitrations. These arbitration concepts are established throughout the world and are procedures essential to the functioning of arbitration.

Although we support many of the principles underlying the Arbitration Bill, because of its overbroad scope and its potential impact on a wide variety of domestic and international commercial arbitration agreements, we oppose the current draft of the Arbitration Bill and most particularly its form as an amendment to the FAA. We discuss below each of the areas impacted by the bill:

a. Consumers—We support protecting the due process rights of consumers who may have virtually no choice but to enter into certain types of agreements containing arbitration clauses (e.g., credit card agreements). However, we oppose Section 2(b)(1) as currently drafted and as an amendment to the FAA, and take no position at this time with respect to the optimal legislative remedy. We will be studying further the relative merits of addressing concerns about the ability of consumers to obtain

justice through legislation that (i) invalidates pre-dispute arbitration agreements, (ii) provides for consumer opt-outs, or (iii) provides for fairness through procedural safeguards, and will also examine the ability of the courts to absorb potentially increased caseloads at current funding levels without adverse impacts on other disputes not amenable to arbitration. We would oppose any legislation addressing consumer concerns that is framed as an amendment to the FAA rather than as a separate statute as discussed *infra* at paragraph 2(e).

b. Employees—Although we support protecting due process rights for employees, we oppose Section 2(b)(1) because it is overbroad as currently drafted in its application to all employment agreements, an area in which arbitration has historically played a significant and socially useful role. One glaring example is that the Arbitration Bill would invalidate pre-dispute arbitration provisions in all employment agreements, including those between sophisticated parties with significant bargaining power who actively negotiate and freely enter into agreements containing arbitration provisions. We will be studying further the impact on the ability of employees to obtain justice with regard to employment-related disputes of legislation that (i) invalidates pre-dispute arbitration agreements, (ii) safeguards the ability of employees to freely contract for various forms of alternative dispute resolution, and/or (iii) provides for fairness through procedural safeguards. We will also be studying the ability of the courts to absorb any potentially increased caseloads at current funding levels without adverse impacts on other disputes not amenable to arbitration. We would oppose any legislation addressing employment concerns that is framed as an amendment to the FAA rather than as a separate statute as discussed *infra* at paragraph 2(e).

c. Franchises—We oppose Section 2(b)(1) insofar as it would invalidate pre-dispute arbitration provisions in franchise relationships. Importantly, franchise arrangements are agreements between businesses and this legislation will impact a vast sector of domestic and international businesses. Today, more than 75 industries operate within the franchising format and account for a significant percentage of all establishments in many important lines of business including restaurants, lodging, and retail food. Consumers frequent franchise establishments because they can depend on the consistent quality of franchised products and services. Arbitration agreements help both franchisors and franchisees by providing a confidential forum in which to air disputes that could affect the franchised brand. Invalidating arbitration clauses in franchise agreements could impact the quality and service of the brand, not only harming the franchisors but also the franchisees.

The need for arbitration is even more pressing in the international franchise context. Many of the U.S. franchise businesses are multinational operations with dozens to hundreds of franchisees around the world. Illustrative of global franchise operations are McDonald's, Burger King, Hilton, Intercontinental, Athlete's Foot and UPS Stores. If cross-border pre-dispute arbitration provisions in franchise agreements are voided, U.S.-based franchisors will be placed at an extreme disadvantage to franchisors of other nationalities and forced to either (1) choose foreign law and venue to govern arbitration agreements, or (2) litigate disputes in domestic courts all around the world which may be slow to resolve disputes and biased in favor of a local party.

d. Disputes Arising Under a Statute Intended to Protect Civil Rights—We oppose the enactment of Section 2(b)(2) of the Arbitration Bill which invalidates a pre-dispute arbitration agreement if it "requires arbitration of a dispute arising under a statute intended to protect civil rights." The Arbitration Bill does not specify which statutes are intended to be covered by the language "statute intended to protect civil rights" and such language arguably includes multiple U.S. and even foreign statutes.

As noted above, H.R. 1020, as introduced in the 111th Congress, deleted the reference to "parties of unequal bargaining power," but the continued inclusion of "civil rights statutes" may enable creative litigants to assert a claim under a statute, domestic or foreign, argued to fall within this rubric and gain the consequences of the AFA. Under the Arbitration Bill, a litigant's mere invocation of such a statute—even if the statutory claim is without merit—would apparently invalidate an otherwise fully enforceable arbitration clause.

e. The Arbitration Bill Overrules Established Arbitration Doctrines—Because of the potential for an amendment to the FAA to create an impact far beyond its original intended scope, we oppose the enactment of the Arbitration Bill or any other legislation designed to deal with the protection of a limited class of potential arbitration parties as an amendment to the FAA.[3] We also oppose the enactment of Section 2(c) of the Arbitration Bill which would alter in *all* arbitrations the current law as to the allocation of authority and timing of review between the court and the arbitrators as to the jurisdiction of the arbitral tribunal. Such legislation would reverse decades of U.S. Supreme Court precedents on "separability" and "*competence-competence*," doctrines which are the conceptual cornerstones of arbitration as an autonomous and effective form of dispute resolution and serve to create the framework for the division of authority between the court and the arbitrator. The proposed amendments to Section 2(c) of the FAA do not limit the reach of these changes to the categories of disputes for which it seeks to invalidate pre-dispute agreements. Nor does the Arbitration Bill distinguish between domestic and international disputes. The changes in the law proposed would thus apply to all arbitrations equally.

The doctrine of separability means that the agreement to arbitrate is "separate" or "separable" from the underlying contract, so that a contract is viewed as containing two discrete agreements: the agreement to arbitrate and the underlying contract. Making this distinction, the invalidity of the underlying contract does not necessarily invalidate the agreement to arbitrate and does not deprive the arbitrator of jurisdiction to decide on the validity of the underlying contract. Based on this principle, cases are referred to the arbitrator by the court if it is the underlying contract and not the agreement to arbitrate that is challenged.

Competence-competence is the principle pursuant to which a determination is made as to how the authority to decide issues is allocated between courts and arbitrators. This allocation determines both (i) the question of who rules first on the arbitrators' jurisdiction (i.e., whether the court determines it on a motion to stay or compel arbitration or upon review of the award on a petition to vacate or confirm the award), and (ii) what standard of review is to be given to the arbitrators' ruling on challenges to their jurisdiction. Under established U.S. principles of *competence-competence*, if the challenge is not based on an objection to the validity or scope of the agreement to arbitrate itself, the arbitrator decides first.

Over 40 years ago in *Prima Paint v. Flood & Conklin,* 388 U.S. 395, 404 (1967) the Supreme Court established the doctrine of separability. The Court stated that such a principle was necessary to effectuate the parties' intention and serve the objectives of the FAA that parties be allowed to proceed in arbitration in accordance with their agreement in a speedy manner "and not subject to delay and obstruction by the courts." This holding has been reaffirmed and expanded in several Supreme Court decisions rendered since 1967. In *First Options of Chicago v. Kaplan,* 514 U.S. 938 (1995), the Supreme Court clarified the concept of *competence-competence*. *See also Buckeye Check Cashing v. Cardegna,* 546 U.S. 440 (2006).

The principles of separability and *competence-competence* do not bar court review for all time but make a choice as to who should be delayed. A choice must be made between the party seeking to arbitrate on the basis of an arbitration clause who would like to move forward with the arbitration and the party who would like to delay it in court proceedings. When entering into the arbitration agreement the parties in a commercial transaction have a parallel and mutual interest in utilizing arbitration and gaining its benefits. Once a dispute arises, however, the respondents in the arbitration very frequently have an interest in delay, as defendants in all cases generally do, causing them to attempt to delay the proceedings by a detour to the courthouse if that is available. In the United States, based on the Court's recognition of the arbitration agreement itself (or of the parties' agreement to have the arbitrator decide whether there is an agreement to arbitrate), the combined doctrines make a choice in favor of allowing the arbitration to go forward in accordance with the agreement of the parties to arbitrate, with the decision of the arbitrator to be reviewed by the court at the conclusion.

Modern arbitration statutes of many countries codify the principles of separability and *competence-competence*. *See, e.g.*, UNCITRAL Model Law on Commercial Arbitration, Article 16 (which has been adopted in over 50 countries including Japan, India, Mexico, Nigeria, and Russia); English Arbitration Act of 1996, Sections 7, 30; Swiss Private International Law, Sections 178(3), 186; French *Nouveau Code de Procédure Civile*, Article 1458. The ICSID Convention, to which the United States is a party, also expressly provides in Section 3, Article 41 that the arbitral tribunal shall determine its own competence and jurisdiction. Institutional rules for international arbitration likewise provide for the arbitral tribunal to decide on its own jurisdiction and incorporate the principles of separability and *competence-competence*.[4]

While the precise application of *competence-competence* and separability varies somewhat from jurisdiction to jurisdiction, at a minimum, the universal rule is that the arbitrator may proceed with the arbitration notwithstanding jurisdictional challenges. This is consistent with current U.S. law pursuant to which a party can ask the court under the FAA to stay the arbitration, but unless a court issues an order staying the arbitration, the arbitrator has authority to proceed with the matter.

The Arbitration Bill would overturn this fundamental principle of arbitration jurisprudence. Under the Arbitration Bill U.S. courts will have the sole authority to determine the validity of arbitration agreements, "irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement." This is a sweeping overhaul of arbitration law both as developed by the courts in the United States and as established internationally. It would mean that the arbitrator would have to stop the proceedings if a party alleged that the contract was for any reason invalid or unenforceable, and courts would have to serve as watchdogs for all arbitrations, even if the challenging party had no specific objection to the arbitration clause itself. Claims that a contract is void or unenforceable for some reason arise in virtually every contract dispute. By requiring the courts alone to review such claimed defects of the contract, the Arbitration Bill would lead to the very involvement in court proceedings that the parties sought to avoid by entering into the arbitration agreement in the first place. The parties' expectations of a forum of choice with all of the benefits of arbitration would be defeated and the U.S. courts will have to handle a larger number of cases added to already crowded dockets. In the international context this is of particular concern as parties choose arbitration

to avoid being subject to domestic courts, an objective that would be defeated by this provision.

3. Consequences of the Arbitration Bill

The Arbitration Bill would have profound and unintended consequences for all forms of domestic and international arbitration and could also have a grave and harmful impact on international commerce. In its present form the Arbitration Bill applies retroactively to existing contracts under which disputes have not yet arisen, and thus would overturn existing arbitration agreements and expectations as to both substantive and procedural matters. It would cause untold delays and additional costs and alter the economics of the bargains that were made. Courts have acknowledged the significance of the contractual provisions that deal with dispute resolution to the economics of the transaction. As the Supreme Court said in *Bremen v. Zapata Off-Shore Company, supra,* 407 U.S. at 14, in addressing the dispute resolution clause of the contract: "it would be unrealistic to think that the parties did not conduct their negotiations, including fixing the monetary terms, with the consequences of the forum clause figuring prominently in their calculations." *See also Carnival Cruise Lines v. Shute,* 499 U.S.585, 594 (1991); *Roby v. Corporation Lloyd's,* 996 F.2d 1353, 1363 (2d Cir. 1993).

However, even applying the Arbitration Bill only prospectively would not save it from inflicting severe harm. Domestic parties would be leery of contracting for arbitration and forced to forgo its important benefits if they were likely to be caught up in a lengthy and expensive side trip into the courts. As the changes in U.S. law become known, the U.S. will no longer be viewed as a friendly forum for international arbitration, and parties engaged in international commerce would shun the U.S. for fear of being dragged into U.S. domestic courts. International arbitration would move elsewhere with the consequent inconvenience and increased costs for U.S. parties and loss of revenues for U.S. institutions. Indeed, U.S. parties could find themselves in the bizarre position of choosing the law of a foreign jurisdiction over U.S. law as the governing law in their international contracts to avoid the evisceration of their arbitration agreements. Both domestic and international arbitration would be chilled in a manner neither intended by the Arbitration Bill's proponents nor necessary to achieve its purpose.

4. Other Arbitration Bills Pending

So many arbitration bills have been introduced in Congress that it is not possible to address all of them in this Report. Some of these bills attempt to impose procedural requirements on arbitration, as an alternative to invalidating arbitration agreements. While establishing due process standards for specified classes of arbitration parties is certainly an alternative that should be given serious consideration and may in some cases be the best way to address the concerns identified, care must be taken to ensure that such legislation is either clearly limited to the classes the statute is intended to protect or consistent with established arbitration practice.

For example, the Fair Arbitration Act of 2007, S. 1135, 110th Cong. (2007), would require an administering institution, thus banning *ad hoc* arbitration, and would require that the arbitrator be a member of the Bar of the court in the United States where the hearing is conducted. These features conflict directly with standard arbitration practice and would make it virtually impossible to hold international arbitrations in the United States. Additionally, both domestic and international arbitrations are frequently and effectively conducted without an administering institution. One of the common features of international arbitration is the selection of at least one arbitrator who is not linked to the jurisdiction of either of the parties so as to ensure neutrality. Other conflicts between arbitration practice and proposed bills exist.

The problems that may be raised for commercial arbitration by new statutory procedural due process requirements in arbitration can be avoided if such requirements are limited in application to the designated classes the statute is intended to protect. At the very least, great care must be taken not to interfere with standard commercial arbitration practices in the drafting of any arbitration legislation.

Conclusion

The Arbitration Bill will radically change the legal framework with respect to the validity of pre-dispute arbitration agreements in a broad range of cases and the division of authority between the courts and the arbitrators. These changes will have a major impact on both domestic and international business interests and lead to extensive and expensive court proceedings that the parties contracted to avoid. This does not appear to be the intention of the Arbitration Bill's proponents and great care must be taken in the drafting of any legislation to protect specific categories of disputants to ensure that the legislation has no unintended impact on commercial disputes.

The goals of the Arbitration Bill can be achieved in various ways without the negative effects that the bill in its present form will have on U.S. businesses. The enactment by Congress of a separate statute protecting designated classes is least likely to cause unintentional adverse impacts on U.S. businesses that select arbitration as the dispute resolution mechanism in commercial transactions. This could be accomplished as a new Chapter 4 of the FAA, as an amendment to another relevant statute or as a new and separate statute. Such a separate statute could be tailored to meet the specific concerns of the legislature and would be consistent with previously enacted

legislation that established different rules for arbitration for discrete categories of disputants.[5] If such a separate statute is enacted, it would be clear that existing commercial arbitration agreements would continue to be valid and enforceable and the fundamental doctrines of *competence-competence* and separability would continue to be applicable with respect to all arbitrations not covered by the new statute.

Regardless of whether the Arbitration Bill is enacted as a separate statute or a new section of the FAA, it should be redrafted and clarified. For example, Congress should consider specifying that the amendments apply only to arbitrations concerning the designated classes and not to other disputes, eliminating or at least clearly defining the vague terms used in the Arbitration Bill and imposing a minimum dollar threshold with regard to arbitrable disputes as is done with respect to consumer claims in other countries. *See, e.g.*, English Arbitration Act of 1996 § 91. Other less problematic legislation is undoubtedly possible to address the concerns. However, without significant revision, the Arbitration Bill is likely to have far-reaching harmful consequences.

The FAA has functioned effectively for over 80 years and can now be applied with the benefit of decades of Supreme Court and lower court precedents. Addressing certain issues of concern with an amendment to the FAA, as the Arbitration Bill does, would likely lead to confusion in the courts as to what aspects of the amendments are applicable to commercial disputes, and to years of expensive and extensive litigation as those issues are clarified. While careful drafting might conceivably accomplish all of the goals sought though an amendment to the FAA, the risks associated with such an amendment cause us to urge that any legislation introduced be crafted as a separate statute.

In short, careful drafting can prevent the creation of problems for commercial arbitration, but without careful redrafting the Arbitration Bill is likely to have broad unintended negative consequences for businesses, courts and litigants.

Respectfully submitted,
Dispute Resolution Section
March 18, 2009

Endnotes

1. We note that the reference to parties of unequal bargaining was deleted in the Arbitration Fairness Act of 2009, H.R. 1020, but we include a discussion of that language because such language may be in the Senate version when it is reintroduced and provisions which were deleted in the current House of Representatives bill may be reinserted in the course of the legislative process.
2. As noted above, the 2007 Senate and House versions of the Arbitration Bill also included the words "or to regulate contracts or transactions between parties of unequal bargaining power." We are firmly opposed to the inclusion of this undefined phrase in any proposed legislation as in virtually every transaction one party can be argued to have greater power. Additionally, there are a great many statutes that are presumably designed to protect parties of unequal bargaining power, including securities, antitrust, ERISA, parts of the Uniform Commercial Code, bankruptcy statutes, intellectual property law and a host of others. Even the consumer protection laws which have been enacted in states across the country, similar to Section 349 of the New York State General Business Law, the New York State Consumer Protection Act, could be implicated. While intended to protect consumers, these statutes are very often raised in commercial cases, and, if the words "to regulate contracts or transactions between parties of unequal bargaining power" were included in the Arbitration Bill, could likely trigger its non-enforceability provision.
3. *See, e.g.*, The Fairness in Nursing Home Arbitration Act of 2009, H.R. 1237 (FNHAA) that adds a separate provision at the end of Chapter One of the FAA which defines the type of pre-dispute arbitration agreements to which it applies. Although this is a minor improvement over legislation which alters and amends the existing provisions of the FAA, we continue to urge that any legislation that renders unenforceable specific classes of pre-dispute arbitration agreements be redrafted as a separate statute rather than an amendment to Chapter One of the FAA. If the FNHAA were to be enacted as an amendment to Chapter One of the FAA, it is likely that other protected class arbitration legislation would follow suit, increasing its potential to impair all forms of commercial arbitration. Additionally, we are concerned that the legislative findings which preface the Arbitration Bill could undermine the rationale and deference accorded to arbitration generally and arguably call into question for all arbitrations the underpinning of established judicial precedents.
4. *See, e.g.*, American Arbitration Association International Dispute Resolution Procedures, Article 15; International Chamber of Commerce for the International Court of Arbitration, Rules of Arbitration, Article 6, Section 4; Arbitration Rules of the World Intellectual Property Organization, Article 36; Arbitration Rules of the London Court of International Arbitration, Article 23.1; Swiss Rules of International Arbitration, Article 21; Arbitration Rules of the Singapore International Arbitration Centre, Article 25.1; Arbitration Rules of the Dubai International Arbitration Centre, Article 6.1; Arbitration Rules of the Hong Kong International Arbitration Centre, Article 20.
5. *See, e.g.*, arbitration provisions relating to motor vehicle franchises at 15 U.S.C. § 1226; poultry growers at 7 U.S.C. § 197c and credit extension to members of the armed service at 10 U.S.C. § 987.

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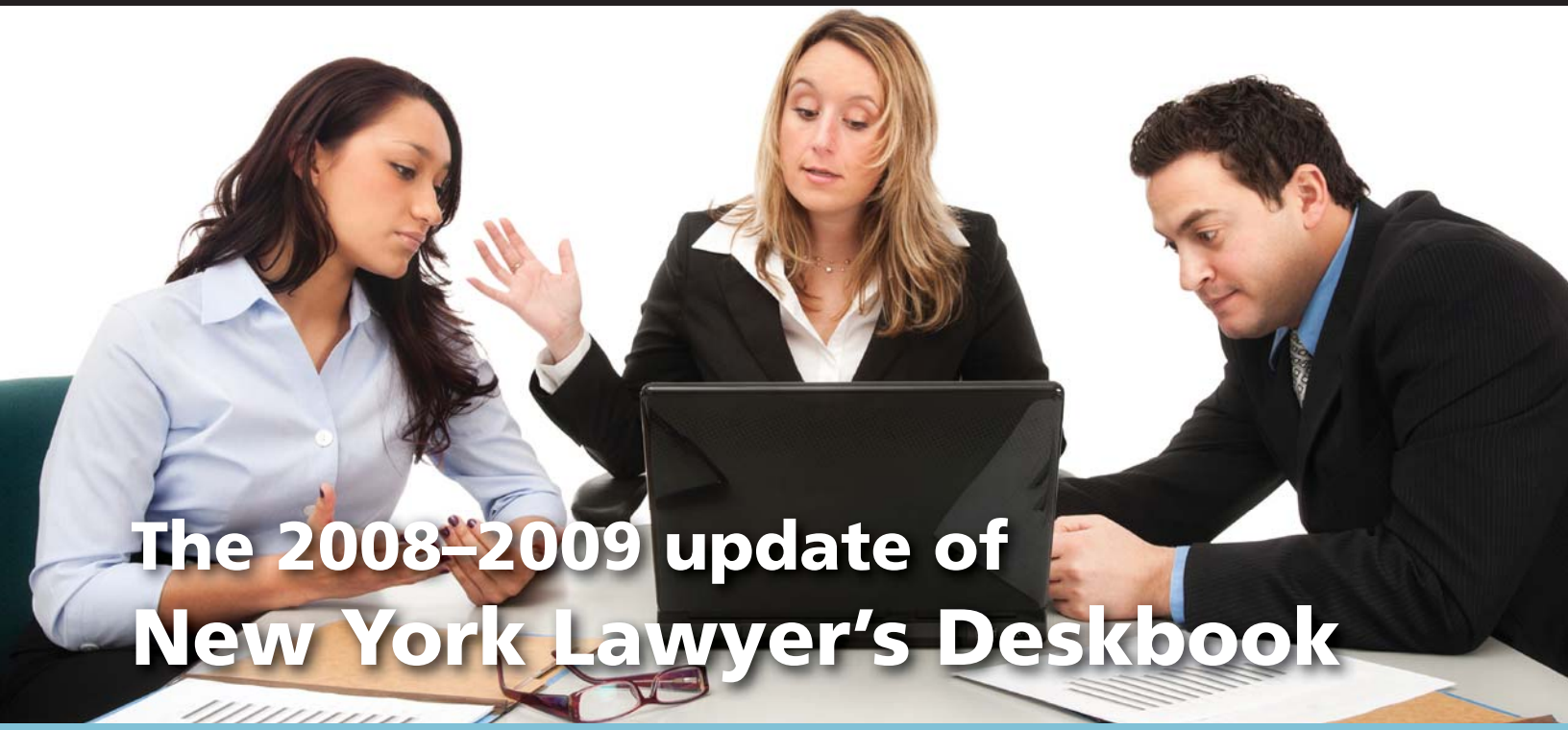

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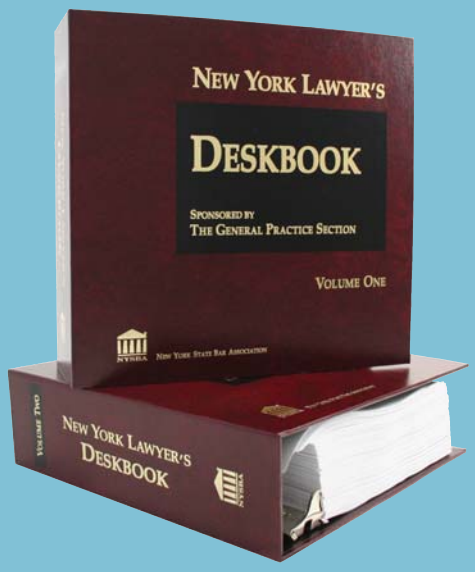

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