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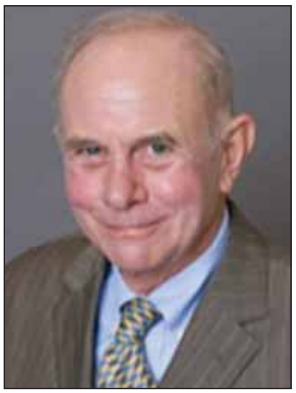
Message from the Chair


John Wilkinson

As I reflect on the first six years of the Dispute Resolution Section's existence, the words that come immediately to mind are energy, commitment, persistence and competence, as well as a wonderful collegiality which has led to a great working environment and an amazing ability to get things done. All of this has resulted in wonderful, measurable accomplishments such as:

- Our significant collaboration in the successful formation of the New York International Arbitration Center, which will be instrumental in attracting arbitrations to New York from around the world.
- The *Guidelines for the Efficient Conduct of the Pre-Hearing Phase of Domestic Commercial Arbitrations and International Arbitrations*. The Guidelines were adopted by the NYSBA's House of Delegates and represent a major step forward in the effort to blunt the criticism that arbitration is becoming too much like litigation.
- The wonderful, eye-catching brochure on *Why Choose New York for International Arbitration?*
- The Section's Recommendations for the Adoption of Court-Annexed Mediation Throughout the Courts of New York State. If implemented, the Recommendations will greatly reduce court congestion, as well as litigation costs of the parties, while leading to mutually satisfactory results.
- Our push to expand the inclusion of ADR in law school courses, which could only result in expanded future use of arbitration and mediation.
- The ADR Resource Guide, which is on the NYSBA website and which contains an exhaustive listing of the arbitration and mediation resources which are available in New York State.
- The successful opposition to bills in the New York Legislature which would have been significantly adverse to the interests of the ADR community.
- The immense strides in diversity of Section membership, and Section leadership, as well as diversity of participants in Section-sponsored programs.
- The well received, multi-day arbitration and mediation training programs which the Section offers each year and which are invariably "sold out."
- The excitement generated by the New Lawyers and Law Students Committee, which puts on a jam-packed reception for young lawyers each year and is currently organizing a unique mock arbitration competition which will involve participation of every law school in New York State.

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Message from the Co-Editors-in-Chief


Edna Sussman


Sherman Kahn


Laura A. Kaster

As we begin Volume 7 of *New York Dispute Resolution Lawyer*, we can reflect on six years of articles at the leading edge of the dispute resolution field. And the field is a diverse one indeed; ranging from arbitration to mediation to ombudsmen and collaborative law and negotiated resolution of disputes in both domestic and international matters. *New York Dispute Resolution Lawyer* has sought to reflect the diversity of dispute resolution with a wide array of perspectives from practitioners of many disciplines. This issue is no exception and we hope that you will find an item of interest no matter what your background may be, whether advocate or neutral in the dispute resolution field.

We are also at an exciting moment for dispute resolution practice in New York. The Dispute Resolution Section has been instrumental in getting The New York International Arbitration Center up and running, providing a world class facility to hold arbitrations in New York and a forum for educating the world dispute resolution community about New York's attractions as an arbitration forum. This is also a significant contribution to the New York economic and legal community. In addition, the International Chamber of Commerce has begun administering arbitrations in New York, making New York a true center for ICC arbitration. The ICC's new facility adds further depth to New York's already deep bench of providers administering arbitrations, with the AAA, JAMS and CPR already a strong presence here.

We encourage all of our readers to give their attention to the message from our distinguished chair John Wilkinson. In this message, John not only presents the extraordinary accomplishments of the Section over the last six years, but also provides a convincing argument for the continued use of arbitration and mediation as a better alternative to litigation for resolution of all manner of disputes

Dispute Resolution Section News

In this issue we report on the Dispute Resolution Section's Annual Meeting program. We also announce a new subcommittee of the mediation committee dedicated to the mediation of issues concerning trusts, estates, guardianship and the elderly.

Ethics

Our columnist Elayne Greenberg, Professor at St. John's University School of Law, submits another provocative examination of ethical issues raised by dispute resolution practice. In this issue, Professor Greenberg addresses how the "cheater's high," the term coined by behavioral ethics researchers to describe the positive feeling we experience when we cheat, affects our behavior when we negotiate. She seeks in the column to heighten the reader's awareness of his or her internal ethical lines and what happens when negotiators near the edge of an ethical line.

Arbitration

This issue contains a particularly rich selection of writing regarding arbitration. Ignatius Grande and Joseph Lee write about the persistent problem of decreasing e-discovery costs in arbitration. Eric Tuchman submits an explanation of the changes the AAA has recently made to its Commercial Arbitration Rules. Steven Reisberg submits an article outlining the differences between arbitration and expert evaluation, a little-known alternative to arbitration used particularly for purchase price adjustments and valuation of assets. David Hobbs, a valuation expert, and Chris Thorpe then provide extremely helpful background regarding the criteria used to value a business in arbitration. Lea Haber Kuck and Greg Litt give us an update on the incredibly fast-moving legal landscape at the intersection of arbitration and class actions. Gerald Levine provides an introduction to the arbitration of domain names under the auspices of the Uniform Domain-Name Dispute-Resolution Policy (UDRP), a very important and very busy area of arbitration many practitioners know nothing about. Finally, Ross Kartez provides an update regarding the *BG Group PLC v. Republic of Argentina* case currently pending at the United States Supreme Court.

Mediation

Claudia Winkler, currently working with the New York International Arbitration Center, provides a provocative article about how mediators can use "framing" as a negotiation tool to obtain better results for the parties. Simeon Baum and Daniel Kolb write about thorny ethical issues that arise in mediation when a mediator's duty to maintain confidences collides with principles of party autonomy and informed consent.

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- The Section's wonderful publications, most notably *New York Dispute Resolution Lawyer*, which is well worth the immense effort that goes into it, if measured by the wide and enthusiastic acclaim which the publication has received.
- The wonderful and well-received day-long programs at the Section's Fall and Annual Meetings, which have invariably featured cutting-edge topics that are addressed by the real leaders in the profession.

The foregoing are just some of many examples of what has led to our reputation throughout the NYSBA as the Section that really gets things done.

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As I think back on the numerous contributions our Section has made to the ADR movement over the past several years, I pause to consider whether our efforts are in furtherance of something that is really important. While there are certainly detractors of ADR who would loudly say "no," the fact is that many of the detractors have an economic interest in not having disputes resolved efficiently, promptly and cost-effectively. Since these detractors are quick to advance every conceivable criticism (and then some) against ADR, let me take a moment to focus on some of the benefits of arbitration and mediation which are important and measurable.

Arbitration

In most cases, arbitration is a faster, more cost-effective means of resolving disputes than is litigation. For example, the largest arbitration providers report that the average time from commencement of a domestic, commercial arbitration to issuance of a final award is in the range of 7 to 7.3 months. In contrast, the median length of time from filing through trial in civil cases in U.S. District Courts in 2011 was 23.4 months and a good bit longer than that for some of the busier courts.[1]

But speed and cost-effectiveness are not the only benefits of arbitration. Arbitrating parties, for example, can design their own dispute resolution process to meet their particular needs; they can pick their own arbitrators with expertise in the subject matter of the dispute; they can determine the nature and scope of discovery and in most instances, can expect far less but nonetheless more meaningful discovery than they would typically encounter in court; they are part of a flexible process that can be adjusted to meet their needs as the case progresses; they can expect a private hearing with limited attendees, and they can provide for complete confidentiality as long as the proceeding stays in the arbitration forum; they can expect a final result that is only appealable on very limited grounds or, if they wish, they can provide for a more exhaustive (but still highly efficient) appeal to another panel of arbitrators; and despite all the contrary exhortations of arbitration's critics, studies convincingly show that arbitrators do not simply split the baby but, rather, reason their way to a result which they think is right and include that result in their award. Speaking personally, I have served as an arbitrator in many hundreds of cases over many years and have never once seen the baby "split" in the fashion stated by many arbitration critics.

While international arbitration is very different from domestic, it shares all of the benefits enumerated above. In addition, international arbitration is subject to the New York Convention, to which 140 nations are parties. This Convention provides for the effective enforcement of international arbitration agreements and awards across borders. In contrast, judgments of national courts are far more difficult, and often impossible, to enforce in other countries.

* * * *

Is the foregoing meant to suggest that arbitration is perfect? No. Have there been isolated instances when a substandard arbitrator has permitted discovery to run amok or has admitted mountains of irrelevant or redundant evidence to a point where the arbitration is just as expensive as litigation? Yes. A few comments on this, however:

1. Instances such as these are far, far fewer than they were just a few years ago. One reason for this is that the American Arbitration Association has aggressively implemented its "muscular arbitrator" initiative and has recently amended its rules to make arbitration much faster and more cost-effective. Other arbitration providers have also been active in recent years with regard to significant improvements in the arbitration process.
2. As previously stated, the NYSBA has adopted this Section's *Guidelines for the Efficient Conduct of the Pre-Hearing Phase of Domestic Commercial Arbitrations and International Arbitrations*. These Guidelines are oft-cited and have proven a rallying point for arbitrators and parties who want to keep the arbitration process under control, while at the same time affording enough discovery and hearing time to permit a fair result.[2]
3. Today, out of control arbitration is an outlier and is generally the result of a mutual desire of the parties to conduct the arbitration in accordance with the norms of court litigation. Ironically, parties and counsel who jointly make such a choice are often the most vociferous critics of arbitration when their self-chosen process results in years of unnecessary discovery and hearing time.

4. I would urge general counsel who have had a bad experience with arbitration to try again. My guess is that such general counsel have had at least as many runaway litigations overseen by substandard judges as poorly conducted arbitrations. In any event, the caliber of the arbitrator panels of the major providers has been substantially upgraded over the last five years, and I really believe that general counsel who have been disillusioned by one or two inefficient arbitrations should try it again because I truly think they will be very pleasantly surprised.

Mediation

In a very different sense, mediation is at least as beneficial to disputing parties as arbitration. Thus, for example:

- Mediation avoids the uncertainty of trial and often averts the possibility of a devastatingly adverse verdict that could literally wipe out one's business.
- Mediation often permits resolution at an early stage before serious time and money are spent on the dispute.
- Mediation permits, indeed encourages, parties to forge creative solutions and to preserve existing (and profitable) relationships to an extent which would have been impossible in court.
- Mediation can dispense with the emotional burden of living through a hotly contested trial, which can be highly taxing on one's psyche and, in addition, it averts the loss of time and money that might have been far better spent in furtherance of one's business.
- Mediation provides parties with an opportunity to be heard and often leaves them with the feeling that they have had their day in court and that it is time to put the dispute behind them.
- Mediation is conducted in private, with the mediator being bound to confidentiality and with the parties typically entering an agreement to preserve confidentiality among themselves.
- The caliber of the mediators on the panels of the major arbitration providers is uniformly high. This is important since the mediator's role in the process is vital. As is stated in this Section's *Recommendations for the Adoption of Court-Annexed Mediation Throughout the Courts of New York State (Civil):*

> An experienced mediator can serve as a sounding board, help identify and frame the relevant issues, help the parties make an objective risk/reward and cost/benefit analysis between settling their dispute or proceeding to trial, foster creative solutions not previously considered by the parties that may reach beyond the scope of the remedies available in court. The mediator can also provide the patience and persistence that is often necessary to help parties reach resolution.
>
> Mediators can help parties communicate constructively and overcome hostilities that may interfere with making a rational assessment of settlement compared to the costs and uncertainties of trial. Mediators can also serve as unbiased "agents of reality" who help the parties objectively address their litigation alternatives. Attorney advocates may have advocacy bias, whereby they tend to believe in and overvalue the strength of their client's case. A mediator without any stake in the outcome can be effective in helping the parties be realistic as to the likely outcome at trial.
>
> By meeting privately in confidential sessions with each party and counsel, participants can speak with total candor. The mediator can help the parties ascertain their real interests and concerns and objectively assess the weaknesses as well as the strengths of their case. This process typically leads to a mutually agreeable settlement.

* * * *

In sum, there is good reason for satisfaction and excitement throughout the Dispute Resolution Section. First, the Section has many exceptional, trend-setting accomplishments of which it can be very proud. And second, the sphere within which the Section operates (the entire field of ADR) is vitally important in so many different ways. So when we view the totality of the Section's activities, we see highly significant accomplishments in a field of vital importance—that's a pretty good formula for the high success of our Section.

Endnotes

1. Many of the facts and thoughts herein concerning arbitration are taken from a publication of the ABA's Section of Dispute Resolution titled *Benefits of Arbitration for Commercial Disputes.*
2. The College of Commercial Arbitrators' Protocols for Expeditious, Cost-Effective Commercial Arbitration have also made a significant contribution to the recent focus and emphasis on efficiency and cost-effectiveness in arbitration.

John Wilkinson

New Subcommittee of Mediation Committee

A new subcommittee of our Section has been formed, the Subcommittee on Trusts, Estates, Guardianship and the Elderly. The first meeting was held on September 25, 2013 with over 35 in attendance in person plus 13 on the phone. Its second meeting was December16, 2013.

The meetings were interactive and quite exciting. Each of the areas we cover interrelate and interact; mediation is not sufficiently utilized in any of these fields. The disputes we hope to address generally relate to interpersonal differences that involve a great deal of emotions, and often a long family history that overclouds the immediate disputes and legal issues. Mediation appears to be a natural for such disputes.

The subcommittee intends to collect and circulate copies of various pre-dispute agreements to mediate for wills, trusts, guardianship, and agreements relating to the elderly, and copies of statutes from other states that include mediation. We will circulate these to the group after we have vetted them as model provisions. In addition, we will undertake the related effort of expanding and facilitating the use of mediation in these areas.

The subcommittee encourages anyone interested in these topics to join us in this important work.

Reports from the 2014 Dispute Resolution Section Annual Meeting Program

Panel I: Has Success Changed Mediation? How Has—or Might—the Growth and Institutionalization of Mediation Changed the Culture, Opportunities, Strategies, and Practices of Mediators, Counsel and Parties?

(Recorded by Richard A. Berrios)

Program Co-Chair Simeon H. Baum, Esq., mediator and arbitrator with Resolve Mediation Services, acted as moderator for this panel composed of Robert B. Davidson, Esq., mediator and arbitrator with JAMS; Professor Lela P. Love, Director of the Kukin Program for Conflict Resolution at Benjamin N. Cardozo School of Law; Rebecca T. Price, Esq., Mediation Supervisor for the United States District Court for the Southern District of New York; and Margaret L. Shaw, Esq., mediator and arbitrator with JAMS, and founder of ADR Associates which merged with JAMS in 2004.

Mr. Baum provided a brief introduction: When explaining mediation's success over the last twenty years, he credited the utility of mediation as a process that "does good on an individualized level," that offers clients opportunities and remedies not found in the usual adversarial processes, and offers a certain overall freedom for those involved. He asked the panelists whether they thought the novelty of mediation which was so elemental in its success in the past is still an integral part of its success today. Each panelist agreed that the institutionalization of mediation has changed mediation's parameters and thus the opportunities for its success. Mr. Baum asked the panel whether there are any recent changes or differences in the mediation process that could have an impact on mediation's future success.

Joint Sessions. Ms. Shaw noted differences in the pre-mediation process, changes in how parties value mediation, and changes in mediators themselves. She stated that in her practice, joint sessions at the opening of a mediation have become less popular and many parties have opted not to use them. Ms. Shaw stressed that the joint session is one of the most effective tools in mediation, yet noted that the parties' freedom to choose their own process is also important. Ms. Shaw suggested that to remedy this conflict, mediators should be more assertive in educating the parties. A more assertive mediator could explain to the parties why a joint session could be valuable to resolving their conflict.

Emerging Trends. The panel discussed a recent trend towards parties prematurely moving straight to discussion on deal making and hard numbers, causing them to lose out on creative discussions and other solutions unique to mediation. They also touched on some trends that could affect the success of mediation, including repeat players who hide the proverbial ball from the mediator and jaded mediators who do no more than carry numbers back and forth. Both threaten the effectiveness of the mediation process and could taint the overall mediation experience.

Collaborative vs. Adversarial Mediation. Professor Love suggested that jaded mediators and repeat players with ulterior motives are products of the adversarial / positional model of dispute resolution , and that such issues are better addressed through education and a move towards the interest-based model of mediation. Professor Love also expounded upon Ms. Shaw's point regarding joint sessions. She recounted a story about her husband who had a "nightmare" of a mediation experience. The parties in dispute were an employer and an employee who agreed to mediate. Under the circumstances, a simple joint session could have been quite productive. Professor Love's husband had an idea of what mediation

was supposed to look like, and was quite excited about participating in a collaborative process. However, in the actual mediation, the parties were kept separate for the entire process, the lawyers essentially excluded their clients, and the mediator hopelessly shuttled from one side to the other. A joint session might have been very useful. Professor Love pointed out that some jurisdictions, like California, have taken steps to discourage joint sessions in mediation. Her takeaway point was that in order to keep the mediation wheel turning, we must place that wheel on a collaborative axle.

Pre-Mediation Preparation. Mr. Davidson followed up from the perspective of a mediator who deals primarily with complex commercial disputes. He has noticed a change in the preparation and sophistication of parties, which has put pressure on mediators to be just as prepared. The mediator now must spend more time reviewing relevant materials and in pre-mediation conferences to plan how to tailor the process to the specific dispute. A lack of such preparation could result in a premature and ineffective mediation. Mr. Davidson opined that many complex commercial disputes are mediated at too early a stage. He noted that it is the job of the mediator to be assertive in guiding the process between such sophisticated parties, lest the mediator be labeled a pushover.

Mediator Proposals. Mr. Davidson also explained how mediator proposals can play an important role in settling complex disputes. However, even though a mediator's proposal is only a suggestion, Mr. Davidson cautioned against repeatedly providing mediator proposals to repeat players, as such proposals become expected and interfere with the collaborative efforts of the parties. Mr. Davidson posited that in complex commercial disputes with repeat players, mediator proposals should be provided only as a last ditch effort to help the parties settle their dispute.

Court-ordered Mediation. Ms. Price's response to the "pushover mediator" and the need for a more assertive neutral was an expression of hope. She noted that in the Southern District of New York, the Court sends parties to mediation, and gives the mediators more autonomy to shape the process. Working with fewer repeat players and more parties experiencing mediation for the first time, Ms. Price urged mediators to seize opportunities to educate parties, guide them through their decision-making process, and to create the type of experience that mediators will want parties to talk about.

Early Stage Mediation. A member of the audience questioned whether mediation has become a victim of its own success, based on the theory that a large part of what made mediation successful was that it was most useful in late-stage disputes. He suggested that success became problematic when mediation tried to adapt itself to early stage disputes, when parties are not ready to settle and instead have the incentive to use the process as a less expensive discovery tool and a means to test the merits of their case. Professor Love responded that mediation need not be a victim of its own success and that early stage mediations can be successful as long as mediators thoroughly work through the dispute with the parties and tailor the process to the early stage of the dispute. Love believes that the earlier the mediation process is initiated, the more chance there is for eventual success. Mr. Davidson stated that early stage mediations are still an opportunity for a five-way conversation. To have that conversation, early-stage mediations have to be managed effectively. When asked about party self-determination and the limits of mediator assertiveness, the panel balanced the two by emphasizing the role of mediators as professional coaches and educators to the parties. While self-determination trumps, the panel stressed that any choice by the parties should be an educated one.

In-house Counsel as Party Representative. Another question posed to the panel was from the perspective of in-house counsel: whether it is advisable for in-house counsel to represent their client at mediation. While the panel did not declare an outright prohibition, they raised the issues of settlement authority and the collaborative process as big concerns. Mr. Davidson said that in his practice in-house attorneys representing their clients at mediation is a somewhat common phenomenon, but tends to take away from the essential five-way conversation of mediation. Davidson recommended bringing point people with full authority to settle, and allocating lawyer-client roles accordingly. Ms. Shaw also recommended bringing point people with settlement authority. She acknowledged that officers of corporations and other sophisticated clientele might be busier and unavailable to be present at mediation, but she reminded the audience that technology has kept pace, and referred to successful mediation sessions where busy clients participated via videoconference using technologies like Skype.

Maintaining Ethical Practices. Another question that was posed to the panel was whether a mediator's push for market share can affect best practices. Professor Love reminded the room that ethics and professional responsibility play a significant role in best practices for mediators. Of course, she admitted, there will be those who compromise professionalism to make a "quick buck," but if the market demands it, the profession can and should find an ethical way to utilize best practices which will result in the end in increasing everyone's market share.

Summary of Program II: Report from the Trenches; Making It Work—How Experienced Arbitrators Resolve Challenging Issues as to Discovery, Motion Practice, Adjournments, Sanctions, Hearings, and Awards—and What Counsel and Parties Can Do To Foster a Successful Process

(Recorded by Nahid Noori)

The Program Chair was Charles J. Moxley, Esq. of MoxleyADR LLC, arbitrator, mediator, and litigator, and

the panelists included Lea Haber Kuck, Esq. of Skadden Arps Slate, Meagher & Flom LLP, counsel for arbitration and litigation of complex disputes arising out of international business transactions; Edna Sussman, Esq. of SussmanADR, arbitrator and mediator and the Distinguished ADR Practitioner in Residence at the Fordham School of Law; Jeffrey T. Zaino, Esq. the Vice President of the Commercial Division of the American Arbitration Association in New York; Deborah Masucci, Esq. of the AIG Employee Relations Department and manager of its employee dispute resolution program, and John H. Wilkinson, Esq. of John Wilkinson Law, arbitrator and mediator.

The discussion largely revolved around how to make arbitration faster and more economical without sacrificing fairness and due process. Mr. Moxley kicked off the discussion by asking how such a process should be designed and actualized. He noted that in a broad sense, there is no real answer to this question because in practice arbitrators reconfigure the arbitration process to meet the respective parties' needs.

The Relationship Between Arbitration and Mediation. A general consensus among the panel was that mediation was a terribly underutilized tool, particularly with regard to cases pending in the Southern District of New York. Jeff Zaino posited that the AAA had recently introduced significant changes in the AAA's Commercial Arbitration rules to address such issues. The revised Rules provide arbitrators with additional tools and authority to effectively manage the arbitration process. One such example is the new Commercial Arbitration Rule 9, which provides:

> In all cases where a claim or counterclaim exceeds $75,000, upon the AAA's administration of the arbitration or at any time while the arbitration is pending, the parties shall mediate their dispute pursuant to the applicable provisions of the AAA's Commercial Mediation Procedures, or as otherwise agreed by the parties. Absent an agreement of the parties to the contrary, the mediation shall take place concurrently with the arbitration and shall not serve to delay the arbitration proceedings. However, any party to an arbitration may unilaterally opt out of this rule upon notification to the AAA and the other parties to the arbitration. The parties shall confirm the completion of any mediation or any decision to opt out of this rule to the AAA. Unless agreed to by all parties and the mediator, the mediator shall not be appointed as an arbitrator to the case.

This new rule is intended to provide additional impetus for and facilitate mediation, which will take place concurrently with the arbitration, so as not to delay the proceedings.

Drafting of Arbitration Clauses. Many of the panelists noted that because transactional attorneys (and not arbitration experts) are too often the point persons on the drafting of arbitration clauses in agreements, opportunities for drafting more efficient and effective arbitration clauses are often missed. Generic arbitration clauses, or a clause adapted from another agreement, can be unwieldy and unsuited to the parties and their potential disputes. A new mechanism that AAA has created to address this issue is the AAA's "clause builder tool," available on the AAA website. The tool, which is free, takes the user through various online prompts for those elements the AAA deems important to include in the arbitration clause. After the user goes through various sections inquiring about relevant information, the tool provides a brief explanation of why the inclusion of certain language is recommended. Effective arbitration clause drafting allows the parties to start out with a more efficient process that is more closely suited to the parties' needs. However, Lea Haber Kuck noted that although model clauses and clause building tools can be helpful tools in time pressed situations, they are not an adequate substitute for the advice of experienced arbitration counsel.

Deborah Masucci noted that many corporations hardly ever want to be in court, thus have an affinity towards arbitration, and how an arbitration clause is drafted depends greatly on the business, its culture, and a particular business' needs. Ms. Masucci noted that the arbitration clause is a grand opportunity to set a "roadmap" for the case.

The Preliminary Hearing. In the past, preliminary hearings were usually a thirty-minute or less phone call, but now they hearings can go on for hours. As a result, many attorneys are reluctant to include their clients, although many arbitrators prefer that clients be included at this particular stage.. Preliminary hearings can also serve to forecast potentially problematic issues. Mr. Zaino noted that another change made to the AAA Commercial Arbitration Rules was to streamline the preliminary hearing, because structured and organized preliminary hearings make for a more efficient arbitration. Paragraph (a) of the new Preliminary Hearing Rule 21 provides that

> At the discretion of the arbitrator, and depending on the size and complexity of the arbitration, a preliminary hearing should be scheduled as soon as practicable after the arbitrator has been appointed. The parties should be invited to attend the preliminary hearing along with their representatives. The preliminary hearing may be conducted in person or by telephone.

The new AAA Rules also include a Preliminary Hearing Procedures checklist (Rule P-2) consisting of 19 items that, depending on the size, subject matter, and complexity of the dispute and subject to the discretion of the arbitrator, may be addressed during the preliminary hearing. Furthermore, the new rules provide that the arbitrator shall issue a written order memorializing decisions made or agreements reached during the preliminary hearing.

Discovery. Discovery is another challenge to many arbitrators (and the efficiency of arbitration) as it can easily become an exhaustive and seemingly endless accumulation of information, which is both costly and time consuming. Mr. Moxley began the discussion on discovery with the appropriate use of depositions. Depositions were traditionally not a feature of the arbitration process, but for more complex cases they can be useful and have become more prevalent. Mr. Wilkinson noted that one of the reasons for this is that many attorneys are simply not comfortable conducting cross-examinations without depositions. The upside of having depositions (as pointed out by Mrs. Masucci) is that they result in more limited interrogatories. Furthermore, the parties hardly ever wish to be surprised and want to have the opportunity to assess the credibility of the witness before the attorneys do.

E-Discovery. The panelists pointed out that up to 90% of the cost of arbitration can be for discovery. There was a query as to whether the arbitrator should bring up e-discovery? Edna Sussman suggested that it be brought up during the preliminary hearing. The arbitrator should set time parameters, and then make sure that the parties are communicating on the process of discovery. Clarity at the outset is crucial. If there is to be e-discovery, it should be established how the searches will be conducted, whether internally or externally, and what search terms will be used.

E-Discovery can be a huge problem—no matter how carefully it is done, something can always go wrong. Unfortunately its use is sometimes unavoidable given how pervasive our use of technology is with regard to the storage and preservation of data. It has become at times almost a necessary evil. Most counsel welcome arbitrators who are open to the process of e-discovery. One way to combat the high cost of e-discovery is to require attorneys come back to the table with estimates of costs proportional to the value of the case.

Arbitration Subpoenas. The use of non-party subpoenas is now one of the most frequent areas of disagreement among parties to arbitration. (*See* article, "Non-Party Subpoenas" on page 225 of the DR Annual Meeting Coursebook.) The law of non-party subpoenas is extremely complex and unsettled. One issue, therefore, is when it is appropriate for arbitrators to sign particular subpoenas directed to non-parties. This is difficult because the law varies from jurisdiction to jurisdiction and often multiple jurisdictions are involved. As a best practice, arbitrators should try to facilitate the use of limited subpoenas that are appropriate to the scope of discovery in a particular arbitration.

Witness Statements. Providing copies of witness statements relatively early on in the arbitration could be helpful in making the process more efficient, especially in absence of depositions.

Dispositive Motions. Depending on the circumstances, dispositive motions can increase efficiency and streamline the process of arbitration. AAA Commercial Rule 33 provides:

> The arbitrator may allow the filing of and make rulings upon a dispositive motion only if the arbitrator determines that the moving party has shown that the motion is likely to succeed and dispose of or narrow the issues in the case.

The arbitrator can thus require that prior to making a dispositive motion, a party must seek leave to do so from the arbitrator, showing both that the motion will be effective in disposing of or narrowing issues and also that it is likely to succeed.

Adjournments. Arbitrators need to be careful about denying adjournments to avoid award challenges. If an adjournment is not allowed, the reasons for such should be explicitly set forth in the award.

Sanctions. There can be a problem with ordering sanctions as there is a split in the applicable caselaw about whether or not an arbitrator is authorized to award them. The new AAA Commercial Rule 58 explicitly authorized sanctions under certain circumstances.

Program III: Making the Hard Calls: How Experienced Neutrals and Counsel Resolve Difficult Ethical Issues

(Recorded by Taier Perlman)

This panel focused on some of the nuanced ethical issues faced by mediators and arbitrators. The moderator, Daniel F. Kolb of Davis Polk & Wardwell, began the discussion by stating that the ethical principles of impartiality, informed consent and confidentiality among others, are at the heart of the practice of ADR, not secondary issues as some would believe. In addition, biases and the business interests of the mediator or arbitrator may impact the process and conflict with these ethical principles.

Conflicts of Interest. Retired Judge Barry A. Cozier, presently counsel at LeClair Ryan, discussed how the issue of conflicts is critical for an arbitrator. Conflicts of interest, he explained, are related to the broader issue of

disclosure. If a conflict is not properly disclosed it could lead to a vacated arbitration award. Judge Cozier stressed the importance of disclosing the conflict, a requirement memorialized in the ethics codes of JAMS and AAA among others. The difficulty with the disclosure requirement, according to Mr. Cozier, is how to translate it into practical terms and what the scope of the disclosure should be. He summarized an instructive Second Circuit case in which appellants attacked an arbitration award favorable to respondents based on evident partiality of the arbitrator who failed to disclose that partners in his firm were currently advising the respondents. The court held that while the lead arbitrator was careless for not investigating and disclosing this conflict, it was too trivial to overturn the award. Cozier noted that it is still unclear whether an arbitrator has an affirmative duty to investigate conflicts during the pendency of the arbitration, and if such an affirmative duty exists how far does it go?

Can All Conflicts Be Waived? The discussion then moved on to the topic of whether and how an arbitrator should disclose being solicited for employment by one or both of the parties in the course of the arbitration. Model Rule ("MR") of Professional Conduct 1.12 was noted, but the language does not mention an arbitrator. Abigail J. Pessen of Abigail Pessen Dispute Resolution Services explained that Cannon 1 for arbitrators encapsulates the same principle of MR 1.12. She does not believe that even getting permission from the parties for being solicited for employment would be acceptable because it creates a clear conflict. Ms. Pessen noted the relevant California rule on this subject, under which the arbitrator would have to disclose that he or she is considering accepting an offer of employment from one of the parties. If, however, the arbitrator does not make that disclosure from the outset, then he or she is prohibited from entertaining an offer for such employment. If an arbitrator does not comply with this proscription, his or her issued award risks being vacated.

Business Pressures on Neutrals. Krista Gottlieb of the ADR Center and Law Office of Krista Gottlieb in Buffalo, NY added that the prospect of potential employment question shows the business pressure that comes to bear on neutrals. In the context of mediation, Ms. Gottlieb advised that the best thing to do would be to disclose any relevant business interest as quickly as possible. For a mediator, it is imperative that they be impartial, free of favoritism, bias conflict of interest and pre-existing relationships with any of the parties at the mediation table. If any of those things even arguably exist it is crucial they be disclosed for the integrity of the process. Ms. Gottlieb noted that this issue becomes trickier when only one of the parties is paying the mediator. There is a genuine unbalance created when that happens and it endangers neutrality, especially if the paying party (such as an employer) repeatedly pays for the same mediator in other disputes.

Who Is Paying? Kathleen M. Scanlon of the Law Offices of Kathleen M. Scanlon, PLLC, expanded on the subject of who is actually paying the neutral. She noted that even third party funding can affect the biases of the arbitrator, because those third party funders can still be connected to the parties or arbitrators. Ms. Scanlon stated that the various codes of ethics may give an arbitrator different answers on whether something can lead to actual or perceived bias or partiality. She noted that third-party funding of arbitrations is an area where real business pressures come out, and invited audience members to share their experiences.

Identifying Game-changing Issues? Mr. Kolb then moved the discussion to ethical issues in mediation. Ms. Gottlieb contrasted the vision of the mediator as a potted plant versus the mediator as an illuminator. She posed a few difficult rhetorical questions: if neither one of the parties has identified a critical (and even possibly determinative) issue in the conflict, should the mediator identify it for them? Would identifying the issue affect the mediator's impartiality? How does that affect the value of party self-determination? If something favors one party over the other, should it be brought up? Or would that just detract from the progress of the mediation?

Tension Between Various Ethical Obligations. Ms. Scanlon noted that there is a very real tension in the ethical rules between the ethical obligations of a lawyer, a mediator, and an arbitrator, and that most states have not addressed this tension in their model rules. A lawyer's duty to disclose may conflict with a mediator's duty of impartiality. Ms. Scanlon noted that Florida, South Carolina and Tennessee address this issue in their respective Mediator Codes, and that Georgia, Washington, and North Carolina have fiddled with their model rules to address that tension for lawyers.

Arbitration is Different. Ms. Pessen explained that in an arbitration context, this issue is not that relevant because the concept of self-determination, so integral to mediation, is not at issue. Since arbitrations provide a top-down decision, an arbitrator's ethical duty is to conduct a fair process. Mr. Cozier added to this sentiment by explaining that in arbitration, the arbitrator's function is adjudicative, which is different from the function of a mediator. An arbitrator is determining facts and law, and at various junctions can ask the parties for submissions or direct their attention to issues.

Court-appointed Mediators and Arbitrators. The panel discussion ended with questions from the audience. An audience member asked if the rules are different when the mediator or arbitrator is appointed by the court. Mr. Cozier answered that there would be no difference in duty for the arbitrator or mediator to professionally and ethically work with the parties. Ms. Gottlieb added that the obligations would be the same as long as there was no special direction given from the court.

Program IV: The Inner Game: How Awareness of Their Inner Landscape Helps Mediators and Negotiators Develop Greater Freedom, Clarity, Insight and Empathy in Their Personal and Professional Lives

(Recorded by Taier Perlman)

Who would have thought that the NYSBA Dispute Resolution Section's Annual Meeting would include a group meditation session splendidly orchestrated by Rachel A. Wohl, the Executive Director of the Maryland Mediation & Conflict Resolution Office?

The program started with a Tao Te Ching poem read by Simeon Baum:

- Act without doing;
- Work without effort.
- Think of the small as large
- And the few as many
- Confront the difficult
- While it is still easy;
- Accomplish the big
- By a series of small acts.
- The master never reaches for the great;
- Thus she achieves greatness.
- When she runs into difficulty,
- She stops and gives herself to it.
- She doesn't cling to her own comfort;
- Thus problems are not problems for her.

Ms. Wohl took over and discussed several ills common to the legal profession. The rate of lawyer suicides was the fourth highest rate of all professions; lawyers are 3.6 times more likely to be depressed than non-lawyers; there is a very high rate of burn-out from the practice itself. This profession, Ms. Wohl declared, really needs Mindfulness.

Mindfulness, explained Ms. Wohl, is paying focused non-judgmental attention in the moment. She addressed some of the misconceptions about meditation—that it is not about having no thoughts and having your mind go blank.

She noted that there is lots of mind clutter all the time, and in mindfulness meditation we learn how to make a subtle shift from being inside our thoughts to observing our thoughts. We are not our minds and we have access to much deeper awareness than the chatter in our minds.

Ms. Wohl noted that mindfulness is very simple; it just takes practice. One tool is breathing, focusing on anchoring in the present moment through our breath. She then explained that we must witness our consciousness, not be active in it. She then led the audience through a breathing exercise and a brief group meditation.

Mindfulness practice, noted Ms. Wohl, helps us to remain calm and to act responsively, not reactively. This calm translates into our general presence and affects our reception in virtually any setting. For a mediator, Ms. Wohl explained, being calm has a huge effect on the disputing parties in the room. To bring peace to the table, you must be at peace. Being calm, respectful, and non-judgmental is an important quality that mediators have to bring to the table. Mindfulness practice allows a person to learn the patterns of one's thoughts, and then to gain freedom from them. The thoughts do not stop happening, but we gain freedom from their control.

She noted that "In that space of noticing the thinking, inside that space, is where we become responsive and skillful. We can check in with ourselves and see where our mind is. Are we judging, are we being harsh on ourselves? Meditation requires self-compassion, being gentle with ourselves."

In concluding, Ms. Wohl noted that lawyers are type-A, always hard on themselves, and fail to exercise self-compassion in their lives. But it is integral for lawyers to have self-compassion and to take the time to just "be in the present moment." Mindfulness practice is a self-care measure that can help lawyers deal with the stress of their profession.

ETHICAL COMPASS: The Cheater's "High"—Harmonize Ethics, Research and Negation Behavior

By Professor Elayne E. Greenberg

Introduction

In the context of negotiations, how does "cheater's high" influence our ethical behavior, decision-making and negotiation strategy? "Cheater's high" is the term coined by behavioral ethics researchers to describe the positive feeling we experience when we cheat.[1] Rather than feel guilty for these ethical transgressions as was previously believed, those who cheat actually experience a positive effect that further incentivizes the unethical behavior to continue. Even though some who are perched on their ivory tower may feel immune from "cheater's high," social scientists remind us that at times we all cheat to varying degrees. This cheating reality is problematic for us all, because it collides with a lawyer's ethical obligation to be truthful.

In this column, I will discuss how the research about "cheater's high" contributes to our understanding of why we as negotiators may blur truth telling in negotiations. The purpose of this column is not to debate the lines between truth and falsity in negotiations, but to heighten our awareness to our own internal ethical lines and how we react when we get to close to the edge, fueled by the "cheater's high." To begin, I will provide an overview of the research on "cheater's high." In Part II, I will explain a lawyer's ethical anchoring in truthfulness. Then, in Part III, I will extrapolate what the research on "cheater's high" contributes to the discussion on ethical negotiations.

Part One: Behavioral Ethics Researchers Teach Us About "Cheater's High"

The research on cheater's high studied the emotional response of people making voluntary, unethical decisions on a spectrum of problem-solving tasks where there was no salient victim and no obvious harm. [2] Several relevant lessons were learned.

First, we have a fundamental need to believe that we are good moral beings and often insist that our ethical behavior conforms to that belief. However, researchers have shown there is a misalignment between what we believe is ethical, what we predict we *should* ethically do and how we *actually behave*, in the heat of the ethical moment. To clarify, the ethical decision-making process is guided by two components: the *should self* and the *want self*. The *should* self shapes our long-term, rational ethical decision-making and controls how we view our own ethical behavior. The *want self* provides us with a different ethical vantage point and compels us to act in the heat of the moment. The research has has shown that many people, when asked to forecast how they will respond to an ethical dilemma in the future, will often over predict their ethical behavior. Moreover, when people do commit minor ethical transgressions, they have the ability to rationalize these ethical transgressions in a way that allows them to maintain their belief that they are moral beings.

Second, we all cheat. In the heat of the moment, the "want" self compels us to focus on the short-term benefits that we might have rather than the long-term negative consequences of ethical transgressions such as reputational costs. This focus on the short-term benefits when the want-self is operational, elicits a positive effect in the individual. The research further explains that so long as the moral transgressor, aka cheater, doesn't believe that the cheating hasn't actually harmed anyone, the cheater may actually feel good about the cheating, continuing to believe he or she is still a moral person, the positive effect known as "cheater's high."

Cheater's high is reinforced for three primary reasons.[3] First, there may be actual gains from cheating such as additional money or beating an opponent. Second, "cheater's high" may give the transgressor the psychological kick that comes from circumventing the rules to deceive and manipulate others Third, the cheater may experience a sense of personal pride for overcoming rules and finding loopholes in a process that is designed to constrain behavior.

Several factors increase cheating.[4] Cheating increases cheating. Thus, test subjects wearing knockoffs were more likely to cheat. The thinking is, if I am willing to push some ethical limits, I am more likely to push others. Mental depletion is another factor that makes an individual more susceptible to the want self than the should self. Dieters are more likely to cheat at the end of the day when will power has become exhausted. A third factor that increases cheating is the cheater's ability to rationalize that the cheating is not really hurting anyone. Of surprise, cheating is not increased if the cheater knows that there is the likelihood of being caught or that he will gain a sum of money from the cheating.

The researchers have also found that there are several interventions that have been shown to increase moral

behavior.[5] For example, reminders of morality right at the decision-making juncture have been found to have a beneficial effect. Bursting my delusional bubble, the researchers also painfully reminds that Ethics CLE programs and column like this one have little impact on contributing to ethical behavior: Another helpful intervention to promote ethical behavior, signatures at the top of forms are more apt to have ethical information follow than forms that require signatures at the bottom. A third recommended intervention is to help deflate the cheater's rationalization that there are no victims by actually identifying the victims that could be harmed.

Thus, the research on "cheater's high" explains why we may make ethical behavioral transgressions. The positive emotions that accompany such transgressions allow people to rationalize that they are still the good moral beings they believe themselves to be. Yet, this reality collides with our ethical obligations as lawyers.

Part Two: The New York Rules of Professional Conduct Rule 4.1: Truthfulness in Statements to Others

In New York, lawyers representing a client in negotiations have an ethical obligation to be truthful about *all* (emphasis added) facts. The New York Rules of Professional Conduct Rule 4.1 Truthfulness in Statements to Others specifically provides:

> In the course of representing a client, a lawyer shall not knowingly make a false statement of fact or law to a third person.[6]

This is a heightened obligation of truthfulness that is distinguishable from the correlate ABA Model Rule 4.1 that requires truth telling just for *material* facts.[7]

As explained in his commentary, Roy Simon states that for there to be a violation of Rule 4.1, the misrepresentation must have three components.[8] The misrepresentation must take place in the course of representing a client. The misrepresentation must be knowingly made. Third, the misrepresentation must be made to a third person. Interestingly, "conventions of negotiations" such as estimates of price and a party's expression of what constitutes an acceptable settlement are not considered violations of this rule.[9]

The challenge for many in applying this ethical rule and incentivizing truth telling is that in the course of negotiation there is little consensus about the line between truth and "strategic" negotiation tactics. Is it cheating or a negotiation strategy to keep your cards close to your chest, withhold information, proffer an attenuated version of the truth and make offers that have little to do with any objective reality?

Part Three: "Cheater's High," Negotiations and Interventions

The research on "cheater's high" explains, in part, why some lawyers may continue to engage in questionable ethical behavior in negotiations. If we are to be truthful, both the collaborative and hardball negotiation styles offer opportunities for cheating. However, this uncomfortable discussion about the lines between truth and falsity in negotiations instead *often* morphs into the more comfortable discussion about what constitutes good advocacy in negotiations. While some of us believe that candor and the sharing of quality information in negotiations are more than likely to yield an optimal outcome for our clients, others laugh at the naiveté of this approach, and instead adamantly believe that a "hardball approach" is strategically advantageous for promoting your client's interests. Advocates who use this approach tend to keep their cards close to their chest, withhold important information, proffer an attenuated version of the truth and make offers that have little to do with any objective reality.

Whether our negotiation advocacy style is "hardball" collaborative or a hybrid of the two approaches, truth telling is an ever-present issue in negotiation. There is a question about whether some of the aforementioned hardball strategies, even though effective, are ethical or acceptable "conventions of negotiations." A more subtle inquiry is how collaborative negotiators, too, may cheat. Although negotiators who subscribe to the collaborative approach believe their approach is a more candid approach, collaborative negotiators may still present nuances of the truth in a way that questions the ethics of truth-telling.

The research on cheater's high clarifies why such questionable ethical behavior continues in both the hardball and collaborative negotiation styles. For some, effective advocates and hardball negotiators are one and the same. Your goal is to get an advantage. Hardball negotiators take great pride in their reputation and talk about the "high" they get negotiating. There are no victims, it's just the game of negotiations. One ethical transgression makes the next one easier. And, the better negotiator is the one who knows how to bend the rules, find the loophole to victory. For collaborative negotiators, the cloak of collaboration may provide a false sense of the collaborator's commitment to candidness and sharing of information that the collaborator may exploit to cheat and gain an advantage in negotiations.

Gleaning lessons from the research, there are affirmative steps that we can all take to incentivize our truth telling. First, we need to become aware that this is an issue. Second, prior to entering negotiations, we may read the Professional Rules as an ethical anchoring to promote our ethical decision-making. Third, we might create Negotiate

Agreements and Confidentiality Agreements that require our signatures on the top, as another reinforcement to promote truth telling.

Conclusion

"Cheater's high" is one example of the contribution behavioral ethics research contributes to our understanding of our professional and personal ethical behavior as negotiators. I chose to write this column about "cheater high" because I have always been fascinated with the rush many of our colleagues say they experience when negotiating. I hope this column prompts readers to scrutinize their negotiating behavior once again. It is also an opportunity to re-align our negotiating behavior with our personal values and professional ethical mandates. Yes, we may all have different ideas about what constitutes ethical behavior in negotiations and whether there is even such a concept as an absolute truth. Nevertheless, as ethical practitioners we strive to interpret our ethical mandates in a way that is internally consistent with our personal and professional beliefs.

Endnotes

1. *See, e.g.*, Dan Ariely, *The (Honest) Truth About Dishonesty*, (HarperCollins 2012); Dan Ariely, "Why We Lie," WSJ.com (May 26, 2012); and Nicole E. Ruedy, Celia Moore, Francesca Fino, Maurice E. Schweitzer, *The Cheater's High: The* Unexpected *Affective Benefits of Unethical Behavior*, J. Pers & Soc. Psych. 2013, Vol. 105, No. 4 , pp. 531-48.
2. *Id.*
3. Ruedy et al., *supra* note 1 at 533.
4. Ariely, *supra* note 1 at WSJ.com.
5. *Supra* note 1.
6. Simon's N.Y. Rules of Prof'l Conduct Annotated at 1007 (2013).
7. *Id.* at 1008.
8. *Id.* at 1009.
9. *Id.* at 1008.

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Message from the Co-Editors-in-Chief *(continued from page 2)*

International

Alexandra Dosman examines recent authority on the always difficult issue of when non-signatories may be bound to international arbitration agreements. Prof. Dr. André Niedostadek, LL.M submits an examination of the German Mediation Act and provides a basic overview of the key issues addressed and the experiences with mediation under this new law. Sherman Kahn discusses whether patent related disputes will emerge as a major subject matter of international investor-state arbitration.

Book Reviews

Kim Landsman reviews *The Rise of Transparency in International Arbitration: The Case for the Anonymous Publication of Arbitral Awards*, by Alberto Malatesta and Rinaldo Sali, which examines the emerging push for transparency in arbitration and the tension that creates with traditional concepts of confidentiality in arbitration.

Stefan Kalina reviews the new Third Edition of the *College of Commercial Arbitrators Guide to Best Practices in Commercial Arbitration*, which has been has been substantially expanded and updated, incorporating several new chapters on subjects such as including intra-tribunal relations, arbitrators' fees, electronic discovery, and hybrid arbitration processes.

Case Notes

The case notes in this issue examine a recent case from the Second Circuit examining the applicability of the Foreign Sovereign Immunities Act to arbitration awards against foreign governments; a case from the Ninth Circuit, reaffirming that, under *Hall Street*, parties cannot preclude federal courts from reviewing arbitration awards under the criteria set forth in Section 10 of the Federal Arbitration Act; and the *Doral Financial* case from the First Circuit, which makes clear that arbitrators have the discretion to exclude evidence without fear of vacatur provided parties are given sufficient opportunity to be heard.

Edna Sussman, Laura A. Kaster and Sherman Kahn

How Technology Assisted Review Can Decrease the Cost of E-Discovery in Arbitrations

By Ignatius Grande and Joseph Lee

In recent years, corporations have been overwhelmed by the amount of data that they continue to create and receive. There are more than 3 zettabytes (1 ZB = 1 billion terabytes) of digital data stored around the globe—an approximate 50 percent increase from 2011. At this rate of growth, the global volume of stored digital data will reach 8 ZB by 2015.[1] This era of "Big Data" has challenged all companies to better manage the emails and other electronically stored information that they create and receive. The amount of data in existence has also made it increasingly difficult to manage the cost of litigation. The federal judiciary has taken note and in recent months has been pondering proposed changes to the Federal Rules of Civil Procedure that aim to rein in the costs of litigation by clarifying the requirements for a judge to issue sanctions and by placing increased emphasis on the concept of proportionality.[2] Another way that parties and attorneys have attempted to limit the costs of e-discovery is by pursuing arbitration as a dispute resolution method.

For many years, arbitration was perceived as a way to resolve disputes in which parties could avoid the costly discovery that was inherent in litigation. Surely that is still the case for certain categories of disputes that are not document or email intensive. However, for more complex arbitrations, it is nearly impossible to avoid some document review. Many in the arbitration world have viewed e-discovery with great trepidation.[3] Many think that there is no place for e-discovery in arbitrations, but the reality is that it is no longer possible to avoid Big Data, even in the arbitration world. Even though parties in an arbitration can agree to preemptively limit the scope of e-discovery by way of arbitration agreements,[4] there are many, many more documents and emails that need to be reviewed today to resolve a dispute than was the case several years ago.[5] A typical complex arbitration today may involve being faced with the scenario of sifting through countless emails and documents in order to even understand the case and then, later on, having to review large productions received from the other side. This is true even if the parties agree to exchange *no documentary discovery at all*, as each party will have large amounts of electronic data in its own files that it must review.

At the same time that the amount of data being created by companies has increased, new technologies have emerged to help manage that data in e-discovery. In recent years, law firms and corporations have increasingly made use of technology assisted review ("TAR") to aid in culling down the huge amounts of data at issue in large disputes. These tools have been available for several years, but it was only in 2012 that they received widespread acceptance thanks to a series of judicial opinions in which a number of courts approved of their use. TAR is an ideal tool to make use of in litigation and it is crucial that arbitrators and parties to arbitrations understand how it works.

There are different ways in which technology assisted review can be applied. However, TAR generally utilizes an algorithm to apply advanced analytics to cull through vast amounts of data to help the case team hone in on the most relevant information. TAR is faster and more accurate than manual review in which reviewers go through every document one by one (often referred to as "linear review"). TAR not only helps to prioritize a review, but since it does such a good job prioritizing, under certain circumstances, it may be possible to leave a large percentage of the document set unreviewed because the algorithm quickly pushes most of the responsive documents to the top of the review pile.

The most common application of TAR begins with a subject matter expert, who knows the ins and outs of the case, coding a seed set of documents which ordinarily are pulled as a random sample from the entire database. As the subject matter expert reviews documents, he or she is training and refining an algorithm, which after a certain point will be able to rank the documents in the data set in order of their likelihood of responsiveness. Needless to say, this process can create enormous efficiencies. As a result, the cost savings resulting from the use of TAR can be impressive. Clients often claim that they have been able to save 50% or even 80%[6] of the cost that it ordinarily would take to review a set of data with the use of TAR.

Between Big Data and TAR and the increasing complexities of e-discovery, attorneys can no longer feign ignorance when it comes to technology. Some arbitration rules have begun to note the importance of understanding technology in order to efficiently arbitrate a claim.[7] In addition, arbitrators and those arbitrating a matter who are attorneys, are now subject to ethics rules that make ignorance of TAR simply unacceptable. In 2012, the American Bar Association passed an amendment to Comment 6 to Model Rule 1.1, which states: "to maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, including the benefits and risks associated with the technology." Further, the ABA Commission on Ethics noted the critical importance of this Comment given the growing importance of technology in modern practice. Whatever their role in a case, whether it be a litigation or an arbitration, attorneys have an affirmative duty to understand how technology affects

their case, whether TAR should be used and, if it is used, that it is used correctly.

The first judicial opinion to discuss technology assisted review in depth was *Da Silva Moore v. Publicis Groupe*.[8] In this opinion, Magistrate Judge Peck held that TAR "is an available tool and should be seriously considered for use in large-data-volume cases where it may save the producing party (or both parties) significant amounts of legal fees in document review."[9] Magistrate Judge Peck also emphasized the importance of using an appropriate process when deploying TAR. He noted that, "[a]s with keywords or any other technological solution to e-discovery, counsel must design an appropriate process, including the use of available technology with appropriate quality control testing, to review and produce relevant ESI."[10] *Da Silva Moore* has been followed by a series of court decisions[11] that have addressed different aspects of TAR and predictive coding, but the end result is that TAR is here to stay and it is already changing the way in which parties handle litigation and investigations.

The rules that govern arbitration have always dictated that the process of exchanging information be done in the most cost-effective and expeditious manner available.[12] If parties to arbitration and arbitrators work to find the most cost effective strategies in cases with significant e-discovery, they will have no choice but to consider TAR techniques. In the coming years, it will be incumbent upon all arbitrators to have an understanding of how TAR works so that they can help facilitate and encourage the use of TAR when its use will help save costs and the time required to review large amounts of data. TAR will not be the perfect solution for every matter or arbitration; arbitrations involving a small volume of data may not warrant an elaborate TAR review protocol. The cost of entry may be too high and the time to generate and refine a proper seed set may take too long. But certainly in matters that involve large volumes of data, TAR should be seriously considered by the parties.

Technology is a double-edged sword. It has caused an explosion of data, to be sure, but it has also provided us with the tools to manage and cull through it. Technology Assisted Review is an effective tool that can help to manage the time and costs spent in arbitration. Arbitrating parties and arbitrators alike must consider using this technology if they want to choose the least costly path to understanding the documentary evidence at issue in the arbitration. If arbitration is to be perceived as a more cost effective option to litigation, it is crucial that TAR be a consideration for all large complex matters.

Endnotes

1. IDC Predictions 2012: Competing for 2020, Volume: 1 Executive Information: Top 10 Predictions (as of December 2012, there were 2.7 ZBs of data).
2. See http://www.uscourts.gov/RulesAndPolicies/rules/proposed-amendments.aspx (the public comment period to comment on the proposed changes to the Federal Rules of Civil Procedure ends on February 15, 2014).
3. Sherman Kahn, *E-Discovery Demystified for Arbitrators—Tips for How to Manage e-Discovery for Efficient Proceedings*, NYSBA New York Dispute Resolution Lawyer, Spring 2012, p. 32.
4. Forstadt, Joseph, Discovery in Arbitration, ADR & The Law (20th Ed., 2006) ("The source of information as to how extensive the discovery process will be in any particular arbitration is the arbitration agreement itself.").
5. Steven Seidenberg, I*nternational Arbitration Loses Its Grip: Are U.S. lawyers to blame?*, ABA Journal, April 2010, p. 53.
6. Relativity Analytics Client Testimonials, https://kcura.com/relativity/testimonials/law-firms, Alison B. Silverstein, Managing Director, Discovery and Dispute Services ("Through the use of Relativity Assisted Review, we were able to save our clients 80 percent of their typical review costs and meet extraordinary deadlines that were otherwise unachievable.").
7. International Institute for Conflict Prevention and Resolution, Rule 11 ("The Tribunal may require and facilitate such discovery as it shall determine is appropriate in the circumstances, taking into account the…desirability of making discovery expeditious and cost-effective; JAMS Recommended Arbitration Discovery Protocols For Domestic, Commercial Cases, Jan. 6, 2010 (JAMS arbitrators are trained to deal with the technological issues that arise in connection with electronic data).
8. *Da Silva Moore v. Publicis Groupe & MSL Group*, 11 Civ. 1279 (ALC) (S.D.N.Y. Feb. 24, 2012).
9. *Da Silva Moore*, 11 Civ. 1279 at 25.
10. *Id.* at 25-26.
11. *Global Aerospace v. Landow Aviation*, No. CL 61040 (Vir. Cir. Ct. Apr. 23, 2012); *Re: Actos (Pioglitazone) Products Liability Litigation*, No. 6:11-md-2299 (W.D. La. July 27, 2012); *EORHB, Inc., et al. v. HOA Holdings, LLC*, C.A. No. 7409-VCL (Del. Ch. Oct. 15, 2012); *Re: Biomet M2a Magnum Hip Implant Products Liability Litigation*, 3:12-md-2391-RLM-CAN (N.D.Ind. April 18, 2013).
12. *See* AAA Commercial Rules, Rule 21 (which states that arbitrators may "take such steps as they may deem necessary or desirable to avoid delay and to achieve a just, speedy and cost-effective resolution of Large, Complex Commercial Cases"); *see also*, The Uniform Arbitration Act of 2000, Section 17, ("An arbitrator may permit such discovery as the arbitrator decides is appropriate in the circumstances, taking into account…the desirability of making the proceeding fair, expeditious, and cost effective.").

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The American Arbitration Association's Amended Commercial Arbitration Rules

By Eric P. Tuchmann

On October 1, 2013, the American Arbitration Association ("AAA") amended its Commercial Arbitration Rules. The amendments were made after a comprehensive review of the Commercial Rules ("Rules") took place that included obtaining feedback from parties, advocates, neutrals and others knowledgeable about the arbitration process, and which also involved the substantive input of the AAA's Practice Committee of the Board of Directors. The amendments reflect the AAA's desire to implement changes that will result in a more streamlined, cost-effective and tightly managed arbitration process. These improved outcomes will be accomplished by incorporating procedural changes, enhancing arbitrator authority, and by providing tools to arbitrators and parties that will encourage efficiencies in the way that arbitrations are conducted. Wherever a rule was amended, added or deleted, the AAA's primary interest was to be responsive to the preferences about the arbitration process that parties have expressed to the AAA, to react to developments in the law, or to incorporate enhancements to the arbitration process that were identified by AAA arbitrators and staff.

Amending the Rules also required a significant amount of careful deliberation, since the Rules have extremely broad application and apply to the largest number of commercial arbitrations administered by the AAA. There is considerable variation in the size of arbitrations administered under the Rules. In particular, the Rules are written into contracts that have resulted in billion-dollar claims as well as those that only involve a few thousand dollars. In addition, they apply to disputes that arise in a wide variety of fields and industries. Accordingly, it was critical that the amendments did not implement changes that would negatively impact their application or efficiency in any of those contexts.

With all of these considerations in mind, amendments and improvements to the Rules have been made in areas related to the use of mediation in conjunction with arbitration, the effective management of the arbitration process, dispositive motions, emergency measures of protection, non-payment of arbitration fees by a party, and sanctions. Still more rules were amended to implement less significant but still important changes.

Mediation

The most novel amendment to the Rules is the inclusion of a required mediation step in "R-9 Mediation," which provides that "…upon the AAA's administration of the arbitration or at any time while the arbitration is pending, the parties shall mediate their dispute pursuant to the applicable provisions of the AAA's Commercial Mediation Procedures, or as otherwise agreed by the parties." To avoid implementing a mediation procedure that could result in additional administrative steps or delays in the arbitration process, R-9 also provides that "…the mediation shall take place concurrently with the arbitration and shall not serve to delay the arbitration proceedings." R-9 rule formalizes the AAA's expectation that all parties will utilize mediation in conjunction with the arbitration process in recognition that, when effectively utilized, mediation successfully resolves a large percent of disputes. In addition, mediation is now increasingly incorporated into the dispute resolution process as a matter of course for many parties and attorneys. Finally, the requirement of a mediation step in conjunction with an AAA-administered arbitration reflects that an important part of the AAA's mission is devoted to assisting parties in resolving their disputes through various means, and not solely through the use of arbitration.

There are important qualifiers to R-9 in recognition of the fact that the timing and appropriateness of mediation for a particular dispute can be very fact- and case- specific, in addition to the fact that a successful mediation process is driven by a significant amount of party autonomy. First, any party to an arbitration may unilaterally opt out of the mediation requirement. Second, the mediation requirement only applies in cases where a claim or counterclaim exceeds $75,000. While mediation can also be very helpful in resolving smaller value claims, the AAA's Expedited Rules apply to arbitrations involving relatively smaller value claims and as a result are already subject to procedures that provide for lower costs and expedited time frames for the conclusion of the arbitration. Third, R-9 states that the mediation may take place at any time when the arbitration is pending, and while the default presumption is that the mediation would take place pursuant to the AAA's Commercial Mediation Procedures, it is permissible for the mediation to take place pursuant to other procedures as well.

Effective Management of the Arbitration Process

Another major initiative of the AAA as reflected in the Rules was the addition of new rules or modification of prior rules that give arbitrators and the AAA significantly greater latitude and authority to manage arbitrations efficiently and expeditiously. Parties expressed a desire for an arbitration process that is more tightly managed, and that provides arbitrators with clearer authority to manage the conduct of the arbitration including scheduling, document exchange and production of information.

Preliminary Hearing

The AAA has long emphasized that a well-structured preliminary hearing that takes place very early upon the

arbitrator's appointment is an important contributing factor in getting an arbitration on the right track. As a result, a revised rule on preliminary hearings, R-21, states that at the discretion of the arbitrator, a preliminary hearing should be held as soon as practicable after the arbitrator has been appointed. The amended rule also now suggests that the parties themselves, not just their outside attorneys, should be invited to attend the hearing, which is a reflection of the AAA's experience that actual party participation increases the likelihood that all participants in the arbitration process will have a firm understanding at an early time about deadlines, costs, information exchange and other aspects of the arbitration.

R-21(b) also provides tools for an efficiently managed preliminary hearing through the incorporation of newly created and detailed Preliminary Hearing Procedures. P-1 provides guiding principles that apply to preliminary hearings in AAA administered arbitration. Specifically, P-1(a) states that arbitrators should "maximize efficiency and economy," and that each party will be provided with a fair opportunity to present its case. P-1(b) warns against importing procedures from court systems into the arbitration process. P-2 then outlines a checklist of 19 items to be considered at the preliminary hearing depending on the size, complexity and subject matter of the dispute. Among the issues on the checklist are whether there are any conditions precedent to arbitration, whether any party will seek additional information about or modifications to any claim asserted in the arbitration, the extent that dispositive motions may be sought, the need to address scheduling issues including establishing dates to identify witnesses, the exchange of documents, submissions and exhibits, and the form of the award desired by the parties.

Pre-Hearing Exchange and Production of Information

An additional aspect of the arbitration process that contributes to an efficient arbitration process is to provide additional structure to the exchange and production of information. R-22 now gives arbitrators more direct control over the exchange of information, stating in R-22(a) that "the arbitrator shall manage any necessary exchange of information among the parties with a view to achieving an efficient and economical resolution of the dispute, while at the same time promoting equality of treatment and safeguarding each party's opportunity to fairly present its claims and defenses." R-22 also provides the arbitrator with the authority to require parties to exchange documents that they intend to rely upon, to update their exchanges, respond to reasonable document requests, and when documents are to be exchanged in electronic form, to make them available in the form most convenient and economical for the party in possession of the documents.

Enforcement Powers of the Arbitrator

In another new rule, R-23, arbitrators are provided with the broad power to issue orders necessary to accomplish the goals of conducting a fair an efficient arbitration. R-23(a) enables arbitrators to condition the exchange or admissibility of confidential documents and information on appropriate orders to preserve confidentiality. R-23(b) then allows arbitrators to impose reasonable search parameters for electronic documents and allocate the costs of producing documents including e-documents. Willful non-compliance with an arbitrator's order may also result in an arbitrator drawing adverse inferences, excluding evidence, allocating costs or providing an interim award of costs in addition to the issuance of other enforcement orders that are permissible under applicable law.

Conduct of the Proceedings and Evidence by Written Statements, and Post-Hearing Filings of Documents and Other Evidence

The Rule on Conduct of Proceeding, R-32, was modified to more explicitly provide parties with flexibility regarding the means of presenting evidence and to take advantage of technology that has become readily accessible such as video-conferencing, Internet-based communications and telephone conferencing. Using these means of presenting evidence, so long as they provide for a full opportunity for parties to present evidence and cross examination when witnesses are involved, can bring substantial efficiencies into the arbitration process.

The circumstances under which evidence may be introduced through written statements have also been addressed in R-35. The use of written statements, a predominant practice in international arbitration, is increasingly common in domestic arbitrations. R-35 now provides a roadmap for the use of such written statements, including the need for parties to give written notice for any witness or expert who has provided a witness statement to appear at the arbitration for examination. To the extent that the witness fails to appear, the arbitrator is permitted to disregard the witness statement. Similarly, if a witness' testimony is essential but the witness is unavailable, the arbitrator may order their appearance at a location where the witness can be compelled to attend.

Effective Management in the Procedures for Large, Complex, Commercial Disputes

The large majority of Rule amendments will also apply to cases that are being administered pursuant to the Procedures for Large, Complex, Commercial Disputes ("LCC Procedures"). The LCC Procedures apply in all cases where a disclosed claim or counterclaim exceeds $500,000, and they also provide various additional features such as default claim thresholds to determine whether a single or three arbitrator tribunal shall be appointed, the presumption that the AAA will conduct an administrative conference call with the parties, and additional guidelines for the management of the arbitration proceedings. The LCC Procedures now include a presumption that a preliminary hearing will take place as promptly as practicable after the selection of the arbitrators occurs.

Further, the LCC Procedures give specific direction on the issue of depositions and the limitations that should be considered by arbitrators when ordering depositions. Specifically, LCC Procedure L-3(f) states that "[i]n exceptional cases, at the discretion of the arbitrator , upon good cause shown and consistent with the expedited nature of arbitration, the arbitrator may order depositions to obtain the testimony…relevant and material to the outcome of the case."

Dispositive Motions

The prior version of the Rules was silent on the issue of an arbitrator's authority to entertain and grant dispositive motions, and despite the broad authority granted to arbitrators regarding the conduct of the arbitration in addition to their own authority to decide a particular issue, some disputes arose regarding an arbitrator's authority to grant such motions. Accordingly, a new rule, R-33, was included to resolve any doubt that the arbitrator is authorized to allow the filing of dispositive motions where the "arbitrator determines that the moving party has shown that the motion is likely to succeed and dispose of or narrow the issues in the case."

Emergency Measures of Protection

Another new Rule, R-38, entitles parties to have an emergency arbitrator appointed who can decide requests for emergency relief that may be necessary prior to the selection and appointment of the arbitral tribunal that will hear the parties' underlying dispute. This rule applies in all arbitrations where the agreement containing the arbitration clause was entered into on or after October 1, 2013, the effective date of the amended Rules. Prior versions of the Commercial Rules contained a provision for emergency measures; however, they were optional and had to be agreed upon either after a dispute arose or by specific reference in the parties' arbitration agreement.

The new Rule specifies that the AAA will appoint an emergency arbitrator within 24 hours of the AAA's receipt of a party's request. The Rule's inclusion of a provision for emergency measures is similar to the one adopted in the International Centre for Dispute Resolution's ("ICDR") International Rules, which has very been successful in enabling parties to obtain emergency relief within the arbitral forum in a prompt and predictable manner.

The Rule provides that a party may seek emergency relief by notifying the AAA and the other parties to the arbitration. The AAA then appoints an emergency arbitrator within one business day, and within two business days the emergency arbitrator establishes a schedule for the consideration of the application for emergency relief. If after considering the application for emergency relief the arbitrator has determined, pursuant to R-38(e) that "immediate and irreparable loss or damage shall result in the absence of emergency relief…the emergency arbitrator may enter an interim order or award granting the relief…." The emergency arbitrator retains the ability to modify an interim award of emergency relief until the arbitral tribunal that will consider the merits of the dispute is appointed, at which time the emergency arbitrator has no further authority to act.

Non-Payment by a Party

An increasing concern of parties in recent years arises out of arbitrations where one party refuses to deposit his or her share of arbitrator compensation or administrative charges. Under those circumstances, the prior Rules permitted the other party to advance the fees of the non-paying party, or to decline to do so, in which case the tribunal was informed that all arbitrator deposits were not on hand. Upon learning that deposits had not been made, the tribunal had the option of suspending or terminating the proceeding. The amended Rules now provide an additional option in the event that a party refuses to deposit arbitrators' compensation. Specifically, R-57 states that to the extent the law allows, a party may request that an arbitrator take action in light of another party's non-payment including limiting the non-paying party's ability to assert or pursue its claim, so long as the arbitrator does not preclude the non-paying party from defending a claim or counterclaim.

Sanctions

Another area where parties expressed a desire for a change in the Rules related to the authority of arbitrators to keep objectionable conduct in check. Accordingly, and also in light of case law that developed on the issue, the amended Rules contain new provisions regarding the authority of arbitrators to sanction a party. R-58 provides the arbitrator with authority to order sanctions where a party fails to comply with its obligations under the rules or with an order of the arbitrator. However, to the extent the sanction limits any party's participation in the arbitration or results in an adverse determination, the arbitrator must explain in writing the reason for the order and require the submission of evidence and legal argument prior to making of an award. Importantly, R-58 does not permit an arbitrator to sanction a party by issuing a default award, and before making any determination regarding the issuance of a sanction, the party that is subject to a sanction must be given the right to respond.

Other Amendments

The amended Rules contain numerous additional changes covering a range of issues that are intended to address purely administrative matters. For example, the deadlines applicable to answers, changes of claim, the return of arbitrator selection lists and other matters were changed from 15 days to 14 days to resolve the problem of due dates falling on weekends. In addition, the Rule applicable to filing demands for arbitrations, R-4, was substantially redrafted and reorganized in an effort to make it more readable and to make the filing process easier to understand.

Other amendments cover more substantive issues. With regard to fixing the locale of the arbitration, R-11, arbitrators will have the authority in many circumstances to reconsider the AAA's locale determination that had been made prior to the arbitrator's appointment whereas the AAA's determinations under prior rules were final and not reviewable by an arbitrator. An additional amendment to the Rules is contained in R-17, which now places a duty on the parties and the representatives and not just the arbitrators to disclose potential conflicts with an appointed arbitrator.

Conclusion

The amendments to the AAA's Commercial Arbitration Rules reflect significant changes in the arbitration process, each of which is designed to improve AAA-administered arbitrations by incorporating and encouraging best practices by parties and arbitrators. Arbitrators have been provided with greater authority to manage the arbitration process generally, including discovery and document exchange, and the early settlement of disputes is actively encouraged through a required mediation step that is contained within the Rules.

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The Basics of Company Valuation for Dispute Resolution Professionals

By David R. Hobbs and Chris Thorpe

Introduction

Arbitrators and mediators are frequently asked to resolve disputes a fundamental part of which is the proper valuation of a company. Such disputes can arise from any number of factual situations ranging from the dissolution of a partnership to a dispute over a failed merger. When presented with such disputes, arbitrators are often asked to decide between two competing expert analyses, each prepared by one of the parties, and each presenting a valuation analysis based on what that party believes best supports its position in the dispute. Mediators often have even less to work with as disputes frequently go to mediation before the parties have exchanged expert analysis. It is therefore useful if dispute resolvers have a basic understanding of how experts go about valuing companies.

This article seeks to familiarize mediators and arbitrators with the basic fundamentals of valuing a company. It will introduce the common methodologies used by valuation experts and discuss common pitfalls and areas of caution. The information in this article should help dispute resolution professionals assess parties' competing valuation claims.

At the most basic level, value is the price at which a willing buyer and willing seller would agree to an arm's length transaction. However, the value of a company will change over time and depending on economic circumstances. Valuation of a company includes assessment of data regarding the company's business as well as external factors. Valuation of both publicly traded and private companies is significantly impacted by external factors including the general economic environment, interest rates and whether financing is readily available or difficult to obtain. Though some may see valuation as a precise science, it is also an art that requires sound judgment.

Valuation Methodologies

There are many popular valuation techniques ranging from determining liquidation value to discounted cash flow analysis. This article focuses on valuing a company as a going concern, which means the company continues as an active trade or business. In particular, this article explains the three most common and accepted valuation techniques—comparable company analysis, precedent transaction analysis and discounted cash flow analysis. These techniques do have their limitations such as when valuing intellectual property. However, one must always remember that even when valuing such intangible assets they are only worth the future cash flow that they can produce or protect. Always keep in mind that buyers of these assets will at some point require real economic returns. For example, what is a patent worth? One must assess the market for the product that the patent produces and what cash flow it may produce in the future as well as the value of other similar patents when they have been sold. In this sense, the analysis is not dissimilar to corporate valuation.

Comparable Company Analysis

Comparable company analysis is a market-based approach to valuation. This analysis compares the value of a company to other similar businesses in its industry. The premise is simple—investors will likely pay similar prices for similar companies. Given the requirement for current valuation metrics (*i.e.*, the need for a publicly available valuation benchmark) the most appropriate comparable companies are publicly traded companies. This can be problematic when using comparable company analysis to value smaller businesses, which will be discussed later in this article.

The critical question is what is a comparable company? The practical answer is to pick competitors of the company to be valued that have similar growth and margins. Sometimes, unfortunately, the closest "comparable" may be a single division of a diversified holding company, making the relevant data more difficult to obtain. These cases must be examined on a case-by-case basis. There is no bright line test to decide when a company is no longer comparable.

On the contrary, it may be that the company to be valued operates in two or more unrelated businesses. In this instance, it could be appropriate to perform a sum-of-the-parts ("SOTP") analysis. In a SOTP analysis you value each of a company's businesses separately then total the individual values to derive the value of the entire company.

As a part of the analysis, the valuation expert may use a multiple of a company's cash flow or earnings to estimate its "enterprise value." Enterprise value ("EV") is defined as equity value plus debt minus cash. EV as a multiple of "EBITDA" (earnings before interest, taxes, depreciation and amortization) is perhaps the most commonly used valuation metric, but the metric used should be the one that is most relevant to the valuation target's industry. For example, technology companies are frequently valued using an EV to *sales* multiple (rather than EV to EBITDA) because many technology companies do not have positive earnings or a price/earnings ("P/E"), in part because debt is not heavily used that industry. It all depends on the sector. However, for most industries enterprise value as a multiple of EBITDA is an appropriate measure.

Let's look at an example of trying to value a widget company. It has competitors Company A, B and C below.

Company	Sales	Profit Margin	Earnings Growth	EV / EBITDA
A	$250mm	15%	10%	8x
B	$750mm	12%	6%	7x
C	$400mm	10%	5%	6x
Average	$467mm	12.3%	7%	7x
Valuation Target	$75mm	10%	15%	?

This is an illustration that highlights the common problems finding comparable companies that have similar dynamics. Should the expert pick the average or shade the valuation towards the most comparable company valuations? One is constrained by the data set but it is necessary to use judgment, and not simply pick averages unless appropriately scrutinized. Often smaller companies will be growing faster than larger competitors. This is due do a number of factors including that it is just harder to grow a larger than smaller base of business. All things being equal faster growing companies, unless they are very small as discussed below, will garner a higher valuation multiple. The logic is simply that the better the future prospects of a company the more a buyer will pay for it as a multiple of dollars earned; a dollar growing at 20% a year is worth more than a dollar growing at 3%.

Small Company Valuation Issues

The comparable company analysis is a good place to discuss size and its impacts on valuation (although size will impact valuation under any analysis). One is often challenged valuing a smaller company when the only valuation metrics available are for large publicly traded companies. Also, "small" is relative. Large investment banks may start incorporating risk premiums for "small" companies at enterprise values of $250 million to speak nothing of a small but prosperous family business.

Small companies tend to have fewer resources and customers and less access to capital and diversity of revenue than do larger ones. Typically it is more likely that a smaller company will fall into company-threatening financial challenges than a larger one. Also, investors prize liquidity and generally it is easier for a larger company to have a liquidity event (e.g., IPO, sell shares if it is public, etc.). Due to these additional risk factors, investors demand a higher rate of return for a smaller company than for a larger company in the same industry. This risk premium can vary but is estimated at 4-5%[1] and is stated as an interest rate added to the weighted average cost of capital ("WACC") which will be discussed later in this article.

Precedent Transaction Analysis

Precedent transaction, also called comparable transaction (or acquisition), analysis is related to comparable company analysis. However, precedent transaction analysis uses the valuation metrics of acquired companies. The methodology seeks to value a company based on what it would be sold for by applying the valuation metrics of past transactions. The companies should still be in the same line of business with similar size and growth prospects.

There are several challenges with precedent transaction analysis. As with comparable company analysis, it can be challenging to find companies that are in the same line of business with similar margins and growth prospects at the time of sale. Another common issue is that precedent transactions take place over time and the applicable valuation metrics (also called multiples) used at one point in time can be different than at another. For instance, perhaps a close competitor was acquired in 2007 but a less similar comparable was acquired last year. Certainly the valuation must be mindful of distressed sales as well as whether transactions were done at peaks and troughs of the cycle.

Discounted Cash Flow Analysis

Discounted cash flow analysis ("DCF") seeks to value a company based on the after-tax cashflow that the company generates. Cash flow in this case is literally the amount of cash that is available to pay equity and debt providers in a given year. It is not based on an accounting methodology. Importantly, it adjusts EBITDA for changes in net working capital, taxes paid, capital expenditures, and deferred taxes (see below).

EBIT	Earnings before interest and taxes
Less: Taxes	Less taxes at the statutory tax rate
=NOPAT	Net operating profit after tax
Add: Depreciation and Amortization	Add back of non-cash accounting charges
Less: Increase in Net Working Capital	Subtract increase in working capital and add a decrease in working capital. "Net" ignores cash
Less: Capital Expenditures	Subtract capital expenditures used to maintain and grow the business
Add: Increase in Deferred Taxes	Incorporates the tax shield of accelerated depreciation allowed by the IRS
=After-Tax Cash Flow	The amount of cash a company generates in a given year

With proper information, it is possible to calculate reasonably accurate numbers for past cash flow. The question becomes how to project cash flow into the future. How many years can be projected with any certainty? The most-commonly used periods are 5 or 10 years forward. Generally, the more stable the business the longer its cash flow can be projected with confidence. A valuation expert may feel comfortable in projecting the cash flow for a company selling a consumer staple such as milk or cheese for 10 years. But, the same expert could struggle to project the financial outlook for a high fashion retailer or technology company from one year to the next.

The projection period should incorporate at least two important considerations: i) that the projection period covers an economic or product life cycle and ii) whether the company's growth or financial outlook may change in the next 5 to 10 years. With respect to the first consideration, imagine you are valuing a company that sells products to an original equipment manufacturer ("OEM") that changes its platform every six years; and the changeover in platform requires capital expenditures that are five times the normal amount. The company has to re-engineer its production cycle and make new tools and dyes perhaps. A 5-year discounted cash flow that begins after the most recent changeover would understate the general capital expenditure requirements of the business. In regards to the second consideration, one must keep in mind that high growth companies usually do not continue along a torrid trajectory (e.g., "trees don't grow to the sky") and conversely the company with low earnings in a recessionary period may see earnings rebound in a normal economic environment.

Merely projecting cash flow out for a period of years does not value the company. It is necessary also to calculate a "terminal value." The terminal value is the value of the company beyond the 5-10 year projection period. In essence it is an attempt to discount the cash flows beyond the projection period. However careful the valuation expert is in formulating projections, the terminal value will be a significant driver of the entire valuation of the company. Often, particularly in the case of a 5-year DCF, the terminal value can be significantly more than 50% of the entire estimated value. Thus the assumption of terminal value must be considered with great care.

There are three common methodologies used to calculate the terminal value. These are i) using the ending year EBITDA (or the most relevant financial metric) to calculate a comparable company valuation, ii) using precedent transaction analysis and iii) using a perpetuity or perpetuity with growth model. We have previously discussed in detail the first two valuation methodologies. Valuation practitioners debate how to decide between the two methods. The ultimate choice comes down to an analysis of the typical investor exit in the industry; *i.e.*, sale vs. IPO or some other personal judgment based upon the factual circumstances. The third methodology is used in industries where long-term growth is very predictable and is close to the rate of inflation or GDP. Again, think of consumer staples such as basic food products. Assuming a 5-year DCF, to calculate the terminal value one should take the cash flow one year forward from the fifth year ("CF_6") divided by the WACC,[2] CF_6 / WACC. If there is growth, subtract the growth rate from the WACC, CF_6 / (WACC-growth).

The final piece of the puzzle is to discount the cash flows and terminal value to today's dollars. A dollar in the future is worth less than a dollar today. Every project has a certain amount risk. For the cost of equity, the risk is compared to that of investing in a broad set of stocks such as the S&P 500 (by far the most common). The cost of debt is compared to a risk-free bond, the U.S. Treasury 10-year Note. After establishing these two rates, to establish a discounted value, the expert multiplies each by the respective portion of the capital structure represented by equity and debt.[3] The WACC is the sum of these two calculations.

After determining the discount rates, the enterprise or firm value is determined by discounting each of the cash flow and the terminal value. Then, to arrive at the value of the equity, the final step is to subtract the debt from the enterprise value and add the cash on the balance sheet. This same methodology is used for comparable company and precedent transaction analysis if the expert is using enterprise valuation metrics to derive a valuation. For purposes of this calculation, debt means long-term liabilities plus the portion of long-term liabilities due in the current year. A common question that arises is why not subtract current liabilities? Current liabilities such as accounts payable are part of working capital. These are liabilities that arise out of the natural running of the business. They are not a financing choice but a requirement just like machinery. Long-term debt, however, is a financing decision. The current owner actively decided to fund the business using debt vs. equity. In industries that utilize a significant amount of lease financing, such as airlines or retail (with significant store leases), it is prudent to consider adding the present value of leases to amount of debt on the balance sheet. This treatment typically occurs when there are significant leases that if ignored would grossly underestimate the leverage of the company.

Other factors may come into play as well. For example, the valuation methodologies discussed above are valuations for an entire company. Sometimes it is necessary to value a less than complete interest in a company. In general, control is valued. In fact, mergers and acquisitions bankers will often call the average of corporate acquisition premiums as the "market for corporate control." Simply put, where valuing a less than complete equity stake, it is important to take into account whether the valuation is on an equity stake that provides control or a minority interest? For a large equity stake such as 75%

that provides control, there might not be any discount over the implied valuation for 100% of the company.

Liquidity can also be an issue. In valuing a small stake in a private company there might be a significant discount due to illiquidity, in addition to lack of control as previously discussed. If it is a minority but still large stake in a public company, a minor discount might arise due to the friction of making several stock sales to liquidate the position.

This article is intended to serve as a primer and reference piece for arbitrators and mediators who may be faced with valuation issues. The authors hope that it helps enhance appreciation and awareness of common valuation techniques and some of the pitfalls involved in corporate valuations.

Endnotes

1. Equity Risk Premiums (ERP): Determinants, Estimation and Implications—The 2013 Edition (March 2013), Aswath Damodaran, Stern School of Business.
2. Weighted Average Cost of Capital.
3. The following explanation provides a more detailed explanation of the cost of equity and debt. The cost of equity is defined as $R_e=R_f + ß(R_m-R_f)$, where R_e is the cost of equity, R_f is the risk free rate, ß is the beta or relative volatility of the equity vs. a broad index (for instance a 1.3 beta means the equity value of the project will move, on average, 1.3 times that of the broader market as a whole). The required equity market return, R_m, is the long-term rate that investors require to invest in equities. Typically, companies such as Ibbotson or Duff & Phelps calculate the equity risk premium ("E_{rp}") which is (R_m-R_f). As of the spring of 2013 Duff & Phelps estimates E_{rp} to be 5%. (Duff & Phelps Risk Premium Report 2013, page 100.) The cost of debt is an after-tax calculation given the tax shield of interest (i.e., interest is deductible for tax purposes). The cost of debt should be appropriate for the risk profile of the company. The formula is $R_d=R_d(1-t)$ where R_d is the nominal interest rate on long-term debt and t=tax rate.

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The Forum of Choice for Arbitrating Cybersquatting: The Uniform Domain Name Dispute Resolution Policy

By Gerald M. Levine

What we recognize today as self-evident about the world wide web with its mixture of opportunity and opportunism was hardly visible in the early 1990s when the Internet began its transformation from the online network created by the academy in the 1980s to the commercial marketplace of today. Then as now anyone, anywhere in the world, without oversight or restriction could register a domain name in any language and launch it into cyberspace for anyone, anywhere in the world to access. There are no gatekeepers at the acquisition stage to demand justification for a registrant's choice of domain name. By the mid-1990s business leaders, who had grown increasingly apprehensive about the predatory side of the Internet, began to demand a more efficient legal mechanism for challenging opportunists taking advantage of their intellectual property as an alternative to enduring the costs and delays of civil litigation.

"The great benefit of the UDRP is that it is quick (decisions are filed within 40 to 60 days of commencement), efficient (template pleadings and no in-person appearances) and cost-effective (a minimal fee of $1,300 to $4,000 [depending on provider and 1 or 3-member Panel for up to 5 domain names] for filing a complaint and a few thousand dollars more if the parties retain counsel)."

The turning point came in 1998. In that year the U.S. government created the Internet Corporation for Assigned Names and Numbers (ICANN)[1] and interest groups and governments meeting under the auspices of the World Intellectual Property Organization (WIPO) fashioned an arbitral regime[2] which ICANN adopted in 1999 as the Uniform Domain Name Dispute Resolution Policy (UDRP or the Policy).[3] In the same year the U.S. Congress enacted the Anticybersquatting Consumer Protection Act (ACPA).[4] The two regimes are constructed on different models for combating cybersquatting that reflect the different priorities that brought them into existence.

The UDRP is a *sui generis* alternative dispute resolution procedure that is available to any trademark owner in any jurisdiction in the world. Unlike domestic and international commercial arbitrations it is expressly nonexclusive. Complainants have a choice of fora. Decisions are not *res judicata* against the aggrieved party commencing a post-hearing action in a court of law. Also unlike commercial arbitrations, the UDRP is a paper only, online regime. Panelists (as UDRP arbitrators are called) have created and apply a functioning jurisprudence specially fashioned to adjudicate claims of "infringement." In the UDRP context, infringement means violation of rights as defined in the Policy, not trademark infringement. The UDRP is not a substitute for the ACPA. Since its inception the UDRP has become the forum of choice to challenge infringing domain names. Astonishingly, through 2013 panelists have issued over 40,000 reasoned decisions, all of them publicly available on providers' databases.[5] This contrasts with two or three dozen decisions from U.S. federal courts of which only a small number have received appellate review.

Every procedural step under the UDRP regime has been simplified, from the contents of pleadings and service on accused domain name holders to issuance of decisions and implementation of requested remedies. These are all important matters and deserve attention, but this article touches lightly only on one procedural feature, namely the agreement that binds respondents to submit to arbitration. The balance of the article focuses more broadly on the UDRP's substantive features, namely its requirements, its evidentiary demands, panelists' achievement in creating a supranational jurisprudence, and briefly the key structural difference between UDRP and the ACPA. The remedy in both fora for cybersquatting is a mandatory injunction to cancel or transfer disputed domain names; in essence, the domain name holder suffers a forfeiture of its domain name if its registration is found to be abusive. The UDRP has no provision for damages although it does have provision for a declaration of reverse domain name hijacking.[6] The great benefit of the UDRP is that it is quick (decisions are filed within 40 to 60 days of commencement), efficient (template pleadings and no in-person appearances) and cost-effective (a minimal fee of $1,300 to $4,000 [depending on provider and 1- or 3-member Panel for up to 5 domain names] for filing a complaint and a few thousand dollars more if the parties retain counsel).

One might ask, What compels a domain name holder to arbitrate a claim? The answer lies in the web of contracts between ICANN and registrars on the one hand and registrars and registrants on the other. There are no independent registrars. The registration agreement which all purchasers must execute as a condition for taking possession of a domain name and which binds them to arbitration is drafted to conform with requirements promul-

gated by ICANN in a Registrar Accreditation Agreement (RAA).[7]

The RAA incorporates the UDRP's representation and warranty provision that "(a) the statements that you made in your Registration Agreement are complete and accurate; (b) to your knowledge, the registration of the domain name will not infringe upon or otherwise violate the rights of any third party; (c) you are not registering the domain name for an unlawful purpose; and (d) you will not knowingly use the domain name in violation of any applicable laws or regulations." The provision concludes with the statement that "[i]t is your responsibility to determine whether your domain name registration infringes or violates someone else's rights."[8] "[T]he Policy does not aim to adjudicate between genuine conflicting interests."[9] It is designed only to deal with clear cases of cybersquatting.

There are three separate requirements for proving cybersquatting: a) a trademark "right" by the complainant, b) a lack of right or legitimate interest by the respondent, and c) proof of abusive registration. The term "abusive registration," of which there are four nonexclusive examples, means respondent registered the domain name in bad faith *and* is using it in bad faith. The conjunctive requirement that distinguishes the UDRP from the "either/or" model of the ACPA[10] is also one of the reasons for a substantial number of denied complaints, which average approximately 300 annually.[11]

There are three distinct, although nonexclusive, affirmative defenses to cybersquatting. The first defense is that "before any notice of the dispute" the respondent is making a bona fide offering of goods or services. This is construed to include nominative fair use and a purely UDRP analogy to that doctrine based on commercial fair use. The second defense is that the respondent has been "commonly known by the domain name" which is construed to mean that it was known by the name before it registered the domain. The third defense is that the respondent is using the domain name in a noncommercial or fair use manner which includes uses constitutionally protected under the First Amendment.

A minority of denied complaints involve trademark owners selecting the wrong forum, sometimes purposefully.[12] This purposefulness is apparent where the trademark owner attempts to vindicate an alleged right acquired subsequent to the registration of the domain name for which it has standing but no actionable claim. Proof of a trademark right only gets a complainant to "first base."[13] The reason for this is that the relative timing of domain name registration and trademark acquisition makes it impossible to prove registration in bad faith (that is, the complainant is "fouled out" by the conjunctive requirement).[14] Alleged bad faith use subsequent to good faith registration is actionable if at all in an ACPA action.[15]

However, the majority of denied complaints involve choices of domain names composed of lexical strings in which respondents either demonstrate a right or legitimate interest (paragraphs 4(a)(ii) and 4(c) of the Policy) or complainants are unable to marshal proof that the domain names were registered in bad faith (paragraphs 4(a)(iii) and 4(b) of the Policy, not holding a domain name for any proscribed purpose). Other reasons include claims found to be outside the scope of the Policy (e.g., personal and trade names that are not eligible for trademark registration) or go beyond UDRP jurisdiction (e.g., disputed rights and interpretation of contract terms). That the naming choices are either identical or confusingly similar to a complainant's trademark (paragraph 4(a)(i) of the Policy) is ultimately irrelevant if complainant is unable to prove that respondent both registered the domain name in bad faith *and* is using the domain name in bad faith (paragraph 4(b)(i-iv) of the Policy).

"The UDRP makes significant evidentiary demands on the parties to prove their contentions of good and bad faith registration."

What is generally underappreciated about an administrative proceeding is that the UDRP makes significant evidentiary demands on the parties to prove their contentions of good and bad faith registration. In explaining these demands it is useful to begin by pointing out that the Policy requires the parties or their counsel to certify to the truth of any factual statements and that the pleading "is not being presented for any improper purpose."[16] A number of complainants have been tripped up alleging facts contradicted by actual facts that have entered the record through respondent. In still other circumstances, complainants offer conjecture of bad faith rather than demonstrable evidence of abusive registration. All of these situations raise issues of credibility that undermine a complainant's case.

From the beginning there has been criticism of inconsistency in decision making, which is not surprising given that the jurisprudence has developed without appellate review. The point was accepted in an early decision where the Panel warned his colleagues that "[a decision] should consist of more than, '[i]t depends [on] what panelist you draw.'"[17] Some of the inconsistency occurs in areas where there are split views of the law (e.g., does the First Amendment protect the right to register a name identical to the trademark or only the expression within the website?). However, on the whole it can fairly be said that panelists have created and apply a function-

ing and able jurisprudence. It has been achieved (as stated in many UDRP decisions) through "a strong body of precedent" which "is strongly persuasive" even if not binding.[18]

"On the whole it can fairly be said that panelists have created and apply a functioning and able jurisprudence."

Endnotes

1. ICANN is "an internationally organized, non-profit corporation [formed in 1998] that has responsibility for Internet Protocol (IP) address space allocation, protocol identifier assignment, generic (gTLD) and country code (ccTLD) Top-Level Domain name system management, and root server system management functions." ["Background Points" posted by ICANN on its web site at <icann.org/general/ background.htm>.] Its mission "is to coordinate, at the overall level, the global Internet's systems of unique identifiers, and in particular to ensure the stable and secure operation of the Internet's unique identifier systems."
2. The Management of Internet Names and Addresses: Intellectual Property Issues, Final Report of the World Intellectual Property Organization Internet Domain Name Process (April 30, 1999). The Final Report is available at http://www.wipo.int/amc/en/processes/process1/report/finalreport.html.
3. The UDRP and Rules are available at http://www.icann.org/en/help/dndr/udrp. ICANN Second Staff Report on Implementation Documents for the Uniform Dispute Resolution Policy (October 24, 1999). Until September 29, 2009 ICANN operated as a quasi-administrative agency under a Memorandum of Understanding with the U.S. Department of Commerce. This relationship changed with the signing of The Affirmation of Commitments effective September 30, 2009. An explanation of the Affirmation and the text is available at <http://www.icann.org/en/announcements/announcement- 30sep09-en.htm>.
4. The ACPA is a section in the Trademark Act of 1946, 15 U.S.C. §1125(d).
5. There are currently five providers, but two most productive are the World Intellectual Property Organization located in Geneva, Switzerland (WIPO) and the National Arbitration Forum located in Minneapolis, Minnesota (NAF). A consolidated database of decisions in available at <udrpsearch.com>.
6. Rule 15(e) of the Rules of the Policy.
7. The RAA is available at http://www.icann.org/en/gsearch/registrar%2Baccreditation %2Bagreement.
8. UDRP, ¶ 2.
9. *Rapido TV Limited v. Jan Duffy-King*, D2000-0449) (WIPO August 17, 2000).
10. 15 U.S.C. §1125(d)(1)(A): "A person shall be liable in a civil action by the owner of a mark…if, without regard to the goods or services of the parties, that person—(i) has a bad faith intent to profit from that mark…and (ii) registers, traffics in, or uses a domain name [in a proscribed manner]."
11. Statistics compiled by WIPO. No comparable statistics from NAF.
12. For decisions filed in 2013, 26 complainants were sanctioned for reverse domain name hijacking (WIPO, 14; NAF 11; ADR.eu 1).
13. *RapidShare AG, Christian Schmid v. N/A Maxim Tvortsov*, D2010-0696 (WIPO June 22, 2010).
14. WIPO Overview of WIPO Panel Views on Selected UDRP Questions, Second Edition. "Consensus view: Generally speaking, although a trademark can form a basis for a UDRP action under the first element irrespective of its date…when a domain name is registered by the respondent before the complainant's relied-upon trademark right is shown to have been first established… the registration of the domain name would not have been in bad faith because the registrant could not have contemplated the complainant's then non-existent right." The Overview is available at http://www.wipo.int/amc/en/domains/search/overview/index.html.
15. See *DSPT International v. Nahum*, 624 F.3d 1213 (9th Cir. 2010) (The Court held that "[e]ven if a domain name was put up innocently and used properly for years, a person is liable under 15 U.S.C. § 1125(d) if he subsequently uses the domain name with a bad faith intent to profit from the protected mark by holding the domain name for ransom").
16. Paragraph 3(b)(xiv) of the Rules of the Policy: "Complainant certifies that the information contained in this Complaint is to the best of Complainant's knowledge complete and accurate, that this Complaint is not being presented for any improper purpose, such as to harass, and that the assertions in this Complaint are warranted under these Rules and under applicable law, as it now exists or as it may be extended by a good-faith and reasonable argument."
17. *Time Inc. v. Chip Cooper*, D2000-1342 (WIPO February 13, 2001) (<lifemagazine.com>).
18. *Pantaloon Retail India Limited v. RareNames, WebReg*, D2010-0587 (WIPO June 21, 2010).

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Class Arbitration Decisions in 2013 Confirmed the Importance of Class Action Waivers

By Lea Haber Kuck and Gregory A. Litt

The U.S. Supreme Court has taken an active interest in the difficult issues raised by the intersection of class actions and arbitration, issuing four class arbitration decisions in the last four years. In June 2013, it rendered two of those decisions, answering questions left open by the Court's earlier pivotal decisions in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*[1] and *AT&T Mobility LLC v. Concepcion*.[2] These decisions—*Oxford Health Plans LLC v. Sutter*[3] and *American Express Co. v. Italian Colors Restaurant*[4]—had an immediate impact on pending class arbitration cases around the country, and together they confirm the importance of including class action waivers in arbitration clauses where the parties do not intend to permit class action proceedings.

Oxford Health Plans LLC v. Sutter: Interpreting the Sounds of Silence

In *Stolt-Nielsen*, the Supreme Court held that "a party may not be compelled under the FAA [Federal Arbitration Act] to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so."[5] After the decision was rendered in 2010, parties continued to file class arbitrations,[6] but the federal courts split over how to proceed when an arbitrator infers a contractual basis for class arbitration even though the arbitration clause is silent on the subject.

The Second Circuit in *Jock v. Sterling Jewelers Inc.*[7] and the Third Circuit in *Oxford Health Plans*[8] each upheld an arbitrator's decision permitting class arbitration despite the lack of any specific reference to class actions in the arbitration clause. Both courts observed that the arbitrators made their decisions by interpreting the parties' arbitration clauses and finding a contractual basis for class arbitration, as required by *Stolt-Nielsen*.[9] After noting the narrow scope of review of arbitration awards permitted by the Federal Arbitration Act ("FAA"), both the Second and Third Circuits held that once the arbitrator has interpreted the parties' agreement, courts are not empowered to second-guess the decision.[10]

The Fifth Circuit, however, in *Reed v. Florida Metropolitan University, Inc.*, expressly rejected the Second and Third Circuit decisions explaining: "We read *Stolt-Nielsen* as requiring courts to ensure that an arbitrator has a legal basis for his class arbitration determination, even while applying the appropriately deferential standard of review. Such an analysis necessarily requires some consideration of the arbitrator's award and rationale."[11] After performing this analysis, the Fifth Circuit reversed the district court's decision, which had confirmed an arbitrator's clause construction award permitting class arbitration, and directed that the arbitration proceed bilaterally.[12]

To address this circuit split, the Supreme Court granted certiorari to review the Third Circuit's decision in *Oxford Health Plans*.[13] Oxford sought to rely on Section 10(a)(4) of the FAA, the same provision applied by the Supreme Court to vacate the award in *Stolt-Nielsen*, which allows a court to vacate an arbitral award "'where the arbitrator[] exceeded [his] powers.'"[14] Invoking *Stolt-Nielsen* and other precedents that set forth the extremely limited scope of permissible review under Section 10(a)(4), Justice Kagan, writing for the majority, explained that "the sole question" the courts may consider is "whether the arbitrator (even arguably) interpreted the parties' contract, not whether he got its meaning right or wrong."[15] In the case before it, the Court found that the arbitrator "considered [the parties'] contract and decided whether it reflected an agreement to permit class proceedings. That suffices to show that the arbitrator did not 'exceed[ ] [his] powers.'"[16] Accordingly, the Court affirmed the Third Circuit's decision and the arbitrator's award survived. The June 2013 decision has already been applied in several cases to ratify arbitrators' decisions permitting class arbitration despite facially silent clauses.[17]

Significant issues remain, however. In a footnote in the *Oxford Health Plans* decision, the Supreme Court noted that it would have faced "a different issue if Oxford had argued below that the availability of class arbitration is a so-called 'question of arbitrability,'" which would be "presumptively for courts to decide," and would thus allow the courts to review the arbitrator's decision *de novo*.[18] The Court noted that "*Stolt-Nielsen* made clear that this Court has not yet decided whether the availability of class arbitration is a question of arbitrability," but explained that the case did not provide it with the opportunity to do so because Oxford had agreed to submit the determination to the arbitrator.[19] In a concurring opinion, Justice Alito (joined by Justice Thomas) argued that the availability of class arbitration was a determination that should be made by the courts, but he recognized that Oxford's agreement to submit the question to the arbitrator removed the decision from the courts' consideration, and thus he joined the majority opinion.[20]

Only five months later, in November 2013, the Sixth Circuit held in *Reed Elsevier, Inc. ex rel. LexisNexis Division v. Crockett* that "the question whether an arbitration agreement permits classwide arbitration is a gateway matter, which is reserved 'for judicial determination unless the parties clearly and unmistakably provide otherwise.'"[21]

The court reasoned that "[g]ateway questions are fundamental to the manner in which the parties will resolve their dispute—whereas subsidiary questions," which should be left to the arbitrator, "concern details," and "whether the parties arbitrate one claim or 1,000 in a single proceeding is no mere detail."[22] The Sixth Circuit went on to determine that the parties had not "clearly and unmistakably" committed the class arbitration decision to the arbitrator, so it was left for the courts to decide, and the court decided that the clause, silent as to class proceedings, did not provide for class arbitration.[23]

The cases will continue to develop, and during the next year or two, they may provide more clarity on whether the availability of class arbitration is a decision for the courts or the arbitrator. But the unmistakable lesson to be learned from all of these cases is that if an arbitration clause is silent regarding class arbitration, the parties cannot be entirely certain what a court or arbitrator will do. To obtain certainty as to whether class arbitration will be permitted, arbitration clause drafters should either expressly assent to class arbitration or expressly waive it.

American Express Co. v. Italian Colors Restaurant: Waive It Goodbye

If parties expressly waive class arbitration, the Supreme Court has made clear that the waiver will be honored—even if the waiver is considered unconscionable under state law and even if it effectively forecloses the vindication of certain federal statutory rights.

In *Stolt-Nielsen*, the Supreme Court made clear that in the ordinary case, arbitrations cannot be brought on behalf of a class absent the agreement of the parties to this procedure,[24] and therefore certainly not when the parties expressly agreed to exclude arbitrations of class claims. But what about the case where waiver of the right to bring claims on behalf of a class conflicts with another legal principle or mandate?

In 2011, the Supreme Court ruled in *AT&T Mobility v. Concepcion* that California's state-law "*Discover Bank* Rule"—which applied California's unconcionability doctrine to bar class action waivers as unconscionable in some arbitration agreements—was preempted by the FAA, which requires courts to enforce arbitration clauses as written, with their class action waivers intact.[25] But state law unconscionability doctrines were not the only legal rules that courts used to strike down class action waivers, and in 2013, the Court took the opportunity to address the question in the context of federal statutory rights.

In 2009, the Second Circuit issued its first decision in a dispute between American Express Co. and Italian Colors Restaurant, a restaurant that accepted American Express cards.[26] Italian Colors brought claims on behalf of a class of merchants against American Express for alleged violations of federal antitrust law. In response, American Express sought to enforce the arbitration clause in its agreement with Italian Colors, which included a class action waiver. The Second Circuit struck down the class action waiver, finding that "the size of the recovery [potentially] received by *any* individual plaintiff will be too small to justify the expenditure of bringing an individual action."[27] The court cited a statement by the Supreme Court, almost 25 years earlier, that if the terms of an arbitration agreement operated as "'a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, [the Court] would have little hesitation in condemning the agreement as against public policy.'"[28]

Six days after it decided *Stolt-Nielsen*, the Supreme Court granted certiorari in *Italian Colors* in order to vacate and remand the case to the Second Circuit for reconsideration in light of the *Stolt-Nielsen* decision.[29] On remand, the Second Circuit reaffirmed its power to strike down the class action waiver in the American Express agreement. It concluded that because its prior decision had not ordered class-wide arbitration—a decision which would have been at odds with *Stolt-Nielsen*—but had instead remanded to the district court to allow the defendant the opportunity to withdraw its motion to compel arbitration, its prior ruling was valid and could be reinstated.[30]

The Supreme Court granted certiorari again, resulting in the June 2013 decision. Reversing the Second Circuit, the Court held that a contractual waiver of class arbitration is enforceable under the FAA even when the plaintiff's cost of individually arbitrating a federal statutory claim—such as a claim for violation of the federal antitrust laws—vastly exceeds the individual's potential recovery.[31] The Court ruled that the "effective vindication doctrine" cited by the Second Circuit might be applicable if the arbitration clause actually barred a party from raising a federal statutory claim, but it could not be applied simply because the expense of proving a claim outweighed an individual's potential recovery.[32] Justice Kagan (joined by Justices Ginsburg and Breyer) filed a vigorous dissent, contending that the result of enforcing the class action waiver was that "[t]he monopolist gets to use its monopoly power to insist on a contract effectively depriving its victims of all legal recourse" against its allegedly anti-competitive practices.[33]

Since the Supreme Court issued its decision, the Second Circuit has applied it twice to cases brought under the Fair Labor Standards Act of 1938 ("FLSA").[34] In the first of those cases, *Sutherland v. Ernst & Young LLP*,[35] the plaintiff, on behalf of herself and others similarly situated, sought to recover overtime wages pursuant to the FLSA and New York state wage regulations.[36] The district court denied the defendant's motion to compel arbitration because it found that the class-action waiver provision in the arbitration agreement was unenforceable.[37] During the pendency of the appeal of the decision to the Second Circuit, the Supreme Court decided *Italian Colors*.

On appeal, the Second Circuit reversed, ruling that "in light of the Supreme Court's holding that the 'effective vindication doctrine' cannot be used to invalidate class-action waiver provisions in circumstances where the recovery sought is exceeded by the costs of individual arbitration, we are bound to conclude that Sutherland's arguments are insufficient to invalidate the class-action waiver provision at issue here."[38]

Three days later, the Second Circuit issued a similar decision in *Raniere v. Citigroup Inc.*,[39] in which employees of Citigroup raised claims that the court characterized as "virtually identical to those raised" in *Sutherland*.[40]

The message of *Italian Colors* and its Second Circuit progeny is clear: class action waivers are likely to be enforced even if it is economically unreasonable for an individual plaintiff to proceed alone, and even if the effective result is that plaintiffs have no practical means of enforcing their federal statutory rights.[41]

Conclusion

The Supreme Court's recent decisions demonstrate the importance of clearly drafting arbitration clauses with respect to class arbitration. Parties may explicitly provide for class arbitration in their agreements, or they can explicitly exclude it, but if parties fail to address the issue, they may end up in an unsettled procedural morass.

Endnotes

1. 559 U.S. 662 (2010).
2. 131 S. Ct. 1740 (2011).
3. 133 S. Ct. 2064 (2013).
4. 133 S. Ct. 2304 (2013).
5. 559 U.S. at 664.
6. There were 27 class arbitration filings with the AAA in 2010 and 36 such filings in 2011. *See* Gregory A. Litt & Tina Praprotnik, *After* Stolt-Nielsen, *Circuits Split, But AAA Filings Continue*, 27-7 Mealey's Int'l Arb. Rep., 22 (2012).
7. 646 F.3d 113 (2d Cir. 2011), *cert. denied*, 132 S. Ct. 1742 (2012).
8. 675 F.3d 215 (3d Cir. 2012), *aff'd*, 133 S. Ct. 2064 (2013).
9. 646 F.3d at 124; 675 F.3d at 222-24.
10. 646 F.3d at 125 (referencing decades-old principle of granting arbitrator's decision "substantial deference" (citation omitted)); 675 F.3d at 219 (noting application of "more deferential standard of review" in support of federal policy favoring arbitration).
11. 681 F.3d 630, 645 & n.13 (5th Cir. 2012) (citation omitted) abrogated by *Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064 (2013).
12. *Id.* at 646.
13. 133 S. Ct. at 2068.
14. *Id.* (alteration in original) (citation omitted).
15. *Id.* (alteration in original) (citation omitted).
16. *Id.* at 2069.
17. *See, e.g., DIRECTV, LLC v. John Arndt*, No. 13-10033, 2013 WL 5718384 (11th Cir. Oct. 22, 2013) (per curiam); *Southern Comm. Serv., Inc. v. Thomas*, 720 F.3d 1352 (11th Cir. Jul. 12, 2013), *cert. denied*, 2014 WL 210671 (U.S. Jan. 21, 2014).
18. 133 S. Ct. at 2068 n.2.
19. *Id.*
20. *Id.* at 2071-72. Justice Alito noted that in the absence of a "concession" such as Oxford's, courts should "pause before concluding that the availability of class arbitration is a question the arbitrator should decide." *Id.* at 2072.
21. 734 F.3d 594, 599 (6th Cir. 2013) (internal citations omitted). At least one district court has disagreed with and declined to follow the Sixth Circuit's decision. *See Lee v. JPMorgan Chase & Co.*, ___ F. Supp. 2d ___, 2013 WL 6068601 (C.D. Cal. Nov. 14, 2013) at *4.
22. 734 F.3d at 598.
23. *Id.* at 599-600.
24. 559 U.S. at 664-65.
25. 131 S. Ct. at 1747 ("When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA.").
26. *In re Am. Express Merchants' Litig.*, 554 F.3d 300 (2d Cir. 2009), *vacated*, 130 S. Ct. 2401 (2010).
27. *Id.* at 320.
28. *Id.* at 319 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 n.19 (1985)).
29. *See Am. Express Co. v. Italian Colors Rest.*, 130 S. Ct. 2401, 2401 (2010).
30. *In re Am. Express Merchants' Litig.*, 634 F.3d 187, 200 (2d Cir. 2011).
31. 133 S. Ct. at 2310.
32. *Id.* at 2011 (noting "the fact that it is not worth the expense involved in proving a statutory remedy does not constitute the elimination of the *right to pursue* that remedy").
33. *Id.* at 2313.
34. 29 U.S.C. §§ 201-204, 206-207, 209-219.
35. 726 F.3d 290 (2d Cir. 2013).
36. *Id.* at 293-94.
37. *Id.* at 295.
38. *Id.* at 298-99.
39. 533 Fed. App'x 11 (2d Cir. 2013).
40. *Id.* at 14 (finding the lower court erred in holding that a waiver is unenforceable as to the class or any individual "'if any one potential class member meets the burden of proving that his costs preclude him from effectively vindicating his statutory rights in arbitration'" (citation omitted)).
41. Without reference to *Italian Colors* and with only a passing reference to *Sutherland*, the Fifth Circuit issued a decision on December 3, 2013, overturning a decision by the National Labor Relations Board that an employer violated the National Labor Relations Act when it required its employees to sign a class action waiver. *See D.R. Horton, Inc. v. NLRB*, 737 F.3d 344, 362 (5th Cir. 2013).

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What Is Expert Determination? The Secret Alternative to Arbitration

By Steven H. Reisberg

Arbitration, of course, is well known in the United States. What is not generally known is that there is an alternative to arbitration. The law recognizes two well developed and distinct types of alternative dispute resolution proceedings, each of which lead to a final and binding result: (i) arbitration and (ii) expert determination. Expert determination is a powerful alternative to arbitration which, when properly understood, can be preferable to arbitration for certain types of disputes. Expert determinations are governed by their own body of law that is separate, distinct, and materially different from the law of arbitration.

"Expert determination is a powerful alternative to arbitration which, when properly understood, can be preferable to arbitration for certain types of disputes."

The lack of present awareness of the law of expert determination in New York is particularly surprising. The New York Legislature over fifty years ago enacted specific legislation governing expert determinations as a form of dispute resolution separate from arbitration. This legislation, which has become virtually unknown among contemporary practitioners, is found in CPLR Article 76 (as opposed to Article 75, which governs arbitration) and is supplemented by extensive case law. The Legislature added Article 76 to the CPLR specifically in order to ensure that the parties' election to have their dispute resolved by expert determination, as opposed to arbitration, is fully recognized and enforced by the New York courts. *See In re Penn Cent. Corp.*, 56 N.Y.2d 120, 126-27 (1982).

The law of expert determination is the subject of a report recently issued by the New York City Bar called "Purchase Price Adjustment Clauses and Expert Determinations: Legal Issues, Practical Problems and Suggested Improvements."[1]

The City Bar Report sets forth the general jurisprudence of the law of expert determinations. The Report takes a particularly close look at cases concerning purchase price adjustment disputes, described below. While New York law is particularly well developed in this general area, there has been substantial confusion in the federal courts and in courts of other states concerning whether a particular dispute resolution clause provides for expert determination or arbitration. The Report also examines some of the issues that have been the subject of litigation relating to such clauses, and makes suggestions as to how parties can draft these clauses so as to better express their intent and to minimize litigation.

Agreements governing the purchase and sale of private companies often include a provision allowing for an adjustment in the purchase price as of the closing date. Parties include such clauses because there can be a substantial period of time between the signing of the purchase agreement and the closing of the transaction. During this time, the value of the company may change. Purchase price adjustment clauses commonly contain their own dispute resolution mechanism. The parties usually agree that any dispute concerning the adjustment to the purchase price is to be submitted to an independent accounting firm for a final and binding determination.

Contracts providing for the final and binding resolution of an issue by submission to one or more experts can be found in a wide range of other commercial agreements.[2] These include, for example, the determination of rent adjustments under long-term leases,[3] the price to be paid upon exercise of an option to purchase shares in a private company or an option to purchase real property,[4] and the amount of loss under an insurance policy.[5]

Expert determination, as distinct from arbitration, is recognized under the laws of many other countries, including England, Canada, Australia, New Zealand, Belgium, Germany, Hong Kong, Italy, France, and The Netherlands, among others. While each country has its own rules regarding expert determinations, what is important is that "[m]ost jurisdictions concur that arbitration laws do not apply to expert determination proceedings."[6] This is the same position taken in the current draft of the Restatement Third of the U.S. Law of International Arbitration, which distinguishes and excludes expert determinations from its definition of arbitration.

New York state courts have regularly confirmed determinations made by independent accounting firms in purchase price adjustment disputes under the statutory authority of New York CPLR § 7601, while at the same time recognizing and explaining why such proceedings are not arbitrations and not governed by arbitration law. *See, e.g., Westmoreland Coal Co. v. Entech, Inc.*, 100 N.Y.2d 352 (2003) (petition pursuant to CPLR § 7601 to compel party to submit purchase price dispute to independent accounting firm); *Doosan Infracore Co. v. Ingersoll-Rand Co.*, No. 652170/2010 (N.Y. Sup. Ct. Mar. 15, 2011) (confirming accounting firm's purchase price adjustment).

Indeed, Section 7601 was enacted in order to provide for judicial enforcement of expert determinations as sepa-

rate and distinct from arbitration. Section 7601 provides that a "special proceeding may be commenced to specifically enforce an agreement that a question of valuation, appraisal or other issue or controversy be determined by a person named or to be selected." A report to the New York Legislature, submitted in support of legislation that led to the enactment of what is today Article 76 of the CPLR, recited the long and broad use of expert determinations, as follows:

> Many business agreements contain provisions for determination by a designated third party…of valuation, appraisal of loss, verification of performance, ascertainment of quantity or quality, fixing of boundary lines, or other specific questions relevant to the transaction. Agreements of this kind were recognized as valid at an early date.[7]

Courts had previously held that such agreements could not be specifically enforced under the statute governing arbitration, because they were not arbitrations. *See In re Delmar Box Co.*, 309 N.Y. at 63-64, 66. CPLR § 7601 provides the courts with broad statutory authority to enforce expert determination clauses, including the authority to confirm the decision made by the expert and enter it as a court judgment. *See In re Penn Central Corp.*, 56 N.Y.2d at 128-30.

While arbitration and expert determination have many similarities, there are also important differences. The laws governing expert determination and arbitration are materially different in several important ways, involving matters of both substance and procedure. The Report describes and explains those differences, focusing on four points.

First, a close analysis of the case law reveals that the fundamental difference between an expert determination and arbitration can be found in the scope of authority the parties are delegating to the decision maker. As more fully discussed in the Report, in a typical expert determination the authority granted to the expert is limited to deciding a specific *factual* dispute concerning a matter within the special expertise of the decision maker, usually concerning an issue of valuation. The decision maker is expected to use his or her specialized knowledge to resolve the specified fact issue. The parties do not normally grant the expert the authority to decide legal claims, make binding determination of law, interpret contracts, decide liability, or award damages. As a consequence, expert determinations can be much faster, more focused, and substantially less expensive than arbitration.

In arbitration, on the other hand, the parties normally intend to delegate to the decision maker full authority to decide all legal and factual issues necessary to resolve all claims that fall within the scope of the arbitration clause. The grant of authority to an arbitrator, but not to an expert, is analogous to the powers of a judge. Arbitrators are expected to rule on issues of law, make binding interpretations of contracts, resolve disputed issues of fact, determine liability, and award damages or other forms of relief. Arbitration ordinarily encompasses the resolution of the entire controversy submitted to arbitration, while an expert determination is usually limited to the resolution of specific issues of fact. Where the fact issue resolves the entire controversy submitted, an expert determination can be confirmed by a court as a judgment. *See In re Penn Central Corp.*, 56 N.Y.2d at 128-30.

"The laws governing expert determination and arbitration are materially different in several important ways, involving matters of both substance and procedure."

Second, there are very significant differences in procedure. Arbitration requires procedural protections appropriate to an adversarial proceeding. An arbitrator is required to decide the matter only on the evidence submitted by the parties. Arbitrators are expected to hold a hearing or otherwise provide the parties with a fair opportunity to present their evidence. Most importantly, an arbitrator may not engage in any independent investigation, hear evidence outside the presence of the parties, or participate in any *ex parte* communications.

In an expert determination, these procedural restrictions do not automatically apply. Experts may act on the basis of their own special knowledge and expertise. The expert, subject to any limitations imposed by the parties in the contract, has inquisitorial powers and can exercise that discretion to gather information from any source that in the expert's judgment is required to resolve the matter, including by independent investigation and *ex parte* communication. As a result, not all the evidence an expert considers must be presented at a hearing in the presence of the parties. These more informal procedures also allow for an expert determination to be structured so as to provide a faster resolution of a specified factual issue than if the same issue were to be resolved by arbitration.

Third, there are substantial differences in the standard of review. Review of an arbitration award is governed by the Federal Arbitration Act (the "FAA"). The grounds to set aside an arbitration award are limited. *See* 9 U.S.C. § 10. Courts will not review an arbitration award on the grounds that the arbitrator may have made an error of law or mistake of fact. Furthermore, the parties cannot by contract change the standard of review set forth in the FAA.

Expert determinations are governed by State law, not the FAA. The standard under New York law, as well as the law of many other states, is that such determinations will be binding on the parties in the absence of "fraud,

bad faith or palpable mistake."[8] Moreover, parties can contractually set the standard of review to be applied in reviewing the expert's determination. For example, the parties may agree that the expert's determination shall be final and binding on all parties, except in the case of manifest error.

Fourth, an arbitration award is enforceable the United States under the FAA and, in contracting states, under the U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention"). Expert determinations are governed solely by state law and most likely would not be afforded the benefit of the New York Convention.

An increase in awareness of the law of expert determination, as an alternative to arbitration, will allow parties to choose the form of dispute resolution most appropriate to their specific needs.

Endnotes

1. The full Report is available at www2.nycbar.org/Publications/reports/.
2. The terms historically used to distinguish expert determination from arbitration are "appraisal" or "appraisement." *See In re Penn Cent. Corp.*, 56 N.Y.2d at 126-27 ("Historically, the courts have recognized a basic distinction between appraisal and arbitration.") Today, as under English law, the more appropriate term for this alternative to arbitration is expert determination.
3. *See Rice v. Ritz Assocs., Inc.*, 450 N.Y.S.2d 7 (1st Dep't 1982), *aff'd*, 58 N.Y.2d 923 (1983) (rent adjustment under lease).
4. *See, e.g., Tonkery v. Martina*, 78 N.Y.2d 893 (1991) (purchase price upon exercise of option to be fixed by three appraisers); *Trio Asbestos Removal Corp. v. Marinelli*, 37 A.D.3d 475 (2d Dep't 2007) (valuation of shares to be sold to be determined by the company's accounting firm).
5. *See, e.g.*, LEE R. RUSS & THOMAS F. SEGALLA, 15 COUCH ON INS. § 209:8 (3d ed. 2012).
6. *See* JOHN KENDALL, CLIVE FREEDMAN, & JAMES FARRELL, EXPERT DETERMINATION at 2, 309 (4th ed. 2008).
7. See LAW REVISION COMM'N, RECOMMENDATION TO THE LEGISLATURE RELATING TO ENFORCEMENT OF AGREEMENTS FOR APPRAISAL OR VALUATION AND TO ARBITRATION OF CERTAIN NON-JUSTICIABLE ISSUES, N.Y. Legis. Doc 65(C), at 385 (1957).
8. *See, e.g. Liberty Fabrics, Inc. v. Corporate Props. Associates*, 5, 636 N.Y.S.2d 781 (1st Dep't 1996).

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Condition Confusion
A Look at *BG Group PLC v. Republic of Argentina*

By Ross J. Kartez

In *BG Group PLC v. Republic of Argentina*,[1] currently before the Supreme Court, the Court will soon issue a decision of vital importance to the practice of arbitration. In *BG Group*, the question before the Supreme Court is which tribunal, the court or the arbitrator, is to determine whether certain conditions in an arbitration agreement have been met. The question in *BG Group* is complicated by the arbitration agreement at issue in the case, a bilateral investment treaty between Argentina and the United Kingdom that provides for arbitration by investors against the sovereigns under certain circumstances. In order for the Supreme Court to resolve the issue before it, the Court must clarify the difference between conditions precedent to arbitration and conditions of substantive arbitrability.

Generally, conditions precedent are provisions, such as notice requirements, that do not impact the validity of an arbitration agreement.[2] Conditions of arbitrability, on the other hand, are conditions that must be complied with in order for the arbitration agreement to be binding (i.e., requiring an arbitration to be brought within a specified time).[3]

It is well-settled that compliance with a condition precedent to arbitration is for an arbitrator to decide.[4] It is also well-settled that formation and validity of an arbitration clause is for a court to decide (provided the parties have not agreed to submit the question of arbitrability to the arbitration panel).[5] What is more difficult is to distinguish which type of condition a particular contractual provision is. The D.C. Circuit's decision in *BG Group PLC v. Republic of Argentina*[6] has demonstrated that in certain circumstances, the distinction between the two types of conditions is not entirely clear, making the appropriate tribunal to decide compliance equally uncertain. The Supreme Court will hopefully provide some clarity.

The Arbitration Agreement

The arbitration agreement in dispute in *BG Group* is not an agreement between private entities, but rather the bilateral investment treaty between the United Kingdom and Argentina (the "Treaty"), which took effect in 1993. Argentina and the United Kingdom negotiated the Treaty to foster foreign investment into Argentina following a series of economic reforms, which included privatizing transportation and distribution of Argentina's state-owned gas resources. Soon after the Treaty took effect, BG Group PLC ("BG Group"), a British corporation, made a substantial investment in an Argentine gas transport company, but in 2001 Argentina's economy collapsed. In response, Argentina enacted emergency laws that superseded many of the economic reforms, established a renegotiation process for public service contracts (excluding any licensee who sought redress in court or arbitration), and stayed injunctions and enforcement of final judgments pertaining to the emergency law's effect on the economy. Eight months after the stay expired, BG Group served Argentina with a notice of arbitration pursuant to the Treaty.

"The DC Circuit's decision in BG Group PLC v. Republic of Argentina *has demonstrated that in certain circumstances, the distinction between the two types of conditions is not entirely clear, making the appropriate tribunal to decide compliance equally uncertain. The Supreme Court will hopefully provide some clarity."*

The Treaty, like many bilateral investment treaties, provides that investors from each party to the Treaty that have investments in the other party may arbitrate disputes with that party. The Treaty's dispute resolution clause provides,[7] in summary, that disputes arising under the terms of the Treaty are to be submitted to a competent tribunal of the party in whose territory the investment was made (*i.e.*, in the case of BG Group, an Argentine Court). Disputes under the Treaty may then be submitted to international arbitration if one of the parties requests, when: *after eighteen months, the competent tribunal has not given its final decision; or where the competent tribunal has made a final decision, but the parties are still in dispute.* Notably, the Treaty does not provide that a final decision from the competent tribunal bears any weight before the arbitration tribunal.

The Arbitration and Subsequent Court Proceedings

BG Group initiated an arbitration without first submitting the matter to the Argentine courts. Argentina contested jurisdiction on the ground that BG Group had not met the eighteen month litigation prerequisite to arbitration called for in the Treaty. BG Group argued in response that it was not required to submit the dispute

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Scenes from the Dispute Resolution Section

Annual Meeting, Award Ceremony and Cocktail Reception

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(continued from page 35)

to an Argentine court because the dispute would not have been resolved within eighteen months. The arbitrators agreed with BG Group and, alternatively, the panel determined it had jurisdiction "because Argentina by emergency decrees had restricted access to its courts and had excluded from the renegotiation process any licensee that sought redress, a literal reading of the Treaty would produce an 'absurd and unreasonable result' [citation omitted]."[8] After finding it had jurisdiction and after hearing the merits of the dispute, the panel determined that Argentina had violated the Treaty and awarded BG Group $185,285,485.85 in damages.

Argentina brought an action in the D.C. District Court to vacate or modify the panel's award; BG Group cross-moved for enforcement. Argentina again argued that it never agreed to arbitrate the dispute because under the Treaty, prior to arbitration, BG Group was required to submit the dispute to an Argentine court for a period of eighteen months. Argentina contended that, since BG Group had failed to comply with this condition, Argentina never agreed to arbitration with BG Group and the dispute was not arbitrable. The District Court rejected Argentina's argument and refused to question the arbitration panel's determination of arbitrability on the ground that the parties had delegated the question of arbitrability to the arbitration panel. In making its decision, the Court relied on arguments made by Argentina during the motion hearing whereby Argentina conceded that the Treaty delegated the question of arbitrability to the arbitration panel.[9] Because the contracting parties had delegated the issue of arbitrability to the arbitration panel and the panel decided the issue, the Court was unwilling to disturb that decision. The District Court denied vacatur and granted enforcement.

The D.C. Circuit reversed the District Court and vacated the award. The D.C. Circuit framed the issue as a "gateway question" to be determined based on the contracting nations' intent. Thus the question to be decided was, "did they, as contracting parties, intend that an investor under the Treaty could seek arbitration without first fulfilling Article 8(1)'s requirement that recourse initially be sought in a court of the contracting party…? [And] whether the contracting parties intended the answer to be provided by a court or an arbitrator."[10] The D.C. Circuit found that Argentina never conceded that the question of arbitrability was delegated to the arbitration panel and the District Court misinterpreted Argentina's argument at the motion hearing.[11] In contrast, the D.C. Circuit found that based on a review of the Treaty, the contracting parties intentionally left out language granting the arbitration panel the authority to decide arbitrability. And "[i]n such circumstances, where 'the parties did not agree to submit the arbitrability question itself to arbitration, then the district court should decide that question…independently '[citations omitted]."[12] The D.C. Circuit reasoned that since the gateway provision at issue requires court intervention, it is logical to assume the parties intended a court determine whether the provision be followed. The D.C. Circuit stated, "[b]ecause the Treaty provides that a precondition to arbitration of an investor's claim is an initial resort to a contracting party's court, and the Treaty is silent on who decides arbitrability when that precondition is disregarded, we hold that the question of arbitrability is an independent question of law for the court to decide."[13]

Arguments Before the Supreme Court

BG Group filed a petition for *certiorari* with the United States Supreme Court, which the Court granted. BG Group presented various arguments to the Supreme Court in support of its position that the arbitration panel and not the court is the appropriate tribunal to review compliance with the Treaty's litigation provision. BG Group argued that the D.C. Circuit's presumption that U.S. courts decide questions of arbitrability is inapplicable to the Treaty's litigation provision because that presumption is only for rare circumstances. Rather, BG Group contended, the Treaty's litigation requirement is akin to a condition precedent to be decided by the arbitrator under the Supreme Court's *Howsam* decision.[14] BG Group argued that, under the Treaty, the arbitration panel is the only tribunal empowered to make final decisions, including decisions about jurisdiction. The arbitration panel made its decision after considering the litigation requirement, thus their decision should be final.[15]

Argentina argued that the court is the appropriate tribunal to decide whether the parties agreed to arbitrate their dispute because the litigation requirement is a condition to Argentina's *consent to arbitrate* and not a simple condition precedent. Argentina argued that there had been no consent because the Treaty is a unilateral offer by Argentina to arbitrate only with parties who had first submitted their dispute to an Argentine court. According to Argentina, by commencing an arbitration without abiding by the litigation requirement, BG Group presented a counter-offer to this unilateral offer that Argentina had rejected. Further, Argentina argued that the D.C. Circuit had reviewed all considerations and made its decision in accordance with United States and international law.[16]

The United States, as *amicus curiae*, argued that de novo review by a court is appropriate to decide issues regarding the disputed condition where a condition goes to a state's consent to arbitrate. The United States further argued that ordinary contract principles should not control with respect to the interpretation of arbitration clauses contained in bilateral investment treaties, but rather courts should use principles of treaty interpretation to examine "the treaty's text and other relevant materials for

determining the treaty parties' intent."[17] Thus, the United States argued that the Supreme Court should remand the case so the lower court can apply the principles of treaty interpretation to questions of arbitrability under the Treaty. However, the United States did not articulate what it contended the result on remand should be.

"The current state of the law has led to serious confusion in the interpretation of arbitration agreements and has the potential to seriously damage the United States' reputation as a center for international arbitration."

A variety of arbitration organizations submitted amicus briefs supporting the position of BG Group. These included a distinguished group of twenty professors and practitioners of arbitration law, the United States Counsel for International Business (USCIB) and the American Arbitration Association ("AAA").[18] The AAA, for example, in its *amicus curiae* brief called for the D.C. Circuit to be reversed, placing a strong emphasis on the negative impact the D.C. Circuit's decision will have on the practice of arbitration in the United States.[19]

The Courts Reaction at Oral Argument

The Supreme Court heard oral argument on December 2, 2013.[20] At oral argument, the justices' questions suggested that they were struggling with the difference between procedural conditions precedent and substantive conditions of arbitrability.[21] The justices' questions suggested that they had particular discomfort with the United States' position that arbitration agreements in treaties should be treated differently from other agreements.[22] Generally, the justices' questions suggested some sympathy for BG Group's position.[23] Of course, it is not possible to predict a result from the questioning at a Supreme Court argument. Nonetheless, it appears that the Court may add some clarity to the question of whether arbitrators or courts resolve questions regarding conditions in arbitration agreements.

Conclusion

The current state of the law has led to serious confusion in the interpretation of arbitration agreements and has the potential to seriously damage the United States' reputation as a center for international arbitration. Hopefully the Supreme Court will issue a decision that resolves this condition confusion and makes clear the circumstances under which courts rather than arbitrators decide conditions precedent in arbitration.

Endnotes

1. No. 12-138.
2. See *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002).
3. *Id.*
4. See *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543 (1964).
5. See *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995); see also *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002).
6. No. 12-138.
7. Agreement Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Argentina for the Promotion and Protection of Investments, U.K.-Arg., Dec. 11, 1990, 1765 U.N.T.S. 33. Art. 8(1) and Art. 8(2).
8. *Republic of Argentina v. BG Group PLC*, 665 F.3d 1363, 1368 (D.C. Cir. 2012).
9. *Republic of Argentina v. BG Group PLC*, 764 F.Supp.2d 21, 33 (D.D.C. 2011).
10. *Republic of Argentina v. BG Group PLC*, 665 F.3d 1363, 1369 (D.C. Cir. 2012).
11. *Id.*, 665 F.3d 1363, 1370 (D.C. Cir. 2012).
12. *Id.*
13. *Id.*, 665 F.3d 1363, 1371 (D.C. Cir. 2012).
14. See *Howsam*, 537 U.S. 79.
15. *BG Group PLC v. Republic of Argentina*, No. 12-138; see Brief for Petitioner.
16. *BG Group PLC v. Republic of Argentina*, No. 12-138; see Brief for Respondent.
17. *BG Group PLC v. Republic of Argentina*, No. 12-138; see Brief for the United States as Amicus Curiae in Support of Vacatur and Remand, p. 7.
18. *BG Group PLC v. Republic of Argentina*, No. 12-138, Motion for leave to file amicus brief filed by Professors and Practitioners of Arbitration Law; Motion for leave to file amicus brief filed by United States Council for International Business; Motion for leave to file amicus brief filed by American Arbitration Association.
19. *BG Group PLC v. Republic of Argentina*, No. 12-138; see Brief of Amicus Curiae the American Arbitration Association in Support of Petitioner, p. i and 5.
20. www.supremecourt.gov/oral_arguments/argument_transcripts.aspx.
21. *BG Group PLC v. Republic of Argentina*, No. 12-138, U.S. Tr. (Dec. 2, 2013) p. 4; 30-31; 35; and 44.
22. *BG Group PLC v. Republic of Argentina*, No. 12-138, U.S. Tr. (Dec. 2, 2013) p. 33-34.
23. *BG Group PLC v. Republic of Argentina*, No. 12-138, U.S. Tr. (Dec. 2, 2013) p. 14-15; 33; 44-47; and 58.

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Negotiation Tricks for Successful Mediators: The Framing Effect

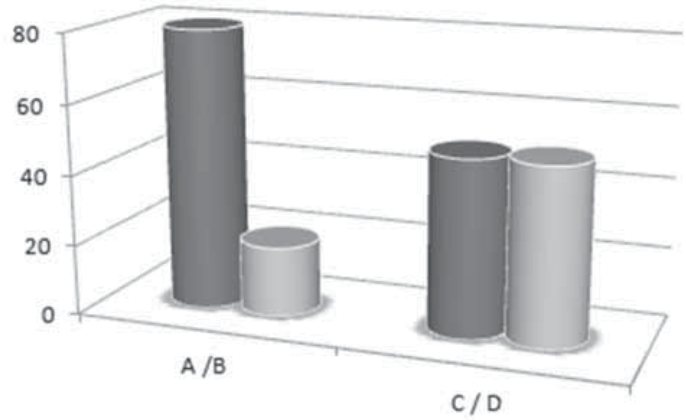
By Claudia Winkler

On February 13, 2013 a group of 120 Harvard students was confronted with an atypical life-or-death decision.

> *"Imagine you are leading a country that experiences an unprecedented epidemic, expected to kill 600 people. Two alternative programs to fight the disease have been proposed and you have exact scientific estimates of the consequences following the implementation of either. If program A is adopted, 200 people will be saved. If program B is adopted, there is a one-third probability that all people will be saved and a two-thirds probability that no people will be saved. Which would you chose?"*

The author, a member of the class, instantly logged "A" into the little voting device that had been distributed to collect the students' individual responses.

> *"Now how would you decide if the two alternative programs you have to chose from were the following. If program C is adopted, 400 people will die. If program D is adopted, there is a one-third probability that nobody will die and a two-thirds probability that 600 people will die."*



The author chose "D." Seconds after the last student made her choice a bar chart appeared on the big screen.

In the first, positively formulated version of the question, 80% of the students voted for program A, the safe strategy that saves 200 people. Only 20% chose program B, the risky strategy. In the second, negatively formulated version of the question, only 50% chose the safe program, while the rest opted for the riskier one. It does not take much explanation to show that options A and C are the same. In option A 200 out of 600 people are saved; in option C 400 out of 600 people die, leaving 200 saved. Options B and D are the same too. Option B has a one-third probability that all will be saved. Option D has a two-thirds probability that no one will be saved, i.e., one-third possibility that all will be saved.

Realizing that they had failed to correctly conceptualize the presented numbers and make a rational decision based on them, some students joked about having chosen the right profession to apply their excellent numerical skills to. Others stared at the numbers skeptically. All were confused about the decisions they had just made. *We had been framed*.

The Power of Framing

Framing is an innate skill, used by our subconscious every day. Framing makes us declare some aspects of a situation we experience meaningful, but not others. Framing helps us to draw other people's or our own attention to a specific aspect of an issue. Framing defines our individual angle on the world. Framing influences our perceptions and decisions. Framing is our process of constructing and representing our interpretation of a situation.

Good negotiators take frequent advantage of framing as a means of representing a subject and purposefully presenting issues in ways advantageous to them. The most prominent example is the shift from positions to interests, as Fischer & Ury have taught for decades.[1] Other tools of framing include: losses versus gains, short versus long horizons, aggregation versus segregation and superordinate versus concrete goals. All these framing mechanisms can also provide mediators with a variety of tools helpful to influence the parties' perceptions and decisions.

Framing in Mediation

Mediators do not have negotiation power. We do not have leverage points or bargaining strengths. In fact we lack any (direct) power to compel an agreement between the parties. Our greatest power lies in the committed trust in us to be the liaison between the parties and in being relied upon to help them communicate and to use our persuasive skills to assist them in coming to an agreement.

(Re-)framing, subconsciously or purposefully, is every mediator's most used and most powerful tool. With both parties strongly believing that their views are right, the mediator is called to reframe this self-centered approach to a more solution-oriented, problem-solving and collaborative perspective. Restating and reframing negative, egocentric, positional and unproductive statements or viewpoints to more positive, open, interest-based and productive communication can take the same issue from an impasse to a solvable conflict.

Successful framing as a mediator is more difficult than as a negotiator as it requires the mediator to first get to a full understanding of the parties' views of the dispute. Once in sync with a party's construction of reality the me-

diator needs to "pierce the party's operative mythology and alter, shift, or transform the context of a dispute so that it is susceptible to resolution."[2] By "context" Benjamin means the "framing or understanding of the dispute, how a party views what the fight is about and presents it."

Therefore, the challenge for the mediator is to recognize the frame that the parties operate in. The mediator can then, step by step, provide them with an alternative way of conceptualizing their conflict in a common frame by 1) acknowledging their own frame, 2) merging their frames of thinking on a meta level by identifying their common interests, to then 3) creating a more productive and cooperative framework for both parties.

The mediator might be inclined to make rational arguments to accomplish this. From our balcony perspective it is easy to see why and how the parties are being irrational or "ill-framed." But the power of the mediator does not rest in rationality or logical argument; the parties already have their rational arguments. It is often not enough to explain to them why and how they should see their issue differently. It is not enough to study beetles under the microscope and know everything about them. In order to truly be able to understand and have influence we have to understand what it *feels* like to be a beetle. Only the full understanding of the rational and emotional power of the parties' frames can allow a mediator to pick them up and show—rather than tell—them how to reframe the issue in a way that is consistent with their world-view but transforms their perception of impasse into a resolvable dispute.

The "frame adoption hypothesis," as developed in negotiation literature, suggests that frames adopted and communicated by one party will influence the frame adopted by the other, helping the convergence of the parties' views of their situations.[3] *Argumentum a minori ad maius*, given the influence of the negotiating opponents on each other's frames, it seems to be safe to assume that the framing efforts of the mediator will have an even more powerful influence on the perceived realities of the parties. In fact, frame selection results, as in the opening experiment, have been shown to rarely derive from the parties' communication but from external sources.[4] The mediator can be considered such an external source. Studies have also shown that frames suggested by "experienced players," a role mediators often embody, can have a strong influence on the behavior of the players, i.e., parties.[5] Assuming that every frame the parties bring into the mediation is malleable by a skilled mediator, and considering framing's tremendous potential value to aid the solution of a dispute, more emphasis should be placed on the use of framing as a mediator's most precious tool in helping parties resolve their dispute.

Mediators can use reframing to reinterpret the circumstances of a mediation in a multitude of ways, including the mediation process and the parties' expectations thereof, issues of what is considered just and fair, and the parties' identity concerns.[6] While of incredible power, these sophisticated tools of social cognition are beyond the scope of this article, which focuses on reframing the substantive issues on the table.

Prospect Theory

One of the most effective framing techniques and the one that has been proven to have the strongest impact on decision making[7] is called "Prospect Theory"[8] or the "gain or loss frame" (let's call it "GOLF"). The GOLF conceptualizes any outcome, issue or decision as either a gain or a loss, seeking to take advantage of scientific research that shows that human beings value gain and loss differently.

The core finding of Prospect Theory is that "losses loom larger than gains."[9] The pleasure of winning $100 is experienced less intensely than the pain of losing the same $100. Losses are experienced more strongly than would be expected on the basis of purely numerical, logical judgment, assuming a perfect correlation between an increase in value / happiness and a decrease in value / happiness.

GOLF Frames

Often GOLFs are self-created cognitive representations of a party's perceived bargaining situation. It is also possible that a party adopts a frame that is communicated by the other side or by the mediator. The difference in behavior and results depending on the parties' perceptions, *i.e.,* frames, has been proven by many experiments (*e.g.*, bargaining games) that systematically provide different sets of instructions and other exogenous sources to strategically place negotiators in different GOLFs.

One example is framing into *profit* versus *expense.* For example, in a study with MBA students and professional buyers, one half of the participants received instructions describing the negotiation outcome and terms as possible expenses, the other half received the same numbers framed as possible profits to make.[10] Another way to articulate the alternative frames would be to communicate "I really have to make a *profit*" vis-à-vis "I really need to cut *expenses.*"[11]

Effects of GOLFing

The way perceived gains or perceived losses affect people's emotions with different magnitude leads to a series of impacts on thinking and behavior in negotiations and mediations. Recent brain studies using magnetic response imaging have provided biological explanations for this phenomenon by showing that different parts of our brain deal with information framed as potential gains and information framed as potential losses.[12] The influences on our behavior can be grouped into three categories.

Risk-taking. Because of our higher sensitivity to losses, humans tend to go with the more conservative strategy in gain-frame situations but adopt higher risk strategies when faced with possible losses, trying everything to

avoid them. This means that we show a more risk-averse attitude towards solutions framed as gains and more risk-seeking attitude if confronted with solutions framed as losses.[13] This behavior is explained by our negative emotional connections with loss-frame situations.

Demands. Studies have shown that the average demand a party makes is higher if the party operates under a loss-frame, particularly when the party perceives that the other side is also adopting a loss frame. In contrast, negotiations framed in a gain-frame tend to involve lower demands.[14]

Compromises/Concessions. A similar phenomenon has been witnessed in the parties' willingness to make concessions. Average concessions are lower when faced with a loss-frame, while gain-frames tend to produce higher concessions.[15] Interestingly, smaller concession will be *perceived* as bigger by the other side when operating in a loss-frame setting rather than in a gain-frame.[16] This can result in the interesting paradox of parties in loss-frames offering smaller concessions than parties in gain-frames, yet those smaller concessions will be perceived as larger.

Overall, negotiations framed as losses seem to have a higher risk to create an impasse[17] while negotiations framed as gains are more likely to settle[18] and are expected to yield greater mutual gain.[19] The increased willingness to make risky decisions in a loss frame setting results in greater willingness to walk away from an objectively beneficial deal that would beat the party's BATNA (Best Alternative to Negotiated Agreement) but falls short of the party's established (negative) reference point. On the other side, decisions framed as possible losses have been shown to create higher motivation for the parties to make a bigger effort to come to a resolution. Parties take more risks and invest more effort to avoid losses than to obtain gains.[20]

Summarizing all these findings, GOLFing can yield the following effects:

GAIN-Frame Effects	LOSS-Frame Effects
Thinking "decrease in gains"	Thinking "increase in losses"
Conservative strategies (risk-averse)	Risky strategies (risk-seeking)
Lower demands	Higher demands
Larger and more concessions	Aversive to making concessions (but same size concession will loom bigger if presented in loss frame)
Less motivation to find a solution	Framing a decision as possible loss motivates parties to invest time and energy
More likely to settle; greater mutual gain	More impasses and conflict escalation

"We Had Been Framed"

All this serves as an explanation for why the voting results the students rendered in the above-mentioned experiment fell so far from meeting the standards for a rational, educated decision. When this experiment was first conducted by Amos Tversky and Daniel Kahneman in 1981, program A, presented in a positive frame ("saves 200 lives"), was chosen by 72% of participants. Program C, where the same choice was presented in a negative frame ("400 people will die"), was chosen by only 22%.[21]

Changing the GOLF from positive to negative in this hypothetical scenario led to an almost perfect reversal of programs chosen by the two different groups of professionals involved in Kahneman's study.[22] Being given the negative framework in the second scenario, people responded with a higher readiness to take risks than in the positively framed scenario. The certain death of 400 people seems less acceptable than the two-thirds chance of the death of 600 people. In contrast to that, in the positive scenario, the certain rescue of 200 people seems better than the one-third possibility of saving all 600. With positive outcomes in mind we prefer risk-averse, safe options. With negative outcomes in mind we prefer risk-taking.

This example of GOLFing shows how decisively a changing of frames can influence the way we *perceive* a problem or a solution. Choices between gambles and sure things are resolved differently, depending on whether the outcome is perceived as positive or negative. Changing the frame in one or the other way can be as influential as turning around our entire assessment of a situation or an option.

Recommendations for Mediators

Like any powerful tool, framing needs careful handling. Being cognizant that we are all subject to the power of frames and realizing how we can utilize the same in helping parties to resolve conflict is only the first step. The recommendations below help ensure most effective use of this valuable technique.

1. As mediators we should try to be more mindful about the way we communicate with the parties. What are the frames *we* have in mind for this mediation and what is the frame we are conveying to the parties by the use of our specific terms and language?
2. In caucusing situations we have to make sure we use our language to accurately represent not only the substantive message provided to us but also the frame in which it was communicated (e.g. small concessions appearing bigger in loss-frames).
3. When listening to the parties' stories we can watch their language to find out whether they are thinking in a loss- or in a gain-frame by recognizing key words such as gain, profit, income, benefits, earn-

ings, winning or loss, expense, damage, concession, cost, compromise, outlay, etc.

4. Once understanding how the parties perceive their situations we can slowly help them conceptualize their conflict in a more productive way, keeping it in line with their world-view but gently refocusing their perceptions.
5. We can be aware that framing a decision as a gain will encourage the parties to make bigger concessions and be more risk-averse, making the resolution of the conflict and a mutually beneficial outcome more likely.
6. We can frame a decision as a possible loss to boost the parties' motivation to more seriously invest their time and energy in the mediation.
7. We can use framing to emphasize the full value of an offer.
8. We can make a concession by one side seem more generous and cooperative to the other by presenting it in a loss-frame.
9. We can shift frames when confronted with an impasse or an escalation of a negotiation. Often framing can break a stalemate because both parties, while negotiating in good faith, have framed the problem differently and cannot see why the other side will not accept their "objectively" fair offer.

Endnotes

1. Roger Fisher, William Ury & Bruce Patton, Getting to YES (2011).
2. Robert D. Benjamin, *The Constructive Uses of Deception: Skills, Strategies, and Techniques of the Folkloric Trickster Figure and Their Application by Mediators,* 13(1) Mediation Quarterly 3, 7 (1995).
3. De Dreu et al., *Effects of Gain-Loss Frames in Negotiation: Loss Aversion, Mismatching, and Frame Adoption*, 60 Organizational Behavior and Human Decision Process 90, 92 (1994).
4. Kathleen L. McGinn & Markus Nöth, *Communicating Framing in Negotiations,* Harvard Business School Working Paper 12-109, June 13, 2013, 8.
5. McGinn, *supra* note 4, at 7.
6. See very detailed Barbara Gray, *Mediation as Framing and Framing within Mediation,* in The Blackwell Handbook of Mediation 193 (M. S. Herrman ed., 2009).
7. Ayanna K. Thomas & Peter R. Millar, *Reducing the Framing Effect in Older and Younger Adults by Encouraging Analytic Processing* 67(2), The Journals Of Gerontology. Series B, Psychological Sciences And Social Sciences 139 (2012), available at http://ase.tufts.edu/psychology/caml/pdfs/Thomas&Millar2011.pdf; for the same conclusion and research references on how the framing effect works differently well on various individuals and groups see also Petru L. Curseu, *Framing Effects in Small-Group and Intergroup Negotiation: A Cognitive Perspective*, in Framing Matters. Perspectives on Negotiation Research and Practice in Communication 71, 73 (W.A. Donohue, R.G. Rogan & S. Kaufman eds. 2011).
8. Prospect Theory has been developed in behavioral economic science by Daniel Kahneman and Amos Tversky. See Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision under Risk*, Econometrica, 263 (1979).
9. Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the Psychology of Choice*, Science 453, 456 (1981).
10. Paul H. Schurr, *Effects of Gain and Loss Decision Frames on Risky Purchase Negotiations,* 72 Journal of Applied Psychology 351 (1987).
11. McGinn, *supra* note 4, at 6-7.
12. Cf. Weller et al., *Neural correlates of adaptive decision making for risky gains and losses*, Psychological Science 958 (2007).
13. Curseu, *supra* note 7, at 77.
14. De Dreu, *supra* note 3, at 100-101; in their paper, De Dreu et al. analyze the influence on the dynamics between the parties depending on their own frames and their perception of the other side's frame or the other side's communicated frame.
15. De Dreu, *supra* note 3, at 100; Curseu, *supra* note 7, at 83; McGinn, *supra* note 4, at 6.
16. De Dreu, *supra* note 3, at 99.
17. George Wu, *Two Psychological Traps in Negotiation*, Harvard Business School Cases (1996).
18. De Dreu, *supra* note 3, at 91.
19. McGinn, *supra* note 4, at 6.
20. Steven Handel, *Framing Motivation in Terms of Losses*, The Emotion Machine (March 20, 2013), available at http://www.theemotionmachine.com/framing-motivation-in-terms-of-losses.
21. Tversky & Kahneman, *supra* note 9, at 453.
22. In contrast to the opening example in this article, the original experiment by Tversky & Kahneman was conducted using separate testing groups for the positive and the negative scenario. The less pronounced results for the negative scenario, programs C and D, in the opening example (Harvard 50%–50%; Tversky & Kahneman 22%–88%), can be explained by the pre-existing knowledge of the positive options by the Harvard participants when deciding on the negative options.

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Conflicts Between the Ethical Principles That Are Critical to Preserving Trust in the Mediation Process—A Need for Increased Understanding and Concern

By Simeon H. Baum and Daniel F. Kolb

The parties' trust in the mediation process is vital to the success of most, if not all, mediations and adherence to the guiding ethical principles that govern mediations is essential to the preservation of that trust. To maintain the parties' confidence the ethical principles that guide mediators are not secondary or collateral to the mediation process. They are central to it and define it.[1]

The guiding principles are that the parties should have full "self-determination" and any agreement reached should be based on "informed consent."[2] The mediator is to be "impartial,"[3] free of conflicts of interest[4] and, subject to limited exceptions,[5] the process is to be "confidential," with the preservation of confidentiality of matters discussed in private caucus especially important.[6] The mediator is to promote "good faith" and "honesty" among the parties,[7] with the quality of the process to be maintained.[8] To the extent that the mediator can embrace and adhere to those ideals the parties' trust will be preserved; but if those guiding principles do not control, the parties' trust may be eroded or lost.

Given the importance of those ethical ideals that are central to the process, it is a particularly troubling reality that as many mediations unfold the mediator will need to confront and grapple with direct conflicts in the application of those principles. Such conflicts can very often present challenges for the mediator that are of material importance to the course of the mediation and to maintenance of the parties' trust. Addressing those challenges, while accommodating the needs of the parties and maintaining an effective mediation process, can require the very highest form of the mediator's art.

It is especially troubling that due to such conflicts mediations may not always be conducted in full compliance with the ethical ideals. When conflicts between the guiding principles result in their not always being followed it is not because the mediator is "unethical" or unwilling to pursue the ideals diligently. It is very often because the nature of the conflicts is such that they cannot be readily overcome.

Typical of such conflicts is the dilemma that arises when the mediator learns that a party or counsel for a party are not fully "informed." A party or counsel may be unaware of a key legal principle or a key procedural matter, such as the waiver of a defense, that would make all the difference. Critical facts may be known to one side and not the other. Such shortfalls can arise because a party is not well represented or not represented at all or, more serious, because one party has hidden facts from another. The mediator may know of such shortfalls from his or her own experience or from what a party has told the mediator in private caucus, with those statements cloaked by confidentiality.

In such situations the ideals of party self-determination and informed consent on the one hand and impartiality and confidentiality on the other are in conflict. If the mediator acts to inform the ignorant party or that party's counsel he or she will be favoring one side and abandoning his or her need to be impartial. If to bring the party the missing information the mediator shares facts learned only in private caucus he or she will also be departing from the pledge of confidentiality. If he or she were to do so the important trust that the parties have as they deal with a purportedly impartial mediator in confidential sessions could well be lost. Yet if the ignorant party proceeds without the missing information, an agreement reached as a result may not meet the ideal of informed consent, and, depending on the materiality of the missing information, could be challenged later by the party who is not fully informed.

The challenge can become greater if the mediator discovers that the key information has not been shared between or among the parties because one of the parties intends to deceive another or if attorney misconduct is involved. Possessed of such information, the mediator faces further conflicts between the critical promise of confidentiality on the one hand and his or her responsibility to promote honesty and fairness among the parties on the other. If the mediator is a lawyer in New York and many other states, there may be a further conflict with his or her professional duty under the Code of Professional Responsibility to report attorney wrongdoing.[9]

To layer on another problem, the mediator needs to be cautious in trying to move ahead not to be driven by ego or personal considerations. If, for example, he or she leaves a party ignorant on a key matter it may actually be easier to reach an agreement than if the party is well informed. If such an agreement is reached and it improves or sustains the mediator's settlement record, but the mediator has acted in a way which is questionable in pursuit of a better record, he or she will be in direct conflict with the clear ethical principle that mandates against such motivations.[10] Given that prompting a settlement is seen by many to be the mediator's mission it can often be difficult to tell whether the mediator is pursuing that worthy goal or a better record or both. The not infrequent desire of a

mediator to promote fairness, which the ethical guidelines do not make a part of the mediator's mission,[11] may also make the analysis of motives difficult.

Still more complexity arises if the information of which one side is ignorant is significant but not vital or possibly only of interest. As the importance of the information is lessened the need to consider acting is lessened. That may lead to increased difficulty in deciding whether any action is necessary.

Of course, because mediation is often undertaken before there has been a full exchange of information, the parties will in practice have often accepted the risk that they have not considered everything, preferring cost saving and avoidance of risk to full knowledge. That being the case there will often be an informational asymmetry that the mediator, and the parties, will need to accept. In such cases the parties' consent is informed by the awareness that they may be missing information.

Unfortunately, it is a reality that some of the more thoughtful suggestions, code provisions and legislative enactments which have been provided to assist the mediator in navigating through such troubled waters will not always bring wholly satisfying answers either for the parties or the mediator. For example, where a party has factual information that the party knows his or her adversary lacks one proposal is for the mediator privately to suggest that the knowledgeable party share the information with the uninformed adversary. The party possessed of the information may recognize (or counsel may recognize) the potential for overturning an agreement later and want to avoid that risk. If the information is then conveyed with the consent of the knowledgeable party it may be said that the result will be beneficial to both sides. A lasting agreement may then be reached based on truly informed consent.

But what if the knowledgeable party prefers to take his or her chances with an agreement while taking advantage of the fact that some information has not been disclosed to the adversary? The mediator is not free to breach confidentiality and will know that the ignorant party may enter into an agreement while being misled by the party's adversary. The mediator must skillfully deal with that challenge knowing that the ideal requires that a mediator encourage honesty and candor among the parties. Maintaining confidentiality and impartiality are vital in maintaining trust, but other important principles will not have been fully respected.

Another path for the mediator that has been suggested, especially where a principle of law or a procedural problem is the point as to which a party is ignorant, is to urge the ignorant party to be sure that all legal doctrines or concepts have been checked or procedural points reviewed. That may include telling a party who is not represented that he or she should seek counsel. Such an approach seems attractive because it does not actually call for the mediator to tell the ignorant party outright what that party does not know. It, therefore, does not seem as much of a departure from impartiality or a breach of confidence. But, since the mediator's effort, presumably undertaken in good faith pursuit of "informed consent," is to try to, in effect, lead the horse to water, is that not just another way of helping one side to the detriment of the other, effectively becoming an advocate for one side? And even though a breach of confidentiality may not have occurred "in so many words," is leading a party to a missing fact previously shared with the mediator in confidence not arguably a breach of confidentiality, albeit subtle?

If lawyer misconduct is involved it has been suggested that the right answer is to report counsel, if, as required by the Code of Professional Responsibility, the misconduct indicates the lawyer is dishonest. That argument is based on the premise that the Code of Professional Responsibility in most states is court mandated, whereas mediation codes of conduct often are not and, therefore, may be trumped by the court rule.[12] That can arguably solve the problem for the mediator but what will it do to the mediation process if confidentiality is breached? It may well destroy trust, and what if the mediation or the ethical principles for mediators are court mandated?

To address the conflict the ABA has suggested what has been called an "exit door" for the lawyer.[13] The idea is that he or she can avoid the dilemma by advising the parties at the outset of the mediation that he or she does not represent them as an attorney, thereby freeing the mediator from professional duties as an attorney, including the need to report attorney wrongdoing. Unfortunately, while arguably freeing the mediator-lawyer from responsibility, such remedies still leave the process flawed.

As other ways of freeing lawyers of the dilemma, six states have changed their ethical guidelines for mediators to either free the lawyer of the duty to report attorney misconduct or to expressly allow a mediator-lawyer to report misconduct.[14] While they too provide an escape for the mediator-lawyer they also leave the process flawed.

Yet another solution is for the mediator to withdraw, as he or she might if criminal conduct, domestic abuse or violence were involved.[15] The mediator may thereby avoid association with an agreement based on something short of informed consent and he or she will not have favored one side or breached confidentiality. But, if that is the preferred solution, a good many more mediations will fail, and the parties may just move ahead to settle either alone or with a different mediator as the result of a deficient process.

The mediator-lawyer might also decide simply to risk being sanctioned in order to preserve confidentiality. While lawyers are rarely sanctioned for failing to report other lawyers, it can happen, and again the process will

fall short of what is promised by the guiding ethical principles.[16]

In addition to existing legislation and ethical pronouncements that may free mediator-lawyers of some of the burdens resulting from the clash of ethical ideals, other bright line rules could be adopted that would effectively take the mediator off the hook. But such bright line qualifications of ethical principles could seriously erode the public confidence in the mediation process that is promoted by allowing each of the ideals to stand as inviolate. If a party thinks that mediator impartiality, confidentiality, informed consent or party self-determination are subject to too many exceptions, the trust that comes from a belief that each principle will be respected cannot be sustained. Also, where the code of Professional Responsibility is applicable, failure to apply its requirements may bring discredit to the legal profession.

Conclusion

Especially because conflicts in ethical principles go to the heart of the mediation process and confidence in it, there should be increased emphasis on the singular importance of ethical ideals in mediation and the need to grapple sensitively and successfully with the inevitable conflicts between the defining ethical ideals. Mediators should actively seek answers and focus on strategies for addressing such dilemmas as they seek to preserve trust in the process and guide the parties toward resolution.

Encountering ethical dilemmas can activate heightened awareness in the mediator, building deeper understanding and requiring greater subtlety, flexibility and sensitivity. These are the very qualities that mediators bring to the mediation process. As trust is at the heart of ethics and is the ingredient missing from conflict that the mediator seeks to replace, so too, the efforts of a mediator to handle conflicts sensitively and seek creative solutions are themselves efforts to build trust, repair relationships and work towards resolution.

It is important that the mediation community seek a broader consensus on what to do with such serious problems. Such a consensus would put mediators in better position to deal artfully with ethical dilemmas.

Endnotes

1. The Preamble to the Model Standards of Conduct identifies promotion of "public confidence in mediation as a process for resolving disputes" as a primary goal. See also Ellen Waldman, Mediation Ethics Cases and Commentaries 119–124, 149 (2011).
2. The Model Standards of Conduct for Mediators Standard I.
3. The Model Standards of Conduct for Mediators Standard II.
4. The Model Standards of Conduct for Mediators Standard III.
5. Disclosure may be mandated in some cases of attorney wrongdoing or child abuse. Ellen Waldman, Mediation Ethics Cases and Commentaries 255–275 (2011).
6. The Model Standards of Conduct for Mediators Standard V.
7. The Model Standards of Conduct for Mediators Standard VI.4.
8. The Model Standards of Conduct Standard VI.
9. New York Rules of Professional Conduct Section 8.3; altogether 36 states including New York have codes of professional responsibility for lawyers that conflict with their ethical requirements for mediators, 34 Campbell L. Rev. 205 4 (2011).
10. The Model Standards of Mediator Conduct Section I.B.
11. The Model Standards of Conduct do not contain any principle requiring that fairness be assured. There has been much scholarly debate on the point but the standards have generally not been set to promote fairness. Ellen Waldman, Mediation Ethics Cases and Commentaries 5-6, 118-119, 124 (2011).
12. Ellen Waldman, Mediation Ethics Cases and Commentaries 257 (2011).
13. 34 Campbell L. Rev. 205 2-3 (2011).
14. 34 Campbell L. Rev. 205 5-6 (2011).
15. In some jurisdictions elder abuse and threats to property may permit mediators to withdraw. The Model Standards of Conduct Sections VI.B. and C.; see also 34 Campbell L. Rev. 205 8 (2011).
16. 34 Campbell L. Rev 205 3-6 (2011).

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The German Mediation Act—An Overview

By Prof. Dr. André Niedostadek, LL.M.

Introduction

In 2012 after an intense debate, the Mediation Act became the first codification of mediation and related provisions in German law. Although in-court mediation recently became popular in Germany, the new Mediation Act launches principles and standards for out-of-court mediation. It is Germany's implementation of the "European Directive on Certain Aspects of Mediation in Civil and Commercial Matters." Nevertheless the Mediation Act does not concentrate on these issues but deals with mediation in a broad sense—in a short nine sections. This article gives a basic overview of the key issues addressed and the experiences with mediation under this new law effective since July 26, 2012

The Mediation Act

The Mediation Act is recognizable to U.S. practitioners but it regulates mediation practice both in terms of the actual process of the mediation and the training of mediators. In Section 1 mediation is defined as a confidential and structured process in which the parties strive, on a voluntary basis and autonomously, to achieve an amicable resolution of their conflict with the assistance of one or more mediators. The mediator is an independent and impartial person without any decision-making power who guides the parties through the mediation. So s/he has no authority to impose a decision.

Section 2 of the Mediation Act specifies the intersection of process and the role of a mediator. The provision addresses some significant aspects of the process: Of course the mediator shall be selected by the parties. And—once selected—s/he shall satisfy herself or himself that the parties have understood the basic principles of the mediation process and the way in which it is conducted, and that they are participating in mediation voluntarily. The Mediation Act points out that the mediator's obligations shall be equal to all parties: supporting communication among the parties and ensuring that the parties are integrated into the mediation process in an appropriate and fair manner. Caucus with individual parties is only permitted if the parties agree. Third parties can only become involved in mediation with the consent of all parties. Voluntariness is an important aspect. Therefore, this section also points out that parties can terminate mediation at any time. The mediator can also terminate the mediation under certain circumstances, especially if communication or settlement between the parties is felt to be unlikely. In the event that a settlement is reached by the parties, the Mediation Act makes clear the mediator shall make efforts to ensure that they conclude the agreement understanding the underlying circumstances and that they understand the content of the agreement. If necessary, the mediator may inform the parties acting *pro se* of the possibility of having the agreement examined by external advisers. Subject to the parties' consent, the settlement reached can be recorded in the form of a final agreement.

"The Mediation Act is recognizable to U.S. practitioners but it regulates mediation practice both in terms of the actual process of the mediation and the training of mediators."

Section 3 of the Mediation Act focuses on the mediators' neutrality and includes disclosure obligations: The mediator shall disclose all circumstances to the parties that could impede his independence or impartiality. If such circumstances exist the parties must consent to the mediator's ongoing participation. On the other hand some limitations on mediation practice are addressed:

- A person who has acted in the same matter for one of the parties prior to the mediation shall not be permitted to act as a mediator. The mediator shall also not be permitted to act in the same matter for either of the parties either during or subsequent to mediation.
- A person shall not be permitted to act as mediator if another person who is part of the same professional cooperative or office-sharing arrangement has acted for one of the parties in the same matter before the mediation. Such a person shall also not be permitted to act for either of the parties in the matter either during or subsequent to mediation. This restriction does not apply in individual cases where the parties involved, having been given comprehensive information, give their consent, and where this does not conflict with considerations relating to the administration of justice.

And last but not least, the mediator shall be bound to provide the parties with information about his or her professional background, training and experience in the field of mediation if they request so.

Another fundamental aspect of the Mediation Act is the duty of confidentiality (applied unless otherwise provided by law). It is an identifying feature of a mediation process and therefore the mediator shall inform the parties about the extent of the duty of confidentiality. This duty is very broad and includes all information mediators learn in the course of performing their activity. But there are a few exceptions: Notwithstanding other legal provisions regarding the duty of confidentiality, this duty shall not apply where

- disclosure of the content of the agreement reached in the mediation process is necessary in order to implement or enforce that agreement,
- disclosure is necessary for overriding considerations of public policy (*ordre public*), in particular when required to avert a risk posed to a child's well-being or to prevent serious harm to the physical or mental integrity of a person, or
- facts are concerned that are common knowledge or that are not sufficiently significant to warrant confidential treatment.

"…the quality of mediation was a major concern of the German legislature."

The Mediation Act also deals with the training of the mediator and the so called "certified mediator" (Section 5). This corresponds to the demand for a quality management for mediation services. First of all there is a personal responsibility: The mediator is responsible for ensuring that, by virtue of appropriate initial training and regular further training, s/he possesses the theoretical knowledge and practical experience needed to guide the parties through mediation in a competent manner. Suitable initial training shall impart the following in particular:

- knowledge about the fundamentals of mediation as well as the process and framework conditions therefor,
- negotiation and communication techniques,
- conflict competence,
- knowledge about the law governing mediation and the role of the law in mediation, and
- includes practical exercises, role play and supervision.

A person may use the term "certified mediator" under certain circumstances. S/he has to complete initial training as a mediator that fulfills requirements that will be regulated in by statute. Although planned for, these provisions are not yet in force. It is also anticipated that continuing training will be required of certified mediators.

Section 6 of the Mediation Act provides authority for the Federal Ministry of Justice to enact by statutory instrument more specific provisions on the initial training for certified mediators, ongoing training and the standards applicable to training institutions. The statutory instrument can set out the following in particular:

- specific provisions on the content of initial training;
- more specific provisions on the content of additional post-certification training;
- minimum learning hours for trainings;
- intervals at which additional training must be undertaken;
- requirements for teaching staff deployed in training institutions;
- provisions on certification;
- rules on the completion of initial training;
- transitional provisions for persons who were already working as mediators prior to the entry into force of this Act.

This list demonstrates that the quality of mediation was a major concern of the German legislature.

Section 7 deals with academic research projects. The Federation and the federal regions (*Bundeslaender*) can conclude agreements on academic research projects in order to ascertain the impact of financial support of mediation schemes for the *Bundeslaender*. The Federal Government shall, after completion of the academic research projects, inform the German Parliament (*Bundestag*) of the experience gathered and the findings arrived at. This is a first step but does not incorporate a real promotion of mediation.

Section 8 contains a provision that is considered to be one of the most important rules of the Mediation Act. It refers to the evaluation: The Federal Government shall report to the German parliament (*Bundestag*) after five years by 26 June 2017 on the impact of this Act and the development of mediation in Germany, and on the situation of initial and further training for mediators. In particular, the report shall examine and appraise whether for reasons of quality assurance and consumer protection further legislative measures in the field of initial and further training for mediators are required.

The final section 9 includes a transitional provision which relates to the concept of in-trial mediation. As Julia Flockermann pointed out[1] there was a major controversy about this topic during the legislative procedure, because in-trial mediation by judges has been well-received but it has not been welcome by freelance mediators. The concern was that in-court-mediation by judges charging no fees in addition to the usual court fees would distort competition. But finally, in keeping with the spirit of mediation, a compromise was found: Now the concept of in-trial mediation as an independent approach is not explicitly mentioned in the Mediation Act. Nevertheless mediation in civil matters and by courts of administrative jurisdiction, of social jurisdiction, of fiscal jurisdiction and of labour jurisdiction was conducted until August 2013. And furthermore it might be interesting for U.S. practitioners to know that as one part of the compromise after August 2013, a case can be referred to judicial conciliatory proceedings even if it is not called in-court mediation. The trial judge or one of the parties can encourage this

step. Specially trained conciliation judges, who have no power to decide the matter, can use all methods of dispute resolution including mediation to find an amicable settlement. If the parties cannot reach an agreement, the process returns to the trial judge again. But all this is not explicitly addressed in the Mediation Act, which focuses on out-of-court mediation.

Conclusion

The Mediation Act was considered to be a milestone. But it is still unclear if the expectations will be met. Out-of-court mediation is hardly an established approach yet. Only a few specialists are able to work solely as mediators whereas most offer mediation incidentally as lawyers, psychologists or in other professions. This form of Alternative Dispute Resolution is probably still unknown to a lot of people in Germany. But this is also an incentive: There is still some pioneering work to do. Of course the law cannot chance any attitudes but the Mediation Act and its focus on quality standards provides an opportunity for mediation to grow as a viable form of conflict resolution.

Endnote

1. J. Flockerman, *How German Judges Will Use Mediation Under the Recent German "Mediation Law,"* New York Dispute Resolution Lawyer, Vol. 5. No. 2, 68 (Fall 2012).

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In New York, Limitations on Use of Estoppel Doctrine to Join Non-Signatories to an Arbitration Agreement

By Alexandra Dosman

The issue of when and how non-signatories may be bound to an arbitration agreement is one of perennial interest to the arbitration community. In approaching cases involving non-signatories, arbitral tribunals and courts must grapple with complex questions of jurisdictional competence, choice of law, and the scope of a party's consent to arbitrate. This article does not address the vexing questions of who—the court or the arbitral tribunal—decides whether a valid arbitration agreement exists between a signatory and a non-signatory, and of which law applies. Rather, this article sets out commonly used theories to bind non-signatories to arbitrate, and examines a recent New York Court of Appeals decision that rejected an attempt to join a non-signatory on an estoppel theory.

Questions relating to non-signatories to an agreement to arbitrate arise in various circumstances. For example, a signatory to a contract containing an arbitration clause may attempt to arbitrate against the parent company of the other contracting party. Or, a non-signatory may seek to stay court litigation brought against it, on the basis that the matter is covered by an arbitration agreement entered into by the plaintiff.

Different jurisdictions employ different terms and theories to implicate non-signatories, from the "group of companies" doctrine accepted under French law to the more strict interpretation favored by English courts. The New York approach was set out by the Second Circuit in *Thomson-CSF, S.A. Am. Arb. Ass'n*, 63 F.3d 773 (2d Cir. 1995). In *Thomson*, a signatory to an arbitration agreement brought suit against both its contractual counterparty and the counterparty's parent company, which had not signed the agreement to arbitrate. Noting that arbitration is contractual by nature, the Second Circuit stated, "It does not follow, however, that under the [Federal Arbitration Act] an obligation to arbitrate attaches only to one who has personally signed the written arbitration provision… This Court has made clear that a non-signatory party may be bound to an arbitration agreement if so dictated by the ordinary principles of contract and agency." *Thomson*, 64 F.3d 776 (internal citations omitted).

The Second Circuit went on to list five common law doctrines under which non-signatories have been bound by arbitration agreements: (1) incorporation by reference; (2) assumption; (3) agency; (4) veil-piercing / alter ego; and (5) estoppel. *See Thomson*, 64 F.3d 776-778.

(1) Incorporation by reference. Following normal contract principles, a non-signatory may be bound by an arbitration clause when it enters into a separate agreement incorporating the contract containing the arbitration clause.

(2) Assumption. Subsequent behavior by non-signatories that evidences an assumption of the obligation to arbitrate may bind the non-signatory. For example, if a party actively participates in an arbitration without raising any objection, a court may find that it has assumed the obligation to arbitrate.

(3) Agency. New York courts have recognized that non-signatories may be bound to arbitration agreements based on agency principles. The traditional limitations on these principles apply, such as that the agent must be acting within the scope of its authority.

"In a recent case, the New York Court of Appeals considered—and rejected—an attempt to bind a non-signatory to an arbitration agreement under a 'direct benefits estoppel theory.'"

(4) Veil-piercing / alter ego. As a general matter, separate corporate identities are respected. Courts will only disregard the corporate form where necessary to prevent fraud or wrongdoing, or where the facts show "a virtual abandonment of separateness" between corporate entities. A non-signatory may be bound to an arbitration agreement when it is found to be the alter ego of a signatory.

(5) Estoppel. In *Thomson*, the Second Circuit affirmed the principle that a party that "knowingly accepted the benefits" of an agreement may later be estopped from denying an obligation to arbitrate under that agreement. The Court noted that the benefit to the non-signatory must be "direct." *Thomson*, 64 F.3d 778.

In a recent case, the New York Court of Appeals considered—and rejected—an attempt to bind a non-signatory to an arbitration agreement under a "direct benefits estoppel theory." *Matter of Belzberg v. Verus Invs. Holdings Inc.*, 21 N.Y.3d 626, 2013 N.Y. Slip Op. 06729 (2013).

The case was brought by a securities brokerage, Jefferies & Co., against its customer (Verus) for reimbursement of certain taxes paid by Jefferies to the Canadian tax authorities related to a securities purchase through Verus'

account at Jefferies. The securities account agreement between Verus and Jefferies contained an arbitration clause. The respondent Verus then attempted to bring claims against additional entities as part of the existing arbitration. In particular, Verus asserted claims against Samuel Belzberg, an individual involved in the underlying securities purchase as a financial adviser, as well as entities related to him. Neither Mr. Belzberg nor the other entities were signatories to the arbitration agreement contained in the securities account agreement.

"The use of the estoppel doctrine in the context of non-signatories to an arbitration agreement has provoked significant controversy and commentary."

The non-signatories petitioned a New York state court to stay the arbitration pending a determination of whether they were proper parties. Following a hearing, the lower court ordered a permanent stay of the arbitration as against Mr. Belzberg. The court concluded that the doctrine of "arbitration by estoppel" did not apply because Mr. Belzberg did not receive a benefit that flowed directly from the securities agreement containing the arbitration clause. The intermediate appellate court reversed, finding that Mr. Belzberg controlled material aspects of the securities transaction (including the direction of profits) and that he directly benefited from the agreement. The highest court of New York, the New York Court of Appeals, granted leave to appeal.

The New York Court of Appeals underlined that "nonsignatories are generally not subject to arbitration agreements," and that such agreements "must not be so broadly construed as to encompass claims and parties that were not intended by the original contract." *Belzberg*, 21 N.Y.3d 626 (internal citation omitted). However, the Court noted that in "limited circumstances" it is proper for non-signatories to be joined, including when a non-signatory knowingly exploits the benefits of an agreement containing an arbitration clause and receives benefits flowing directly from the agreement. *Id.* Only "direct" benefits permit the successful application of the estoppel theory. *Id.* at 630-631.

In *Belzberg*, the New York Court of Appeals characterized a "direct" benefit as one that flows from the agreement itself, rather than from surrounding circumstances:

> The guiding principle is whether the benefit gained by the nonsignatory is one that can be traced directly to the agreement containing the arbitration clause. The mere existence of an agreement with attendant circumstances that prove advantageous to the nonsignatory would not constitute the type of direct benefits justifying compelling arbitration by a nonparty to the underlying contract. Also, absent the nonsignatory's reliance on the agreement itself for the derived benefit, the theory would extend beyond those who gain something of value as a direct consequence of the agreement. *Belzberg*, 21 N.Y.3d 633-634.

In that case, the Court of Appeals found that the alleged benefit to Mr. Belzberg—the diversion of profits to a different individual—did not constitute a direct enough benefit to engage the estoppel doctrine. The Court reasoned that Mr. Belzberg's diversion of profits was due to his role as financial advisor to an entity involved in the underlying securities transaction, not as a result of any relationship with Jefferies, Verus, or the contract between Jefferies and Verus. The Court clarified that a "but for" causality argument—that without the use of the Jefferies account, Mr. Belzberg's diversion of profits would not have been possible—was insufficient to overcome the "usual rule" that non-signatories are not bound to arbitration agreements. *Belzberg*, 21 N.Y.3d 634.

The use of the estoppel doctrine in the context of non-signatories to an arbitration agreement has provoked significant controversy and commentary. With *Belzberg*, the New York Court of Appeals both endorsed the existence of the doctrine and confirmed its limited scope when determining if a non-signatory is bound by (or may take advantage of) a contractual agreement to arbitrate.

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Will Patents Be the Next Wave in Investor-State Arbitration?

By Sherman Kahn

It is not controversial that intellectual property can be a protected investment under both bilateral and multilateral investment treaties. For example, the 2012 U.S. Model Bilateral Investment Treaty defines investment as follows:

> **"investment"** means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include:
>
> . . .
>
> (f) intellectual property rights;
>
> . . ."[1]

While the formulations differ, other U.S. Bilateral Investment Treaties ("BITs") similarly include IP rights as protectable investments.[2] Likewise, U.S. bilateral and multilateral free trade agreements protect investment in intellectual property.[3] Protection of international property in bilateral and multilateral investment protection treaties is not limited to the United States; rather it is widespread.[4]

Certainly, then, an aggrieved international investor would have rights under such international agreements to bring an arbitration should a host state take an action depriving the investor of patent rights qualifying as an investment under the applicable treaty. Nonetheless, patent related investment arbitration has not, to date, been common; rather investment arbitration has been more concentrated in heavy industries such as oil and gas, mining and infrastructure projects.[5]

A few intellectual property issues have recently emerged in investor-state arbitration. This article discusses some of these developments.

A. Tobacco Trademarks

In recent years, trademark rights have provided the putative basis for a variety of investor-state arbitrations brought by the tobacco industry to combat labeling restrictions imposed by states on tobacco products. Perhaps the most prominent of these arbitrations is one brought by a Hong Kong subsidiary of Philip Morris against Australia under the Australia-Hong Kong BIT challenging Australia's imposition of plain packaging requirements on cigarettes.[6] In its Notice of Arbitration, Philip Morris Asia Limited ("Philip Morris") claims that it owns a covered investment through shares in Philip Morris's Australian subsidiary which, in turn, holds rights in intellectual property.[7] Philip Morris alleges in its notice of arbitration that Australia's plain packaging statute deprives Philip Morris of its trademarks rights and goodwill in violation of the BIT's provisions on expropriation, fair and equitable treatment, unreasonable impairment of the investment and full protection and security.[8] Philip Morris also alleges that the plain packaging legislation violates the treaty's umbrella clause—*i.e.*, that each party shall observe any obligation it may have entered with regard to investments of investors of the other contracting party—by allegedly failing to adhere to obligations under the Agreement on Trade Related Aspects of Intellectual Property Rights ("TRIPS"), the Agreement on Technical Barriers to Trade ("TBT") and the Paris Convention for the Protection of Intellectual Property ("Paris Convention").[9] The arbitration is ongoing, with the most recent event, a hearing on bifurcation of the tribunal's decision on jurisdiction in February 2014.[10]

The Philip Morris Australia arbitration appears to be part of a concerted effort by the tobacco industry to utilize international investment and IP harmonization treaties as a tool to combat anti-tobacco legislation around the world.[11] Philip Morris has brought a similar arbitration challenging plain packaging legislation in Uruguay; an ICSID tribunal confirmed jurisdiction over this challenge in July of 2013.[12] *The New York Times* reports that threats from tobacco companies of treaty arbitration have caused countries around the world to back off of strict tobacco restrictions.[13]

It remains to be seen whether the tobacco industry is successful in this use of investment protection treaties against anti-smoking legislation. It also remains to be seen whether, should the tobacco industry be successful, such success would lead to limitations on investment protection, particularly where intellectual property rights conflict with health and safety concerns.

B. Compulsory Patent Licenses

Article 30 of the TRIPS agreement authorizes governments to make exceptions to the patent holder's right to exploit patented technology (*i.e.*, compulsory licenses) provided that the exception to the patent holder's right to exclude does not unreasonably conflict with the normal exploitation of the patent and does not unreasonably prejudice the legitimate interests of the patent holder.[14] Article 31 of the TRIPS agreement provides for the conditions under which a government can impose a compulsory license including, among other requirements, that the proposed licensee have tried and failed to negotiate a

license on reasonable commercial terms and that the patent holder is paid adequate remuneration in the circumstances of each case, taking into account the economic value of the authorization.[15] However, the TRIPS agreement leaves the decision regarding the commercial terms to the government issuing the license.[16]

The compulsory license provisions of the TRIPS agreement enable governments to promote public policy goals, for example, enhancing affordable availability of anti-retroviral drugs for the treatment of HIV.[17] Some countries have used the compulsory licensing regime as a way to force pharmaceutical companies to the bargaining table to lower prices on a broad range of medications.[18]

Dispute resolution under the TRIPS agreement is limited to state-to-state arbitration.[19] Some commentators have suggested, though, that treaty arbitration under BITs can provide a direct right of action for companies unhappy with compulsory license decisions under the TRIPS Agreement.[20] Nonetheless, to date no BIT-based arbitrations have emerged based on TRIPS compulsory licenses. It is possible that, as reported with respect to the tobacco industry, the pharmaceutical industry has used the possibility of investment arbitration as a negotiating tool to influence compensation under proposed compulsory licenses. It is also possible that the right case has not yet arrived. It remains to be seen whether TRIPS compulsory-related licenses will become a subject of investor-state arbitration.

C. Challenges to Patent Invalidity Findings

Outside the context of the compulsory license, there is now one instance in which a patent holder has brought an investment arbitration claiming interference by a government with patent rights. Eli Lilly and Company, a United States pharmaceutical company, has initiated an arbitration under NAFTA against Canada challenging a legal doctrine Canada has developed to circumscribe the scope of patentable subject matter.[21] Eli Lilly's arbitration demand challenges decisions of Canada's courts invalidating two Canadian patents owned by Eli Lilly covering a drug called Zyprexa, used for the treatment of schizophrenia and other psychotic disorders, and a second drug called Strattera used in the treatment of ADHD.[22] The Canadian courts invalidated each of the two patents on the ground that the patents did not satisfy the "utility" requirement of Canada's patent act.[23]

The general requirements for patentability around the world are that an invention be new, useful and non-obvious. The TRIPS agreement is consistent with this general set of requirements, stating that, subject to limited exceptions, patents shall be available "for any inventions whether products or processes, in all fields of technology, provided that they are new, involve an inventive step and are capable of industrial application."[24] A footnote to the previously quoted description states that for purposes of the section "inventive step" may be deemed synonymous with non-obvious and "capable of industrial application" may be deemed synonymous with "useful."[25]

Generally the utility requirement is very broadly interpreted and any invention that is industrially useful can be patented if it meets the novelty and non-obviousness requirements. In its arbitration demand, Eli Lilly refers to Canada's Manual of Patent Office Practice in effect as of 1994, which describes Canada's utility requirement broadly as "[if] an invention is totally useless, the purposes and objects of the grant would fail and such grant would consequently be void on the grounds of false suggestion, failure of consideration and having tendency to hinder progress."[26]

"Some commentators have suggested, though, that treaty arbitration under BITs can provide a direct right of action for companies unhappy with compulsory license decisions under the TRIPS Agreement."

Canada's courts, however, subsequent to its accession to NAFTA further interpreted Canada's utility requirement to require that, if a patent predicts a particular utility, the patent application must demonstrate or soundly predict the utility promised by the patent at the time of the patent application; *i.e.*, provide a sound factual basis for the predicted utility.[27] The Canadian Courts used this doctrine, referred to as the "promise doctrine" to invalidate the two patents at issue in the Eli Lilly arbitration.[28]

Eli Lilly argues in its arbitration demand that Canada's application of the promise doctrine to invalidate its patents on Zyprexa and Srattera violate its treaty rights as an investor under NAFTA Section 1709(1), the TRIPS agreement and the Patent Cooperation Treaty allegedly resulting in expropriation of the value of Eli Lilly's investment, unfair treatment of the pharmaceutical sector and failure to provide Eli Lilly with a minimum standard of treatment.[29] Eli Lilly claims damages against Canada in an amount not less than 500 million Canadian dollars.[30]

Canada has not yet responded to Eli Lilly's arbitration demand, but it can be expected to vigorously contest Eli Lilly's claims. Whether Eli Lilly can obtain relief against Canada in connection with this action—essentially a challenge to the Canadian courts' interpretation of the requirements of its domestic patent law—will be instructive regarding whether other parties pursue future challenges to state restrictions on intellectual property.[31] Nonetheless, Eli Lilly's arbitration demand suggests that patent holders are beginning to include investment arbitration in their arsenal of tools to protect their patent rights.

D. Patent Reform and Cutting Edge Technology

Patent reform is currently a hot issue. The United States, for example, is contemplating a variety of patent reforms to combat what some see as inappropriate assertion of patent rights by entities that do not themselves practice patented inventions (referred to as non-practicing entities or less politely as "patent trolls"). As of December 2013 at least eleven pending patent reform proposals have been introduced in the United States Congress.[32] Most of the proposed reforms are procedural changes, but clearly Congress is interested in reforming the patent system and international patent holders aggrieved by reforms may choose to seek relief through investor-state arbitration.

Similarly, the continued evolution of the law regarding patentability of DNA-related inventions could lead to investment claims. Last year the U.S. Supreme Court overruled the Federal Circuit Court of Appeals (which decides all patent related appeals) and decided that while synthetically created DNA is patentable, the isolation of naturally occurring DNA is not patentable.[33] The Supreme Court rejected an argument that the isolation of DNA should be held patentable based upon the Patent and Trademark Office's ("PTO") past practice of awarding patents on extracted DNA.[34] A foreign inventor who had relied on PTO practice might seek relief with an investment treaty claim.[35]

"As the amounts claimed in the Eli Lilly arbitration demonstrate, patent rights can be enormously valuable. With stakes that high, patent owners are likely to look far and wide for new tools to protect their patent rights."

E. Conclusion

As the amounts claimed in the Eli Lilly arbitration demonstrate, patent rights can be enormously valuable. With stakes that high, patent owners are likely to look far and wide for new tools to protect their patent rights. To date, intellectual property has not been an active area in investor state arbitration. It will be interesting to see whether more such arbitration develops in the future as states balance their international IP harmonization commitments with their domestic patent policy.

Endnotes

1. 2012 U.S. Model Bilateral Investment Treaty, Art. 1: Definitions.
2. *See, e.g.*, U.S. Uruguay Bilateral Investment Treaty (in force as of November 1, 2006), Article 1 ("investment" includes "intellectual property"); U.S. Turkey Bilateral Investment Treaty (in force as of May 18, 1990), Article 1(c) ("investment" includes "intellectual property, including rights with respect [to] copyrights and related patents, trademarks and tradenames, industrial designs, trade secrets and know-how, and goodwill"); U.S. Czech Republic BIT (in force as of December 10, 1992 and amended May 1, 2004), Article 1(a) ("investment" includes "intellectual property which includes, inter alia, rights pertaining to: literary and artistic works including sound recordings, inventions in all fields of human endeavor, industrial designs, semiconductor mask works, trade secrets, know-how, and confidential business information, and trademarks, service marks and trade names").
3. CAFTA explicitly includes intellectual property in its definition of "investment." CAFTA, Article 10.28. The investment definition in the NAFTA treaty is less clear, stating that "investment" includes "real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes." NAFTA, Article 1139. However, both CAFTA and NAFTA provide in detail for protection of intellectual property. CAFTA, Chapter 14; NAFTA, Chapter 17. U.S. bilateral free trade agreements also provide for protection of intellectual property investment although not always for investor-state arbitration. *See, e.g.*, U.S. Australia Free Trade Agreement, Article 11.17.4(f) (providing for protection of intellectual property investments but not providing for investor-state arbitration).
4. *See e.g.*, France Model Bilateral Investment Treaty, Article 1.1(d); Germany Model Bilateral Investment Treaty, Article 1.1(d).
5. The ICSID 2013 Annual Report describes the oil, gas and mining sector as "dominant" with respect to new proceedings in 2013 with 25% of total proceedings concentrated in that sector.
6. Notice of Arbitration, Philip Morris Asia Limited and the Commonwealth of Australia, 21 November 2011.
7. *Id.*, ¶ 5.6. Intellectual property is defined in the Australia-Hong Kong BIT as "intellectual property rights including rights with respect to copyright, patents, trademarks, trade names, industrial designs, trade secrets, know-how and goodwill." Australia-Hong Kong BIT, Article 1(e)(iv).
8. Notice of Arbitration, Philip Morris Asia Limited and the Commonwealth of Australia, 21 November 2011, Paragraph 7.2.
9. *Id.*, ¶ 7.15-7.17.
10. Procedural Order No. 7, Philip Morris Asia Limited and the Commonwealth of Australia, December 31, 2012.
11. *See, Tobacco Firms' Strategy Limits Poorer Nations' Smoking Laws*, New York Times, December 13, 2013.
12. *Philip Morris Barands SARL, et al. and Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, July 2, 2013 Decision on Jurisdiction.
13. *Tobacco Firms' Strategy Limits Poorer Nations' Smoking Laws*, New York Times, December 13, 2013. According to the New York Times, countries that have backed off on tobacco restrictions due to threats of investment claims include developing countries such as Namibia and Uganda and even developed countries like New Zealand and Canada.
14. Agreement on Trade Related Aspects of Intellectual Property Rights ("TRIPS"), Article 30.
15. *Id.*
16. WTO Website: TRIPS and Health: Frequently asked Questions – licensing of pharmaceuticals and TRIPS, http://www.wto.org/english/tratop_e/trips_e/public_health_faq_e.htm.
17. *See, e.g., Brazilian President Silva Issues Compulsory License for Merck's Antiretroviral Efavirenz*, Kaiser Health News, May 7, 2007.
18. *See, e.g., Thailand Defies Drug Makers on Patent Issue*, New York Times, April 11, 2007.
19. Agreement on Trade Related Aspects of Intellectual Property Rights ("TRIPS"), Article 64.
20. *See, e.g.*, Gibson, Christopher, *A Look at the Compulsory License in Investment Arbitration: The Case of Indirect Expropriation*, American University International Law Review, Vol. 25, p. 357 (2010); Peter B. Rutledge, TRIPS and BITs: An Essay on Compulsory Licenses,

Expropriation, and International Arbitration, 13 N.C. L.J. & Tech. On. 149 (2012). At least one law firm has issued a marketing piece suggesting treaty arbitration as a means of defending against compulsory licenses. Treaty Protection for Global Patents: A response to a Growing Problem for Multinational Pharmaceutical Companies, Jones Day Commentary, October 2012.

21. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013.
22. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013, ¶¶ 25-27.
23. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013, ¶¶ 20-21.
24. TRIPS Agreement, Article 27, § 1.
25. TRIPS Agreement, n. 5.
26. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013, ¶ 8.
27. See, Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013, ¶¶ 34-39; see also, Apotex Inc. v. Pfizer Canada Inc., Federal Court of Appeal 2011 FCA 236, ¶ 30. The closest analog to the promise doctrine under United States patent law is the requirement of "enablement" under 25 U.S.C. § 112 ¶ 1, which generally requires that a patent must enable a person of skill in the art to practice the claimed invention. Enablement requires that a person of skill be able to practice the invention without undue experimentation. The difference between the U.S. enablement concept and the promise doctrine is arguably one of degree rather than concept.
28. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013, ¶¶ 48-65.
29. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013.
30. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013, ¶¶ 85.
31. Interestingly, NAFTA does not directly refer to intellectual property as a protected investment, suggesting it may be one of the less attractive treaties for alleging patent related investment claims.
32. SHIELD Act, H.R. 845; End Anonymous Patents Act, H.R. 2024; Patent Litigation and Innovation Act, H.R. 2639; Stopping the Offensive Use of Patents Act, H.R. 2766; Innovation Act, H.R. 3309; Innovation Protection Act, H.R. 3349; Demand Letter Transparency Act, H.R. 3540; Patent Quality Improvement Act, S. 866; Patent Abuse Reduction Act, S. 1013; Patent Litigation Integrity Act, S. 1612; Patent Transparency and Improvements Act, S. 1720.
33. Association for Molecular Pathology v. Myriad Genetics, Inc., 133 S. Ct. 2107 (2013).
34. *Id.* at 2118.
35. One district court has applied Myriad to hold that a patent on diagnostic methods using the extraction of natural DNA sequences are likewise not patentable. Ariosa Diagnostics, Inc. v. Sequenom, Inc., 2013 U.S. Dist. LEXIS 156554 (N.D. Cal. 2013). Should this decision be upheld by the Federal Circuit, a large number of issued patents may be rendered useless. It is worth noting, though, that the TRIPS agreement includes a specific exception allowing states to exclude from patentability "diagnostic, therapeutic and surgical methods for the treatment of humans or animals." TRIPS Agreement, Art. 27.3(a).

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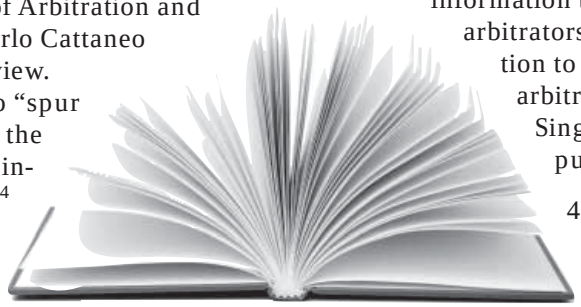
Book Reviews

The Rise of Transparency in International Arbitration: The Case for the Anonymous Publication of Arbitral Awards

Edited by Alberto Malatesta and Rinaldo Sali
Reviewed by Kim J. Landsman

A specter is haunting international arbitration—the specter of transparency. It is the subject of a report on publication of arbitral decisions by the International Commercial Disputes Committee of the City Bar Association,[1] a project by Professor Catherine A. Rogers to create a database of arbitrators and their decisions,[2] and the recently published collection of essays resulting from a joint project of the Milan Chamber of Arbitration and the Law School of the University Carlo Cattaneo (LIUC)[3] that is the subject of this review. The stated intention of the book is to "spur discussion and to shed new light on the traditional idea of confidentiality in international commercial arbitration,"[4] and it could be considered transparency's manifesto. The chapters written by Alexis Mourre and Rinaldo Sali argue that increased transparency is already changing the nature of international arbitration and will bring further radical (dare I say revolutionary?) change to that staid world.



Arbitration is not necessarily confidential, but it is far from easily accessible. International arbitration, especially, has been criticized as a discrete and insular practice area characterized by difficult and uneven access to information. Professor Catherine Rogers, for example, has noted the "significant information asymmetries" that impair informed decisions on choosing arbitrators: "[T]ypically information about an arbitrator's conduct and decisional track record (as well as anecdotal information that might be useful in the selection process) is available to a relatively closed circle of arbitration insiders who treat such information as proprietary."[5]

Various suggestions have been made to try to loosen membership in the club to make it more open and diverse. All of the authors in this collection of essays are well ensconced in the international arbitration establishment who nevertheless believe in that goal and see greater transparency as at least one important way to achieve it.

Transparency, the book states, is a matter of loosening traditional notions of the confidentiality of arbitration and of publishing its awards and other decisions. As to the latter, the Report of the International Commercial Disputes Committee of the City Bar summarizes a survey of the publication practices of ten leading arbitration institutions that show a pronounced trend (with certain notable exceptions) toward publishing awards and other decisions (including decisions on challenges to arbitrators), but great diversity in policies and practices implementing the increased publication. Among its findings are that:

1. Only two of the ten surveyed institutions (the Hong Kong International Arbitration Centre and the Swiss Chamber) still publish nothing.

2. At the other extreme, ICSID, the Society of Maritime Arbitrators, and the Court of Arbitration for Sport attempt to publish all awards without editing out party or arbitrator information, either by rule or with the parties' consent.

3. In between are several institutions that publish selected awards or summaries but edit out any information that would identify the parties and arbitrators. The LCIA has restricted publication to decisions resolving challenges to arbitrators, while the rest (ICC, ICDR, Singapore, and Stockholm Chamber) publish selected, redacted awards.

4. Institutional rules and national laws vary as to whether there is any obligation of the parties to keep confidential information about or from arbitrations. All institutions' rules on party confidentiality, however, have exceptions for court filings to enforce or vacate awards. At least in the United States, those court filings will generally, absent the rare sealing order, be public. Those court files are therefore a potentially fertile ground for finding full, unredacted arbitral decisions, and some legal publishers have contemplated or are already mining those files to publish arbitral awards.

The Report also discusses the many issues raised by the trend toward publication, including its impact on traditional concepts of confidentiality, whether the information it provides will contribute to opening up and diversifying what has been considered a tight clique of arbitrators and practitioners, whether it will shift international arbitration toward more of a precedent-based system, how the knowledge that the awards are written for a broader public audience than just the parties before them will affect the cost, content and style of awards, and whether editing awards for publication (e.g., to eliminate party information) is worth the effort and cost.

As noted above, institutions that publish unredacted awards tend to be outliers: ICSID deals with investor disputes with national governments that have strong public interest components; the Society of Maritime Arbitrators is a very small subset of the international arbitration

community with few secrets among practitioners; and the Court of Arbitration for Sport publishes appeals from decisions that have already generated publicity.

The more mainstream institutions that publish edited awards take out not just party information, which can be a labor-intensive task, but also the names of the arbitrators. The former type of editing serves the client base and its perceived desire for confidentiality. It is unclear what interest is served by not publishing arbitrators' names.

The Milan Chamber has taken a bolder approach. It too edits outs information that would tend to identify the parties, but publishes "[t]he names of the arbitrators and the mechanism of their appointment."[6] Renaldo Sali, the Deputy Secretary General of the Milan Chamber of Commerce, defends the publication of arbitrators' names as "an incentive to vary the appointments and expand the professional pool of arbitrators: the move from an elitist phase in which only the same few people are appointed to one in which new generations of young well-trained professionals are appointed as arbitrators is another important factor in the growth of arbitration, and an essential part of the policy of any serious arbitral institution."[7]

He approvingly cites Professor Rogers on the need to expand the pool of arbitrators. Like her, Sali believes that a centralized, easily accessed database about arbitrators that has some sense of validation and evaluation from respected members of the profession would assist that goal. He argues that "[a] more systematic evaluation system that incorporates both objective measures and user feedback would create a more level and transparent playing field against which more objective assessments can be made."[8] The unanswered question is whether there is reason to believe that an evaluation system reflecting the assessments of the arbitration establishment (a requirement for its validation as a tool) will actually serve the desire for inclusiveness and diversity. Why should we trust the insiders to open up international arbitration to become more inclusive?

As indicated by the subtitle of the book ("The Case for the Anonymous Publication of Arbitral Awards"), all of the essays share some enthusiasm for transparency. Some argue that transparency is itself an important beneficial change; others that it will lead to more radical changes. Of the numerous eminent authors in the book, Alexis Mourre is the most emphatic on the benefits it will bring.[9]

Mr. Mourre makes the important point that if publication of arbitration decisions is to enhance the credibility of the process, then it cannot be either random (e.g., due to a party moving to vacate or confirm an award) or selected by the institution according to its concept of what is important or will make the institution look good: "The issue is however not *how* arbitration awards are selected for publication, but whether there should at all be any such selection, except for awards that are manifestly deprived of any interest."[10]

To that end, Professor Catherine Rogers has begun an interesting attempt to counteract the bias inherent in publication of decisions determined by institutional selection or court filings, and to increase publicly available knowledge about arbitrators. Her plan is to encourage parties to disclose decisions that will be available and searchable on a website with minimal editing to protect especially sensitive information and trade secrets. She also plans to implement a program to make information about arbitrators more equally accessible through what she calls "the 'International Arbitrator Information Project,' a project that would aim to provide reliable, online one-stop-shopping for information about arbitrators."[11]

The contributors to this volume see publication of awards as contributing to an essentially common law system of precedents establishing a private international commercial law, often referred to as *lex mercatoria*. This would mean that advocates in their memorials would argue—and arbitrators in their awards would cite and follow or distinguish—prior published awards. The extent to which advocates cite arbitral awards is not known or perhaps even knowable, given that memorials are not publicly available. As to awards themselves, no one has recently made any attempt to determine the extent of citation of published awards.

Mourre cites but is not deterred by Gabrielle Kaufman-Kohler's claim in her 2005 Freshfields lecture that the extent of citation in awards of other arbitral decisions is quite small and that "[a]side from procedural issues, perhaps, one can see no precedential value or self-standing rule creation in commercial arbitration awards."[12] He counters that "arbitral case law is a reality in practice, albeit an imperfect one. Past solutions have some impact on the thinking of arbitrators having to resolve future cases, even though they may not be referred to in their awards. The true question is therefore not whether the precedential effect of awards exists at all, but how it operates in practice."[13]

Neither is Mourre deterred by the point that most contracts require arbitrators to apply the law of a specific nation, state, or province, for which those entities' courts would presumably be the most authoritative, if not exclusive, source for determining the law to be applied: "[I]f non-national rules of law are to play any role in the adjudication of international trade disputes, arbitral precedents cannot but be an important source—albeit not exclusive—of the same."[14] Perhaps international arbitrators interpreting a nation's contract law, like federal judges interpreting state law in a diversity case, know that they are writing on water, in the sense that any holding will have no status as legal precedent and can be undone

by an authoritative ruling from the jurisdiction's courts, but the stature of those doing the writing carries persuasive power and may become in practice the authoritative precedent it is not by law. That is, of course, another argument for publishing the names of the arbitrators with their awards.

The financial cost of increased transparency is a significant issue that is not addressed in any of the essays. A few institutions (ICSID, SMA, and CAS) publish at least some awards in unredacted form, but most who publish say that they are careful to remove information that would identify the parties—indeed, that is the explanation for being able to publish notwithstanding an institutional rule requiring confidentiality. Editing awards is labor-intensive; it requires staff time that will presumably translate to higher administrative fees. Since many of the authors hold important positions in the secretariats of major arbitral institutions, they would be in the ideal position to address that issue and disclose the extent of time and effort required to collect, edit, and publish the awards, the resulting administrative cost, and who bears it. It is disappointing that they did not.

Rinaldo Sali ends his essay with the astute observation that "[a]rbitration abounds with theoretical analyses, comments and academic studies, but there are very few empirical figures and data."[15] We cannot tell where greater transparency will lead and whether and how it will change the nature of arbitration, but it may at least provide some much-needed data on which to base future arguments on the benefits and flaws of the system and how it could be improved.

Many questions about transparency remain unanswered and not even addressed in this book, but it nicely fulfills its stated intention "to spur discussion and shed new light" on the subject. Along with the Report of the City Bar's International Disputes Committee, the book highlights the reality that the market for arbitration administration is diverse and competitive. Many important choices in arbitration are more or less the same across the institutions, including the choice of arbitrators (no institution requires parties to choose from a vetted list), the ways of conducting an arbitration (e.g., as to the extent of discovery and of live testimony on direct examination), the language and the location (though some institutions' rules have defaults, the parties are free to choose). Institutional rules and practices on confidentiality and publication of awards, however, demonstrate great diversity. To the extent those issues are significant to those contemplating or advising on arbitration clauses, they should be part of the discussion of the selection of the institution to administer a dispute. To the extent that they do, we may, over the long term, see clients voting with their feet on where to go for arbitration administration according to whether transparency is desirable and what type of transparency is more desirable than others.

Endnotes

1. Report by the Committee on International Commercial Disputes of the Association of the Bar of the City of New York. Publication of International Arbitration Awards and Decisions ("Report") available on the City Bar's website at http://www2.nycbar.org/pdf/report/uploads/20072645-PublicationofInternationalArbitrationAwardsandDecisions.pdf. The author of this review is the principal author of the Report.
2. *E.g.*, Catherine A. Rogers, *The International Arbitrator Information Project: From an Ideation to Operation*, Kluwer Arbitration Blog (Dec. 10, 2012), at http://kluwerarbitrationblog.com/blog/author/catherinerogers/.
3. Alberto Malatesta and Rinaldo Sali, eds., The Rise of Transparency in International Arbitration: The Case for the Anonymous Publication of Arbitral Awards (Juris 2013) ("Rise of Transparency"). References below to chapters in Rise of Transparency will note the specific author and page number cited in the book.
4. Preface at xiii.
5. Catherine A. Rogers, *Emerging Dilemmas in International Economic Arbitration: The Vocation of the International Arbitrator*, 20 Am. U. Int'l L. Rev. 957, 969 (2005).
6. Milan Chamber of Arbitration Guidelines for Publication of Arbitral Awards, Guideline 2.1, p. 32.
7. Rinaldo Sali, Transparency and Confidentiality: How and Why to Publish Arbtration Decisions, p. 83. *See also* Benedetta Coppa, *Confidentiality in the Arbitration Rules of the Milan Chamber*, p. 150 (publishing the names of arbitrators is important "to increase their responsibility, and to assist parties to point them, thus contributing to the evolution of a class of effective arbitrators, including young and competent professionals").
8. Michael McIlwrath and Roland Schroeder, *Users Need More Transparency in International Arbitration*, pp. 102-03.
9. Alexis Mourre, *The Case for the Publication of Arbitral Awards*, in The Rise of Transparence in International Arbitration: The Case for the Anonymous Publication of Arbitral Awards 53 (Juris 2013) (hereinafter, "Mourre").
10. Mourre, p. 65 (emphasis in original).
11. Catherine A. Rogers, *The International Arbitrator Information Project: From an Ideation to Operation*, Kluwer Arbitration Blog (Dec. 10, 2012), which can be read at http://kluwerarbitrationblog.com/blog/author/catherinerogers/.
12. Gabrielle Kaufmann-Kohler, *Arbitral Precedent: Dream, Necessity or Excuse?*, 23 Arb. Int'l 357, 362-63 (2007).
13. Mourre, p. 56.
14. Mourre, p. 58.
15. Sali, p. 85.

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* * *

The College of Commercial Arbitrators Guide to Best Practices in Commercial Arbitration, Third Edition

James M. Gaitis, Editor-in-Chief
Carl F. Ingwalson, Jr. and Vivien B. Shelanski, Editors (JurisNet, LLC 2014)
Reviewed by Stefan B. Kalina

The vitality of commercial arbitration lies, in part, in its versatility. The process begins with the parties' choice to arbitrate their dispute. Once arbitration is selected, it must then be carried through by arbitrators and rules selected by the parties. This inherent flexibility raises its own set of challenges for arbitrators. They must erect a procedural framework that is faithful to the particular process the parties selected while also ensuring fairness, efficiency and a proper resolution. Decision points to achieve these goals come early and often.

Arbitrators can be asked at the outset to determine such threshold issues as their very authority over substantive and procedural aspects of the dispute. Down the line, they are asked to determine the scope of the issues to be decided and prehearing discovery. This all comes before the penultimate award is made. That award is, of course, informed by such prior determinations over whether and how factual and expert evidence may be presented—either at a hearing, on written submissions, or both. The order and magnitude of these, and many other decisions, are ever increasing as the choice to arbitrate is being made by parties across nearly every sector of the economy.

Arbitrators make these decisions, and many others, in semi-autonomous fashion. Although arbitrators are bound by the parties' agreement, most agreements will not—nor cannot—address every step of the arbitration. As is often the case, the agreement may incorporate a particular rule scheme to fill the void (*i.e.*, AAA Commercial Rules, etc.). Such rule schemes, however, are often drafted in purposefully broad language to provide room for anticipated flexibility. Of course, "courts continue to defer to the arbitrator's procedural decision-making and exercise limited authority over their awards." Accordingly, arbitrators must look elsewhere for guidance on the issues they will necessarily be asked to confront and decide.

Born of "these circumstances," the *CCA*[1] *Guide to Best Practices in Commercial Arbitration* (the "*Guide*") to was developed as "valuable tool" to assist arbitrators, whom parties look to "as an expert in the arbitration process." The value of the *Guide* lies first in the CCA itself, "a nonprofit organization composed of prominent, experienced arbitrators" that seeks to contribute to "the businesses and lawyers who depend on arbitration as a primary means of dispute resolution." The CCA has thus published this "best practices manual" to present the collective guidance of "experienced and respected members"[2] on how to "actively address a multitude of procedural issues" in arbitration as well as how to "manage such arbitrations and [adjudicate] the claims and defenses of arbitrating parties." More than a procedural manual, the "aim" of the *Guide* "is to identify best practices that arbitrators can employ to provide users of arbitration with the highest possible standards of economy and fairness."

"More than a procedural manual, the 'aim' of the Guide *'is to identify best practices that arbitrators can employ to provide users of arbitration with the highest possible standards of economy and fairness.'"*

Consistent with the flexibility of arbitration, the *Guide* recognizes the impossibility of providing readers with a rigid set of practices that should invariably be followed in every situation. The value of the *Guide* thus lies in the "pros and cons" offered by such "experienced and respected" arbitrators on how to handle specific issues. Rather than simply direct its readers, the *Guide* invites them to weigh the merits of several vetted options. For example, in addressing whether arbitrators should encourage settlement by either suggesting that the parties mediate or by structuring the arbitration to facilitate settlement, the *Guide* recognizes that "the issues involved are subtle" and implicate "competing considerations regarding the role of the arbitrator." Likewise, the *Guide* offers more than one technique as to how arbitrators may utilize their hearing management discretion to attain more effective expert presentations. In the main, the "best practice" offered by the *Guide* is how to "select the technique best suited to the situation."

The *Guide* executes this approach in a clear and concise manner. It presents a series of best practices in successive chapters that track the stages of commercial arbitration, beginning with the appointment of the arbitrators and concluding with post award matters. Each chapter is further broken down into a series of subtopics that arise at each procedural juncture. In many cases, each topic or subtopic is headlined by a bold-faced statement of the suggested best practice.

As but one example, the *Guide* introduces the topic of managing exhibits at the hearing with this best practice: "Arbitrators can ease the burden of managing exhibits by establishing clear and simple ground rules." A more specific best practice is then offered: "Arbitrators differ in their practices with respect to how exhibits are submitted to the arbitrators and offered into evidence. The preferred

practice, in each instance, is that which is most efficient and least expensive." Separate discussions then flesh out these best practices in more specific settings such as how to submit and admit exhibits as well as how to deal with core exhibits, demonstrative exhibits and exhibits created during the hearing. This chronological and straightforward approach is repeated throughout all the chapters of the *Guide*. It makes for easy reference, especially for arbitrators and practitioners who may be dealing with a live issue and need a solution in real time.

Many readers already familiar with the prior editions of the *Guide* will find that this Third Edition has been revised and expanded to reflect evolving caselaw and to account for updated rules from CPR, AAA, JAMS, ICDR, UNCITRAL and IBA. Many of the topical discussions include comparative rule citations and case references. These provide welcome context that allows readers to consider and evaluate the best practice suited for their situation. Indeed, the third edition adds new chapters on intratribunal relations, arbitrators' fees, eDiscovery, and hybrid arbitration processes. These add depth and round out the *Guide's* complete treatment of the arbitration process.

The best practices set forth in the *Guide* are aimed at realizing the benefits of commercial arbitration in a given dispute. As a corollary to this goal, the Third Edition also contains an appendix that reprints the CCA's *Protocols for Expeditious, Cost-Effective Commercial Arbitration: Key Action Steps for Business Users, Counsel, Arbitrators & Arbitration Provider Institutions*. The Protocols address the interests of many stakeholders in commercial arbitration and provide them with tools and commentary for reducing delay and expense in the process. The *Protocols* thus amplify the best practices and further complement the *Guide's* appeal to a wide audience of practitioners and arbitrators. Accordingly, the *Guide* should be commended to anyone interested in effectively using and improving one's experience with commercial arbitration.

Endnotes

1. College of Commercial Arbitrators.
2. They include several members of the New York State Bar Association Dispute Resolution Section who edit and contribute to this *Journal* publication.

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Second Circuit Denies Argentina's Foreign Sovereign Immunity Claim in Arbitration Dispute—*Blue Ridge Investments, L.L.C. v. Republic of Argentina*, 735 F.3d 72 (2d Cir. 2013)

By Michael L. Huggins

The Foreign Sovereign Immunities Act ("FSIA"),[1] which provides the sole source of subject matter jurisdiction over a foreign sovereign in the courts of the United States ("U.S."), is not an ironclad shield for a foreign sovereign to avoid the recognition and enforcement of arbitral awards. While the FSIA creates a general rule of foreign sovereign immunity from the jurisdiction of the courts in the United States, it also provides certain statutory exceptions.[2] The Second Circuit, in *Blue Ridge Investments, LLC v. Republic of Argentina*, examines two such exceptions, namely, the "Implied Waiver Exception" and the "Arbitral Award Exception."[3] Under the Implied Waiver Exception, a foreign sovereign is not immune to suit in the United States where it has explicitly or implicitly waived its immunity, "notwithstanding any withdrawal of the waiver which the foreign state may purport to effect except in accordance with the terms of the waiver."[4] Moreover, under the Arbitral Award Exception, foreign sovereign immunity is waived where the action is brought "to confirm an award made pursuant to an agreement to arbitrate, if…the agreement or award is or may be governed by a treaty or other international agreement in force for the United States calling for the recognition and enforcement of arbitral awards."[5]

Background

In *Blue Ridge*, the Second Circuit affirmed the finding of Judge Gardephe of the Southern District of New York ("SDNY") that the Republic of Argentina ("Argentina") waived its foreign sovereign immunity against an arbitral award issued to Blue Ridge Investments, L.L.C. ("Blue Ridge") and remanded the case for further proceedings.

In 1995, CMS Gas Transmission Company ("CMS") acquired a 25% ownership interest in Transportadora de Gas del Norte ("TGN"), a gas transportation company owned by Argentina. Since the beginning of its period of privatization and economic reform in 1989, Argentina had permitted public utilities licensees like TGN to adjust gas tariffs every six months in accordance with the United States Producer Price Index. In late 1999, however, following Argentina's economic crisis, Argentina and gas companies agreed to suspend the gas tariffs for six months with the caveat that costs of deferral would be recouped within a year. Rather than indemnify the losses, however, Argentina froze the United States Producer Price Index adjustments for gas tariffs indefinitely and, ultimately, terminated public utility licensees' right to adjust tariffs at all.

In July 2001, CMS initiated arbitration before an International Centre for the Settlement of Investment Disputes ("ICSID") tribunal asserting that Argentina had breached its obligations to accord CMS as a U.S. investor in Argentina "fair and equitable treatment," pursuant to the Treaty Concerning the Reciprocal Encouragement and Protection of Investment ("Bilateral Investment Treaty" or "Treaty").[6] The Treaty holds Argentina to certain standards of conduct toward U.S. investors and provides that U.S. investors may arbitrate investment disputes with Argentina before ICSID. The ICSID tribunal awarded $133.2 million plus interest ("Award") to CMS, finding that Argentina breached its fair and equitable treatment obligations to CMS guaranteed in Article II(2)(a) of the Bilateral Investment Treaty and its obligations with regard to the investment guaranteed in Article II(2)(c) of the Treaty. An ICSID Annulment Committee subsequently rejected Argentina's application to have the Award annulled.

In June 2008, Blue Ridge notified Argentina that it had purchased CMS's interest in the Award. In January 2010, Blue Ridge filed a petition to confirm the Award pursuant to Article 54 of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the "ICSID Convention"), which provides for the automatic recognition and enforcement of awards in Contracting States.[7] Argentina then moved to dismiss the petition on several grounds, arguing, *inter alia*, that it was immune from suit pursuant to the FSIA. After Judge Gardephe denied Argentina's motion to dismiss and rejected each of its arguments, Argentina appealed to the Second Circuit.

Argentina Waived Its Foreign Sovereign Immunity Under the FSIA's Implied Waiver and Arbitral Award Exceptions

Reviewing *de novo* the District Court's legal conclusions regarding subject matter jurisdiction under the FSIA, the Court of Appeals first examined the Implied Waiver Exception.[8] The Court found that its prior holding in *Seetransport Wiking Trader Schiffarhtsgesellschaft MBH & Co., Kommanditgesellschaft v. Navimpex Centrala Navala*[9] compels the conclusion that Argentina waived its foreign sovereign immunity by signing the ICSID Convention.

In *Seetransport*, the Second Circuit held that the Socialist Republic of Romania ("Romania") waived its foreign sovereign immunity by becoming a signatory to the Convention on the Recognition and Enforcement of Arbitral Awards ("CFREAA") because, by the CFREAA's provision that "[e]ach Contracting State shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon," Romania must have contemplated enforcement actions in other signatory States.[10] Similarly, the ICSID Convention's Article 54 provides that Contracting States "shall recognize an award rendered pursuant to th[e] Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State."[11] The Second Circuit concluded that, in light of this provision, Argentina must have contemplated enforcement actions in other Contracting States, including the United States and, thus, Argentina implicitly waived its foreign sovereign immunity.

The Court of Appeals next addressed the Arbitral Award Exception, noting that every court that has considered whether the Arbitral Award Exception applies to awards issued pursuant to the ICSID Convention has answered affirmatively (citing three district court cases only). The Court highlighted that Argentina agreed to submit its dispute to arbitration under the ICSID Convention, which calls for the recognition and enforcement of arbitral awards and to which both Argentina and the United States are Contracting States. In agreeing to submit its dispute with CMS to arbitration under the ICSID Convention, Argentina waived its foreign sovereign immunity with respect to the recognition and enforcement of the Award.

The Second Circuit thus affirmed the District Court's findings that Argentina waived its foreign sovereign immunity against the recognition and enforcement of the arbitral award in this action and remanded the case for further proceedings consistent with the Second Circuit decision.

Conclusion

While the FSIA establishes a general rule of foreign sovereign immunity from the jurisdiction of United States courts, arbitral awards may still be recognized and enforced under exceptions such as the Implied Waiver Exception and the Arbitral Award Exception.

Endnotes

1. 28 U.S.C. § 1604 (2013).
2. 28 U.S.C. §§ 1604, 1605(a) (2013).
3. 735 F.3d 72 (2d Cir. 2013).
4. 28 U.S.C. § 1605(a)(1) (2013).
5. 28 U.S.C. § 1605(a)(6)(B) (2013).
6. U.S.-Arg., Nov. 14, 1991, S. Treaty Doc. No. 103–2 (1993).
7. Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159.
8. The Court of Appeals found that it had personal jurisdiction under the "collateral order doctrine" to consider whether the District Court erred in concluding that Argentina had waived its foreign sovereign immunity because the ruling was sufficiently "final" and distinct from the merits to be appealable without waiting for a final judgment to be entered. *Blue Ridge*, 735 F.3d at 79 (citation omitted). The Court further held that it could not exercise Pendant Appellate Jurisdiction to consider whether the District Court erred in concluding that Blue Ridge, as an assignee, could state a claim to confirm the underlying award of the ICSID because that issue was not "inextricably intertwined" with the question of whether Argentina waived its foreign sovereign immunity. *Id.* at 81.
9. 989 F.2d 572 (2d Cir. 1993).
10. *Id.* at 578.
11. *Blue Ridge*, 735 F.3d at 84.

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The Ninth Circuit Precludes Parties from Contractually Divesting Courts of Authority to Review Arbitration Awards as Specified in the FAA—*In re Wal-Mart Wage and Hour Employment Practices Litigation*

By Steven W. Shuldman

In *In re Wal-Mart Wage and Hour Employment Practices Litigation*,[1] the Ninth Circuit Court of Appeals considered whether in their arbitration agreement parties could limit the scope of authority to review arbitration awards under Section 10 of the Federal Arbitration Act (FAA). It held that they could not.[2] In *Hall Street Associates, L.L.C. v. Mattel, Inc.*, the Supreme Court ruled that the parties could not expand the reviewing authority;[3] here the Court relied on *Hall Street Associates* to hold that the parties could not divest the courts of the statutory review authority.

Background

In re Wal-Mart arose out of a dispute regarding attorneys' fees resulting from Wal-Mart wage and hour multidistrict litigation.[4] The parties in the litigation had participated in mediation and agreed to a global settlement agreement (Settlement Agreement) in which Wal-Mart would pay $85 million in order to settle all claims against it.[5] Further, the parties agreed to arbitrate the any fee disputes among plaintiffs' counsel in "binding, non-appealable arbitration," as provided in the Settlement Agreement.[6]

The district court approved the Settlement Agreement and a panel of the Ninth Circuit affirmed.[7] During the course of the litigation, relations among the plaintiffs' counsel deteriorated; the arbitration clause was triggered and the Arbitrator was called upon to allocate fees.[8]

Appellants Burton et al. (Burton), Carol Powell LaPlant (LaPlant), and appellees Bonsignore & Brewer (Bonsignore) were lead plaintiffs' counsel.[9] On January 10, 2011, the Arbitrator made his award, allocating the $28 million fees as follows: over $11 million to appellee Bonsignore, over $6 million to appellant Burton Group, and over $730,000 to appellant LaPlant.[10]

Bonsignore moved to confirm the award, while Burton moved to vacate.[11] Finding no legal basis on which to vacate the Arbitrator's award, the district court granted Bonsignore's motion and entered judgment in its favor.[12] Burton then appealed to the Ninth Circuit.[13]

The appellants argued that the district court erred in declining to vacate the award pursuant to § 10(a) of the FAA. The appellee argued that the Ninth Circuit lacked jurisdiction to hear the appeal, because the parties had agreed to "binding, non-appealable arbitration." Further, the appellee argued the district court was correct in its finding that there was no basis to vacate the award under the FAA.

Non-Appealability Clauses: Two Constructions

The parties' Settlement Agreement provided that they "submit any disputes concerning fees…to binding, non-appealable arbitration."[14] The Ninth Circuit noted there were two ways to construe such non-appealability clauses.[15] First, some courts, such as the Third and Eleventh Circuits, have understood such clauses to proscribe only federal court review of the merits of an Arbitrator decision.[16] This would preserve the parties' right to appeal from the decision under the provisions of the FAA.[17] The district court adhered to this view that "a contract provision stating that arbitration is non-appealable signifies that the parties only waive review of the *merits* of the arbitration."[18] Under this view, the arbitration agreement would be enforceable because it does not purport to eliminate the enumerated grounds for vacatur in the FAA.[19]

The second interpretation construes the clause as an attempt to divest federal court of "jurisdiction to review the Arbitrator's fee allocation on *any ground*, including those enumerated in § 10 of the FAA."[20] Courts such as the Second Circuit adhere to this view.[21] Noting that the two possible interpretations render the clause ambiguous, the court then posited that it "need not resolve" which of the two is correct if it concluded that the second construction is unenforceable due to its attempt to eliminate judicial review under § 10 of the FAA.[22]

The Federal Arbitration Act and Vacatur of Arbitration Awards

Congress enacted the FAA in order to "place[] arbitration agreements on equal footing with all other contracts."[23] The FAA provides for limited review of arbitration awards. Though parties have the right to tailor their agreements, the Supreme Court has recognized limits on parties' freedom to alter the statutorily proscribed scope of judicial review of arbitrators' awards.[24]

The FAA permits vacatur of awards only under the following circumstances: (1) the award was procured by fraud or corruption, (2) where any arbitrators displayed partiality, (3) where arbitrators committed misconduct, or (4) where arbitrators exceeded their powers.[25] In *Hall Street Associates*, the Supreme Court rejected the argument that an arbitration clause which expanded judicial review beyond what was provided for in the FAA was enforceable because of the parties' freedom to contract.[26]

The *Hall Street Associates* decision did not resolve whether the parties could limit the courts' review authority. That was the question in *In re Wal-Mart*.[27]

The Ninth Circuit's Reading: Grounds for Vacatur May Not Be Eliminated

The Ninth Circuit noted that the Supreme Court's ruling in *Hall Street Associates* held unenforceable an arbitration agreement that purported to expand the grounds for vacatur.[28] The court did so first as a matter of statutory interpretation. Second, the court recognized the FAA's goal of preserving a minimum level of due process rights for parties in arbitration by providing a fundamental mechanism for courts to review potentially unfair awards while still ensuring quick dispute resolution.[29]

First, as a matter of statutory interpretation, the court cited *Hall Street Associates*, where the Supreme Court found that the FAA's language, compelling that a court "must" confirm an award, unless it is vacated under the reasons above, contained "'no hint of flexibility'" and did not function as a gap filler in cases of contractual silence, but rather an affirmative restriction on arbitration agreements.[30]

Under that analysis, the court found that just as the text of the FAA forecloses an agreement purporting to expand its grounds for vacatur, so too does it foreclose agreements which reduce or eliminate judicial review.[31] In holding that an arbitration agreement may not waive or eliminate grounds for vacatur in the FAA, the Ninth Circuit recognized that the FAA inserts "limited, but crucial safeguards" into the arbitration process.[32] The court held that allowing parties to eliminate, via contract, the protections of judicial review would run counter to Congress's intent to ensure a minimum level of due process in arbitration, while still fostering its goal of facilitating efficient dispute resolution.[33] Recognizing this balance, the court ruled that allowing agreements to circumvent these basic protections would circumvent crucial safeguards against "arbitral abuse."[34]

Conclusion

In re Wal-Mart relies on statutory construction and the due process components incorporated in the FAA to hold that arbitration agreements cannot eliminate judicial review. Drafters should beware and avoid attempts to curtail review.

Endnotes

1. 737 F.3d 1262 (9th Cir. 2013).
2. Id. at 1265.
3. 552 U.S. 576, 584 (2008).
4. *In re Wal-Mart*, 737 F.3d at 1265.
5. *Id.*
6. *Id.*
7. *Id.* at 1265.
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.*
13. *Id.*
14. *Id.* at 1265.
15. *Id.* at 1265-66.
16. *Id.* (citing Southco, Inc. v. Reell Precision Mfg. Corp., 331 F. App'x 925, 927-28 (3d Cir. 2009); Rollins, Inc. v. Black, 167 F. App'x 798, 799 n. 1 (11th Cir. 2006)).
17. *Id.*
18. *Id.* at 1266 (emphasis added).
19. *See id.*
20. *Id.* (emphasis added).
21. *Id.* (citing Hoeft v. MVL Grp., Inc., 343 F.3d 57, 64 (2d Cir. 2003), *overruled on other grounds by* Hall St. Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576 (2008)).
22. *See Hall St. Assocs.*, 552 U.S. at 584 (discussing policy against "full-bore and evidentiary appeals" of awards that threaten to frustrate arbitration's "essential virtue of resolving disputes straightaway").
23. *In re Wal-Mart*, 737 F.3d at 1267 (quoting Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 443 (2006)).
24. *Id.*
25. *Id.* at 1266-67 (quoting 9 U.S.C. § 10(a) (2012)).
26. *Id.* at 1267 (citing *Hall St. Assocs.*, 552 U.S. at 585).
27. *Id.*
28. *Id.*
29. *Id.* at 1268.
30. *Id.* at 1267-68 (quoting *Hall St. Assocs.*, 552 U.S. at 585) (discussing how other sections of the FAA "expressly permit modification by contract").
31. *Id.*
32. *Id.* at 1268 (quoting Hoeft v. MVL Grp., Inc., 343 F.3d 57, 64 (2d Cir. 2003), *overruled on other grounds by Hall St. Assocs.*, 552 U.S. 576).
33. *Id.*
34. *Id.*

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Excluding Evidence in Arbitrations Is Not Always a Basis for Vacatur—*Doral Financial Corp. v. García-Vélez*, 725 F.3d 27 (1st Cir. 2013)

By Laura A. Kaster

One of the nettlesome concerns for an arbitrator is the scope of power to exclude evidence. The reason this concern looms large is that a specific grounds in the Federal Arbitration Act, Section 10(a)(3) requires vacatur of an award when "the arbitrators were guilty of misconduct in refusing to…hear evidence pertinent and material to the controversy…." The First Circuit has clarified both the purpose of the statute's provision and the authority of the arbitrator or panel to administer the process. The Court applies its previous holding that: "Vacatur is appropriate only when the exclusion of relevant evidence so affects the rights of a party that it may be said that he was deprived of a fair hearing."[1] In this case, the Court upheld the district court's denial of vacatur and found that both the scheduling order and the provision of ample opportunity to be heard eliminated any basis for challenging the award on the grounds that a request for third-party subpoenas had been denied.

The underlying arbitration arose out of an employment dispute. Doral terminated García–Vélez as the President of its Consumer Banking Division. García–Vélez filed the arbitration to seek severance compensation. Doral argued that no compensation was due because the termination was "for cause." Shortly after the arbitration was filed, García–Vélez became a top executive at the Miami branch of a bank with whom Doral competed in Puerto Rico. He notified Doral by letter about his new employment, and Doral responded with an amendment to its submission to the arbitration tribunal, adding the claim that it owed no severance to García–Vélez because he had breached the non-competition clause of his employment contract. Doral also moved the tribunal for injunctive relief against García–Vélez and commenced parallel litigation in state court against his employer.

In March of 2009, the arbitration tribunal held a preliminary conference and then issued an agreed scheduling order that specified May 2009 for final information requests and August 2009 for witness lists. The order also stated that, "if a party wishes to issue a subpoena to a third party…the parties shall first confer and determine if there is any disagreement to the date and propriety of the subpoena…. Any dispute, as to a subpoena, shall be resolved by the Tribunal…."[2] After the August date, on September 4, 2009, only five days before the first arbitration hearing was scheduled to begin, Doral filed an "Urgent Motion to Stay the Arbitration Proceedings," stating that the Miami branch of the bank had merged

with its Puerto Rico holding company. According to Doral, the merger proved the falsity of García–Vélez's contention that he exclusively worked for the Miami branch. The tribunal denied the stay, and the arbitration hearings commenced as scheduled on September 9, 2009. After a few days of testimony, Doral's lawyer fell ill and the arbitration was postponed until December 2009. During the recess, Doral submitted interrogatories to which García–Vélez did not respond and applied to the tribunal for third-party subpoenas for his employer. Doral then sought hearing subpoenas for testimony about the merged company. The tribunal refused the subpoenas as untimely and also as broader than they would have permitted had they been timely. The tribunal noted that: Doral "has been aware since the beginning of these proceedings of the witnesses that it is now attempting to subpoena related to its non-competition claim [, because,] [f]or an extended period of time[, Doral has] been engaged in collateral litigation with [García–Vélez's] employer concerning the non-competition provision in the Employment Agreement."[3] When the hearing resumed, Doral was permitted to cross-examine García–Vélez and to put on its own case. The panel ultimately awarded García–Vélez in excess of $2 million and rejected Doral's contention that he had breached the non-competition agreement. Doral appealed and challenged the award under the Federal Arbitration Act for the denial of the subpoenas, thereby allegedly denying it the opportunity to present relevant evidence. The district court rejected Doral's arguments and the Court of Appeals affirmed.

The Court held that Doral was afforded the process due, a fair hearing that included notice, and an opportunity to present relevant evidence and arguments. The tribunal gave adequate notice as to the schedule governing the arbitration proceedings, and granted Doral adequate notice in connection with the process governing the issuance of subpoenas. In addition, the tribunal afforded Doral many other procedural safeguards, including the health-related two-month continuance its counsel obtained as well as the opportunity to weigh in on the scheduling order governing the arbitration proceedings; cross-examine García–Vélez; introduce evidence of its own; file a post-hearing memorandum and a proposed award. The tribunal also provided Doral with ample written support for its decision to deny the subpoena.[4] Importantly, the Court notes that there was no actual evidence of violation of the non-compete and that Doral was actually on a fishing expedition.

In rejecting the challenge to the refusal to obtain additional evidence outside the agreed upon schedule, the Court clarified the boundaries of a Section 10(a)(3) challenge to an award.

Endnotes

1. *Doral Fin. Corp. v. Garcia-Velez*, 725 F.3d 27, 31-32 (1st Cir. 2013) (citing *Hoteles Condado Beach, La Concha and Convention Ctr. v. Union De Tronquistas Local 901*, 763 F.2d 34, 40 (1st Cir. 1985)).
2. *Doral Fin. Corp. v. Garcia-Velez*, 725 F.3d 27, 29 (1st Cir. 2013).
3. *Id.* at 30.
4. *Id.* at 32.

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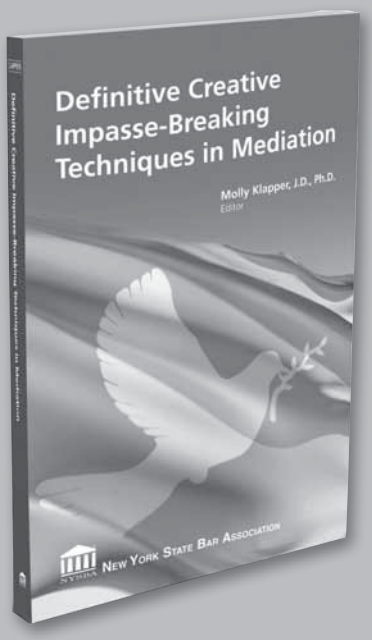

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