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ARBITRATION

This is Part Four of a four-part series by Williams & Connolly's Nick Boyle and Richard Olderman on how arbitration clauses, if properly drafted, may save companies huge amounts of time and money if disputes were to arise (137 CARE, 7/18/16; 138 CARE, 7/19/16; and 139 CARE, 7/20/16).

Securing the Benefits of Arbitration: Thoughtful Drafting of Arbitration Clauses

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PART FOUR

The last installment of our series on drafting effective arbitration clauses takes you from non-party discovery through the merits hearing, the award, and the appeal.

d. Pre-Hearing Discovery from Non-Parties.

The law concerning pre-hearing non-party discovery is, to say the least, unsettled. While Section 7 of the FAA gives arbitrators authority to “summon in writing any person to attend before them or any of them as a witness and in a proper case to bring with him or them any book, record, document or paper which may be deemed material as evidence in the case,” federal courts are divided as to whether, and under what circumstances, Section 7 authorizes pre-hearing discovery from non-parties. 9 U.S.C. § 7. The FAA is silent on this matter.

The most restrictive approach is that taken by the Second Circuit, which has opined that the FAA does not give the arbitrator authority to order non-parties to attend depositions, or the authority to demand that non-parties provide the litigating parties with documents in pre-hearing discovery. *Life Receivables Trust v. Syndicate 102 at Lloyd's of London*, 549 F.3d 210 (2d Cir. 2008). The least restrictive approach is that of the Eighth Circuit, which has ruled that the FAA provides arbitration panels with the authority to require pre-hearing production by non-parties. *In re Sec. Life Ins. Co.*, 228 F.3d 865, 870-71 (8th Cir. 2000). Of the other federal courts of appeals to rule on the issue, the Third Circuit has followed the holding of the Second Circuit, see *Hay Grp., Inc. v. E.B.S. Acquisition Corp.*, 360 F.3d 404, 407 (3d Cir. 2004) (Alito, J.); the Fourth Circuit has also interpreted the statute narrowly, but has suggested that where there is “a showing of special need or hard-

ship” a party can petition the court to permit pre-arbitration discovery, see *COMSAT Corp. v. Nat’l Sci. Found.*, 190 F.3d 269 (4th Cir. 1999); and the Sixth Circuit, in *Am. Fed’n of Television & Radio Artists, AFL-CIO v. WJBK-TV*, 164 F.3d 1004 (6th Cir. 1999), authorized a subpoena directed to a non-party for pre-hearing documents in a labor arbitration.

Note that courts that permit pre-hearing document discovery are not likely to permit pre-hearing depositions, although there are exceptions. See, e.g., *Amgen Inc. v. Kidney Ctr. of Del. Cty., Ltd.*, 879 F. Supp. 878 (N.D. Ill. 1995) (arbitrator has power to compel non-party depositions). In addition to these potential problems, counsel may in some courts face territorial restrictions on the subpoena power of the arbitration panel. In *Dynegy Midstream Servs., LP. v. Trammochem*, 451 F.3d 89 (2d Cir. 2006), the Second Circuit held that Rule 45(a)(3)(B) procedures for obtaining evidence from nonparties located outside the territorial limits of the subpoena power are not available in arbitration. However, the Eighth Circuit has taken a contrary position. See *In re Sec. Life Ins.*, 228 F.3d at 872 (8th Cir. 2000).

In practice, in circuits with a restrictive approach to non-party discovery, the problem is addressed by asking the arbitrators to convene a special hearing, in advance of the main merits hearing, solely to deal with such discovery. Both the Second and Third Circuits have indicated that any person can be ordered to produce documents if called as a witness at a hearing; and that the arbitrator’s authority “is not limited to witnesses at merits hearings, but extends to hearings covering a variety of preliminary matters.” *Life Receivables Trust v. Syndicate 102 at Lloyd’s of London*, 549 F.3d at 218 (2d Cir. 2008); *Hay Grp., Inc. v. E.B.S. Acquisition Corp.*, 360 F.3d at 413-14 (3d Cir. 2004) (Chertoff, J. concurring) (noting that the inconvenience of appearing personally may cause the testifying witness to “deliver the documents and waive presence”); see also *Bailey Shipping Ltd. v. Am. Bureau of Shipping*, No. 12 Civ. 5959 (KPF), 2014 WL 3605606, at *2, 2014 BL 199663 (S.D.N.Y. July 18, 2014) (“[T]here is now no question that arbitrators may, consistent with section 7 [of the FAA], order any person to produce documents so long as that person is called as a witness at a hearing.”) (alteration in original, internal quotation marks and citation omitted). Finally, in *Volt Information Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), the Supreme Court held that in arbitrations otherwise subject to the FAA, parties may agree to have state arbitration procedures apply, so long as those procedures do not undermine the “goals and policies of the FAA.” *Id.* at 478. Accordingly, when non-party discovery is important to the case, a contractual provision calling for the application of state law may be appropriate. Some states expressly grant arbitrators the authority to issue pre-hearing third party document subpoenas. See, e.g., Del. Code Ann. Tit. 10 § 5708(a); N.J. Stat. Ann. § 2A:23b-17.

The parties, therefore, may consider addressing non-party discovery in the arbitration clause, agreeing whether it is to be permitted and, if so, how it should proceed (e.g., one request to the arbitrators for a subpoena or subpoenas by a certain date and a covenant to use “best efforts” to complete discovery by the agreed upon deadline).

9. The Merits Hearing.

“Every hour of a hearing can cost several thousands of dollars given the number of individuals likely to be involved (e.g., attorneys, arbitrators, experts, stenographers, and support staff).” William K. Andrews & Shelly L. Ewald, *Has Arbitration Fulfilled Its Promise? Both Sides of the Debate* 15 (Am. Bar Ass’n 2015). The most obvious and effective strategy to shorten the hearing is an agreement limiting the number of days allotted to the hearing, bearing in mind the needs of the parties to fully present their arguments. The parties can also put specific time limits on pre and post-hearing briefing, and time periods for pre-trial rulings, openings and closings. Other strategies include submitting a joint evidentiary stipulation to the arbitrators and summarizing evidence not in dispute. A common alternative to these restrictions is to give each side a set number of hours to use as they see fit, with the arbitrator given authority to reduce, but not expand, the time limits.

A sample clause, with time limits, might look like this:

The following time limits are to apply to any arbitration hearing arising out of or related to this Agreement:

(1) The evidentiary hearing on the merits (“Hearing”) is to commence within [] days of the service of the response to the arbitration demand. At the Hearing, each side has: [] hours for opening arguments; [] hours for closing arguments; and [] days for presentation of direct evidence and cross-examination, to apportion as they see fit. Pre-hearing briefs shall be submitted [] days prior to the Hearing. Each pre-hearing brief, and any post-hearing brief, shall be limited to [] double-spaced pages. If post-hearing briefs are deemed necessary by the arbitrators, they shall be submitted within [] days after the end of the Hearing.

10. The Award.

a. Timing.

While AAA Commercial Arbitration Rules normally provide for an award within 30 days of the closing of the hearing, parties desiring greater expedition can, as already noted, require an arbitration award within a specified number of months of the notice of intention to arbitrate, or a specified number of weeks after the merits hearing, and provide that the arbitrator(s) must agree to the time constraints before accepting appointment. The parties, necessarily, must agree that the deadline is realistic. It may be wise to allow the arbitrator to reduce (and/or perhaps also extend) time limits for good cause or in appropriate circumstances.

b. Reasoned versus Unreasoned Awards.

Under some arbitration rules, the arbitrator simply announces the result, and provides a numerical award. Such an “unreasoned” award can be rendered quickly and, lacking explanation, the award is harder to subsequently challenge.

The arbitration agreement, however, can provide for a “reasoned award,” which provides key findings and the reasons for those findings. See *Tully Constr. Co./A.J. Pegno Constr. Co., J.V. v. Canam Steel Corp.*, No. 13 Civ. 3037 (PGG), 2015 WL 906128, at *14, 2015 BL 56361 (S.D.N.Y. Mar. 2, 2015) (reasoned award falls somewhere between a standard award (requiring no explanation) and “findings of fact and conclusions of law”). Of course, the more detailed the decision, the

more time it takes to write, the greater the cost, and the more likely it can be challenged in court.

Courts have held that “an arbitrator exceeds his or her authority by issuing an improper form of award.” *Tully Constr. Co./A.J. Pegno Constr. Co., J.V.*, 2015 WL 906128, at *18; *Am. Centennial Ins. v. Global Int’l Reinsurance Co.*, No. 12 Civ. 1400 (PKC), 2012 WL 2821936, at *8, 2012 BL 169420 (S.D.N.Y. July 9, 2012) (collecting cases). The form of decision can be addressed by using one of the following clauses:

The arbitrator(s) shall issue a reasoned decision.

The arbitrator(s) shall issue findings of fact and conclusions of law.

The arbitrator(s) shall provide a standard, unreasoned form of Award.

c. Damages and Interest.

Some arbitration rules exclude punitive damages; some do not. Not only may the parties wish to exclude such damages, they may want to have the applicable interest rate determined by reference to a favorable (typically low) rate such as LIBOR, rather than a state statutory interest rate (which may be relatively high). The Supreme Court has held that arbitrators can order punitive damages unless the parties’ agreement expressly prohibits this category of damages. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 58, 60-61 (1995).

A punitive damages provision may state as follows:

The parties expressly waive and forgo any right to punitive, exemplary, or similar damages as a result of any dispute, controversy, or claim relating to, connected with, or arising out of this agreement or the breach, existence, validity, or termination thereof.

Or:

The arbitrator has no authority to award punitive, consequential, or special damages in any arbitration initiated under this agreement.

The provision governing interest may provide as follows:

Interest shall be awarded at [rate and period] and be compounded [monthly].

If these issues are not dealt with in the arbitration agreement, special attention must be paid to what procedural laws apply. For example, punitive damages are permitted under the FAA, but are barred in New York by the CPLR; legal fees to the prevailing party, discussed below, are allowed under the FAA, but they are not permitted under the CPLR unless the arbitration agreement so provides.

d. Costs and Fees.

There are many costs to arbitration, including the arbitrators’ fees and expenses, expert witness fees, legal fees and administrative costs. Most arbitral bodies charge a fee, in addition to the arbitrators’ fees, which covers the costs of managing the dispute. The parties may wish to expressly state in their agreement the costs and fees that are recoverable, and those that are not. They may give the arbitrators discretion to allocate costs and decide fees; provide an allocation of costs and fees to the prevailing party (a term that the agreement should clearly define); allocate costs and fees in proportion to success; or split costs equally. Sample clauses in-

clude the following provision giving the panel discretion:

The arbitral tribunal may include in its award an allocation to any party of such costs and expenses, including attorneys’ fees [and costs and expenses of experts and witnesses], as the arbitral tribunal shall deem reasonable.

A clause might also allocate costs to the prevailing party:

The arbitral tribunal may award its costs and expenses, including attorneys’ fees, to the prevailing party, if any, and as determined by the arbitral tribunal in its discretion.

Or it might split costs equally:

All costs and expenses of the arbitral panel [and of the arbitral institution] shall be borne by the parties equally. Each party shall bear all costs and expenses (including of its own counsel, experts and witnesses) involved in preparing and presenting its case.

e. Final and Binding.

Because an award, to be enforced, must be final, the agreement should provide that the arbitral award will be final and binding. See 9 U.S.C. § 9 (“If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, . . . any party to the arbitration may apply to the court . . . for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title.”). A sample clause might state as follows:

The award shall be final and binding on the parties and may be entered and enforced in any court having jurisdiction.

f. Appeals.

In federal courts, appellate review of arbitral decisions is extremely narrow. See, e.g., *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008) (grounds for vacating award under the FAA are evident partiality, fraud, corruption, refusing to hear pertinent evidence and ultra vires actions). For the sake of efficiency and finality, this can be just as well; appeals can add time and costs to the process and eliminate the reasons for choosing to arbitrate.

The Supreme Court in *Hall* held that, for cases brought under the FAA, the scope of review may not be expanded by the terms of the agreement. *Id.* Some state courts have held that their state arbitration statutes permit expanded review and are not preempted by the FAA. See, e.g., *Cable Connection, Inc. v. DIRECTV, Inc.*, 190 P.3d 586 (Cal. 2008) (requiring an explicit and unambiguous contract provision for expanded review); *Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84 (Tex. 2011). Other state courts have ruled that their state statutes do not permit expanded review of arbitration awards. See, e.g., *Brookfield Country Club, Inc. v. St. James Brookfield LLC*, 696 S.E.2d 663 (Ga. 2010); *HL 1, LLC v. Riverwalk, LLC*, 15 A.3d 725 (Me. 2011). Some courts have held that parties to an arbitration agreement can reduce the scope of judicial review by agreement, or preclude judicial review entirely. See, e.g., *MACTEC Inc. v. Gorelick*, 427 F.3d 821, 830 (10th Cir. 2005); *Van Duren v. Rzasas-Ormes*, 926 A.2d 372, 374 (N.J. Super. Ct. App. Div. 2007), *aff’d, per curiam*, 948 A.2d 1285 (N.J. 2008).

Certain arbitral bodies, including AAA, JAMS, and CPR, have adopted internal appeal procedures that can vary the finality of the arbitration process. For example,

the JAMS rule allows an appeal to be taken to a separate panel of three JAMS arbitrators, or a single arbitrator if the parties agree; the standard of review will be the same standard an appellate court would apply when reviewing a trial court ruling; and a decision will be made within 21 days of oral argument or service of final briefs, which will not exceed 25 pages double-spaced. *See generally* 33 R. B. Jacobs, *Examining the Elusiveness of Finality and the New Avenue of Appeal Alternatives, Alternatives to the High Cost of Litigation* (Jan. 2015).

To trigger this procedure, the agreement should state:

The Parties adopt and agree to implement the JAMS Optional Arbitration Appeal Procedure (as it exists on the effective date of this Agreement) with respect to any final award in an arbitration arising out of or related to this Agreement.

The AAA Optional Appellate Arbitration Rules permit the parties to include, as part of their contract's arbitration provision, that the arbitral decision may be appealed to an AAA Appeals Tribunal, which may affirm or reverse the underlying decision based upon errors of law that are material and prejudicial to a party, and determinations of fact that are clearly erroneous. For parties wishing to make this appeal procedure available, the AAA recommends the following clause:

Notwithstanding any language to the contrary in the contract documents, the parties hereby agree: that the Underlying Agreement may be appealed pursuant to the AAA's Optional Appellate Arbitration Rules ("Appellate Rules"); that the Underlying Award rendered by the arbitrator(s) shall, at a minimum, be a reasoned award; and that the Underlying Award shall not be considered final until after the time for filing the Notice of Appeal pursuant to the Appellate Rules has expired. Appeals must be initiated within thirty (30) days of receipt of an Underlying Award, as defined by Rule A-3 of the Appellate Rules, by filing a notice of appeal with any AAA office. Following the appeal process the decision rendered by the appeal tribunal may be entered in any court having jurisdiction thereof.

AAA Optional Appellate Arbitration Rules 3-4 (eff. Nov. 1, 2013) (internal quotation marks omitted). The AAA Appellate Arbitration Rules emphasizes that "[u]tilization of these rules is predicated upon agreement of the parties. The right to appeal an arbitration proceeding is a matter of contract. A party may not uni-

laterally appeal an arbitration award under these rules absent agreement with the other party(s)." *Id.* And, of course, invoking these rules adds time and costs to the arbitration process.

Using Expedited Procedures Provided by Arbitral Bodies.

Note that, in lieu of, or to supplement, many of the provision discussed above, pre-existing expedited arbitration procedures are available from AAA and JAMS as well as other arbitral services. JAMS Rules 16.1 and 16.2, for example, provide expedited procedures that govern matters such as document production, e-discovery, depositions, dispositive motions, and timeframes. *See JAMS Comprehensive Arbitration Rules & Procedures* (eff. July 1, 2014), www.jamsadr.com/rules-comprehensive-arbitration. If the parties wish these procedures to apply, JAMS recommends a contract provision along these lines:

Any arbitration arising out of or related to this Agreement shall be conducted in accordance with the expedited procedures set forth in the JAMS Comprehensive Arbitration Rules and Procedures as those Rules exist on the effective date of this Agreement, including Rules 16.1 and 16.2 of those Rules.

JAMS, *supra*, note 16, at 7.

The AAA expedited procedures apply when the amount in controversy is \$75,000 or less, unless the parties determine otherwise. *See* Commercial Rule R-1(b); Expedited Procedure Rule E-2.

Arbitration may appear to be less expensive than litigation, with relaxed evidentiary rules, limited discovery and flexible scheduling, but this is only true if the relevant language of the agreement places some limits on the nature of the arbitration proceedings, and if these limits have been well thought out, to suit the anticipated disputes. A thoughtful well-designed arbitration clause, in place of standard boilerplate, can limit time and expenses and make the arbitration truly worthwhile.