

Ordering Costs to Temper the "Americanization" of International Commercial Arbitration

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Arbitration has historically been the preferred method of resolving international commercial disputes. For parties to an international business transaction, the benefits of arbitration include the privacy of the proceeding, the neutrality of the forum, and the relative ease of enforcing the award under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention).¹

As of late, however, arbitration has received criticism as a less efficient, more costly alternative to litigating in court. An article in the ABA Journal—*International Arbitration Loses Its Grip: Are U.S. Lawyers to Blame?*—reports that between 2006 and 2008 the percentage of in-house counsel who preferred litigation to resolve international disputes rose from 11 percent to 41 percent, just slightly less than the percentage of those who prefer arbitration.² The article suggests that the "Americanization" of international arbitration—the adoption of cumbersome procedures and litigation-like practices that complicate the resolution of a dispute—is at the heart of the growing dissatisfaction with international commercial arbitration.³ This trend towards Americanization is marked by broader discovery, larger damages requests, longer briefing schedules, lengthier briefs, greater reliance on expert testimony, and more procedural challenges to arbitrators and the arbitration.

In particular, a party's recourse to the courts in an attempt to challenge an arbitral proceeding has a deleterious impact on the efficacy of arbitration. These challenges result in parallel proceedings, create potentially lengthy appeals, and require parties to retain local counsel at the seat of arbitration. In addition to these disadvantages, courtroom challenges sometimes eviscerate arbitration's main advantages, such as privacy, choice of decisionmaker, and geographic neutrality.⁴ In essence, invoking court jurisdiction to halt arbitral proceedings or review interlocutory arbitral decisions deprives the other party of the benefit of its agreement to arbitrate.

We here argue that courts and arbitrators presently have the responsibility and the tools to temper challenges to arbitration. While arbitrators are bound by the agreement of the parties on issues of procedure, such as schedules and briefing limits,⁵ courts and arbitrators may use their inherent, statutory, and contractual authority to order costs, including attorneys' fees, to deter litigation tactics that violate the spirit of an agreement to arbitrate disputes. If costs are seen as a likely outcome and significant disadvantage to procedural challenges, then parties will more carefully consider whether and when to exhaust available avenues into U.S. courts.⁶ Recent developments indicate a trend in the United States to give due respect to the agreement to arbitrate and uphold the important public policy in favor

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of arbitration by sanctioning litigants who unsuccessfully and unreasonably invoke court jurisdiction.

Judicial Intervention in International Commercial Arbitration

When an arbitration agreement selects the United States as the place of arbitration, the parties may "negatively" invoke the jurisdiction of U.S. courts⁷ to intervene: (1) after a demand for arbitration is made, but before the arbitral tribunal has been formed; (2) after an arbitral tribunal has been formed, but before the final award has been issued; and (3) after a final arbitral award has been issued.

A party may respond to a demand for arbitration by initiating a court proceeding to challenge the validity of the arbitration agreement or the arbitrability of the proposed subject matter. In the United States, the Federal Arbitration Act (FAA) strictly limits pre-arbitration, judicial intervention, providing for judicial review of only whether the matter is referable to arbitration under a written agreement.

During arbitration, a party may initiate a court proceeding to address a variety of matters, some to facilitate arbitration and others to hinder it. For example, a party may seek judicial assistance in removing an arbitrator or in obtaining discovery from a foreign party.

After an arbitrator or arbitral tribunal issues a final award, a party may challenge the enforceability of the award on narrow grounds under the New York Convention in accordance with Sections 201 to 208 of the FAA.⁸

In sum, a party can obstruct arbitration at three different stages by raising a variety of claims and arguments, sometimes for purely tactical advantage, such as delay. Because an arbitration ends when the final award issues, court proceedings during the first two stages pose the greater concerns about undue postponement, obstruction, and multiplication of proceedings in violation of the agreement to arbitrate. Repeated or bad faith challenges during arbitration also pose the greatest concern for courts and arbitral tribunals.⁹

Sources of Authority for Ordering Costs in Matters Related to Arbitration

Recourse to the courts at any stage of an arbitration proceeding is at odds with the strong U.S. policy favoring arbitration, which is even stronger in the international business context. While judicial challenges to an arbitral award under the New York Convention are grounded on express affirmative rights to review and do not violate the spirit of the agreement to arbitrate, obstructionist challenges before and during arbitration seriously undermine this public policy. Such challenges, however, may be deterred through the imposition of costs and sanctions.

As a guiding principle, arbitration is a private and consensual mechanism for resolving disputes, and the parties are free to fashion their own procedural rules, subject to the limits imposed by law.¹⁰ Parties accordingly can contract for the punishment of bad faith conduct. That is, before a dispute arises, when calmer heads and the spirit of cooperation prevail, parties are free to include a clause empowering the tribunal to award costs to deter bad faith challenges to arbitration.¹¹

In addition to contractual authority, the default rules of most international arbitration institutions provide a mechanism for sanctioning bad faith conduct by empowering a tribunal to issue costs as part of its final award.¹² Thus, if the parties do not contract out of these rules, applicable rules often will confer power to arbitrators.

Even where the arbitration agreement and governing rules are silent, some case authority suggests that arbitral tribunals, like courts, have inherent authority to sanction a party. A recent decision by the U.S. Court of Appeals for the Second Circuit held that arbitrators have authority under a broad agreement to arbitrate to sanction one of the parties for arbitrating in bad faith. In *Reliastar Life Insurance Co. v. EMC National Life Co.*, the court affirmed an arbitral award that included costs and attorneys' fees to the prevailing party despite the arbitration agreement's provision that each party bear the expenses of its own arbitrator and attorneys. The court held that an agreement to arbitrate "any dispute" confers "inherent authority" on arbitrators "to sanction a party that participates in the arbitration in bad faith and that such a sanction may include an award of attorneys' or arbitrators' fees."¹³

As an alternative means of preventing the obstruction of arbitration, the U.S. federal courts have authority to sanction a party (or its counsel) for bringing frivolous claims that frustrate arbitration.¹⁴ For instance, in *Prospect Capital Corporation v. Enmon*, the U.S. District Court for the Southern District of New York granted a motion for monetary sanctions against counsel for its use of "persistent, frivolous litigation" to frustrate arbitrate and then later oppose the confirmation of an arbitration award. In sanctioning the lawyers, the court explained that it felt "obligated to impose sanctions to deter such conduct in the future."¹⁵ Furthermore, recent decisions suggest that other courts as well have started to take steps to ensure that arbitration remains distinct and independent from litigation in court.¹⁶

Conclusion

It is beyond dispute that the United States has declared a strong public policy in favor of international arbitration.¹⁷ The responsibility of preserving the viability and independence of arbitration now lies with arbitral tribunals and, to the extent they are called on to intervene, with the lower federal courts.

One reported aspect of the Americanization of international arbitration—recourse to the courts to challenge ongoing arbitration—seriously threatens its viability. If parties to arbitration agreements invariably end up litigating in open court disputes that should be before an arbitral tribunal, their dispute resolution mechanism has the worst characteristics of both arbitration and litigation: no privacy, as well as lengthy and costly delays, dual proceedings, and appeals. By giving parties and their counsel adequate incentives to adhere to the agreement to arbitrate rather than seek judicial intervention in ongoing arbitration, tribunals and courts will help to temper one consequence of the alleged Americanization of international arbitration.

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¹ U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958, art. I, 330 U.N.T.S. 3, 21 U.S.T. 2517 (June 10, 1958); *see also* Nigel Blackaby & Constantine Partasides, *Redfern and Hunter on International Arbitration* §§ 1.86-1.96 (5th ed. 2009).

² Steven Seidenberg, *International Arbitration Loses Its Grip: Are U.S. Lawyers to Blame?*, A.B.A.J., April 2010, at 50, 51 (citing two surveys of corporate counsel prepared by the School of International Arbitration at Queen Mary, University of London).

³ *See id.* at 50–53 (quoting industry participants).

⁴ Most judicial challenges to arbitration will occur at the seat of the arbitration, which may or may not be the home jurisdiction of one of the parties. *See* Blackaby & Partasides, *supra* note 1, §§ 3.15-3.29.

⁵ *See, e.g.*, United Nations Commission on International Trade Law, Model Law on International Commercial Arbitration, art. 19(1) (1985) (amended 2006) (allowing parties to agree on the procedure to be followed by the arbitral tribunal). If the parties agree to inefficient procedural rules, arbitrators may be powerless beyond suggesting that such inefficiency is unnecessary and counterproductive or using their discretionary powers to propose creative solutions. *See* Allison Ross, *Interview: All about Yves*, *Global Arb. Rev.*, Feb. 19, 2010, at 14, 16 (discussing the "Americanisation of arbitration" as a global epidemic and suggesting some solutions); *cf.* Blackaby & Partasides, *supra* note 1, § 6.10-6.19 (cataloguing relatively narrow limits on party autonomy).

⁶ Though the problem of parties' recourse to the courts to challenge arbitration is global in scope, our analysis here focuses on challenges in U.S. courts.

⁷ Positive judicial intervention, e.g., using courts to enforce arbitration agreements, to compel witness attendance, or to preserve evidence, is distinguishable from efforts to obstruct arbitration and beyond our focus on the Americanization of arbitration. *See* Andy Moody, *Remedies and Tactical Considerations in Connection with State Courts* (Nov. 27, 2009), in *ASA Below 40 Seminar*, available at <http://www.arbitration-ch.org/below-40/seminar-papers.php> (last visited May 27, 2010).

⁸ The New York Convention requires the courts of contracting states to recognize and enforce arbitral awards made in other states, subject to the following limited exceptions:

1. The parties lacked capacity or the arbitration agreement is otherwise invalid.
2. There was a lack of proper notice or other violation of due process.
3. The arbitral tribunal lacked jurisdiction.
4. The arbitral tribunal or procedure violated the arbitration agreement.
5. The award is not binding or has been set aside.
6. The dispute was not arbitrable.
7. Recognition or enforcement of the award would violate public policy.

⁹ Once a party substantively participates in the arbitration, federal arbitration law deems it to have waived any challenge to the arbitration agreement. *See, e.g.*, *PPG Indus., Inc. v. Webster Auto Parts Inc.*, 128 F.3d 103, 109 (2d Cir. 1997).

¹⁰ *See* Blackaby & Partasides, *supra* note 1, § 6.08.

¹¹ The following represents an example of a clause authorizing the tribunal to award costs:

As part of its final award, the tribunal shall have the power to award costs and expenses to the prevailing party or against a party as a sanction for that party's failure to arbitrate in good faith under this agreement.

¹² *See, e.g.*, ICDR International Arbitration Rules, art. 31 ("The tribunal shall fix the costs of arbitration in its award."); London Court of International Arbitration Rules, art. 28; *see also* ICSID Arbitration Rule 28 (allowing the tribunal to award costs).

¹³ *Reliastar Life Ins. Co. v. EMC Nat'l Life Co.*, 564 F.3d 81, 86 (2d Cir. 2009).

¹⁴ *See* Fed. R. Civ. P. 11; 28 U.S.C. § 1927.

¹⁵ *See Prospect Capital Corp. v. Enmon*, No. 08-cv-03721, 2010 BL 185181, at *14–15 (S.D.N.Y. Mar. 9, 2010); *cf. Manning v. Smith, Barney, Harris Upham & Co.*, 822 F. Supp. 1081, 1083–84 (S.D.N.Y. 1993) (imposing sanctions in the context of a challenge to an arbitral award that appeared to be a "largely dilatory effort"); *Quick & Reilly, Inc. v. Jacobson*,

126 F.R.D. 24, 27 (S.D.N.Y. 1989) (sanctioning a challenge to an arbitral award that was "totally devoid of merit").

¹⁶ See, e.g., *DMA Int'l, Inc. v. Qwest Commc'ns Int'l, Inc.*, 585 F.3d 1341, 1345–46 (10th Cir. 2009) ("But only by imposing sanctions in cases like this can we give breath to the 'national policy favoring arbitration.'") (citation omitted); *Rhonda Enters. SA v. Projector SA*, No. 08-cv-09563, 2009 BL 23425, at *2–*3 (S.D.N.Y. Feb. 6, 2009); *Bak v. MCL Fin. Group, Inc.*, 170 Cal. App. 4th 1118, 88 Cal. Rptr. 3d 800 (2009); see also Mark Kantor, *MONEY COLUMN: Lawyers Pay for Aggressive Approach*, *Global Arb. Rev.*, Feb. 16, 2010, at 37; Mark Kantor, *MONEY COLUMN: Costs as Sanction "Okay" Say Three Separate US Courts*, *Global Arb. Rev.*, Sept. 2, 2009, at 33.

¹⁷ See generally FAA, 9 U.S.C. §§ 3, 4, 10; *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985); *David L. Threlkeld & Co. v. Metallgesellschaft Ltd.*, 923 F.2d 245, 248 (2d Cir. 1991) (stating that "[t]he policy in favor of arbitration is even stronger in the context of international business transactions").