

**REPORT ON LEGISLATION BY THE
ARBITRATION COMMITTEE AND
INTERNATIONAL COMMERCIAL DISPUTES COMMITTEE**

A.10393

M. of A. Weinstein

AN ACT to amend the civil practice law and rules, in relation to the appointment of an arbitrator

THIS BILL IS OPPOSED

The Arbitration Committee and International Commercial Disputes Committee of the New York City Bar Association (the “Committees”) submit these comments in opposition to the proposed amendments to Civil Practice Law and Rules (“CPLR”) Article 75, which would work very significant changes to New York’s regulation of business-to-business arbitration proceedings.

Founded in 1870, the New York City Bar Association is a voluntary organization of more than 24,000 attorneys. The Committees consist of lawyers with a wide range of private practice, in-house, not-for-profit and academic experience who seek to educate the bar and the public about legal issues relating to arbitration and other forms of dispute resolution. The Committees oppose four proposed provisions of the proposed legislation that raise questions of particular concern in the context of business-to-business dispute resolution:

- (1) the bill would require that all arbitrators be “neutral third-party arbitrator[s],” and prohibit waiver of this requirement, even by sophisticated commercial parties, prior to the beginning of the arbitration, which would make impossible the widespread practice in certain industries, including, but not limited to, the reinsurance industry, for disputes to be settled by panels that include expert but non-neutral arbitrators appointed by each party (A.10393, § 1, p. 1 lines 3-11);
- (2) the bill would permit parties who know of grounds to challenge an arbitrator to postpone asserting the challenge until the eve of the arbitration hearing, potentially disrupting and delaying the arbitration (A.10393, § 1, p. 2 lines 24-27);
- (3) the bill would substantially increase the cost of arbitration in small and mid-sized disputes by requiring that arbitral awards “state the issues in dispute and contain the arbitrator’s findings of fact and conclusions of law” (A.10393, § 3, p. 3 lines 11-13); and

- (4) the bill would amend the statutory standard of judicial review of arbitral awards under New York State law by permitting courts to vacate arbitral awards where “the arbitrator evidenced a manifest disregard of the law in rendering the award,” an uncertain standard that virtually no other states have adopted in their arbitration law (A.10393, § 4, p. 3 lines 33-34);

The provisions enumerated above and further discussed below risk disrupting long-established arbitration practices and could introduce considerable uncertainty in the resolution of numerous business-to-business disputes in New York. In particular, these provisions contravene a central pillar of New York arbitration law that parties get to decide the contours of their own arbitration process.¹ If the Legislature is concerned about disparate bargaining power, such as in the context of adhesion contracts between companies and consumers, or employment matters, the Committees respectfully suggest that the Legislature address those specific situations, rather than disrupt decades of New York jurisprudence promoting party autonomy in business-to-business arbitration.

DISCUSSION

1. Requirement that all arbitrators be “neutral third-party arbitrator[s],” and prohibiting the waiver of this requirement prior to the beginning of the arbitration

The provisions in Section 1 requiring that all arbitrators—evidently including party-appointed arbitrators—be “neutral third-party arbitrators” would disrupt widespread practices in certain industries. The Memorandum in Support of Legislation (“Supporting Memorandum”) justifies the proposed amendment on the ground that “[t]he quality of the arbitration process is enhanced and the reputation of the arbitration process is protected when the parties have confidence in the impartiality of the arbitrator.”² While arbitral tribunals as a whole typically are required to be neutral, in some industries there is a long-established practice of parties appointing “non-neutral” party-appointed arbitrators or appointing specified arbitrators with particular expertise who do not meet neutrality standards but are trusted by both sides. In arbitrations under reinsurance contracts (between primary insurers and reinsurers or among reinsurers), for example, the ARIAS-US Rules widely used in domestic reinsurance arbitration provide for “disinterested” arbitrators who may not be under the control of either party or have a financial interest in the outcome, but are not required to be “impartial,” as the “neutral umpire” must be. (R. 6.1.)

More broadly, in recognition of the traditional use of non-neutral party-appointed arbitrators in a variety of areas, the ABA-AAA Code of Ethics for Arbitrators in Commercial Disputes as well as a number of sets of arbitral rules recognize that “parties in certain domestic arbitrations in the United States may prefer that party-appointed arbitrators be non-neutral” and

¹ See, e.g., *Sprinzen v. Nomberg*, 389 N.E.2d 456, 460 (N.Y. 1979) (“The utility of the arbitration process itself is derived from its autonomy, and courts must honor the choice of the parties to have their controversy decided within this framework.”).

² A.10393, Supporting Memorandum.

provide special rules and ethical considerations to govern their conduct. In collective bargaining agreements, parties commonly name individuals because of their expertise in the industry who may not meet prevailing standards of neutrality. For example, the Second Circuit confirmed the NFL Commissioner's award in the "Deflategate" arbitration that upheld the Commissioner's own imposition of discipline on Tom Brady on the ground that the parties to the collective bargaining agreement had vested that power in the Commissioner.³ If the provision in the present bill were enacted, parties could not agree to such industry-specific procedures, which might cause them to avoid arbitration in New York to the detriment of New York's status as a leading national and international center for arbitration.

2. Permitting parties who know of grounds to challenge an arbitrator to postpone asserting the challenge until the eve of the arbitration hearing

The provision in Section 1 that would permit a party to withhold, until "prior to the commencement of the arbitration hearing," a challenge to an arbitrator based on grounds disclosed long before by the arbitrator also raises serious concerns. The arbitration hearing occurs near the end of the arbitration process, which can take place months or, in complex cases, a year or more after the arbitrators are appointed. In the meantime, there are typically numerous rulings on, for example, procedural issues, discovery matters or interim relief. The proposed provision would allow a party to hold back, for strategic reasons, a claimed ground for challenge to see, for example, whether the arbitrator in question makes rulings to that party's liking. Under the proposed change a party could then bring a last-minute challenge that inevitably would cause delay, even if the challenge is ill-founded, and would result in a good deal of wasted time, effort and expense for all parties if the last-minute challenge is successful.

Widely accepted arbitration rules recognize these issues and provide for a clear and defined period in which to raise any challenge. For example, the CPR Non-Administered Arbitration Rules provide for a period of fifteen days of learning of the grounds for challenge. (R. 7.6.) The Committees believe that Section 1's proposal to allow for last-minute challenges to arbitrators could have seriously disruptive effects on arbitrations conducted under New York arbitration law.

3. Requirement that arbitral awards "state the issues in dispute and contain the arbitrator's findings of fact and conclusions of law"

The provision in Section 3 that would require "findings of fact and conclusions of law"—concepts imported from court practice—in all arbitration awards under New York law would increase expense, particularly for parties in smaller disputes, and would slow down the arbitration in many cases. While many parties want reasoned awards, many others do not, preferring to have a quick and inexpensive resolution. A review of arbitration procedures in the reinsurance industry noted, for example:

If properly molded and limited to the particular necessities of the given case, the arbitration process is designed to proceed to hearing

³ *NFL Management Council v. NFL Players Ass'n*, 820 F.3d 527, 548 (2d Cir. 2016).

and award much faster and less expensively than litigation. Following the hearing, most arbitration panels in reinsurance disputes promptly issue “non-reasoned” awards – essentially a few lines stating who won and the amount of damages awarded.⁴

Indeed, the Commercial Arbitration Rules of the American Arbitration Association provide that “[t]he arbitrator need not render a reasoned award unless the parties request such an award in writing prior to appointment of the arbitrator or unless the arbitrator determines that a reasoned award is appropriate.” (R. 46(b).) Numerous domestic arbitration awards are issued each year under this and similar provisions in securities arbitration rules. Other rules available to parties reverse the presumption, calling for a reasoned award unless the parties agree otherwise. The Supporting Memorandum states that “[a]dding the requirement for findings of facts and conclusions of law strengthens neutrality and due process protections to all parties in an arbitration proceeding.”⁵ However, the Committees submit that there should be compelling reasons to deprive commercial parties of the ability to choose what kind of arbitration they want, especially where the choice could have a major impact on the time and cost of arbitration. We recommend that the Legislature not disrupt this well-settled and accepted practice without careful study of the costs and benefits.

4. Permitting courts to vacate arbitral awards where “the arbitrator evidenced a manifest disregard of the law in rendering the award”

“Manifest disregard of the law” is a judicially created ground for vacating arbitral awards that is derived from the express provisions in the Federal Arbitration Act and, in particular, the provision that permits an award to be set aside where “the arbitrators have exceeded their powers.”⁶ The manifest-disregard-of-law ground for vacating an award is exceedingly narrow: As the Supporting Memorandum notes, the court must find “first, ‘whether the governing law alleged to have been ignored by the arbitrators was well defined, explicit, and clearly applicable,’ and, second, whether the arbitrator knew about ‘the existence of a clearly governing legal principle but decided to ignore it or pay no attention to it.’”⁷ It is a ground that is often invoked but is rarely successful. In a 2012 report, the International Commercial Disputes Committee calculated that only 16 out of 367 manifest disregard challenges in the federal district courts in the Second Circuit were ultimately successful – less than 5%.⁸ At the same time, the Reporters

⁴ Charles Platto, Peter A. Scarpato and Simeon H. Baum, “Insurance/Reinsurance Arbitration and Mediation,” *The Resolver* 7, 11 (Federal Bar Assoc. Spring 2015) (“*Reinsurance Arbitration*”), available at https://www.cofc.uscourts.gov/sites/default/files/ac_7e6ec08f9abc1518d225a8d073e6b91ea02e349a/Survey%20of%20ADR%20in%20Other%20Fora/The%20Resolver%20Spring%202015%20ADR.pdf.

⁵ A.10393, Supporting Memorandum.

⁶ *Amicizia Societa Navegazione v. Chilean Nitrate & Iodine Sales Corp.*, 274 F.2d 805, 808 (2d Cir. 1960).

⁷ *Schwartz v. Merrill Lynch & Co., Inc.*, 665 F.3d 444, 452 (2d Cir. 2011) (internal citation omitted).

⁸ “The ‘Manifest Disregard of Law’ Doctrine and International Arbitration in New York,” at 6 (Aug. 2012), available at <https://www2.nycbar.org/pdf/report/uploads/20072344-ManifestDisregardofLaw--DoctrineandInternationalArbitrationinNewYork.pdf>. The City Bar Committees have also submitted *amicus* briefs to courts considering these issues, most recently in a brief submitted by the International Commercial Disputes Committee in a case pending in the Appellate Division, First Department, available at http://s3.amazonaws.com/documents.nycbar.org/files/Daesang_v_Nutrasweet_ICDC_10.13.17.pdf.

of the Restatement of the U.S. Law of International Commercial Arbitration have criticized the doctrine because it “causes uncertainty about the enforceability of arbitral awards and discourages parties from choosing the United States as an arbitral seat.” In revising the Uniform Arbitration Act in 2000, the Uniform Law Commissioners voted not to include the standard, noting its vagueness and uncertain status in federal law. The Commissioners further noted that at the time no state had codified the standard.

New York courts interpreting New York law have taken a different route from the federal courts. Although CPLR § 7511 includes the same “exceeding his power” ground for setting aside an arbitral award as the Federal Arbitration Act, the Court of Appeals has not adopted the “manifest disregard” standard for arbitrations governed by the CPLR but rather the test of “irrationality.”⁹ This standard, developed by the courts over decades, balances the compelling need to respect party autonomy and finality with the court’s interest in avoiding serious miscarriages of justice.

The Committees are concerned that adopting the “manifest disregard of the law” standard, particularly without the clarifying gloss that the federal courts have placed on it, would decrease certainty and predictability in New York court decisions on arbitration. The term standing alone might be taken to suggest that courts should overturn arbitration decisions whenever the court concluded that the arbitrators had departed significantly from the court’s view of the law. In any case, a legislative command expanding the grounds for review of awards is likely to be interpreted around the world as suggesting reduced deference to arbitral decisions. Parties generally prefer arbitration venues with reputations for limited court intervention, so adoption of this provision may well discourage parties from choosing to arbitrate in New York, to the detriment of New York’s position as a commercial and arbitral center.

The Supporting Memorandum argues that one benefit of adopting the “manifest disregard” standard is that it would “compel arbitrators to make a good faith and reasonable attempt to follow provisions of substantive law.”¹⁰ But this proposition introduces a separate problem, which is that arbitrators today are *not* required in all cases to rule in accordance with substantive legal principles, and that is viewed as an advantage of arbitration over litigation in certain industries. Many parties select arbitration precisely because they can appoint arbitrators who will decide cases in accordance with the arbitrators’ understanding of commercial standards and broader notions of justice.¹¹

⁹ See *Hackett v. Milbank, Tweed, Hadley & McCloy*, 86 N.Y.2d 146, 155 (1995); *Banc of Am. Sec. v. Knight*, 4 Misc. 3d 756, 759 (Sup. Ct. N.Y. Co. 2004) (“although the New York Court of Appeals recognizes ‘irrationality’ as a non-statutory ground for setting aside an arbitral award under New York law, it does not recognize any independent ‘manifest disregard’ ground.”).

¹⁰ A.10393, Supporting Memorandum.

¹¹ See, e.g., *Silverman v. Benmor Coats, Inc.*, 461 N.E.2d 1261, 1266 (N.Y. 1984) (“absent provision in the arbitration clause itself, an arbitrator is not bound by principles of substantive law or by rules of evidence. He may do justice as he sees it, applying his own sense of law and equity to the facts as he finds them to be and making an award reflecting the spirit rather than the letter of the agreement . . .”) (internal citation omitted); *Sprinzen*, 389 N.E.2d at 458 (“Quite simply, it can be said that the arbitrator is not bound to abide by, absent a contrary provision in the arbitration agreement, those principles of substantive law or rules of procedure which govern the traditional litigation process . . . An arbitrator’s paramount responsibility is to reach an equitable result, and the courts will not assume the role of overseers to mold the award to conform to their sense of justice.”) (internal citation omitted); see

Parties today are free, for example, to choose arbitration rules that permit a decision in accordance with justice and equity, sometimes called *ex aequo et bono*.¹² Here, too, the insurance industry provides an apt example. Most arbitration clauses in the reinsurance industry have a so-called “Honorable Engagements” clause that provides, “The arbitrators shall interpret this Contract as an honorable engagement and not as merely a legal obligation; they are relieved of all judicial formalities and may abstain from following the strict rules of law.” These clauses permit the arbitrators “to render a fair and just award based upon the totality of the circumstances.”¹³ New York’s arbitration statute should not prohibit this widespread and long-standing practice in business-to-business arbitration.

CONCLUSION

For these reasons, the Committees recommend that the sections described above be stricken from the proposed bill due to the impact these changes would have on the existing, well-established arbitration law of New York. The Committees would welcome an opportunity to provide assistance and comments on particular language for any future bill addressing these issues.

Arbitration Committee
Dana MacGrath, Chair

International Commercial Disputes Committee
Richard L. Mattiaccio, Chair

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also Banc of Am. Sec., 4 Misc. 3d at 765 (“[r]ecognizing that arbitrators are not necessarily lawyers” and that arbitrators are “permitted to make errors of law”, which are not grounds for vacatur).

¹² See, e.g., American Arbitration Association Commercial Arbitration Rule 47(a) (“The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties”); International Centre for Dispute Resolution (“ICDR”) Art. 31(3) (“The tribunal shall not decide as *amiable compositeur* or *ex aequo et bono* unless the parties have expressly authorized it to do so”).

¹³ *Reinsurance Arbitration*, *supra*, at 11.