Kluwer Arbitration Blog

Sanctions in US and International Arbitrations: Old Law In Modern Context

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I. Power To Sanction

Courts generally enjoy power to enforce procedural rules and orders by various means, such as fines, adverse inferences, cost/fee awards, preclusion of evidence, and even default judgment. Surprisingly, when arbitrators employ such measures, they enter a legal frontier of unsettled law. Why? An arbitrator's procedural power derives from private contract, not public law, and arbitration contracts almost never overtly address the arbitrator's power to remedy party misbehavior. Even when such contracts adopt procedural rules issued by an arbitral institution, those rules may say little or nothing about sanctions. So, arbitrators must often explore the boundaries of their power without a compass.

II. Vacatur For Exceeding "Powers"

Grounds for vacating arbitration awards are few and narrow. One appears in the Federal Arbitration Act, 9 U.S.C. § 10(a)(4) (2006): "[T]he . . . court . . . may make an order vacating the award . . . where the arbitrators exceeded their powers . . . ." This same language appears in the Uniform Arbitration Act adopted by many states. [1)]

An agreement to arbitrate informs an arbitrator's powers — the scope of subject matters he may decide and the relief he may grant. When an arbitrator awards sanctions for party misbehavior, absent an express agreement that he has the power to do so, he risks the dreaded vacatur.

Such risk and uncertainty should end. It can happen in three ways. First, arbitration clauses could provide expressly for discretion to award sanctions. Second, institutional rules commonly adopted in arbitration agreements could be amended. As discussed below, some of these rules, especially those used in US arbitrations, now contain stout sanctions authority. However, other institutional rules bearing on party misbehavior, especially in the international arena, are either exceedingly narrow in scope, or silent. Also, many arbitration clauses in nakedly call for *ad hoc* proceedings and thus adopt **no** rules at all. Third, arbitrators and courts could embrace a viable theory of contractual intent supporting the power to sanction.

III. The Agreement To Arbitrate

Contracting parties may infuse the arbitrator with sanctions power by, for example, tracking the

language of, or adopting, JAMS Comprehensive Rule 29:

> The Arbitrator may order appropriate sanctions for failure of a Party to comply with its obligations under any of these Rules. These sanctions may include, but are not limited to, assessment of Arbitration fees and Arbitrator compensation and expenses; assessment of any other costs occasioned by the actionable conduct, including reasonable attorneys' fees; exclusion of certain evidence; drawing adverse inferences; or, in extreme cases, determining an issue or issues submitted to Arbitration adversely to the Party that has failed to comply.

Ideal, but such forethought rarely occurs with respect to arbitration clauses, usually considered a boilerplate term inserted at a time when nobody anticipates a dispute.

IV. Institutional Rules

Rule 29 of JAMS Comprehensive Arbitration Rules authorizes a full range of sanctions, including issue default, for bad behavior. [2)] Likewise, Rule 16 of CPR's Administered Arbitration Rules (effective July 1, 2013), and Rule 16 of the CPR's 2007 Rules for Non-Administered Arbitration of International Disputes, both allow a panel to "impose a remedy it deems just, including an award on default".

The new AAA Commercial Arbitration Rules (effective October 1, 2013) stop short of the default sanction, but they otherwise fully arm arbitrators, including adverse inferences, exclusion of evidence, cost/fee shifting, and other "appropriate sanctions". *See* R-23 and R-58.

Articles 28 and 31 of ICDR's International Arbitration Rules permit cost/fee shifting for "dilatory or bad faith conduct", and paragraph 8 of the ICDR Guidelines For Arbitrators Concerning Exchanges Of Information permits adverse inferences for failure to comply with an order for discovery exchange.

Guideline 26 of the IBA Guidelines on Party Representation In International Arbitration (May 2013) permits "appropriate inferences", cost apportionment, and "any other appropriate measure in order to preserve the fairness and integrity of the proceedings . . . ." Similarly, Article 9(5) and 9(6) of the IBA Rules on the Taking of Evidence in International Arbitration allow an adverse inference due to refusal to produce documents or testimony. Article 9(7) permits cost shifting for lack of "good faith in the taking of evidence".

The UNCITRAL Arbitration Rules (2010) have little bite. Article 42 vaguely permits the tribunal to apportion costs, "taking into account the circumstances of the case." However, UNCITRAL Notes on Organizing Arbitral Proceedings at ¶ 48 say that a tribunal may draw adverse inferences from an unjustified failure to produce requested documents.

Arbitrators applying LCIA rules can do little more than chastise recalcitrant parties, with one possible exception. LCIA Rule 28.4 imprecisely says that the arbitrator should, as a general rule, allocate arbitration and legal costs to the prevailing party "except where it appears to the Arbitral Tribunal that in the particular circumstances this general approach is inappropriate."

The ICC Rules of Arbitration are also toothless except for Article 37, which authorizes the tribunal

to apportion costs and fees, taking into account "such circumstances as it considers relevant, including the extent to which each party has conducted the arbitration in an expeditious and cost-effective manner."

Finally, the ICSID Arbitration Rules say nothing about a tribunal's power to remedy misconduct.

V. Sanctions Treatment by Arbitrators and Courts

Some courts have loosely interpreted previous AAA rules to permit sanctions for bad faith. [3] Although the new AAA Rules moot these decisions, they demonstrate a near uniform judicial willingness to stretch in order to uphold awards containing sanctions.

Other courts and panels have broadly divined a panel's "inherent power" to enforce orders and rules. In *ReliaStar Life Insurance Co. v. EMC Nat'l Life Co.*, 564 F.3d 81, 85-87 (2d Cir. 2009), the Second Circuit upheld a $3.5 million award of costs and attorneys fees to a prevailing party whose opponent "lack[ed] good faith". Without a remedy to address such conduct, the court reasoned, "the underlying purposes of arbitration, i.e., efficient and swift resolution of disputes without protracted litigation, could not be achieved."

Recently, the Fifth Circuit found that an arbitrator had "inherent authority to police the arbitration process and fashion appropriate remedies to effectuate this authority . . . . " *See Hamstein Cumberland Music Group v. Estate of Williams*, No. 05-51666, 2013 WL 3227536 at *4 (5th Cir. May 10, 2013). In an *ad hoc* proceeding, the arbitrator imposed a fine against a party who failed to comply with discovery orders and barred the miscreant from offering evidence on an issue. The court upheld both sanctions with little discussion.

Most recently, a Minnesota court embraced the inherent power doctrine in *Seagate Technology, LLC. v. Western Digital Corp*, 834 N.W.2d 555, 563–64 (Minn. Ct. App. 2013). To punish respondents for fabricating evidence, the arbitrator barred them from offering evidence or a defense as to certain issues. Following *ReliaStar*, the court affirmed the award.

In the international arena, an ICSID tribunal found "inherent authority" to protect the integrity of the arbitral process in *Hrvatska Elektroprivreda dd v Republic of Slovenia*, (ICSID Case No ARB/05/24) (2008). On the eve of the hearing, a barrister who belonged to the same chambers as the tribunal's president appeared as counsel, thereby introducing an appearance of conflict. Either the tribunal president or the new barrister had to go. The Tribunal removed the barrister.

VI. An Alternate Rationale Rooted In Contractual Intent

Unfortunately, decisions embracing "inherent power" bear an end-justifies-the-means tang. They seem to extract such "power" from thin air. Another foundation, derived from contractual intent, would serve as a more secure purchase for the power to sanction.

At least in common law jurisdictions, every contract providing that a dispute must be submitted to arbitration can reasonably be interpreted to contain an implied understanding that the arbitrator may enforce procedural rules and orders, including the power to impose sanctions for willful noncompliance. Otherwise, one party could deprive the other of the expected benefits of arbitration. The Massachusetts court in *Superadio* foreshadowed this logic when it reasoned that the absence of power to remedy abuse "would impede [the arbitrator's] ability to adjudicate claims effectively in the manner contemplated by the arbitration process" – the very process created by

mutual intent of the contracting parties. [4)]

A. The Venerable Implied Promise Doctrine

As early as 1853, Lord Campbell opined that contracting parties "impliedly promise that . . . neither will do anything to the prejudice of the other inconsistent with that relation." [5)] In a similar vein, early in the 20th Century Judge Benjamin Cardozo opined in the landmark *Wood v. Lucy, Lady Duff-Gordon*:

> The law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal. It takes a broader view today. A promise may be lacking, and yet the whole writing may be 'instinct with an obligation' imperfectly expressed. If that is so, there is a contract.[6)]

These old pronouncements ring true in the modern arbitration context. A party who refuses to appear at a hearing, refuses to comply with discovery orders, willfully ignores deadlines, or engages in other bad faith conduct undertakes actions "to the prejudice of the other [party] inconsistent with [the] relation [constituted between them by the contract]."

B. Implied Promise Not To Frustrate Mutual Expectations

Many jurisdictions recognize an implied promise not to prevent performance by the other party. In some states, this concept takes the form of an implied obligation of good faith and fair dealing. [7)] This covenant bars "any action that would destroy or injure the other party's rights to the fruits of the contract." [8)]

Redolent of Lord Campbell's reasoning in *Hochester*, the covenant emphasizes faithfulness to an agreed purpose and consistency with justified expectations. Thus, where conduct does not literally breach a written contract term but still deprives a party of the benefit of its bargain, the implied covenant is breached.

Analogous holdings appear even in jurisdictions, like Texas, that do not recognize the implied covenant of good faith and fair dealing. "A duty to cooperate is implied in every contract in which cooperation is necessary for the performance . . . . [A] party to a contract may not hinder, prevent, or interfere with another party's ability to perform its duties under the contract." [9)]

Similarly, in the arbitration context, the covenant of good faith and/or the duty to cooperate imputes to each party a *sub silentio* commitment to abide by the rules and orders contemplated by their arbitrate contract. Otherwise, their common purpose – a fair, less costly and speedier alternative to litigation – can be defeated.

Applying this old doctrine to the modern power issue satisfies the *sine qua non* of an arbitrator's authority – contractual intent.

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References

?1 See, e.g., Tex. Civ. Prac. & Rem. Code § 171(a)(3)(A) (West 2008).

?2 JAMS' International Arbitration Rules (2011), however, expressly preclude default judgment. See Rule 27.2. A tribunal may draw adverse inferences from a party's failure to comply with rules or tribunal directives, see Rule 27.3, and apportion costs and "take into account a party's dilatory or bad faith conduct" in doing so, see Rules 30.2 and 34.4.

?3 *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056, 1064 (9th Cir. 1991) (upheld sanction for unnecessary delay of proceeding, based upon liberal reading of former AAA Commercial Arbitration R-43); *InterChem Asia 2000 PTE. Ltd. v. Oceana Petrochem. AG*, 373 F. Supp. 2d 340, 354 (S.D.N.Y. 2005) (affirmed attorneys' fee award sanctioning tardy document production, based on AAA rule authorizing "award of attorney fees if all parties have requested such an award…."); *Superadio Ltd. P'ship v. Winstar Radio Prods., LLC*, 844 N.E.2d 246, 252 (Mass. 2006) (upheld $1,000-per-day fine for discovery noncompliance, based on supposedly "broad" arbitration provision and expansive reading of former AAA Rule 23).

?4 844 N.E.2d at 253

?5 *Hochester v. De la Tour*, 2 El. & Bl. 678 (1853); 118 Eng. Rep. 922 (Queen's Bench 1853).

?6 118 N.E. 214 (NY 1917).

[7] *See*, e.g., *Reinhardt v. Gemini Motor Transp.*, 879 F. Supp. 2d 1138, 1144 (E.D. Cal. 2012) (California law).

[8] *TVT Records v. Island Def Jam Music Group*, 244 F. Supp. 2d 263 (S.D.N.Y 2003) (New York law).

[9] See, e.g., *Case Corp. v. Hi-Class Bus. Sys. of Am.*, 184 S.W.3d 760, 770 (Tex. App.— Dallas 2005, pet. denied).

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