New York Law Journal

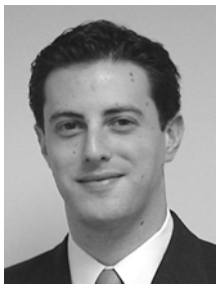
Corporate Update

Thursday, January 6, 2005

ARBITRATION ISSUES

To Write or Not to Write: The Arbitral Dilemma

RICHARD ROTH



JORDAN KAM

ATTENTION all arbitrators -- put down your pens! That is, if you want your contractually binding award to stick, do not explain your well thought out rationale. In what has become a shift in New York common law, courts have now begun a trend of refusing to simply "rubber-stamp" the confirmation of arbitration awards, further delving into the merits of the underlying arbitration.[1]

Yet, this seemingly new -- and on the surface, judicially responsible -- trend is sending an unsavory message to arbitrators. If an arbitrator chooses to include findings of law and fact, the arbitrator allows the parties to understand the consequences of their actions, but at the same time increasing the odds of the court vacating the award. If the arbitrator does not write a rationale, the odds of the court vacating the award decreases significantly, but at the expense of the parties' understanding of what specific conduct has caused liability. Thus, the arbitrator is forced to make a decision that was surely not an intended consequence of the legislature in drafting NY CPLR section 7511.[2]

Explanation Not Required

To that end, it has long been held that an arbitrator is required to supply *neither* an explanation of law nor fact in rendering an award. See, *United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 US 593, 598 (1960) ("[a]rbitrators have no obligation to the court to give their reasons for an award"); *Koch Oil S.A. Transocean Gulf Oil Co.*, 751 F.2d 551, 554 (2d. Cir. 1985) ("arbitrators may render a lump sum award without disclosing their rationale…"). In fact, as the basis for vacating an arbitration award is extremely narrow,[3] virtually the only way to justify a courts' vacatur of an award is if a rationale *is* stated.[4] Thus, it follows that arbitrators can bypass the courts' scrutiny by simply omitting a rationale -- a less than ideal message to be sending to the very same arbitrators whom the parties rely on to dispatch fairness. Realizing this potential abuse of power, some courts have held that the "absence of an explanation may reinforce the reviewing court's confidence that the arbitrators engaged in manifest disregard." *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197, 204 (1998). But this very presumption merely reinforces the problem. While at one time a court's vacatur of an arbitration award was given the same odds as a "snowball's chance in hell," as the number of arbitrations have surged in recent years,[5] such long odds are simply no longer the case. Courts are now beginning to delve into the merits of the underlying arbitration, refusing to simply rubber stamp decisions which the court considers to contain suspect findings of law or fact.

Pursuant to New York case law, arbitrators *should* be able to give a rationale without facing any additional scrutiny from the court (this is the reason for the extremely narrow interpretations of CPLR section 7511). After all, the rationale of an arbitration award serves several important functions.

Continued on page 6

New York Law Journal

To Write or Not to Write: The Arbitral Dilemma

Continued from page 5

Benefits of a Rationale

First and foremost, a written rationale allows both parties of the arbitration to examine their conduct with precision. A stock brokerage firm found liable for unsuitable trading, for example, should have the right to understand exactly what their malfeasant activity entailed. Not only would such a statement of rationale be beneficial for the brokerage firm in curtailing future liability, such a statement would serve the public in general in helping to promote diligence and ethical conduct. Further, particularly when punitive damages are awarded, it is simply a travesty of justice for a respondent in arbitration to not be given a statement containing a finding of fact.

Second, such a statement of rationale creates a quasi-common law within the arbitration context. While arbitration awards, or statements of rationale for that matter, do not set a binding precedence on other arbitration panels, when a rationale is included in an award, it allows outside parties to keep current on how arbitration panel's have been ruling on certain issues.[6] This, arbitration common law, is particularly important since a great deal of arbitrations take place as an industry-wide requirement pursuant to contract.[7] On that note, the need for industry-wide standards of liability cannot be stressed enough -- inconsistent arbitration awards pertaining to similar conduct in unrelated arbitrations, only creates increased litigation down the road.

Additionally, as stated above, without a written rationale for an arbitration award, it becomes virtually impossible for a court to find grounds to vacate an award. But omitting a rationale for that purpose -- in light of the important functions served by inclusion -- would be a grave injustice. Indeed, including a rationale helps to protect and preserve the rights of all parties with respect to petitioning the court to either confirm or vacate the award pursuant to NY CPLR section 7511. That is, each party to an arbitration has the right to move to vacate the ultimate award if any of the aforementioned grounds pursuant to CPLR 7511 are met. When an arbitrator omits the rationale from the award, the arbitrator deprives the parties of having full knowledge of whether one or more of the grounds to vacate are present.

Correctly, the law protects the sanctity of the contractual aspect of an arbitration awards' rationale. That is, a court is forbidden to substitute its own interpretation of the underlying arbitration even if the court is not only convinced that the arbitrator was wrong, but plainly wrong. See *Local 1199, Drug, Hosp. and Health Care Employees Union, RWDSU, AFL-CIO v, Brooks Co.*, 956 F.2d 22 (2d. Cir. 1992). Accordingly, in theory, arbitrators should not feel threatened about potentially having their awards vacated even if a rationale is stated. As discussed above, omitting a rationale from an arbitration award: (i) deprives the parties of the right to know whether a ground to vacate exists; (ii) deprives the liable party of the right to fully understand the nature and extent of their liability (particularly when punitive damages are awarded); and (iii) promotes future litigation as neither the parties involved, nor outside parties, have the opportunity to understand the precise situations where liability exists. Thus, inclusion should be favored.

Why the Change

Right or wrong, with the tremendous increase in arbitrations over the past few years, it is no wonder why courts have now begun to delve into the merits of underlying arbitrations where there are suspect findings of law or fact. Whether the courts are correct in furthering that shift in the common law is a continuing question for another day. For now, two troubling questions remain: (i) would the very same arbitration awards that have been vacated in the past, still have been vacated had no rationale been given at all? and (ii) would the very same arbitration awards that have been confirmed in the past, still have been confirmed had a rationale been provided?

---

[1] See New York Law Journal, Arbitration Awards (Jan. 16, 2003, Tamara Loomis) ("…experts say a recent decision by a New York State appellate court [Sands Brothers & Co. Ltd. v. Generex Pharmaceuticals Inc. 2002 N.Y. Slip Op. 07711 (Oct. 29, 2002)] just made it that much easier to appeal and arbitration award.

[2] NY CPLR §7511 states the grounds for vacating and/or modifying an arbitration award in New York.

[3] Grounds for vacating an arbitration award include: (i) the award was "procured by corruption, fraud or undue means[;]" (ii) the arbitrators were guilty of "evident partiality or corruption[;]" (iii) the arbitrators are guilty of "misconduct[;]" or (iv) the arbitrators "exceeded their powers." See Section 10, Federal Arbitration Act.

[4] Excluding the more transparent situation where the record shows bias by an arbitrator – a ground for vacating an award pursuant to NY CPLR section 7511(b).

[5] As an example, according to the NASD Dispute Resolution website, the number of cases filed in 1990 was 3,617; compared with 8,945 cases filed in the year 2003. See www.nasd.com.

[6] Often times, legal research Web sites such as Westlaw have databases that include recent NASD arbitration awards.

[7] For example, all member firms of the NASD and NYSE are required to submit all disputes between member firms, associated persons and customers to arbitration.

Richard Roth *is the founder and president of the Roth Law Firm, specializing in securities/entertainment arbitration and litigation.* **Jordan Kam** *is an associate at the firm.*