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Trials&TRIBULATIONS

Potential pitfalls when entering into arbitraton agreements

Two recent New York District Court cases highlight issues relevant to those drafting or entering into an arbitration agreement. In *Moss v. BMO Harris Bank*, 13 CV 5438 (July 16, 2015), the Eastern District of New York found that where an arbitration agreement contains an exclusive forum clause, and that forum becomes unavailable, the parties are no longer required to engage in arbitration despite their earlier agreement to do so.

In *NS United Kaiun Kaisha, Ltd. v. Cogent Fibre Inc.*, 15 Civ. 1784 (July 14, 2015), the Southern District of New York addressed, in part, an arbitrator's ability to award attorneys' fees even absent any clause in the parties' arbitration agreement providing for such fees.

By VICTORIA GLEASON
Daily Record Columnist

Generally, agreements to arbitrate are strongly enforced. This is because the parties willingly entered into such agreements, with the concomitant desire to avoid litigation. In *Moss*, plaintiffs commenced a prospective class action asserting that defendants violated the Racketeer Influenced and Corrupt Organizations Act in connection with certain loan agreements entered into between the parties.

The loan agreements each contained identical arbitration provisions that read as follows:

You and we agree that any and all claims, disputes or controversies between you and us, any claim by either of us against the other . . . and any claim arising from or relating to your application for this loan, regarding this loan or any other loan you previously or may later obtain from us, this Note, this agreement to arbitrate all disputes, your agreement not to bring, join or participate in class actions, regarding collection of the loan, alleging fraud or misrepresentation . . . including disputes regarding the matters subject to arbitration, or otherwise, shall be resolved by binding individual (and not joint) arbitration by and under the Code of Procedure of the National Arbitration Forum ("NAF") in effect at the time the claim is filed.

After plaintiffs filed a lawsuit, defendants moved to compel arbitration. The court granted defendants' motion and stayed the case pending arbitration. Thereafter, in accordance with the court's order, plaintiffs sought to commence an arbitration proceeding with the NAF. However, the NAF responded that it was not permitted to arbitrate cases involving consumers and, therefore, could not arbitrate plaintiffs' case.

Plaintiffs thereafter made a motion to vacate the court's order compelling arbitration on the grounds that the NAF declined to arbitrate the matter. Plaintiffs argued that they could not arbitrate because there was no longer any available forum in which to engage in arbitration pursuant to the parties' agreement, and that they were thus entitled to proceed in court.

Defendants did not contest the fact that the NAF could not arbitrate the matter, but instead argued, in part, that the court had the authority to substitute another arbitrator for the NAF under the Federal Arbitration Act. The issue before the court was whether it had the power to substitute another arbitrator, or whether the unavailability of the forum selected by the parties rendered the arbitration clause meaningless and unenforceable.

The court concluded that it did not have the authority to substitute an alternative arbitral body, and granted plaintiffs' motion to vacate the order to compel, leaving plaintiffs free to litigate their claims.

In reaching this conclusion, the court held that where parties to an arbitration agreement include an exclusive arbitration forum in their agreement, and that forum becomes unavailable, the agreement to arbitrate is unenforceable. The court was thus required to determine whether the parties' arbitration clause exclusively designated the NAF as the forum for arbitration.

In finding that the parties exclusively designated the NAF, the court noted that the NAF was specifically mentioned in the arbitration clause, and that the parties did not provide any substitute for the NAF, or any language suggesting that another forum would be acceptable for the arbitration. The court made this finding despite the fact that there was no language in the arbi-

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tration clause indicating that the NAF was the "only" or "exclusive" forum.

It seems surprising that courts will entirely disregard a parties' arbitration agreement because the designated forum is not available as one might assume that the parties' primary purpose in entering into the agreement was to force arbitration, not to designate a particular forum. However, the court's position was just the opposite – that inclusion of language regarding a forum for arbitration only means that the parties wished to arbitrate specifically in that forum, and not that they intended to generally arbitrate all matters potentially arising between them.

Similarly, the court found that it did not have the authority to substitute an arbitrator in this case, despite the fact that Section 5 of the FAA specifically provides that a court has the power to appoint an arbitrator where "for any . . . reason there shall be a lapse in the naming of an arbitrator or arbitrators or umpire, or in filling a vacancy." In relying on Second Circuit case law, the court found that Section 5 does not apply where the parties have chosen an exclusive forum that is no longer available.

From this decision, and several others before it, it is apparent that if parties truly wish to arbitrate any issues that may arise, if they list the forum in which they would prefer the arbitration take place, it is prudent to provide for some form of substitution should that forum subsequently become unavailable.

A second noteworthy issue of which to be aware when engaging in arbitration was addressed in the recent case of NS United Kaiun Kaisha, Ltd. v. Cogent Fibre Inc. In Kaisha, the plaintiff petitioned the court to confirm a multi-million dollar arbitration award. The defendant opposed plaintiff's motion to confirm and cross-moved to vacate the arbitration award on several different grounds, including its assertion that the arbitration panel acted outside its authority when awarding attorneys' fees to the plaintiff in the amount of $889,547.95.

The District Court for the Southern District of New York found the attorneys' fees award proper and granted plaintiff's petition to confirm the arbitration award.

The defendant attacked the award of attorneys' fees on three alternative grounds. First, the defendant argued that since the parties' arbitration clause did not contemplate attorneys' fees, no such fees were permitted. Alternatively, the defendant argued that even if the arbitration panel had the authority to award such fees absent a specific provision in the parties' agreement, such an award was not permitted under New York law.

Finally, the defendant contended that even if New York law permitted an award of attorneys' fees, it was not proper in this case because it did not fall into any exceptions provided for by the American Rule – that each party is responsible for its own attorneys' fees unless there is a contractual provision or statutory basis providing otherwise.

With respect to the first issue, despite the fact that the parties had not contemplated attorneys' fees in connection with any arbitral disputes arising between them, the court noted that there was also no provision in the agreement precluding an award of attorneys' fees. Accordingly, the court found that it was within the arbitrators' authority to grant such fees.

Addressing the defendant's second argument, the court found that the FAA preempts New York law. The FAA grants arbitrators the authority to award attorneys' fees where the parties' arbitration clause is broad, as when the clause provides for arbitration of "any and all controversies" such as the one at issue in that case. Accordingly, the court found that the FAA provided sufficient support for the award of fees.

The defendant's final argument against the award of attorneys' fees was that such an award was against the American Rule, and that no exception existed in this case that would permit a deviation from that rule. Exceptions include an arbitration clause providing for such an award, statutory or other similar authority to grant attorneys' fees, or where a party engaged in bad faith. Unfortunately for the defendant, the court determined that the arbitrators made a "colorable" finding that the defendant had acted in bad faith in connection with the events leading to the filing of the lawsuit and during arbitration. In sum, all of the defendant's arguments against the attorneys' fees award failed and the court confirmed the award.

The lessons gleaned from these cases are enlightening. Parties must ensure that they do not preclude themselves from arbitrating their disputes by incorporating a single arbitration forum in their agreement, lest they risk that forum becoming unavailable. It appears that the safest practice is to include an alternative forum in the agreement, as well as making it clear that the court would have the authority to substitute arbitrators should those listed forums become unavailable.

Additionally, under the FAA, it appears that arbitrators have the authority to award attorneys' fees unless the parties include a provision in their arbitration agreement limiting the arbitrators' power to grant them. Attorneys and others should keep these issues in mind before drafting and entering into an arbitration agreement.

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