

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

A.9505-C (Budget Article VII) – Subpart I, Sect. 6-11

AN ACT to amend the civil practice law and rules, in relation to arbitration agreements

THESE SECTIONS ARE OPPOSED

The Arbitration Committee and International Commercial Disputes Committee of the New York City Bar Association (the “City Bar Committees”) submit these comments on Sections 6-11 of Subpart I of A.9505-C (the “Arbitration Sections”) which, in the context of the annual budget process, would work very significant changes to New York’s regulation of arbitration proceedings. The proposed changes deserve more careful consideration than is available in the context of a budget bill.

Founded in 1870, the New York City Bar Association is a voluntary organization of more than 24,000 attorneys. The City Bar 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. Although there are a number of other features of the Arbitration Sections that raise significant questions, the City Bar Committees limit their comments to four questions of particular concern in the context of business-to-business dispute resolution:

- (1) 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 no other state has adopted in its arbitration law (A.9505-C, Subpart I, § 9, p. 191 lines 51-52);
- (2) 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.9505-C, Subpart I, § 8, p. 191 lines 31-34);
- (3) 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.9505-C, Subpart I, § 6, p. 190 lines 45-48); and

- (4) 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, in particular, 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.9505-C, Subpart I, § 6, p. 190 lines 1-9).

The Bar Committees take no position at this time with respect to the provision of the proposed bill barring, except where inconsistent with federal law, mandatory arbitration clauses in employment disputes alleging discrimination (A.9505-C, Subpart I, § 10, p. 191 line 55 to p. 192 line 6). The provisions enumerated above and further discussed below, however, risk disrupting long-established arbitration practices and could introduce considerable uncertainty in the resolution of numerous business-to-business disputes in New York. The Bar Committees urge that further study be allowed to evaluate the costs and benefits of the Arbitration Sections as a whole.

1. “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.” *Amicizia Societa Navegazione v. Chilean Nitrate & Iodine Sales Corp.*, 274 F.2d 805, 808 (2d Cir. 1960). The manifest-disregard-of-law ground for vacating an award is exceedingly narrow: the court must find “both that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrators was well defined, explicit, and clearly applicable to the case.” *Wallace v. Buttar*, 378 F.3d 182, 189 (2d Cir. 2004). 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%.¹ At the same time, the Reporters 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 no state had codified the standard.

¹ “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.

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.” 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.”) The City Bar Committees are concerned that adopting into State law the federal law standard is unnecessary and, although it would ultimately affect very few cases, it nonetheless would introduce uncertainty as to whether any change in the existing implied “irrationality” standard is intended. At the same time, making an affirmative change in the law on this score would tend to discourage parties from choosing arbitration in New York because of the increased perceived uncertainty.

2. The provision in Section 8 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 many cases in arbitration. Parties often want reasoned awards but many parties do not, preferring to have a quick and inexpensive resolution. 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 Bar 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. In any event, the Legislature should not disrupt a well-settled and accepted practice to permit awards that provide a result without the reasoning that led to that result, without careful study of the costs and benefits.

3. The provision in Section 6 that would permit a party to withhold a challenge to an arbitrator based on grounds disclosed by the arbitrator until “prior to the commencement of the arbitration hearing” 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, typically there are 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, for example, to see whether the arbitrator in question makes rulings to that party’s liking. Under the proposed change a party could 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 UNCITRAL Arbitration Rules provide for a period of fifteen days of learning of the grounds for challenge. (R. 13(1).) The Bar Committees believe that Section 6’s proposal to

allow for last-minute challenges to arbitrators could have seriously disruptive effects on arbitrations conducted under New York arbitration law.

4. The provisions in Section 6 requiring that all arbitrators—evidently including party-appointed arbitrators—be “neutral third-party arbitrators” would disrupt widespread practices in certain industries. 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 provide special rules and ethical considerations to govern their conduct. Also, in collective bargaining agreements, parties commonly name persons 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. *NFL Management Council v. NFL Players Ass’n*, 820 F.3d 527, 548 (2d Cir. 2016). 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.

For these reasons, the Bar Committees recommend that Sections 6-11 be stricken from the budget bill to allow time for additional consideration of the provisions discussed herein, in particular, and the impact of any changes to the existing, well-established arbitration law of New York generally. The Bar 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

March 2018