AUTHORITY OF AN ARBITRATION PANEL TO ISSUE SANCTIONS

By

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I. Introduction

Once in a great while, an arbitration panel encounters counsel who acts in an outrageous fashion or a party that declines to comply with panel orders. Since such situations are relatively rare, a panel may question what authority it has to order sanctions.

When the parties to a contract agree to arbitrate their differences pursuant to the rules of some organization, those rules sometimes authorize the panel to issue sanctions. For instance, R-58 of the Commercial Rules of the AAA provides:

> The arbitrator may, upon a party's request, order appropriate sanctions where a party fails to comply with its obligations under these rules or with an order of the arbitrator. In the event that the arbitrator enters a sanction that limits any party's participation in the arbitration or results in an adverse determination of an issue or issues, the arbitrator shall explain that order in writing and shall require the submission of evidence and legal argument prior to making (*sic*) of an award. The arbitrator may not enter a default award as a sanction.

But what of *ad hoc* arbitrations, not subject to any specific procedural rules? Does the panel have the authority to issue monetary penalties, dismiss claims or defenses, even issue default judgments? The purpose of this article is to explore selected case law on point.

II. Attorneys' and Arbitrators' Fees

§ 10.3 of the reinsurance treaty at issue required that each party pay the fees of its own party arbitrator and attorneys and half the fee of the umpire in *ReliaStar Life Ins. Co. of N.Y. v. EMC National Life Co.* 564 F.3d 81 (2nd Cir. 2009). Nonetheless, the arbitration panel awarded the prevailing party its attorneys' and panel fees plus costs and interest characterizing the conduct of the losing party in the arbitration "as lacking good faith."[1] The issue on appeal was the award of the attorneys' and panel fees.

As a baseline for its ruling, the court made a broad, general statement on the power of arbitration panels:

> [W]e here clarify that a broad arbitration clause, such as the one in this case, . . . confers inherent authority on arbitrators to sanction a party that participates in the arbitration in bad faith and that sanction may include an award of attorney's or arbitrator's fees.[2]

The court took its direction from the reason for arbitration as a dispute resolution technique:

> Indeed, the underlying purpose of arbitration *i.e.* efficient and swift resolution of disputes without protracted litigation, could not be achieved but for good faith arbitration by the parties. Consequently, sanctions, including attorney's fees, are appropriately viewed as a remedy within an arbitrator's authority to effect the goals of arbitration.[3]

Given the broad scope of the arbitration clause, the court reasoned that §10.3 was merely a statement of the American Rule on attorneys' fees, which is to apply to arbitrations conducted in good faith. Absent a more specific contractual limitation on the power of the panel to grant remedies in a bad faith context, the court declined to apply this section to such a context and upheld the award of fees:

> Precisely because the agreement in this case conferred broad authority on the arbitrators, because inherent in such authority is the power to sanction bad faith conduct, and because bad faith is a recognized exception to the American Rule for attorney's fees, we conclude that the simple statement of that Rule in section 10.3 is insufficient to by itself to swallow the exception.[4]

III. Monetary Sanctions and Evidence Barred

Hamstein Cumberland Music Group v. Williams, 2013 U.S. App. Lexis 9528 (5th Cir.) was an appeal of an order with respect to an arbitration over music royalties. When the respondent in the arbitration failed to produce documents related to the royalties, the arbitrator ordered a fine of $500,000 and that the respondent not be allowed to introduce documentary evidence on royalties at the arbitration hearing. The respondent challenged these sanctions but the appellate court upheld them, ruling:

> [The respondent] argues that the arbitrator was not empowered to issue sanctions and therefore exceeded his authority within the means of FAA § 10(a)(4). We disagree. … [A]rbitrators enjoy inherent authority to police the arbitration process and fashion remedies to effectuate this authority, including with respect to conducting discovery and sanctioning failure to abide by ordered disclosures.[5]

Seagate Technology v. Western Digital Corp., 834 N.W. 2d 555 (Ct. App. Minn. 2013) was a dispute over disclosure of trade secrets. The arbitrator found that the respondent had manufactured evidence to support its case and issued an order that: (a) the respondent was precluded from introducing any evidence on the trade secrets at issue; and (b) found for the petitioner on misappropriation of such trade secrets. The court upheld the award, ruling: "[W]e find persuasive and adopt the reasoning of the courts that have found that a broadly worded arbitration agreement, with no limiting language to the contrary, "confers inherent authority of arbitrators to sanction a party that participates in the arbitration in bad faith."[6]

IV. Dismissal of Counterclaim

AmeriCredit Financial Services v. Oxford Mgt. Ser., 627 F. Supp. 2d 85 (E.D.N.Y. 2008), involved a dispute between a principal and its collection agency agent over funds not remitted to the principal and the agent's counterclaim. The arbitrator found that that the agent deliberately destroyed evidence highly relevant to the dispute and dismissed the agent's counterclaim as a result. The agent moved to vacate the order, arguing that the arbitration clause in question did not give the arbitrator the authority to dismiss counterclaims on this basis and because the order violated the prohibition on punitive or exemplary damages in the arbitration clause. The court disagreed:

> Here, the arbitration clause broadly allows the arbitrator to resolve any claim arising out of the [contract]. Therefore, because the counterclaim clearly arose out of the [contract], the arbitrator did not exceed his authority under the [contract] in addressing and dismissing the counterclaim.[7]
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> . . . [E}ven assuming that the dismissal was punishment or a sanction for [destruction of evidence], the [limitation of punitive and exemplary damages in the arbitration clause] is still not implicated because the decision had absolutely nothing to do with "punitive or exemplary damages." It is undisputed that the arbitrator's decision did not provide for punitive or exemplary damages of any sort.[8]

V. Default Orders

The arbitration of a union grievance provided the backdrop for *American Postal Workers Union v. U.S. Postal Service*, 362 F.Supp.2d 284 (D.C. 2005). When the arbitrator was informed that the grievant would be unable to attend the scheduled hearing for medical reasons, the arbitrator asked for medical evidence on point and when the grievant would be able to participate in the hearing. When neither was forthcoming by the assigned date, the arbitrator dismissed the grievance. The union sought to vacate this order as violating the grievant's right to a fundamentally fair hearing and using a procedural device to deny due process. The court rejected these arguments:

> [T]he reason why the grievant did not receive a hearing was because neither she nor the [union] ever responded to these preliminary procedural matters. While the parties certainly have a right to due process and to a fundamentally fair hearing, this does not give the parties the right to disobey a procedural order of an arbitrator and then claim they were treated unfairly because a default judgment is issued.[9]

A *pro se* (without counsel) claim for various types of discrimination and other wrongs against her employer was the issue in *Santos v. General Electric Co.,* 2011 U.S. Dist. Lexis 131925 (S.D.N.Y.) *aff'd* 2011 U.S. Dist. Lexis 131882 (S.D.N.Y). The petitioner's employment agreement included an arbitration clause, which called for arbitration of employment disputes. The arbitrator went to extraordinary lengths to move the arbitration forward but the petitioner repeatedly ignored deadlines, failed to produce ordered documents and abruptly disengaged from telephone conferences. Finally, the arbitrator dismissed the complaint. The magistrate judge rejected any allegation of misconduct on the part of the arbitrator noting: "[T]here can be no question that given the history of plaintiff's failings and the prejudice that they were causing [the employer], the arbitrator acted well within her discretion in finally dismissing the proceedings. Under these circumstances, there is no basis for challenging the ruling."[10]

VI. The Contrary View

There is plenty of verbiage in case law to the effect that the authority of arbitrators is limited by the contract and the issues submitted to the panel for resolution. It is easy to argue from these points that arbitrators lack the authority to issue sanctions unless specifically authorized to do so in the relevant contract. While the author has attempted no exhaustive search for cases that so hold, the author has not happened upon them.

One case that is worth noting, however, is *Luster v. Collins,* 15 Cal.App. 4th 1338 (1993) which involved an easement and the trees located on it. The arbitrator ordered the respondent to cut down trees on the easement and to ensure that the gate to the easement was locked at night. The arbitrator also ordered a sanction of $50 per day for each tree that was not cut down. The court ruled that the arbitrator did not have the authority to order the $50 per day per tree sanction since the California arbitration statute did not specifically authorize sanctions and that the exercise of such power by an arbitrator conflicted with the power of the courts.

VII. Commentary

Certainly the situations in which sanctions are appropriate in arbitrations are few and the behavior that generates them should be egregious. Panels should be extremely cautious about issuing sanctions, particularly those that deprive a party of its defense or cause of action. However, the cases above suggest that the courts are very reluctant to overturn sanctions under such circumstances. Perhaps this is because judges have deeply felt opinions about their ability to control their courtrooms and those who appear there. They can appreciate the need for arbitrators to have some means of maintaining control of their proceedings.

ENDNOTES

[1] 564 F.3d 81 at 85.

[2] *Id.*at 86

[3] *Id.**87.

[4] *Id.* at 89. For a review of prior related cases, *see* Robert M. Hall, *"Inherent Authority" of Arbitration Panels to Grant Attorneys' Fees and Costs*, XVI ARIAS Quarterly No. 2 at 9 (2009).

[5] 2103 U.S. App. Lexis 9528 *11-12 (5th Cir.)

[6] 834 N.W.2d 555, 563 ((Ct.App. Minn. 2013) quoting *ReliaStar Life Ins. Co. v. EMC National Life Co., supra.*

[7] 627 F. Supp.2d 85, 95 (E.D.N.Y. 2008).

[8] *Id.* at 96.

[9] 362 F.Supp. 284, 290 (D.C. Cir. 2005).

[10] 2011 U.S. Dist. Lexis 131925 *60-1 (S.D.N.Y.)