

“Inherent Authority” of Arbitration Panels to Grant

Attorney’s Fees and Costs

By

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I. Introduction

In the past, arbitration panels have been regarded as *ad hoc* bodies created by the agreement of the parties and with powers limited to those stated in the reinsurance contract. However, there is a growing trend in the judiciary to allow panels considerable discretion on matters not addressed in the contract (*e.g.* on consolidation). A recent case in the second circuit, *ReliaStar Life Ins. Co. of N.Y. v. EMC National Life Co.*, 2009 WL 941173 (2nd Cir. 2009),¹ identifies certain “inherent authority” that a panel possesses absent a specific contractual limitation on that power. The purpose of this article is examine this case and selected prior case law to highlight the evolution of this “inherent authority” with respect to attorney’s fees, costs and punitive damages.

II. Selected Prior Case Law

Marshall & Co., Inc. v. Duke, 114 F.3d 188 (11th Cir. 1997) *cert. denied* 522 U.S. 1112 (1998) involved a securities dealer arbitration. The panel denied the claims of the securities investors and awarded the securities brokers substantial attorneys’ fees and costs. The Uniform Submission Agreement used for securities disputes did not address such fees and costs.² On a motion to confirm, the district court held that the panel was within its authority to award these costs and fees on the bases: (a) the investors agreed to the panel hearing this issue; and (b) “[E]very judicial and quasi-judicial body has the right to award attorneys’ fees under the common law bad faith exception to the ‘American Rule.’”³ The court of appeals affirmed and as to point (b) ruled: [T]he arbitrators have the power to award attorneys’ fees pursuant to the “bad faith” exception to the American Rule that each party bears its own attorney’s fees.”⁴

An arbitration concerning ship refitting under the rules of the AAA provided the factual backdrop for *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991). The panel denied the claims of

the ship owner and granted the shipyard compensatory damages, punitive damages, attorneys' fees and costs. The panel's stated rationale for the punitive damages was that the ship owner was guilty of bad faith, deceptive practices and knowingly false representations. The rationale for attorneys' fees was bad faith during the course of the arbitration which caused it to be extended unnecessarily. The ship owner argued the panel acted in excess of its authority under law in granting punitive damages and attorneys' fees.

The district court confirmed the award and the court of appeals affirmed. As to punitive damages, the court noted that the arbitration was pursuant to the AAA rules and that Rule 43 allowed the arbitrators to grant any remedy they deem equitable and within the scope of the agreement (but it did not specifically address costs, attorney's fees or punitive damages).⁵ The court of appeals stated:

We hold that the expansive view that has been taken of the power of arbitrators to decide disputes, coupled with the incorporation of AAA Commercial Arbitration Rule 43 by the parties, provided the arbitration panel here with the authority to make the punitive damage award.⁶

Likewise with respect to attorneys' fees, the court ruled:

Federal law takes an expansive view of arbitrator authority to decide disputes and fashion remedies, particularly when a dispute arises between parties to a commercial contract with an arbitration clause that incorporates AAA Commercial Rule 43, and which applies to every dispute arising under the agreement. In light of the broad power of arbitrators to fashion appropriate remedies and the accepted "bad faith conduct" exception to the American Rule, we hold that it was within the power of the arbitration panel in this case to award the attorneys' fees.⁷

In *Synergy Gas Co. v. Sasso*, 853 F.2d 59 (2nd Cir. 1988) the arbitrator in a labor dispute granted attorneys' fees because the employer discharged an employee without just cause, failed to comply with a prior order to reinstate, acted in bad faith in violating its contractual obligations and in bringing a spurious claim of arbitrator misconduct. The relevant collective bargaining agreement contained a broad arbitration clause but, apparently, did not specifically address attorney's fees, costs or punitive damages. The employer challenged the award as violating New York public policy barring punitive damages in labor disputes. The court of appeals upheld the award as within the power of the panel and found that it was not punitive but compensatory in order to reimburse the employee for expenses he would not have incurred had he been reinstated as ordered in the initial arbitration.

A late shipment of petrochemicals provided the context for *Interchem Asia v. Oceana Petrochemicals AG*, 373 F.Supp. 2d 340 (S.D.N.Y. 2005). The arbitrator found for Interchem and ordered that attorneys' fees be paid by Oceana and its counsel. The court declined to confirm the award against Oceana's counsel individually. Although AAA Commercial Rule 43 allowed the arbitrator grant remedies that were equitable and within the scope of the agreement, it found "implausible to construe" this as justifying an award against the attorney.⁸ While acknowledging that a court has the power to sanction attorneys

personally as part of its “inherent power to police itself,” the court found no such authority for an arbitration panel to act in similar fashion:

[F]inding that the Arbitrator had inherent authority to sanction [the attorney] would directly contradict the principle that an arbitrator’s authority is circumscribed by the agreement of the parties. That principle flows from the basic understanding that arbitration is a consensual arrangement meant to reflect a mutual agreement to resolve disputes outside the courtroom. Arbitration is simply a matter of contract between the parties; it is a way to resolve those disputes – but only those disputes – that the parties have agreed to submit to arbitration.⁹

III. *ReliaStar Life Ins. Co. of N.Y. v. EMC National Life Co.*, 2009 WL 941173 (2nd Cir. 2009)

The arbitration clause in the relevant contract was broad in that it included any dispute with reference to any transaction relating in any way to the treaty. It called for the panel to consider custom and practice in the life or health business. Most significantly, it provided in § 10.3:

Each party shall bear the expense of its own arbitrator . . . and related outside attorneys’ fees, and shall jointly and equally bear with the other party the expenses of the third arbitrator.¹⁰

At the conclusion of an arbitrated dispute under this contract, the panel awarded the cedent nearly \$4 million in attorneys’ and arbitrators’ fees and the costs on the basis that the panel viewed the conduct of the reinsurer in the arbitration as “lacking in good faith.”¹¹ The district court declined to confirm the award of attorneys’ fees on the basis that it violated § 10.3 of the treaty and thus exceeded the panel’s authority.¹²

On appeal, the court characterized the issue as “whether, in light of the parties’ agreement to arbitrate, the arbitrators were authorized to sanction bad faith conduct by awarding attorney’s fees and arbitrator fees.”¹³ The court acknowledged that a party cannot be required to arbitrate a dispute that it has not agreed to submit to panel and that the authority of the panel depends on the intention of the parties as described in the arbitration clause.¹⁴

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.¹⁵

The court took its direction on the facts of this case 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.¹⁶

Given the broad scope of the arbitration clause, the court reasoned that §10.3 was merely a statement of the American Rule on attorney's 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:

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.¹⁷

The dissent, citing to *Interchem Asia v. Oceana Petrochemicals, supra*, noted its "unease" with the notion of the inherent authority of the panel due to: (a) the little effort devoted by the majority to defining the scope and limits of such authority; and (b) the apparent contradiction in "the notion of authority inhering in an arbitration panel, whose authority is derived from the agreement of the parties before it"¹⁸

IV. Commentary

Case law uniformly acknowledges that the authority of an arbitration panel derives from the arbitration clause of the contract at issue. However, that begs the question of whether the panel's authority is determined by what authority the clause grants or what it withholds.¹⁹ *ReliaStar Life Ins. Co. v. EMC Life Co.* seems to answer this question.

This is a very significant case on a number of different levels. For the non-lawyers among the readership, the second circuit includes New York which the largest single location for reinsurance litigation and arbitration in the United States. Thus, this decision will govern the many disputes in the second circuit and will be influential elsewhere.

In addition, *ReliaStar* is significant due to its specific ruling *i.e.* that: (a) an arbitration panel has "inherent authority" with respect to attorney's fees and costs in order to protect the integrity of the arbitration process; and (b) restrictions on such authority must be explicit in the contract to be effective.

Finally, this case is significant for its implicit foundation *i.e.* that an arbitration panel has inherent authority which does not derive from the arbitration agreement but may be limited thereby. It remains

to be seen what additional subject matters (*e.g.* punitive damages) will be included in the inherent authority of arbitration panels as case law develops.

Endnotes

¹ The author thanks Gail Goring of Lovells, counsel for the prevailing party, for providing the briefs on this case.

² But an Arbitrator's Manual used for guidance stated that fees might be awarded in exceptional cases. 941 F.Supp. 1207 at 1214.

³ 114 F.3d 188 at 189-90.

⁴ *Id.* at 190.

⁵ 943 F.2d 1056 at 1063. *See* cases cited by the court which interpret this rule as allowing the arbitrators to grant punitive damages.

⁶ *Id.*

⁷ *Id.* at 1064.

⁸ 373 F.Supp. 2d 340 at 357.

⁹ *Id.* at 53-4 (internal citations and quotation marks omitted).

¹⁰ 2009 WL 941173*1.

¹¹ *Id.**2.

¹² 473 F.Supp.2d 607.

¹³ 2009 WL 941173*3.

¹⁴ *Id.**2

¹⁵ *Id.**4

¹⁶ *Id.**4.

¹⁷ *Id.**6.

¹⁸ *Id.**10

¹⁹ Obviously, the parties to a dispute may choose to grant the panel authority to decide issues or provide remedies which are beyond the scope of the panel's power, inherent or contractual.