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Sanctions

How Courts Punish Arbitration Abuse

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Sanctions in Arbitration-related Litigation

To protect parties' ability to create contracts and encourage them to relieve the strain on the judicial system by agreeing to arbitrate disputes, courts are increasingly willing to sanction parties that frustrate the arbitration process.

HAGIT M. ELUL
PARTNER
HUGHES HUBBARD & REED LLP

Hagit focuses her practice in the fields of litigation and arbitration. She has served as counsel in arbitrations under all major institutional rules, and has represented international clients in a wide array of contract and licensing disputes involving the financial services, energy, pharmaceutical, construction and professional services industries. Hagit also has advised sovereigns on public international law matters, and investment and bilateral treaty disputes.

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For more than 200 years, US courts have adhered to the "American Rule," which is the general principle that all litigants, win or lose, are held accountable for their own attorneys' fees (see *Arcambel v. Wiseman, 3 U.S. 306, 306 (1796)*). The US Supreme Court recently reiterated this common law "bedrock principle," stating that it will not deviate from the American Rule absent explicit statutory authority or contractual agreement (*Baker Botts L.L.P. v. ASARCO LLC, 135 S. Ct. 2158, 2164 (2015)*). The American Rule stands in stark contrast to the practice in most foreign jurisdictions, whether civil or common law, where the prevailing party usually is entitled to recover its attorneys' fees.

More and more, however, US courts are breaking from their strict adherence to the American Rule in cases involving arbitration. In particular, attorneys and their clients who engage in meritless attempts to undermine the arbitration process through collateral litigation face possible sanctions, often in the form of an adverse award of attorneys' fees. Courts are increasingly using these sanctions to:

- Discourage dilatory or abusive litigation tactics.
- Improve efficiency and streamline litigation by lessening frivolous claims or defenses.
- Punish the wrongdoer.
- Compensate the victim of abusive litigation tactics.

(See *Federal Rule of Civil Procedure (FRCP) 11 advisory committee's note (1983)*; see also, for example, *B.L. Harbert Int'l, LLC v. Hercules Steel Co., 441 F.3d 905, 913-14 (11th Cir. 2006), abrogated on other grounds by Frazier v. Citi Financial Corp., 604 F.3d 1313 (11th Cir. 2010)*; *Oliveri v. Thompson, 803 F.2d 1265, 1271 (2d Cir. 1986)*.)

The growing willingness of courts to issue sanctions in these circumstances is rooted in the strong federal policy favoring arbitration. Resolving disputes through arbitration is encouraged under the Federal Arbitration Act (FAA) because it can help relieve congestion in the courts and provide parties with a speedier and less costly alternative to litigation.

The benefits of arbitration, and the goals of the FAA, can be achieved only where the parties involved conduct themselves in a manner consistent with their arbitration agreement during and after the arbitration process. Where a party uses vexatious litigation tactics or refuses to honor an arbitrator's decision, the other party loses the benefits of arbitration that the FAA explicitly safeguards and for which the parties specifically negotiated.

Against this backdrop, this article explores:

- Key provisions of the FAA addressing the enforcement of arbitration agreements and awards.
- Potential sources of a court's authority to issue sanctions in arbitration-related litigation.
- Recent decisions and relevant circumstances where a court imposed sanctions.

ENFORCING AGREEMENTS AND AWARDS UNDER THE FAA

The efficiency of arbitration is promoted by strictly enforcing agreements to arbitrate. FAA Section 2 states that written arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract" (*9 U.S.C. § 2*). Further, the FAA provides limited bases to challenge awards. Under FAA Section 10, courts may vacate an arbitration award only where at least one of the following apply:

- The award was obtained by corruption, fraud or undue means.
- The arbitrators were partial or corrupt.
- The arbitrators were guilty of misconduct by:
  - refusing to postpone the hearing, on sufficient cause shown;
  - refusing to hear evidence pertinent and material to the controversy; or
  - behaving in any other way that causes a party's rights to be prejudiced.
- The arbitrators exceeded their powers or so imperfectly executed them that they did not make a mutual, final and definite award on the subject matter submitted.

(*9 U.S.C. § 10*.)

Even a serious legal or factual error on the part of the arbitral tribunal will not alone justify vacating an award (see *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 559 U.S. 662, 671-72 (2010)*). These limitations make successful motions to vacate an award very unlikely, and the overwhelming majority of challenges to arbitration awards fail.

COURT AUTHORITY TO ISSUE SANCTIONS

There are three main sources of a court's authority to issue sanctions for abusive practices in arbitration-related litigation:

- 28 U.S.C. § 1927.
- FRCP 11.
- The court's inherent authority.

Additionally, the Revised Uniform Arbitration Act (RUAA), which has been enacted in 18 states and the District of Columbia, provides courts with authority to award attorneys' fees in judicial proceedings to confirm or vacate an arbitration award.

SECTION 1927

Courts resort to statutory authority granted under 28 U.S.C. § 1927 most often when imposing sanctions based on a party's interference with arbitration proceedings. Section 1927 states:

> "Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct."

Before imposing sanctions, a court must find clear evidence that the offending party's claims were both:

- **Baseless or without merit.** Although it is necessary for claims to fail in order to be deemed meritless, failure is not a sufficient condition for finding "a total lack of a colorable basis."
- **Brought in bad faith.** For actions to rise to the level of bad faith required under Section 1927, they must be "so completely without merit as to require the conclusion that they must have been undertaken for some improper purpose," such as delay or harassment.

(See *Enmon v. Prospect Capital Corp., 675 F.3d 138, 143 (2d Cir. 2012)*.)

Section 1927 includes attorneys' fees among the category of expenses that a court might require an attorney to satisfy personally, making it clear that the purpose of the statute is to deter unnecessary delays in litigation (see *Oliveri, 803 F.2d*

Sanctions should not exceed what is necessary to deter repetition of the same or similar violating conduct, but may include non-monetary directives and all of the opponent's legal fees resulting from the violation.

FRCP 11 versus Section 1927

Courts have recognized the importance of undertaking the FRCP 11 and Section 1927 analyses separately due to significant differences between the two authorities (see, for example, *Int'l Bhd. of Teamsters, 948 F.2d at 1345-46*).

FRCP 11	Section 1927
Sanctions may be imposed on both counsel and the client.	Sanctions may be imposed only on counsel.
Violations must be based on signed pleadings, motions or other papers.	Violations do not hinge on the presence of a paper.
Only a showing of objective unreasonableness on the part of the attorney or client signing the papers is required.	A showing of subjective bad faith by counsel is required.
The rule may not be employed to sanction obnoxious conduct during the course of the litigation. Instead, misconduct must be judged as of the time the papers were signed.	The statute may be employed to sanction the unreasonable and vexatious multiplication of court proceedings. Therefore, courts can consider the course of conduct and the attorneys' continuing obligation to avoid dilatory tactics.

at 1273). Attorneys' fees generally are an appropriate measure of damages for these types of wasteful litigation because the party who frivolously caused the fees to be accumulated is left to assume the costs.

FRCP 11

FRCP 11 is another source of authority courts use to levy attorneys' fees as a sanction for misconduct in arbitration-related cases. The cornerstone of FRCP 11 is the certification requirement, that is, FRCP 11 sanctions must be based on the signature of an attorney or a party on a pleading, motion or other paper filed in federal court.

A filing violates FRCP 11 either where:

- It has been interposed for any improper purpose.
- After reasonable inquiry, a competent attorney could not form a reasonable belief that the filing is well-grounded in fact and warranted by existing law or a good faith argument for the extension, modification or reversal of existing law.

(See *United States v. Int'l Bhd. of Teamsters, 948 F.2d 1338, 1344 (2d Cir. 1991)*.)

Unlike Section 1927, where sanctions are appropriate only on a clear showing of bad faith or vexatiousness, FRCP 11 sanctions require the somewhat lesser showing that an attorney's conduct was "objectively unreasonable" (see *McMahon v. Shearson/Am. Express, Inc., 896 F.2d 17, 21-22 (2d Cir. 1990)*) (see *Box, FRCP 11 versus Section 1927*).

FRCP 11 specifies that a court may impose an appropriate sanction on any attorney, law firm or party that violated the rule or was responsible for the violation. Most notably, absent exceptional circumstances, a law firm must be held jointly responsible for a violation committed by its partner, associate or employee. Sanctions should not exceed what is necessary to deter repetition of the same or similar violating conduct, but may include non-monetary directives and all of the opponent's legal fees resulting from the violation. (*FRCP 11(c)(1), (4)*.)

Even if a court determines that a party violated FRCP 11, the decision whether to impose a sanction for the violation is in the district court's discretion (see *Perez v. Posse Comitatus, 373 F.3d 321, 325 (2d Cir. 2004)*). Courts may weigh the weakness of a party's arguments against the confusing nature of the judicial system to determine whether it is better to err on the side of finding that a party's arguments were not objectively unreasonable (see, for example, *Ipcon Collections LLC v. Costco Wholesale Corp., 698 F.3d 58, 63-64 (2d Cir. 2012)*).

INHERENT POWER

Courts generally hesitate to award attorneys' fees unless a statute gives them explicit power to do so. However, courts have the inherent power to sanction attorneys for misconduct under a standard that is similar to the one provided by Section 1927. Specifically, a court may award attorneys' fees where counsel acts "in bad faith, vexatiously, wantonly, or for oppressive reasons" (*Int'l Chem. Workers Union (AFL-CIO), Local No. 227 v. BASF Wyandotte Corp., 774 F.2d 43, 47 (2d Cir. 1985)*).

This inherent power allows courts to hold both attorneys and their clients responsible for remedying bad faith or oppressive behaviors by having to pay their opponents' attorneys' fees, and is appropriate "when a party advances a claim lacking colorable basis and does so in bad faith" (*Amaprop Ltd. v. Indiabulls Fin. Servs. Ltd., 483 F. App'x 634, 635 (2d Cir. 2012)*). Both findings must be supported by a high degree of specificity in the factual findings. However, similar to a Section 1927 analysis, a court may infer bad faith if a party's actions are so meritless as to conclude that they must have been undertaken for an improper purpose (see *Enmon, 675 F.3d at 143*). Additionally, a court may find bad faith in the actions that led to the lawsuit and in the conduct of the litigation (see *Roadway Express, Inc. v. Piper, 447 U.S. 752, 766 (1980)*).

THE RUAA

Section 25 of the RUAA states that in judicial proceedings to confirm or vacate an arbitration award, the court may add to its judgment "reasonable attorneys' fees and other reasonable

expenses of litigation incurred" (*RUAA § 25(c)*). Courts applying the RUAA have awarded attorneys' fees in favor of the prevailing party without considering whether the proceeding was brought or conducted in bad faith (see, for example, *Affinity Fin. Corp. v. AARP Fin., Inc., 794 F. Supp. 2d 117, 123 (D.D.C. 2011)* (applying D.C. Code § 16-4425(c)); *Blitz v. Beth Isaac Adas Israel Congregation, 352 Md. 31, 36 (1998)* (applying Section 3-228(b) of the Courts and Judicial Proceedings Article)).

RECENT DECISIONS ISSUING SANCTIONS

Courts have issued sanctions under various circumstances in arbitration-related litigation, including where counsel or a party frivolously:

- Seeks to avoid an arbitration agreement.
- Challenges an arbitration award.
- Engages in forum shopping in confirmation proceedings.
- Initiates collateral litigation to undermine the arbitration process.

Although arbitration awards are not self-executing, a court may find that a party is acting in bad faith where it simply ignores an arbitration award or opposes confirmation proceedings.

AVOIDING ARBITRATION AGREEMENT

Courts have shown little tolerance for parties' attempts to avoid arbitration, and have awarded sanctions in the context of frivolous challenges to arbitration agreements. For example, in *Amaprop Ltd. v. Indiabulls Financial Services Ltd.*, the US Court of Appeals for the Second Circuit upheld the district court's use of its inherent power to sanction a majority shareholder with attorneys' fees for its bad faith efforts to avoid an agreement to arbitrate a dispute with a minority shareholder. By misleadingly redacting language in the arbitration agreement to strengthen its case before the district court, the majority shareholder was found to have multiplied the proceedings without a colorable basis. (*483 F. App'x at 636-37.*)

CHALLENGING ARBITRATION AWARD

Another common way for a party to frustrate the arbitration process is by frivolously challenging an award after the arbitrator's ruling. Courts have used various sources of authority to issue both monetary and non-monetary sanctions in these cases.

Monetary Sanctions

In *DigiTelCom, Ltd. v. Tele2 Sverige AB*, the district court sanctioned a law firm under Section 1927 for filing a meritless motion to vacate an award issued by the International Centre for Dispute Resolution. In a strongly worded decision, the court admonished the attorneys who challenged the arbitration award in court as launching an improper "assault on the Tribunal's factfinding and contractual interpretation rather than on its actual authority," causing all parties involved "to incur unnecessary expense and delay the implementation of the Award." (*2012 WL 3065345, at *3, *7 (S.D.N.Y. July 25, 2012)*.)

It was significant to the court that the dispute arose out of arbitration. It noted that "where parties agree to arbitration as an efficient and lower-cost alternative to litigation, both the parties and the system itself have a strong interest in the finality of those arbitration awards." The court further stated that litigants must be discouraged from defeating the purpose of arbitration by bringing claims "based on nothing more than dissatisfaction with the tribunal's conclusions." (*DigiTelCom, 2012 WL 3065345, at *7.*)

Another district court took a similar approach in *ARMA, S.R.O. v. BAE Systems Overseas, Inc.*, and awarded attorneys' fees under FRCP 11 where a party made "multiple unjustified arguments, misrepresented the record, and even attempted to mislead the Court in its efforts to delay confirmation of the award" (*961 F. Supp. 2d 245, 271 (D.D.C. 2013)*).

Additionally, although arbitration awards are not self-executing, a court may find that a party is acting in bad faith where it simply ignores an arbitration award or opposes confirmation proceedings. For example, in *Sheet Metal Workers' International Ass'n Local Union No. 359 v. Madison Industries, Inc., of Arizona*, the US Court of Appeals for the Ninth Circuit upheld a district court's use of FRCP 11 to award attorneys' fees against a party that "simply refused to honor the award rather than filing a petition to vacate it, and requested a vacation of the award only in response to [a] petition to confirm it." (*84 F.3d 1186, 1192 (9th Cir. 1996)*; see also *Noble Ams. Corp. v. Iroquois Bio-Energy Co., 2012 WL 5278505, at *2-4 (S.D.N.Y. Oct. 25, 2012)* (threatening to sanction a party, unless it could show good cause why the court should not award attorneys' fees and costs, who opposed confirmation proceedings by arguing the court lacked subject matter jurisdiction where that argument had been previously rejected by other courts).)

Additional Non-monetary Sanctions

Courts have gone beyond imposing mere monetary sanctions for abusive litigation in the context of post-arbitration award litigation. For example, in *Prospect Capital Corp. v. Enmon*, the district court sanctioned a law firm that launched "persistent, frivolous litigation filed for the purpose of frustrating arbitration," and grossly mischaracterized the arbitration proceedings in seeking to vacate the award (*2010 WL 2594633, at *1-2 (S.D.N.Y. June 23, 2010)*). The law firm sought to use litigation to enjoin the arbitration proceedings and, later, to challenge an adverse arbitration award.

Relying on both its inherent powers and Section 1927, the court ordered the law firm to pay the costs of the proceedings, totaling

over $350,000 plus interest. It also required the Texas-based firm to disclose the sanctions order with any future applications for admission *pro hac vice* in the Southern District of New York. This order applied to not only the particular attorneys who engaged in the bad faith conduct, but all the attorneys in the firm. (*Prospect Capital Corp., 2010 WL 2594633, at *5.*)

On appeal, the Second Circuit affirmed the monetary sanctions as properly within the district court's discretion based on its finding of bad faith. The Second Circuit remanded to the district court to consider whether to exclude attorneys who joined the firm after the sanctions order was entered from having to disclose the order on future *pro hac vice* applications in the Southern District of New York. (*Enmon, 675 F.3d at 149.*)

FORUM SHOPPING IN CONFIRMATION PROCEEDINGS

Prevailing in arbitration does not render a party immune from sanctions. Section 1927 applies equally to every party in litigation. (See *Roadway Express, Inc., 447 U.S. at 762* (the statute "does not distinguish between winners and losers, or between plaintiffs and defendants" and "is concerned only with limiting the abuse of court processes").)

In *IDS Life Insurance Co. v. Royal Alliance Associates, Inc.*, the US Court of Appeals for the Seventh Circuit reversed the district court's refusal under Section 1927 to sanction Royal Alliance, who had prevailed in arbitration. Royal Alliance had been sued in federal district court in Chicago, and moved to stay the suit and compel arbitration based on an arbitration agreement between the parties. After prevailing in the arbitration, Royal Alliance then, as Judge Richard Posner put it, "scampered off to a New York state court and asked it to confirm the arbitrators' award." According to the Seventh Circuit:

> "The choice of forum was curious, since it was the federal district court in Chicago that at the defendants' urging had stayed the suit filed by the plaintiffs so that the matter could be referred to arbitration. But stranger than the choice of forum was the reason given for the choice, that the district court in Chicago did not have jurisdiction to confirm the award — which is ridiculous."

(*266 F.3d 645, 653 (7th Cir. 2001).*)

The district court had ordered Royal Alliance to drop the New York suit and return to the court in Chicago. However, the district court judge declined to issue sanctions under Section 1927, expressing, among other things, his "own philosophy" against sanctions. The Seventh Circuit reversed, finding that the defendants filed a frivolous suit in New York to further complicate the protracted litigation and "the district judge committed an abuse of discretion in refusing to sanction the defendants' counsel under section 1927." (*266 F.3d at 654.*)

BRINGING COLLATERAL LITIGATION

Where a party brings collateral litigation on issues that fall within the scope of an arbitration agreement, they also face the risk of sanctions. For example:

- In *Parrott v. Corley*, the district court imposed Section 1927 sanctions against plaintiff's counsel in the form of relevant costs and attorneys' fees based on a finding that they unreasonably multiplied the proceedings by contesting the defendant's motion to compel arbitration and simultaneously pursuing a preliminary injunction on claims they should have known were arbitrable and covered by a broad arbitration clause (*2006 WL 2471943, at *3 (E.D. Mich. Aug. 24, 2006), aff'd, 266 F. App'x 412 (6th Cir. 2008)*).
- In *Copeland v. Tom's Foods, Inc.*, the Seventh Circuit upheld a district court's *sua sponte* imposition of FRCP 11 sanctions against an attorney and his law firm for filing a federal complaint that duplicated litigation that a state court already had referred to arbitration (*456 F. App'x 592, 593-95 (7th Cir. 2012)*).
- In *Ingram v. Glast, Phillips & Murray*, the US Court of Appeals for the Fifth Circuit upheld the district court's use of its inherent authority and authority under Section 1927 to impose sanctions of attorneys' fees, costs and expenses, totaling over $184,000, against attorneys for their bad faith conduct, which included the pursuit of post-arbitration litigation raising issues overlapping with those decided in the arbitration knowing that it was a "complete sham" (*196 F. App'x 232, 233 (5th Cir. 2006)*).
- In *Dalenko v. Peden General Contractors, Inc.*, a state appellate court threatened the plaintiff with a criminal contempt charge and precluded her from filing further actions pertaining to her attempt to overturn an arbitration award by bringing a new claim for breach of arbitration agreement (*676 S.E.2d 625, 633-34 (N.C. Ct. App. 2009)*).

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