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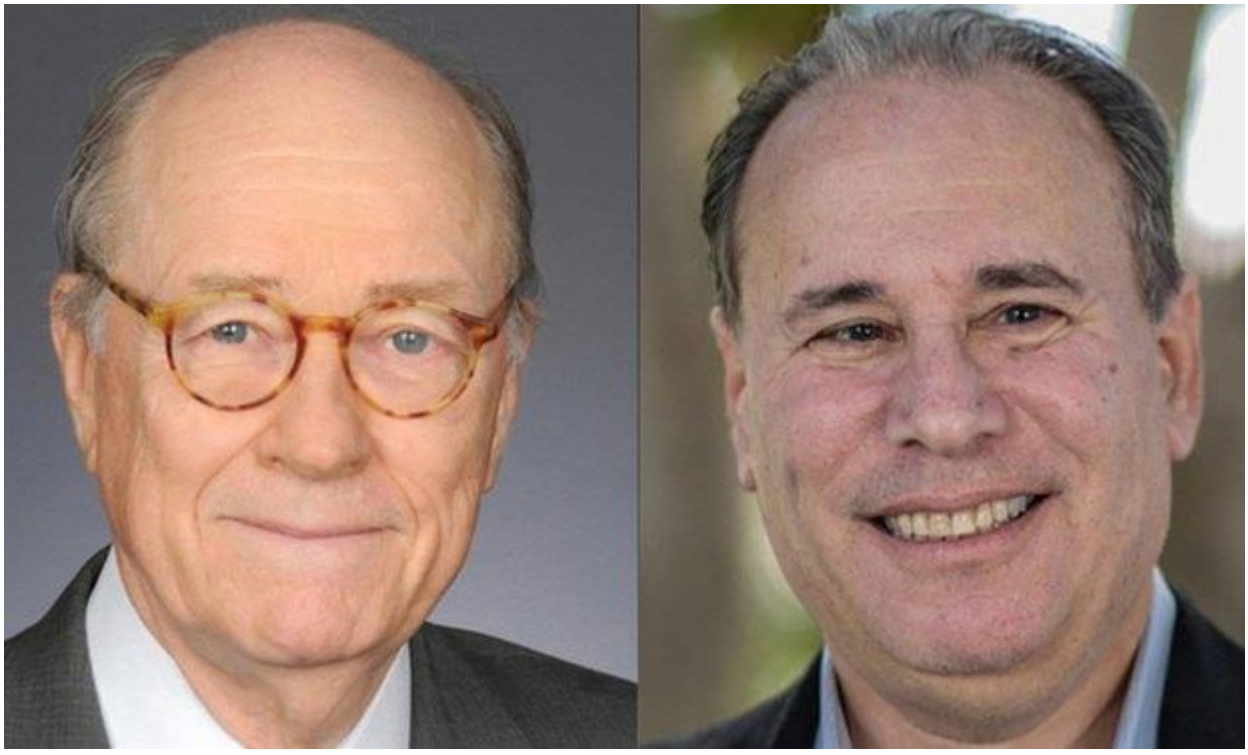
The Case for Distributing Draft Arbitration Awards

In their International Litigation column, Lawrence W. Newman and David Zaslowsky suggest that the international arbitration community might consider the concept of encouraging arbitrators, at least in some circumstances, to distribute draft awards before they are issued as final.

By **Lawrence W. Newman and David Zaslowsky** | January 27, 2021 at 12:30 PM



On more than one occasion, we heard the late Professor Hans Smit tell the following story. He was sitting as arbitrator in an international arbitration case being administered by one of the prominent arbitral institutions (which need not be identified for purposes of this column). He had written his award but, because there were certain complexities in the case, he thought it would be a good idea to send the award to the parties in draft form and give them the opportunity to let him know if they believed there were any errors. He asked the institution if he could do so and was told he could not. He did it anyway. In today's column, we take a closer look at the idea of distributing draft awards.

We start with the obvious question: Why should arbitrators want to distribute drafts of their awards? The simple answer is because they are human. And, humans make mistakes. Or, as Sir John Donaldson (former Master of the Rolls) was quoted in the case discussed below, "[M]istakes will occur even in the practices of the best of arbitrators." In the court system, there are mechanisms for correcting mistakes. Motions for reconsideration give a judge an opportunity to correct her own errors. If that does not work, there is an entire appellate apparatus in place to correct for errors made by a first-instance judge.

There is, however, no such failsafe when it comes to arbitration awards. Under the ICDR rules, for example:

Within 30 days after the receipt of an award, any party, with notice to the other party, may request the arbitral tribunal to interpret the award or correct any clerical, typographical, or computational errors or make an additional award as to claims, counterclaims, or setoffs presented but omitted from the award.

Thus, "correction" of the award is limited to clerical, typographical, or computational errors. To the extent, however, that the arbitrator made a substantive error on the law, or an error of fact, there would be no basis for correcting it. Rules of other arbitral institutions are similar.

Seeking redress in the courts for an arbitrator's error is also not an option. For an international award falling under the New York Convention, the award can be challenged only under the grounds in Article V of the Convention. Error by an arbitrator is not one of those grounds. For awards to which the Federal Arbitration Act (FAA) applies, which can include certain awards in an international arbitration, Section 11 of the FAA mentions "mistake" as one of the grounds on which a court "may" modify an award. But the provision is narrow, applying only "where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award."

One might think that relief might be available under the "manifest disregard of the law" principle, which, as its name implies, is intended to remedy arbitrators' errors. However, after the Supreme Court's decision in Hall Street Assocs. v. Mattel, 552 U.S. 576 (2008), numerous courts have held that the manifest disregard defense is no longer available. See, for example, the rulings of the Fifth Circuit in Citigroup Global Markets v. Bacon, 562 F.3d 349, 350 (5th Cir. 2009), the Eighth Circuit in Medicine Shoppe Int'l v. Turner Invs., 614 F.3d 485, 489 (8th Cir. 2010) and the Eleventh Circuit in Frazier v. CitiFinancial, 604 F.3d 1313 (11th Cir. 2010).

Furthermore, even in those courts where the defense remains viable, the courts repeatedly point out haw narrow the concept is and that it should be used in "exceedingly rare instances." T.Co Metals v. Dempsey Pipe & Supply, 592 F.3d 329, 339 (2d Cir. 2010). It can apply if (1) the relevant law is "clear," (2) it was improperly applied and led to an erroneous outcome, and (3) subjectively, the arbitrator knew of the existence of the law and its applicability to the problem before him, and then ignored it. Id. Yet another consideration is that the manifest disregard concept, as the words indicate, concerns manifest disregard of the "law." It cannot help with errors of "fact," as occurred in the recent English case we discuss below.

Distributing a draft award is a method for redressing in advance an arbitrator error that will likely be irreparable once the award is issued. Interestingly, some years ago, this issue was discussed in the Arbitration Committee of the International Institute for the Prevention and Resolution of Disputes (CPR). The users of arbitration- that is, the in-house lawyers-were generally opposed to the notion. In their view, it was an invitation for increasing the length, and therefore the cost of an arbitration, which many had been chosen in first place because of the perception that arbitration was faster and less expensive than litigation.

These are real concerns. But there are solutions. The arbitrator who distributes a draft award should make clear that she is interested only in "errors" in the award, and send the message that she will not consider any submission that strays outside that narrow ground. Tight time and page limits may add force to the order.

A recent case in England describes vividly a situation in which the arbitrators probably wished they had distributed a draft award. Doglemor Trade Limited, Alexander Bogatikov, DL Management Limited v. Caledor Consulting Limited, Milkhail Khabarov (Case no: CL-2020-000148, Dec. 4, 2020) arose out of an LCIA arbitration award issued by, in the words of the court, "a tribunal of leading arbitrators." The issue before the tribunal was the valuation of certain option shares.

The expert for the Doglemor parties opined that the "enterprise value" of the business was $98 million and that the option shares were worthless after application of the relevant formula in the parties' agreement, whereas the expert for the Caledor parties concluded that the "enterprise value" of the business was $638 million and that the option shares were worth $174 million. These differences, the tribunal found, followed from different

assumptions made by the experts. At the conclusion of the hearing, the tribunal directed the parties to produce an agreed valuation model (the Agreed Model), which would enable it "to determine the numerical effect of resolving the many disputed points of quantum and assess the value of the Option Shares in light of such determinations."

In its Award, the tribunal set out the building blocks of how it used the Agreed Model to arrive at is result, which was a $58 million award in favor of the Caledor parties. But the tribunal made an error. At one point where the model required a certain figure to be subtracted, the tribunal added it instead. Had the Agreed Model been applied properly, the result would have been $4 million instead of $58 million.

The Doglemor parties brought this error to the tribunal's attention under Rule 27(1) of the LCIA Rules, which allows a party to request an arbitral tribunal to correct an award for "any error in computation, any clerical or typographical error, any ambiguity or any mistake of a similar nature." The tribunal issued a written response that acknowledged that it had made an error but the tribunal refused to modify the award. The tribunal explained:

[I]f we made the corrections sought ... this would not result in giving effect to our true intentions, as expressed in the Award, of awarding substantial damages ... The corrected award ... would be a radically different award, not one which we intended to make and not one which it could be said we would have intended to make, even if we had spotted and corrected the error at line item 23 at the time.

The Doglemor parties challenged the award in court under Section 68 of the 1996 Arbitration Act. That provision allows a challenge if (1) there has been a serious irregularity in the tribunal, the proceedings, or the award and (2) the serious irregularity is one that the court considers has caused or will cause substantial injustice to the applicant. The court held that the tribunal's error was a serious irregularity. But the Caledor parties argued that, even if true, there was no substantial injustice because the tribunal had explained in writing that the mistake did not materially affect the outcome of the arbitration. The court disagreed. It said that there was an award for $58 million and, even though the tribunal had said that they intended to award "substantial damages," there was no certainty that it would have been $58 million had the tribunal caught its error.

The court then had to decide the scope of the tribunal's remit on remand. The Doglemor parties argued that here was no justification for remitting anything other than the admitted error. This, of course, would have the effect of limiting the tribunal to issuing an award for $4 million-a windfall for the Doglemor parties because it was significantly less than what the tribunal intended. The Caledor parties countered that the scope of the remission should be sufficiently wide to enable the Tribunal to make the adjustments it considers necessary to reflect the impact of the error. The court adopted neither of these positions. It ruled that the tribunal would not be permitted free reign on remand, but it would be permitted to consider, in addition to the specific error, the EBITDA (earnings before interest, taxes, depreciation and amortization) input to the Agreed Model because the tribunal had expressed in the Award certain flexibility and uncertainty as to the factor.

Ostensibly, the court settled on a middle ground. The practical result, however, was that the tribunal certainly seems to have the flexibility on remand to avoid a $4 million award, which was clearly not the result they intended. How close they can now get to the $58 million will depend on how much leeway the Agreed Model gives them by changing the EBITDA factor. Regardless, had the tribunal distributed its award in draft form before issuing it, the error would have been brought to their attention and they would have had the opportunity to rewrite the opinion to achieve their desired outcome.

How can the arbitration community establish a practice of distributing draft awards? One way would be for parties to include such a practice in their arbitration clause. As a practical matter, however, that seems highly unlikely because, in a very large number of contracts, relatively little attention is paid to arbitration clauses. And, even where it is, it would be the very rare set of parties who would be prepared to include such a novel provision in their clause.

If this practice were to become widespread, it would most likely come through its endorsement by arbitral institutions. Inasmuch as such institutions are more interested in figuring out ways to shorten the length of arbitrations, there will undoubtedly be pushback against a new rule that moves in the opposite direction. But there is a workable solution. First, there can be a minimum dollar value of the award that triggers a right to distribute a draft award. And the practice should not be mandatory. Rather, the rule should provide the arbitrators with the discretion to do so, and perhaps even require also the consent of both parties. The point is that, if the future Hans Smits of the arbitration world believe there is a benefit to their distributing a draft arbitration award, they should be allowed to do so.

Lawrence W. Newman *is of counsel and* **David Zaslowsky** *is a partner in the New York office of Baker McKenzie. They can be reached at lawrence.newman@bakermckenzie.com and david.zaslowsky@bakermckenzie.com, respectively.*