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Clawback Suits Are Not Categorically Exempt from Arbitration under FAA
By Quinton M. Herbert – November 11, 2015

On February 10, 2015, the U.S. Court of Appeals for the Eleventh Circuit held that clawback claims brought by court-appointed receivers are not categorically exempt from arbitration as said claims are subject to arbitration under the Federal Arbitration Act (FAA). In Wiand v. Schneiderman, 778 F.3d 917 (11th Cir. 2015), the Eleventh Circuit upheld the lower court’s decision compelling arbitration and denying a receiver’s motion to vacate an arbitration award in a clawback suit stemming from Arthur Nadel’s $168 million Ponzi scheme. The court essentially held that the proceedings were rightfully ordered to arbitration and deferred to the discretion of the arbitrator on the merits.

Background
In clawback suits, the court appoints a receiver who is required to post a bond. Pursuant to 28 U.S.C. § 754 (login required), once the bond is posted, a receiver is vested with complete jurisdiction over any real and personal property located within the jurisdiction in which he or she is appointed. If the receivership estate has real or personal property in other jurisdictions, the receiver can also obtain jurisdiction over that property by filing a copy of the complaint and the order of appointment within 10 days of appointment in the district court in which property subject to the suit is located. See Guy v. Citizens Fid. Bank & Trust Co., 429 F.2d 828, 833 (6th Cir. 1970).

The pervasiveness of clawback provisions among Fortune 100 companies increased from under 18 percent in 2006 to over 82 percent in 2010. “Focus on Research: Clawbacks Are Here to Stay,” C-Suite Insight, Jan. 2011, at 40, 40–41. The growing trend of clawback claims is likely due in large part to the Sarbanes-Oxley Act of 2002, which requires the U.S. Securities and Exchange Commission (SEC) to pursue the repayment of incentive compensation from senior executives who are involved in a fraud. In practice, the SEC has enforced its clawback powers in only a small number of cases. Jesse M. Fried & Nitzan Shilon, “Excess-Pay Clawbacks,” 36 J. Corp. L. 721, 731–32 (2011).

Beginning in 1999, Arthur Nadel managed six hedge funds through the two investment management companies he controlled. Nadel was actually running a Ponzi scheme, as all of the hedge funds were dramatically undercapitalized. Although the funds claimed to have assets in the hundreds of millions, the actual valuation of the funds was a mere $500,000. When Nadel’s scheme collapsed, investors lost millions and scrambled to recover any assets in the possession of Nadel’s holdings.
The SEC also became involved in efforts to recover or “claw back” alleged false profits earned by early investors in Nadel’s scheme. One such clawback claim is the substance of the case of *Wiand v. Schneiderman*.

**Facts of the Case**
In 2003, Herbert Schneiderman became a limited partner in Victory Fund, Ltd., a hedge fund operated by Arthur Nadel. Victory Fund issued subscription documents and a limited partnership agreement. Both documents contained an arbitration provision. Shortly after executing the subscription documents and limited partnership agreement, Schneiderman was treated as a limited partner of Victory Fund. Consequently, his initial investment of $100,000 was credited to his capital account as were all subsequent gains and losses. These “gains and losses” were reported to limited partners in quarterly statements reflecting the balances of each partner’s account.

Schneiderman died in October 2007. At the time of his death, the valuation of Schneiderman’s interest in Victory Funds as stated in his capital account was $263,660.48. That amount was distributed to his estate.

In January 2009, the SEC brought an emergency enforcement action against Nadel, his investment management companies, and the six hedge funds connected with his scheme, charging them with multiple counts of violating the federal securities law. The SEC sought the appointment of a receiver to manage and preserve all assets of the hedge funds. The court appointed Burton Wiand as the receiver.

Wiand filed over 150 clawback claims in an effort to recover alleged “false profits” earned by early investors in Nadel’s Ponzi scheme. With respect to the Schneiderman estate, Wiand filed suit contending that only $100,000 of the distributive interest paid to Schneiderman’s estate was bona fide and that the remaining balance of $163,660.48 constituted “false profits” that were subject to the clawback claim.

The Schneiderman estate moved to compel arbitration based on the subscription agreement and limited partnership agreement between Schneiderman and Victory Fund. The arbitration clause was broad and provided for arbitration of any disputes or controversies that arose from the agreements. Ultimately, the district court compelled arbitration. Subsequently, the arbitrator ruled in favor of the Schneiderman estate by granting the estate’s motion for summary decision.

On appeal, Wiand made four arguments as to why the district court erred in compelling arbitration. The one discussed here is his contention that the receivership statutes creating his position preclude the use of arbitration in clawback actions.

**The Eleventh Circuit’s Ruling**
The FAA, 9 U.S.C. §§ 1 et seq., mandates that arbitration agreements be enforced unless “overridden by a contrary congressional command.” *Shearson/Am. Express Inc. v. McMahon*.
482 U.S. 220, 226–27 (1987). Accordingly, a party seeking to avoid arbitration bears the burden of establishing Congress’s intent to prohibit waiver of a judicial forum in favor of arbitration for claims involving receivership or securities law. The objecting party can demonstrate a contrary congressional command using a statute’s text or legislative history, or by identifying an “inherent conflict” between arbitration and the statute’s underlying purposes. McMahon, 482 U.S. at 226–27.

Wiand argued that there was an inherent conflict between arbitration and the underlying purpose of 28 U.S.C. § 754, the statute governing receiver appointment. In support of this argument, Wiand relied on prior cases where courts have found inherent conflicts between arbitration and other statutory schemes designed to streamline the distribution of assets. For example, when considering the use of arbitration in a bankruptcy case, the Fourth Circuit concluded that Congress intended to centralize disputes about a debtor’s assets and legal obligations in the bankruptcy courts, and that “[a]rbitration is inconsistent with centralized decision-making.” In re White Mountain Mining Co., 403 F.3d 164, 169 (4th Cir. 2005). In short, Wiand contended that clawback claims, like bankruptcy cases, are designed to facilitate the equitable distribution of assets. Consequently, clawback actions also inherently conflict with the enforcement of arbitration clauses.

The Eleventh Circuit held that the language in 28 U.S.C. § 754 that conveys “complete jurisdiction and control” over receivership assets flows to the receiver and not the district court. Therefore, the jurisdiction mentioned in the statute does not refer to the district court’s authority to decide all disputes relating to the contested property, but rather to the receiver’s right to take charge of all contested property regardless of its physical location.

Having determined that 28 U.S.C. § 754 does not grant exclusive jurisdiction of clawback suits to the appointing district court, the court next focused on Wiand’s comparison of clawback claims to bankruptcy proceedings. The court held that the body of case law related to bankruptcy matters was distinguishable from receivership actions because where a statute provides a special method for the resolution of a particular type of dispute (i.e., bankruptcy), resolving that type of dispute in any other manner would inherently be contrary to the statute. However, the statute authorizing receiverships simply provides authority for a particular person or entity to manage the collection and distribution of receivership assets; 28 U.S.C. § 754 does not establish an explicit method for distributing those assets. The court went on to compare the role of a receiver to that of a trustee in a bankruptcy proceeding.

The court further noted that a receiver stands in the shoes of the receivership entities and not the creditors. Therefore, the receiver is bound by the arbitration clause to the same extent that the receivership entity is bound. Because the receiver stood in the shoes of Victory Fund, he was required to submit to the arbitration agreement negotiated between Victory Fund and Schneiderman.
Finally, the court considered that other courts have referred similar disputes under securities laws to arbitration. The prior precedent related to similar cases, when coupled with the “liberal federal policy” in favor of arbitration, moved the court to hold that there was no inherent conflict between arbitration and the underlying purpose of court-appointed receivers pursuing clawback claims. As such, the receiver failed to meet his burden to prove that arbitration of clawback claims was overridden by contrary congressional intent justifying divergence from the FAA.

**Significance for Future Clawback Claims**  
In short, the Eleventh Circuit solidified its intent to enforce arbitration agreements absent a clear conflict between arbitration under the FAA and the purposes of a governing statute. Absent congressional amendment to 28 U.S.C. § 754, the ruling in *Wiand v. Schneiderman* will make it virtually impossible for receivers in clawback claims to avoid arbitration.

**Keywords:** litigation, ADR, arbitration, clawback clause, receivership, 28 U.S.C. § 754, Arthur Nadel, FAA

Quinton M. Herbert serves as the Deputy Labor Commissioner for the City of Baltimore in Baltimore, Maryland. The views of the author and publication do not reflect those of and may not be imputed to the author’s employer.
An Arbitrator’s Duty to Be On Time
By Marcia L. Adelson and Joan D. Hogarth – November 11, 2015

The failure to issue an arbitration award within the prescribed time period is not a common occurrence. It certainly was not in Texas when the Sims case arose. When it does happen, the purpose and intent of arbitration—party-driven, expedient, and cost-effective means of dispute resolution—is thwarted. Despite the potential for undermining expediency in the arbitration process, courts are willing to defer to the arbitrator’s late decision unless the act of the arbitrator is so egregious as to create actual or potential harm to the parties.

As Justice Brennan noted in United Steelworkers of America v. American Manufacturing Co., 363 U.S. 564 (1960), “arbitration is a creature of contract.” Therefore, the arbitrator’s authority is derived from the parties’ arbitration agreement, applicable arbitration rules (e.g., AAA, FINRA, JAMS, etc.), and applicable arbitration law, either state or federal. The arbitrator is the guardian of the integrity of the process. As such, a duty is imposed on such person or persons to hear and to decide only those issues the parties agreed to arbitrate and to follow any and all procedures agreed to by the parties.

Arbitrator’s Failure to Execute the Duty Granted
In Sims v. Building Tomorrow’s Talent, LLC, No. 07-12-00170-CV (Tex. App. Apr. 30, 2014), the arbitrator failed to issue a ruling within the time period fixed by the parties prior to the arbitration, and as a result the award was vacated. Doris Sims and Matthew Gay were former business partners who had a dispute regarding the enforcement of a mediated settlement agreement. The parties agreed to use arbitration to settle their dispute and to use the mediator who had facilitated the settlement agreement, Michael Whitten, as the arbitrator. The parties executed “proposed arbitration guidelines” in which they agreed to an “expedited process and schedule for arbitration.” The parties further agreed to hold the arbitration hearing on November 24, 2008, and to set a deadline for the reasoned written ruling containing findings of fact and conclusions of law within 14 days of Gay’s written submission. Gay submitted his written brief on December 22, 2008, which meant that the arbitrator’s ruling was due on January 6, 2009. One year after the arbitration hearings, with no ruling having been issued and with Sims’s attorney having contacted Whitten’s office several times, Sims sued Whitten for breach of contract and fraud. Gay intervened and accused Sims of hijacking the arbitration process, noting he had not consented to withdraw from the arbitration.

When Whitten did not issue a ruling after the trial court’s oral order on April 8, 2010, the trial court, on June 18, 2010, then entered a written order directing him to render a written decision on liability and render a schedule for discovery, testimony, and other matters within 14 days. Whitten further was ordered to render a written award within 60 days. Sims objected to the court’s replacing procedures and timelines entered into by the parties. It was 19 months after the initial agreed-to deadline, on August 10, 2010, that Whitten issued his findings of fact and conclusions of law in favor of Gay and against Sims, and on August 25, 2011, he issued a final judgment awarding Gay $195,000 in damages and $92,135.32 in attorney fees. Sims objected to

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the award and filed a motion to vacate it, citing Whitten’s lack of impartiality. Despite the objection, on October 26, 2011, the trial court confirmed the award.

The Court of Appeals for the Seventh District of Texas at Amarillo reversed the trial court on the basis that Whitten “had no authority to enter an arbitration award,” whether it be outside the deadline set in the proposed guidelines for arbitration or in the trial court’s June 19, 2010, order. The court based its decision on the fact that the legislature clearly and unambiguously provided that an arbitrator shall make an award within the time established by the agreement to arbitrate, or if a deadline is not established by agreement, within the time ordered by the court. See Tex. Civ. Prac. & Rem. Code § 171.053(c). The court also commented that Whitten’s conduct defeated the intent of arbitration—a contractual arrangement by the parties “to obtain a speedy and inexpensive final disposition.”

The Arbiterator’s Ethical Obligations

An arbitrator, whether serving on a panel or as a sole arbitrator, should be mindful of the ethical obligations he or she has. For arbitration to remain a significant tool in the judicial system, the behavior and conduct of the arbitrator must be above reproach. Courts refuse to undertake an expansive review of arbitral decisions and generally “will uphold an award so long as the arbitrator ‘offers a barely colorable justification for the outcome reached.’” Jock v. Sterling Jewelers Inc., 646 F.3d 113, 122 (2d Cir. 2011).

The American Bar Association and the American Arbitration Association (AAA) put forth the Code of Ethics for Arbitrators in Commercial Disputes to provide ethical guidelines and standards of conduct for arbitrators and others involved in the field of alternative dispute resolution.

Canon I of the Code says, “An Arbitrator should uphold the integrity and fairness of the arbitration process.” And according to canon I(B)(4), one should accept appointment only if fully satisfied “that he or she can be available to commence the arbitration in accordance with the requirements of the proceeding and thereafter to devote the time and attention to its completion that the parties are reasonably entitled to expect.” Using the Sims case as an example, the arbitrator should not have agreed to serve if he could not issue the award 14 days following the last submission. The parties asked for and had every right to expect an expedited process. The failure to meet the parties’ expectations cost the parties, personally and financially, in that Sims declared bankruptcy amid this protracted and expensive litigation.

According to canon I(F): “An arbitrator should conduct the arbitration process so as to advance the fair and efficient resolution of the matters submitted for decision. An arbitrator should make all reasonable efforts to prevent delaying tactics, harassment of parties or other participants, or other abuse or disruption of the arbitration process.” According to the court’s decision, Whitten’s failure to respond to requests for the ruling frustrated the purpose and intent of arbitration. Furthermore, as the arbitrator, should you determine that you are unable to meet the parties’
schedule, it is your duty to decline to serve or to promptly inform the parties and let them decide how to proceed.

**Arbitrator’s Authority: Broadly Construed**

In the few examples of tardiness of the award, courts have been reluctant to hold to rigid deadlines as grounds for vacating an arbitration award. “Unlike the question of arbitrability, which is decided by the court, not the arbitrator (absent a clear and unmistakable agreement to the contrary), the parties should expect that procedural issues concerning the arbitration hearing and the scheduling of deadlines would be decided by the arbitrator as a final matter.” *Greenspan v. LADT, LLC*, 111 Cal. Rptr. 3d 468, 498 (Ct. App. 2010).

In *Sopko v. Clear Channel Satellite Services, Inc.*, 151 P.3d 663, 667 (Colo. Ct. App. 2006), the court, after a review of timeliness cases across jurisdictions, ruled that “the party seeking to preclude an award issued after the time prescribed by the agreement must show both that it made a timely objection to issuing an award after the time limitation in the agreement and that it has been prejudiced by the delay.”

**The Award Is Confirmed Despite Substandard Arbitrator Performance**

In *Hasbro, Inc. v. Catalyst USA, Inc.*, 367 F.3d 689 (7th Cir. 2004), the Seventh Circuit confirmed an arbitration award in which the arbitration panel failed to close the hearings until December 5, 2001, more than four months after the date the panel had set for final briefings, which was July 10, 2001. It was not until the AAA sent a bill to the parties seeking post-hearing time from July to September was a warning raised for Catalyst. Catalyst discovered in the itemized bill it requested several entries such as “review and revise damage calculations to provide interest” and “extended conferences with panel regarding damage calculations and award.” Armed with this knowledge, Catalyst sought to vacate the award for its being untimely. Here, as in *Sopko*, the court of appeals, applying Wisconsin contract law, noted that (1) untimely performance of a contractual obligation does not result in the harsh penalty of forfeiture or rescission, unless the parties agree that “time is of the essence”; (2) time is not of the essence unless expressly stated; and (3) the mere mention of a time certain within which to render the decision, as was in the governing AAA rules, was not sufficient evidence that time is of the essence. Further despite the untimely award, Catalyst was not prejudiced or harmed as no interest was tacked onto the damages payment it owed Hasbro. However, the court did admonish the panel for its substandard performance.

**Connecticut Is Like Texas: Vacated Because the Award Was Untimely**

The Connecticut Appellate Court in *Remax Right Choice v. Aryeh*, No. AC 26571 (Conn. App. Ct. Apr. 10, 2007), vacated an arbitration award issued approximately 70 days late, because according to *Connecticut General Statutes section 52-416(a)* (emphasis added):

If the time within which an award is rendered has not been fixed in the arbitration agreement, the arbitrator . . . shall render the award within thirty days from the date the hearing or hearings are completed, or, if the parties are to submit additional material after the hearing or hearings, thirty...
days from the date fixed by the arbitrator . . . for the receipt of the material. An award made after that time shall have no legal effect unless the parties expressly extend the time in which the award may be made by an extension or ratification in writing.

The court emphasized that the parties, and not the arbitrator without consent from the parties, can waive the 30-day requirement, but that waiver is an act and not the absence of an act. Here, the act is to “expressly extend the time in which the award may be made by an extension or ratification in writing.” This court, like many others, confirmed the importance of arbitration as an efficient and cost-effective means of dispute resolution, and that failure to comply with the statute does not automatically invalidate the award. The court “acknowledge[d] that has no legal binding effect has meaning,” and deference was given to the legislature for inclusion of such language.

In Connecticut, like Texas, the courts respected the language of the applicable statute in that the arbitrator shall make an award within the time set by the parties or 30 days, and shall is an obligation.

Conclusion
There are important lessons for arbitrators and advocates in these cases. The arbitrator’s authority to determine issues of procedure is vast and wide, and the courts give deference to what the arbitrator decides. It is with this heavy duty of upholding the process that the arbitrator should accept a case. It is the arbitrator’s duty to be clear as to the procedure he or she will be following and to manage the process—part of which includes rendering a timely award. With such power, it is incumbent on the arbitrator to be faithful to ethical guidelines and considerations so as not to defeat the very purpose of the arbitrator’s role and force the parties to litigation. The Sims case highlights how easily an unrestrained arbitrator could be so egregious as to infringe on the arbitration process. Furthermore, in Texas and Connecticut, an award can be vacated solely because it is late.

There are lessons for the advocate as well. A late award, by itself, is no basis for seeking to have the award overturned. In addition to preserving your client’s objections, it is imperative that you are able to demonstrate that a late award creates actual or potential harm if you expect to prevail. An additional resource for parties and advocates is Samuel Estreicher & Steven C. Bennett, “Untimely Arbitration Awards,” N.Y. L.J., Mar. 28, 2006.

Keywords: litigation, ADR, arbitration, vacated, arbitrator authority, untimely

A "Reasoned Award" Requires That the Reasoning Be Expressed

By Sara Kula – November 11, 2015


After a full hearing, the selected arbitrator, John Krol, issued an award granting Tully almost $7 million in damages on its claim, and granting Canam over $350,000 on its counterclaim. The arbitrator listed out categories of alleged damages and the amount awarded for each.

The Dispute

After Krol issued the award, Canam requested that he withdraw the award and instead issue a “reasoned award.” Canam’s argument for a reasoned award was premised on the parties’ arbitration agreement itself and a scheduling order issued by the arbitrator. Specifically, the arbitration agreement governing the dispute provided that the arbitration would be covered by the AAA Arbitration Rules for Complex Construction Cases. Such rules provide that, unless the parties agree otherwise, the arbitrator shall issue a “reasoned award.” Krol had also issued a scheduling order stating that the “arbitrator’s decision shall be reasoned.”

Krol denied Canam’s request to withdraw the award, responding that his final award was a reasoned award because it “sufficiently and specifically incorporates all credible evidence adduced during the hearings, detailing the liability for each item of claim and counterclaim.”

When Tully sought confirmation of the arbitrator’s award in the United States District Court for the Southern District of New York, Canam opposed the petition arguing, among other things, that the arbitrator had exceeded his authority by failing to issue a reasoned award.

What Is a Reasoned Award?

The default rule in arbitration is that the arbitrator may issue a standard award that simply announces the result. However, because arbitration is a matter of contract, parties are free to contract around the default rule. To the extent that parties do so, the award must give effect to the parties’ intent.

According to the *Tully* court, a reasoned award is considered to fall somewhere in between a standard award (requiring no explanation) and “findings of fact and conclusions of law” (which requires the most explanation). A reasoned award requires the arbitrator to set out his or her key findings and, where necessary, the reasons for those findings.
Reviewing Krol’s order, the court found that it contained no explanation whatsoever for the arbitrator’s rulings. The arbitrator did not set forth relevant facts, explain the nature of the claims, or offer any reason or rationale for his determinations as to liability and damages. He simply listed various categories of monetary damages without any explanation as to how he calculated those figures or determined liability. Because the arbitrator failed to include any justification for his decisions, the court found that he had failed to issue a reasoned award.

The Result of the Arbitrator’s Failure

The court then went on to consider whether the arbitrator’s failure to issue a reasoned award justified vacatur of the decision under section 10(a)(4) of the Federal Arbitration Act. Section 10(a)(4) provides that an arbitration award may be vacated “where the arbitrators exceeded their powers.” The court concluded that the arbitrator did exceed his power by rendering a form of award that did not satisfy the requirements stipulated to by the parties in their arbitration agreement. Accordingly, the court held that the arbitrator’s award could not stand and went on to consider the proper remedy.

Tully argued that the proper remedy for the arbitrator’s failure to issue a reasoned award was for the court to remand the matter back to the arbitrator to fulfill his obligation under the agreement. Canam did not address the remedy issue. Before reaching a conclusion, the district court considered the common law doctrine of functus officio—a “doctrine [which] dictates that, once arbitrators have fully exercised their authority to adjudicate the issues submitted to them, their authority over those questions is ended, and the arbitrators have no further authority, absent agreements by the parties, to redetermine th[ose] issues” (internal quotation marks omitted). The court rejected the application of functus officio under the circumstances because the arbitrator had not actually completed his duty under the agreement. Accordingly, the court remanded the matter back to Krol to issue a reasoned award.

Takeaway for Arbitrators

In addition to clarifying the requirements of a reasoned award, the Tully decision highlights how important it is for an arbitrator to be familiar with the terms of the parties’ arbitration agreement and to comply with all of the requirements therein.

Keywords: litigation, ADR, reasoned award, remand, exceeded authority, functus officio

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Young Lawyers: Recent Trends Impacting Enforcement of Arbitration Agreements
By P. Jean Baker – November 11, 2015

In *Atalese v. U.S. Legal Services Group, L.P.*, 99 A.3d 306 (N.J. 2014), *cert. denied*, 135 S. Ct. 2804 (2015), the plaintiff, Patricia Atalese, entered into a contract with U.S. Legal Services Group (USLSG) to provide debt-adjustment services. Atalese paid USLSG approximately $5,000. She sued under the New Jersey *Consumer Fraud Act* and *Truth-in-Consumer Contract, Warranty and Notice Act*, alleging that USLSG misrepresented that the monies were spent on numerous attorneys negotiating with her creditors. She maintained that the only work performed was preparation by one attorney of a single one-page answer for a collection action in which she represented herself. Further she alleged that USLSG settled a single debt, knowingly omitted that USLSG was not a licensed debt adjuster in New Jersey, and violated New Jersey’s usury law.

USLSG moved to compel arbitration based on an arbitration provision in the 23-page service agreement. The arbitration provision provided for arbitration before a single arbitrator in accordance with the rules of either the Judicial Arbitration and Mediation Services (JAMS) or the American Arbitration Association (AAA), as mutually agreed upon by the parties or selected by the party filing the claim. The cost of arbitration, excluding legal fees, was to be split equally or born by the losing party.

**New Jersey Supreme Court Rules Arbitration Agreement Involving Statutory Claims Unenforceable**
The New Jersey Superior Court Law Division and Appellate Division both ruled that arbitration was required. On further appeal, applying the de novo standard of review to the interpretation of the contract, the New Jersey Supreme Court reversed in a unanimous decision. The court reasoned that agreements to arbitrate, like any other contract, must be the product of mutual assent. In addition, an effective waiver of the right to bring suit in a judicial forum requires a party to have full knowledge of his or her legal rights and intent to surrender those rights. This is so not only of agreements to arbitrate, but of any clause in which a party gives up constitutional or statutory rights. Because the arbitration provision in question did not clearly explain that the plaintiff was waiving her right to seek relief in court of her statutory rights, the arbitration agreement was unenforceable.

Anticipating a preemption challenge, the court noted that this decision does not improperly discriminate against arbitration clauses, a problem against which the U.S. Supreme Court warned in *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011). As expected, USLSG filed a petition for a writ of certiorari on January 21, 2015, asking the U.S. Supreme Court to determine whether the Federal Arbitration Act preempts a state law rule holding that an arbitration agreement is unenforceable unless it affirmatively explains that the contracting party is waiving the right to sue in court. Following briefing, on June 8, 2015, the petition was denied.
New Jersey Appellate Court Extends *Atalese* Ruling to Include Common Law Claims

In *Dispenziere v. Kushner Cos.*, 101 A.3d 1126 (N.J. Super. Ct. App. Div. 2014), the plaintiffs were buyers of units in a condominium development. They alleged the developer represented that their units would be part of a large waterfront community, which was to include diverse amenities, including a community center, a health club, a waterfront esplanade, parks, and other recreational improvements. Following purchase, the developer changed the nature of the development, eliminating nearly all of the proposed amenities. The plaintiffs sued the developer alleging consumer fraud and numerous common law fraud, negligence, contract, and warranty theories.

The 17-page purchase agreement contained an arbitration provision on page 10 stating, “Any disputes arising in connection with this Agreement . . . shall be heard and determined by arbitration before a single arbitrator of the American Arbitration Association . . . . The decision of the arbitrator shall be final and binding.” In the public offering statement, there was a stand-alone page with a distinctive font calling attention to the arbitration agreement provision within the purchase agreement.

The defendants moved to compel arbitration. The trial court compelled arbitration, and the plaintiffs appealed. The central issue before the appellate court was whether the plaintiffs actually agreed to arbitrate their claims—particularly whether the consumer signatories were reasonably aware that choosing to arbitrate constituted a waiver of their rights to sue in court rather than arbitrate. Relying on *Atalese*, the court ruled that an arbitration clause that does not contain “clear and unambiguous language that the plaintiff is waiving her right to sue or go to court to secure relief” is not enforceable.

In reaching its decision, the court found that *Atalese* did not restrict its holding to statutory claims. And the fact that some buyers had been represented by counsel did not permit the defendants to avoid *Atalese*. Of particular note, the court did not limit its decision to consumer arbitration agreements either.

Unpublished New Jersey Appellate Decision Extends *Atalese* to Employee Arbitration Agreements

In *Milloul v. Knight Capital Group*, No. A-1953-13T2, 2015 N.J. Super. Unpub. LEXIS 2115 (App. Div. Sept. 1, 2015), the plaintiff was provided a new hire packet containing a number of forms. One of the forms was a one-paragraph employee arbitration agreement called a “Dispute Resolution Agreement” (DRA). The DRA provided that employment disputes would be submitted to final binding arbitration pursuant to the rules of the AAA. According to the plaintiff, he was not given an opportunity to read the forms and he was not told that one of the forms waived his right to sue Knight. The plaintiff filed suit alleging religious discrimination and retaliation. The employer moved to compel arbitration. The trial court compelled arbitration and the plaintiff appealed.
Finding no real distinction between an employee arbitration agreement and a consumer arbitration agreement, the appellate court found the arbitration agreement unenforceable because it did not “state in some express fashion that the employee is sacrificing his or her right to a trial.” Citing *Atalese* the court explained that “an average member of the public may not know—without some explanatory comment—that arbitration is a substitution for the right to have one’s claim adjudicated in a court of law.”

**Kentucky Supreme Court Refuses to Enforce Nursing Home Arbitration Agreements**

Kentucky’s Supreme Court found that three nursing home arbitration agreements were never validly formed because the signing parties did not have authority to give up the decedent’s constitutional right to a jury trial. *Extendicare Homes, Inc. v. Whisman*, Nos. 2013-SC-000426, -000430, -000431, 2015 WL 5634309 (Ky. Sept. 24, 2015). The decision involved three separate matters that were consolidated by the court. All involved nursing homes attempting to compel arbitration of wrongful death and personal injury claims by estates of deceased residents. In each case, a relative with power of attorney signed an admission document that included an arbitration provision.

A 2012 decision of the Kentucky Supreme Court held that decedents cannot affect the rights of their beneficiaries with respect to wrongful death claims. *Ping v. Beverly Enters., Inc.*, 376 S.W.3d 581 (Ky. 2012). So the remaining issue before the court was whether other personal injury claims had to be arbitrated.

Comparing entering into an arbitration agreement with putting a child up for adoption, aborting a pregnancy, and entering into personal servitude, the court explained that a general grant of authority in a power of attorney does not extend to serious waivers of constitutional rights, such as the right to a jury trial. Thus, the court found the statements of authority in the three different powers of attorney to be insufficient to allow the attorney-in-fact to bind the resident to arbitration. To be enforceable, a power of attorney would have to expressly provide for “authority to waive the fundamental right to an adjudication by judge or jury.”

Three of the justices dissented on the basis the decision conflicts with the U.S. Supreme Court’s interpretations of the Federal Arbitration Act because it singles out arbitration agreements for disfavored treatment. Furthermore, agreeing to arbitrate is fundamentally different from giving up parental rights or personal liberty because “arbitration agreements . . . involve no substantive waiver. The principal’s substantive rights remain intact, only the forum for addressing those rights is affected.”

In response to the three dissenters, the majority reasoned that its holding does not conflict with the decisions by the U.S. Supreme Court in *Marmet Health Care Center, Inc. v. Brown*, 132 S. Ct. 1201 (2012), or *Concepcion* because it is not a “blanket prohibition” against arbitration agreements and is instead “a long-standing and well-established policy disfavoring the unknowing and involuntary relinquishment of fundamental constitutional rights regardless of the context in which they arise.”
Congressional Antagonism to Predispute Arbitration Agreements in Long-Term Care Facilities
On September 23, 2015, Senator Al Franken joined 33 other senators in urging the Center for Medicare and Medicaid Services (CMS) to “outlaw the use of unfair pre-dispute arbitration clauses in contracts with long-term care facilities like nursing homes.” CMS is already considering imposing restrictions on long-term care facilities participating in Medicare and Medicaid programs. The new protections if adopted would include the following:

1. Admission to the facility could not be contingent on signing an arbitration agreement.
2. The facility must fully explain in a form understandable by the residents or their representatives that by agreeing to binding arbitration they are waiving their right to file suit in court.
3. The arbitration agreement must be separate from other agreements or paperwork presented to the residents or their representatives for signature.
4. Agreeing to binding arbitration would not prohibit the residents or their representatives from contacting federal, state, or local healthcare officials.

Observations
Statutory, regulatory, and common laws governing enforcement of arbitration agreements are subject to change. Before offering an opinion regarding execution of an arbitration agreement or the filing of a demand for arbitration, counsel should always ascertain whether there have been recent changes regarding enforcement in a jurisdiction where a legal challenge might be raised. In addition, lawyers representing business clients need to remain abreast of such changes to ensure arbitration agreements comply with new enforcement requirements.

Keywords: litigation, ADR, arbitration, arbitration agreement, enforcement, waiver

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Legal practitioners and businesses once viewed arbitration as a faster, less expensive alternative to litigation. But this method of alternative dispute resolution has become protracted and costly as arbitration rules (and arbitrators) more readily permit broad discovery, dispositive motions, and other procedures that prolong resolution of a dispute. The Delaware Rapid Arbitration Act, Del. Code Ann. tit. 10, §§ 5801 et seq. (DRAA or the Act), effective since May 2015, creates an arbitration regime that is commenced in the Delaware Chancery Court—like a typical litigation—but for an arbitration administered by the court rather than an outside arbitration administrator. See also Del. Ch. Rules 96–98 (effective June 2015). Aiming to address the concerns of the legal and business communities about the speed and efficiency of arbitration, the purpose of the Act, as its name suggests, is “to give Delaware business entities a method by which they may resolve business disputes in a prompt, cost-effective, and efficient manner, through voluntary arbitration conducted by expert arbitrators, and to ensure rapid resolution of those business disputes.” Del. Code Ann. tit. 10, § 5802.

As this article will fully discuss below, the provisions of the Act attempt to achieve this goal by, among other things, (1) requiring that an arbitrator issue a final award within (at most) 180 days after appointment, id. § 5808(b), (c); (2) requiring that parties consent to waive the right to certain legal procedures, such as interlocutory appeals, that might delay the arbitration, id. § 5803(c); (3) providing that challenges to the arbitration award may be taken directly to the Delaware Supreme Court, id. § 5809(a); and (4) providing that a final award is confirmed, by operation of law, without the need for further action from the court, and that entry of a final judgment may not be challenged once the award is confirmed, id. § 5810. Before this discussion, the article will briefly discuss how eligible businesses can select the procedures of the Act to resolve their disputes.

How to Select the Act to Resolve Disputes

The requirements to opt for the DRAA to resolve disputes are fairly straightforward. Using the well-known language from section 2 of the Federal Arbitration Act (FAA), 9 U.S.C. § 2, the Act provides that “[a] written agreement to submit to arbitration any controversy existing at or arising after the effective date of the agreement is valid, enforceable, and irrevocable” if the following five conditions are satisfied:

1. The arbitration agreement must be signed by both parties;
2. At least one of the signatories must be a business that is either organized under Delaware law or has its principal place of business in Delaware;
3. No party to the arbitration agreement can be a consumer;
4. The parties must agree that the arbitration agreement is governed by Delaware law (different state laws may govern other matters in the overall agreement); and
5. The arbitration agreement must include an express reference to the DRAA.
Del. Code Ann. tit. 10, § 5803(a). During the pendency of an arbitration, “an agreement may be amended to alter the procedures of the arbitration . . . with the approval of an arbitrator,” but the parties cannot agree to extend the arbitration longer than the 180-day period under section 5808(b) of the Act (discussed below). *Id.*

**Provisions of the Act That Make It “Rapid”**

**180 days or else.** What truly makes the DRAA “rapid” is its requirement that an award be issued within, at most, six months (or 180 days) after the arbitrator is appointed. Under section 5808(b), unless another time is fixed by agreement, “an arbitrator shall issue a final award . . . within 120 days of the arbitrator’s acceptance of [his or her] appointment” (emphasis added). Any extension of this period must be brief. Section 5808(c) states that parties “may extend the time for the final award by unanimous consent in writing . . . but the extension may not exceed . . . 60 days after the expiration” of the 120 days under section 5808(b) (emphasis added). Hence, the maximum 180-day period.

The DRAA is unique in that it imposes penalties on an arbitrator if an award is not issued within the described time period. In particular, under section 5806(b), “an arbitrator that fails to issue a final award in compliance with § 5808(b) . . . is not entitled to full payment of the arbitrator’s fees”: the fee “must be reduced by 25% if the final award is less than 30 days late; . . . by 75% if the final award is between 30 to 60 days late; and . . . by 100% if the final award is more than 60 days late.” The Delaware Chancery Court, which “[d]etermines [the] arbitrator’s fees,” *id.* § 5804(b)(4), has the authority to modify and eliminate the reductions where “exceptional circumstances exist.” *Id.* § 5806(b).

Although arbitrators possess broad authority under the Act to compel the production of documents, issue subpoenas, permit depositions, and make interim rulings, *see id.* § 5807(b), (c), the likely effect of section 5806(b) is that they will be more attentive to limiting the extent of discovery to matters that are essential to resolving issues in the arbitration. This also means that arbitrators will be less likely to allow significant dispositive motions. Additionally, due to the truncated proceedings, the arbitrator and the parties will be forced to work more efficiently. All told, the 180-day requirement should undoubtedly make arbitration under the DRAA faster, more efficient, and cheaper.

**Waiver.** Another feature of the Act that makes its procedures “rapid”—by preventing delays—is the requirement that parties waive their right to certain legal actions that would delay either the arbitration proceedings or the finality of an arbitration award. Specifically, under section 5803(c), a party to an arbitration agreement selecting the DRAA is “deemed to have waived the right to”:

- Seek to enjoin the arbitration;
- Remove any action under the DRAA to federal court;
• Appeal or challenge an interim ruling or order of an arbitrator;
• Appeal or challenge the final award, except under section 5809 (discussed below); and
• Challenge whether an arbitration has been properly held, except under section 5809.

The waiver of these important rights should make arbitration under the DRAA less costly and limit some of the legal maneuvering parties engage in that has the effect of delaying a final, nonappealable award.

**Challenge to the final award.** Under section 12 of the FAA, a party has “three months after the award is filed or delivered” to file a petition challenging the award. 9 U.S.C. § 12 (emphasis added); accord Illinois Uniform Arbitration Act, 710 Ill. Comp. Stat. 5/12(b), /13(a) (“90 days after delivery of a copy of the award” (emphasis added)). This period under section 5809 of the Act is much faster: “A challenge to a final award must be taken within 15 days of the issuance of the final award.” Del. Code Ann. tit. 10, § 5809(b) (emphasis added).

More importantly, section 5809 streamlines the process for challenging an award by providing that any “challenge to a final award may be taken” directly to the state’s highest court, the Delaware Supreme Court; this is the only matter under the Act that the court has jurisdiction to consider. Id. § 5804(a). Typically, a petition challenging an award is filed in the trial court, and parties can appeal, as a matter of right, to the appellate court, and petition the highest court in the jurisdiction to hear the matter. The result is that it can take years to achieve a final, nonappealable judgment from the award. The Act avoids this prolonged appeals process.

The Delaware Supreme Court may “vacate, modify, or correct the final award” in accordance with the limited grounds on which a court may do so under the FAA, id. § 5809(c)—i.e., fraud, evident partiality, arbitrator misconduct, the arbitrators exceeded their powers, evident material miscalculation or mistake, award upon a matter not submitted, or the form of the award is imperfect. See 9 U.S.C. §§ 10, 11. The Delaware Supreme Court may also “order confirmation of a final award, which confirmation shall be deemed to be confirmation under § 5810(a)” (discussed below). Del. Code Ann. tit. 10, § 5809(c).

Section 5809(d) provides for an alternative to the appellate review by the Delaware Supreme Court. Parties may agree to have “[n]o appellate review of a final award” or to have “[a]ppellate review of a final award by [one] or more arbitrators, in which case appellate review shall proceed as provided in the [parties’] agreement.” The appellate arbitrator, like the Delaware Supreme Court, has the authority “to order confirmation of a final award” under section 5810(a). Id. § 5809(d)(2). Having just one level of appellate review under the Act should certainly lead to more rapid finality of arbitration awards.
Confirmation and final judgment. Section 5810 of the Act and the rules promulgated pursuant to it eradicate the need to file a separate petition in a trial court to confirm an arbitration award, and ostensibly make the process of securing a final judgment effortless. Unless a challenge is made to the final award, the award “is deemed to have been confirmed by the Court of Chancery on the fifth business day” following the 15-day period to challenge an award under section 5809(b). Id. § 5810(a). If the parties agreed to no appellate review, the “final award is deemed to have been so confirmed on the fifth business day following its issuance.” Id.

Regarding final judgment, section 5810 states that the appropriate court (i.e., the Delaware Chancery or Superior Court) “shall promptly enter a final judgment in conformity with [the] final award” upon filing of a petition from a party to an arbitration “in which a final award has been confirmed.” Further, the Act’s rules provide that “[n]o answer may be filed in the proceeding” seeking a final judgment, “[n]o discovery may be taken in the proceeding,” and “[u]pon the [c]ourt’s satisfaction that the requirements of [section 5810] have been satisfied, final judgment shall be entered forthwith.” Del. Ch. Rule 97(d)(3)–(5). The Act and its rules seem resolved to removing any hindrance to a final, nonappealable order of judgment once a final award is confirmed.

Conclusion
Initially, legal practitioners will probably be reluctant to suggest to business clients that they invoke the DRAA as the arbitration forum in agreements because the Act is still a new regime and is thus untested. However, if the potential effectiveness of the Act in speeding up arbitration and making it less costly is proven in due course, we should begin to see more practitioners and businesses willing to select the procedures of the Act to resolve disputes—assuming that the appointed arbitrators are knowledgeable, fair, and able to follow existing law.

Keywords: litigation, ADR, Delaware, arbitration, procedures, administrator, rapid

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Insurance Appraisal Proceedings: What May the Appraisers Decide?
By Sheila J. Carpenter – November 11, 2015

A recent California Court of Appeal case, Lee v. California Capital Insurance Co., 188 Cal. Rptr. 3d 753 (Ct. App. 2015), attempted to clarify the dividing line between the authority of the appraisers and the courts in considering disputed property damage claims. California Insurance Code section 2071(a), like the insurance codes of many states, dictates standard language for fire insurance policies, including a procedure for appraisal if the insurer and insured cannot agree on the amount of a loss. Each party selects a “competent and disinterested” appraiser within 20 days of the request for appraisal. The appraisers are then to select an umpire. If they cannot agree on the umpire within 15 days, a court of record where the property is located makes the appointment. The party-appointed appraisers “shall then appraise the loss, stating separately actual cash value and loss to each item; and, failing to agree, shall submit their differences, only, to the umpire. An award in writing, so itemized, of any two when filed with this company shall determine the amount of actual cash value and loss.” Formal discovery is prohibited, and the rules of evidence do not apply. In California, a party seeking to confirm the award follows the same procedure as a party seeking to confirm an arbitration award. California Capital, 188 Cal. Rptr. 3d at 760; see Cal. Civ. Proc. Code § 1286.2.

In California Capital, the insured and the insurance company had wildly different views as to cost of repairs due to a fire in a 12-unit apartment building owned by Li-Lin Sung Lee. The insurer claimed that the damage was largely confined to the one apartment that it asserted suffered flames from the fire. It initially approved payment of about $70,000. Lee’s public adjuster asserted that smoke damage required the interior rooms of five other apartments to be completely dismantled and replaced, iron balcony railings and part of the building’s stucco exterior to be removed, and the entire building to be repainted. Costs were submitted for asbestos abatement, cleaning, reconstruction of the apartments affected, and loss of rent. The claim exceeded $800,000.

The Appraisal and Lower Court Proceedings
Lee requested an appraisal proceeding pursuant to the policy. California Capital requested a reinspection of the property but Lee refused. Instead she filed a petition to compel the appraisal and for appointment of an umpire. The court suspended the case to allow the requested reinspection, after which California Capital paid approximately another $110,000. Upon resumption of the court proceedings, California Capital argued that the court had no authority to order the appraisers to consider the disputes between the parties as to the extent of damage to the apartment building, the scope and cause of damage to the building’s exterior, and work required by code upgrades and other legal requirements, including whether the policy covered the latter.

The initial court order fails. The court granted Lee’s petition to compel the appraisal but ordered that the appraisers were to value only the damages caused by the fire. The
scope of the loss was limited to items agreed by the parties to have been damaged in the fire, and the appraisers were not to make any coverage or causation determinations.

The appraisal proceeding moved forward with a court-appointed umpire. At the appraisal hearing, Lee’s public adjuster continued to argue that the appraisers should consider the entire universe of losses Lee submitted. The umpire suspended the hearing to seek clarification from the court, and two days later Lee filed a bad faith lawsuit against California Capital. California Capital then filed a motion to dismiss the petition to compel the appraisal, arguing that Lee had waived her right to the appraisal proceeding by filing the second lawsuit.

**Query:** The court-appointed umpire was a retired judge. Appraisal procedures, in contrast with the majority of commercial arbitrations, are used because the appraisers employ their own backgrounds and knowledge to resolve disputes over valuation rather than forming judgments based on evidence presented to them in the form of expert reports and testimony. Query whether the appraisal proceeding might have gone more smoothly had the umpire been someone whose business was the appraisal of fire damage. Given the nature of Lee’s claim and her haste to file a bad faith lawsuit, perhaps not; however, the court’s first order was clear (although erroneous), and a business person might not have felt the need to go back to the court for clarification of an issue the court had already decided.

**The second court order produces odd results.** The court denied the motion to dismiss and issued a second order in response to the request for clarification, directing the appraisers to:

value three categories of items: (a) items of loss agreed by the parties to have been damaged by the fire; (b) items of loss asserted by Lee to have been damaged by the fire but where [California Capital] disputes coverage; and (c) items of loss asserted by [California Capital] to have been damaged by the fire but where Lee does not assert a claim.

*California Capital*, 188 Cal. Rptr. 3d at 758 (alterations in original). The appraisers were again directed not to make any causation or coverage determinations. The trial court added: “Following the appraisal proceedings, the parties can through other proceedings resolve their disputes regarding whether an appraised item was covered by the policy, whether the item was damaged, and whether the item was damaged by the fire.” *Id.*

The appraisal panel declined California Capital’s request to inspect the property. It issued a unanimous award that recited separately replacement cost and cash value losses for the insurer’s scope of loss and the insured’s scope of loss. It valued the former at about $190,000 and the latter at about $800,000. The award stated:
The award with attached exhibits takes no position on the appropriate scope of construction or method of repair; it makes no determination of coverage under the insurance policy at issue; it does not indicate what is due and owing under the terms of the insurance policy; it does not provide an interpretation of the insurance policy; it does not address the question of whether items claimed were in fact damaged/destroyed by the fire damage [sic] or other questions of causation. The panel has made no determination whether the items claimed existed.

_California Capital_, 188 Cal. Rptr. 3d at 758 (alterations in original). The trial court entered a judgment attaching the award and noting the limiting language.

**The Court of Appeal Reverses**

California Capital appealed, and the California Court of Appeal (First District) reversed and remanded, holding:

> [T]he award issued in this case pursuant to the trial court’s directive neither complies with the terms of the governing statute nor accomplishes the objectives of an appraisal. It was error to compel the appraisal panel to assign loss values to items simply because they were listed in the insured’s scope of loss and regardless of whether inspection revealed they were undamaged or never existed.

_California Capital_, 188 Cal. Rptr. 3d at 756.

**Standard of review.** The court of appeal reviewed de novo the trial court’s decision to order the appraisal because that decision involved interpretation of the insurance policy and an analysis of the statutory scheme. However, the decision whether to defer the appraisal pending resolution of the scope of loss issues was a matter committed to the sound discretion of the trial court. For purposes of reviewing the appraisal award, the court considered the appraisal proceeding to be an arbitration. Thus, every reasonable inference was made in support of the award. See also _TMM Invs., Ltd. v. Ohio Cas. Ins. Co._, 730 F.3d 466 (5th Cir. 2013).

**Reasoning.** The court noted that while appraisal is a form of limited arbitration, there are significant differences between an appraisal and an arbitration. Arbitrators exercise “essentially judicial functions, including deciding issues of law, and often resolve[] the entire dispute between the parties.” _California Capital_, 188 Cal. Rptr. 3d at 761 (internal quotation marks omitted). On the other hand, an appraiser only has authority to decide a question of fact—the amount of damage to property presented for his or her consideration. The court of appeal rejected California Capital’s assertion that existing case law dictated that only items the parties agreed were damaged by the fire could be considered by the appraisal panel, holding that the panel may assign values to disputed items; those items can be stricken from the award if later proceedings determine that the
items are not covered. Rejecting the argument that this order of events would be wasteful, the court opined that having all items appraised at once was more efficient than potentially requesting a second appraisal for disputed items later found to be covered. It stated that if California Capital had been concerned about the appraisal proceeding being wasteful, it could have requested the lower court to stay the appraisal proceeding pending decisions about disputed items.

**Practice note:** The appraisal procedure is designed to resolve disputed claims very quickly while court procedures generally are not. Thus, for major and sharply disputed losses, unless the opportunity for appraisal will be lost with the passage of time, early consideration should be given to requesting a stay of an appraisal pending coverage or causation decisions. However, in *State Farm Lloyds v. Johnson*, 290 S.W.3d 886, 893–95 (Tex. 2009), the Supreme Court of Texas ruled that appraisals should ordinarily proceed prior to litigation except on rare occasions. It reasoned that appraisal proceedings should be faster and much less expensive than litigation and may resolve the dispute.

**The court’s holding.** “[A] panel does not necessarily exceed its authority by appraising items within a disputed scope of loss when the disputes turn on issues of coverage, causation, or other legal issues that an appraisal panel is not authorized to decide.” *California Capital*, 188 Cal. Rptr. 3d at 765. However, the trial court should not have ordered the panel to evaluate all items Lee claimed were damaged, regardless of whether the items were actually damaged or even existed. Appraisers are to value losses; if an item was not damaged or never existed, there has been no loss. The court of appeals attempted to provide clear guidance on the line between the appraisal panel’s authority and that of the courts:

> The **existence** of damage to an item as well as the **nature** of the claimed item are factors that directly bear upon the valuation of the loss, including the cost to repair or replace the item. By contrast, the **cause** of any damage does not bear upon the amount that may be required to repair or replace the item, although it may be appropriate to include different amounts for the same items of loss when the condition of the property prior to the loss is disputed and relevant to the valuation. Consequently, while an appraisal panel exceeds its authority by awarding nothing for damaged items based on causation or other coverage determinations, a panel does not exceed its authority by awarding nothing for items that are not damaged or never existed, where the nature or existence of the item is readily ascertainable. If there is a dispute about causation, the panel does not exceed its authority if it determines and clearly labels different amounts of loss where the amounts differ due to stated assumptions about the condition of the property prior to the loss.

*California Capital*, 188 Cal. Rptr. 3d at 767.
**Practice note:** The court of appeal did not explicitly say so, but its references to an inspection suggest that the California Capital panel erred in refusing to inspect the property. An inspection would have allowed it to resolve such disputes as differing square footage for the same room and whether a room had one window or two, disputes the court specifically said the panel should have resolved.

**Other Decisions**

California Capital is interesting because it attempts a precise treatment of the limits of an appraisal panel’s authority. A number of courts have struggled with this issue. This short article cannot discuss additional cases in any number or depth, but there are a few recent cases warranting mention because they touch on issues decided in California Capital.

In American Family Mutual Insurance Co. v. Dixon, 450 S.W.3d 831 (Mo. Ct. App. 2014), homeowners claimed damage to their driveway, porch, and wood deck from a hailstorm. The insurer initiated an appraisal proceeding; its appraiser concluded that the driveway and porch had not been damaged by hail and that the damage to the deck was minimal. The Missouri Court of Appeals upheld the homeowners’ position that the question of whether the damages to the property were caused by hail and thus were covered losses under their policy was not for the appraisers. Such questions “may not be delegated lawfully to an internal resolution procedure provided in the insurance policy, but may be fully litigated by Homeowners in a court of law.” Id. at 832.

In TMM Investments, 730 F.3d 466 (5th Cir. 2013), the Fifth Circuit reviewed another hail damage appraisal award involving causation issues. The district court had set aside the award because it believed that the appraisers had improperly decided issues of causation. The appraisal award was a fraction of what the insured sought because the insurer-appointed appraiser and the umpire believed that the roof was in poor condition due to other causes, including improper installation of the membrane, and that the skylights had been damaged by rocks thrown from below rather than by hail. The Fifth Circuit reversed, primarily relying on the Texas Supreme Court’s decision in Johnson, 290 S.W.3d 886 (Tex. 2009), for its discussion of Texas law.

At the very least, Johnson arguably establishes that appraisal panels are within their rights when they consider whether damage was caused by a particular event or was instead the result of non-covered pre-existing perils like wear and tear. . . . To the extent the appraisers merely distinguished damage caused by pre-existing conditions from damage caused by the storm, they were acting within their authority.

TMM Investments, 730 F.3d at 474–75. Johnson takes a practical approach to an appraisal panel deciding causation issues:
Causation relates to both liability and damages because it is the connection between them. . . . In the abstract, it is hard to say whether causation is more a question of liability or damages.

But in actual cases, causation usually falls into one category or the other. Thus, when different causes are alleged for a single injury to property, causation is a liability question for the courts. . . .

By contrast, when different types of damage occur to different items of property, appraisers may have to decide the damage caused by each before the courts can decide liability. . . .

The same is true when the causation question involves separating loss due to a covered event from a property’s pre-existing condition. Wear and tear is excluded in most property policies (including this one) because it occurs in every case. If State Farm is correct that appraisers can never allocate damages between covered and excluded perils, then appraisals can never assess hail damage unless a roof is brand new. That would render appraisal clauses largely inoperative, a construction we must avoid.

Johnson, 290 S.W.3d at 891–93 (footnotes omitted). The Texas Supreme Court noted that although it first dealt with insurance appraisal clauses in the nineteenth century, Johnson was the first case in which it opined on causation. The court concluded from this that, in practice, appraisals were resolving causation disputes.

**Conclusion**
Unlike arbitration panels, appraisal panels are not authorized to decide legal issues. Thus, they may not decide what is or is not covered by an insurance policy. Causation presents a more difficult question because it is normally viewed as a legal issue but, as a practical matter, as the Texas Supreme Court said in Johnson, “appraisers must always consider causation, at least as an initial matter. An appraisal is for damages caused by a specific occurrence, not every repair a home might need.” 290 S.W.3d at 893. The line must be drawn in each case; doing so requires consideration of precedent in the state involved and the factual issues in dispute.

**Keywords:** litigation, ADR, insurance, appraisal, arbitration, scope of loss, causation

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Northern District of Illinois Holds Party Waived Right to Compel Arbitration


Mo’nique Smith, the plaintiff, was hired by Adams & Associates, the defendant. Her employment agreement contained a broad arbitration clause requiring employment-related disputes to be arbitrated. One year later, the defendant terminated the plaintiff’s employment.

In July 2014, the plaintiff filed a *pro se* employment discrimination lawsuit against the defendant. The court appointed counsel to represent the plaintiff, and the appointed counsel filed an amended complaint. At a status hearing the following February, the court set a discovery cut-off date as well as a future status date. In April 2015, the defendant served the plaintiff with interrogatories and a request to produce. On June 4, 2015, the defendant moved to compel arbitration.

Around the same time it moved to compel arbitration, the defendant made an oral motion for the dismissal of the plaintiff’s appointed counsel. The defendant argued that the plaintiff’s counsel from a state-court action had filed an appearance in the instant federal case and that the plaintiff should be barred from proceeding with both retained and appointed counsel. The court denied the defendant’s oral motion and allowed the plaintiff to proceed with both attorneys.

In support of its motion to compel arbitration, the defendant argued that the arbitration clause in the plaintiff’s employment agreement mandated that the parties arbitrate the employment discrimination claims. In opposition, the plaintiff argued that the defendant waived its right to arbitrate the employment dispute by choosing to proceed in the federal forum and defend against the plaintiff’s claims. The court agreed with the plaintiff.

The court acknowledged that the party asserting waiver has a heavy burden in order to overcome the “strong federal policy favoring enforcement of arbitration agreements.” *Id.* at *3. When considering if a party waived its right to arbitrate, the court considered several factors: diligence in litigation; participation in litigation; any substantial delay in its request for arbitration; the party’s participation in discovery; whether its conduct was intentional or merely responsive; and “whether the party opposing arbitration ‘was prejudiced by its reliance on the litigious behavior of the waiving party.’” *Id.* at *3–4. The court noted that waiver is a case-specific inquiry based on the totality of the circumstances.
The court held that the defendant waived its right to arbitration due to its participation in litigation. The court found waiver from the defendant’s acquiescence to the discovery deadline, its initiation of discovery, and its delay of almost one year before filing its motion to compel arbitration. *Id.* at *4.*

Also supporting a finding of waiver, according to the court, was the fact that the defendant’s litigation conduct was not merely responsive. *Id.* Specifically, the court stated that the defendant’s intentional requests for the removal of the plaintiff’s appointed counsel “represent[ed] an affirmative effort to gain a substantive advantage in the federal court case by attempting to force” the plaintiff to proceed pro-se or with her attorney from the state-court action. *Id.* The court’s interactions with counsel “strongly suggest[ed] that [the defendant] made a conscious decision to wait to assert its right to arbitrate to secure whatever tactical advantage it could against an indigent Plaintiff.” *Id.* at *5.*

The lesson learned from *Smith* is simple: If you want to enforce an arbitration agreement, then “don’t delay!” A party seeking to enforce an arbitration clause must request the “earliest feasible determination” of whether claims must be arbitrated. *Id.* at *5.* Any litigation conduct that is more than merely responsive—initiating discovery, for example—could very well be construed as a waiver of the party’s right to arbitrate.

**Keywords:** alternative dispute resolution, adr, litigation, motion to compel arbitration, waiver, waiver by participation

— *Eileen Boyle*, Novack and Macey LLP, Chicago IL

October 27, 2015

"Outlined" Mediation Settlement Agreement Enforced

In *PNC Bank, N.A. v. Springboro Medical Arts*, 2015-Ohio-3386 (Ohio App. Ct. 2015), an Ohio appellate court held that a mediation agreement was binding even though the agreement only “outlined” the settlement terms and recited that the parties later would draft a “formal” settlement agreement.

In *Springboro*, PNC made a loan that went into default and that had been guaranteed by Joshua Wright (Wright). The dispute over Wright’s liability was referred to mediation. During the mediation, the parties reached an agreement that was transcribed by the mediator (Mediation Settlement). The Mediation Settlement provided that PNC would release Wright if Wright: (a)
paid PNC certain amounts on certain dates; and (b) provided PNC with a “financial statement showing no more than $160,000 in assets.” *Id.* at ¶ 6. The Mediation Settlement also stated that the parties would draft “such additional [formal] documents as are required to give effect to these outlined terms.” *Id.* No such formal documents were prepared.

PNC asked the trial court to declare the Mediation Settlement void due to the failure of an “express condition precedent,” namely, that Wright’s financial statement indicated he had “assets exceeding $160,000.” *Id.* at ¶ 8. In response, Wright filed a motion to enforce the Mediation Settlement and to admit parol evidence showing that the term “assets” referred only to Wright’s collectible, non-exempt assets.

The trial court rejected Wright’s argument. It found that: (1) the Mediation Settlement was a “fully integrated” and enforceable contract; and (2) the term “assets” was unambiguous, parol evidence was inadmissible, and that “assets” was not confined to Wright’s non-exempt assets. The trial court entered judgment in PNC’s favor, finding that Wright had not complied with the Mediation Settlement because his financial statement showed that his total “assets” exceeded $160,000.

The appellate court affirmed the trial court’s findings that the Mediation Settlement was a fully integrated and enforceable contract, that “assets” was unambiguous, and that parol evidence was therefore not admissible. In so ruling, it rejected Wright’s argument that the Mediation Settlement was not final. “Although the [Mediation Settlement] stated that the parties ‘shall draft in formal legal language and form such additional documents as are required …’ this does not mean that additional documents were, in fact, required to create a binding agreement.” *Id.* at ¶ 21. Instead, the court held, the “pertinent consideration” is whether the parties formed a clear and definite agreement containing “all the essential terms for a binding contract.” *Id.* The court noted that the Mediation Statement contained the essential terms for a binding settlement agreement. It also stated that there was no evidence that the parties “did not intend to be bound by the terms of an agreement until formalized in a written document.” *Id.* at ¶ 25. To the contrary, the court observed, “Wright signed the written [Mediation Settlement] and we must conclude that he intended to be bound by the terms as expressed at that time…. ” *Id.* at ¶ 28.

Turning to the meaning of “assets,” the appellate court, like the trial court, gleaned the meaning of the term from a dictionary. It parted ways from the trial court; however, because the “trial court considered only Wright’s ‘total assets’ and did not consider the part of the general definition that defines assets as property ‘applicable to or subject to the payment of debts.’” *Id.* at ¶ 35. Noting that Ohio law exempted from execution several items on Wright’s financial statements, the court held that Wright’s assets did not exceed $160,000, and thus, Wright had not failed to comply with the Mediation Settlement.

*Springboro* should remind practitioners of two basic lessons. First, if one does not want to risk being bound by incomplete settlement agreements—so common in the mediation context—make
that abundantly clear; at the very least, one should not sign the “outlined” agreement. Second, parties should take the time to clearly define key settlement terms.

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