

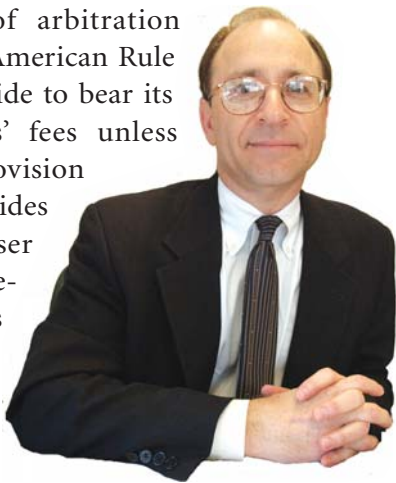
Arbitration Freed From American Fee Rule

Award of attorneys' fees can cost clients more than litigation

By **RICHARD S. ORDER**

Traditionally, arbitration has been touted as a fast, quick, and cheap alternative to litigation. In recent years, however, commercial arbitration has become more and more like litigation in many respects. In fact, arbitration may be even more expensive than litigation if your clients get stuck paying their opponents' attorneys' fees.

The form of arbitration known as the American Rule requires each side to bear its own attorneys' fees unless a contract provision or statute provides for the loser to pay the prevailing party's attorneys' fees. Arbitrators follow the exception to the American Rule by awarding attorneys' fees pursuant to an arbitration clause providing that the prevailing party will recover its attorneys' fees from



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the loser, or in connection with awarding damages under a statutory claim that provides for recovery of attorneys' fees.

Most lawyers and arbitrators do not realize, however, that the American Rule itself governs only litigation and not arbitration and, therefore, that arbitrators are not constrained from awarding attorneys' fees even in the absence of a contractual or statutory provision.

attorneys' fees, despite the absence of a contractual or statutory provision. Such requests usually appear simply in a boilerplate prayer for relief in the arbitration demand and the response to the demand, and in the conclusion of the pre- and post-hearing briefs. Since lawyers are so prone to using formulaic pleadings and stock conclusions in their briefs, they often put little thought into the effect such requests may have; or

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As a result, arbitrators are free to include attorneys' fees in their discretion as part of an award of damages to the claimant, or even to award attorneys' fees to a successful respondent, according to decisions of the U.S. Court of Appeals for the 6th Circuit, the Northern District of Illinois, and the Texas Court of Appeals.

Mutual Fee Requests

Another basis for awarding attorneys' fees in arbitration occurs when both sides request recovery of their

just include them in the off-chance of success, even when they know there is no contractual or statutory basis for attorneys' fees.

The Southern District of New York and the 6th Circuit have held, however, that requests by both parties for attorneys' fees constitute a submission of the issue of attorneys' fees to the arbitrators.

Furthermore, many courts have recognized that fundamental to the philosophy of arbitration is the principle that once an issue is mutually submitted to the arbitrators, it

cannot be withdrawn unilaterally. Otherwise, needless to say, the party who sees its case is not going well would be able to deprive the other party of an award on an issue.

Consequently, if both parties request attorneys' fees in the absence of a contractual or statutory provision and one party briefs the issue, the other party cannot escape by trying to withdraw its attorneys' fees claim and then arguing there is no mutual request for attorneys' fees.

The rules of some arbitration services provide such a broad range of remedies that courts have held a submission of a dispute to the arbitration service constitutes a submission to a plethora of potential awards, including attorneys' fees. For example, Rule R-43(d)(ii) of the American Arbitration Association Commercial Arbitration Rules provides that "[t]he award of the arbitrator(s) may include . . . an award of attorneys' fees if all parties have requested such an award or it is authorized by law or their arbitration agreement."

Fertile Grounds For Fee Awards

While not expressly referring to attorneys' fees, the National Association of Securities Dealers Dispute Resolution Code of Arbitration Procedure also is rather expansive in its available remedies. NASD Code Rule 10330(e) provides for an award to contain "damages and other relief," and Rule 10332(c) specifically allows for the award of "other costs and expenses of the parties and arbitrator(s) which are within the scope of the agreement of the parties."

Since NASD Conduct Rules 3110(f)(4)(B) and (D) prohibit

NASD securities firm members from imposing any condition in arbitration agreements that "limits the ability of a party to file any claim in arbitration; . . . [or] limits the ability of arbitrators to make any award," securities firms may not enforce any prohibition on the recovery of attorneys' fees in their arbitration agreements, buried in the small print of their account opening documents.

The FAA Factor

The Federal Arbitration Act (FAA), which governs any arbitration pursuant to an agreement in a contract involving interstate commerce, neither expressly authorizes nor expressly prohibits an award of attorneys' fees. Nevertheless, it is well established under the FAA that arbitrators have the inherent equitable authority to fashion appropriate awards, including awarding attorneys' fees and arbitration costs. Under the pro-arbitration policies of the FAA, courts have made it clear that issues upon which an arbitration agreement is silent, such as the availability of attorneys' fees, should be considered as within the scope of arbitration, particularly if the arbitration agreement broadly covers any and all controversies between the parties.

As the U.S. Supreme Court and the U.S. Court of Appeals for the 2nd Circuit have held, a party cannot avoid an award of attorneys' fees to its opponent by arguing that the state substantive law designated in the arbitration agreement governs and supersedes either the FAA or the procedural rules of an arbitration service provider agreed to in the arbitration agreement.

First, if the arbitration agreement

is subject to the FAA, the FAA trumps a choice of state substantive law under the Supremacy Clause of the Constitution. Since the FAA is a procedural statute, its procedures will control even if the arbitration agreement provides that all issues arising under the contract are to be determined by the laws of the designated state.

Accordingly, an arbitration provision that specifies the contract will be construed and interpreted under New York law, which prohibits an arbitration award of attorneys' fees in the absence of a contractual or statutory right, will not prevent an award of attorneys' fees under the FAA.

Second, the rules of any arbitration provider selected in the arbitration agreement will override, on procedural matters, the choice of state substantive law.

All of this means that there are many factors to consider when advising clients about arbitration. If you extol the virtues of arbitration to a client, make sure to discuss the possibility of recouping your fees or, on the downside, having to pay their adversary's attorneys' fees. If you are drafting an arbitration agreement, consider whether to use language that would support or preclude an award of attorneys' fees. If you simply ignore the issue, you may be doubling your client's arbitration costs. ■

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