

October 26, 2022

ADR Case Update 2022 - 19

Federal Circuit Courts

- SERVICE OF SUMMONS NOT REQUIRED TO CONFIRM FOREIGN ARBITRAL AWARD**

Commodities & Minerals Enterprise LTD v CVG Ferrominera Orinoco, C.A.
United States Court of Appeals, Second Circuit
2022 WL 4661845
October 3, 2022

Venezuelan company Ferrominera chartered the General Piar from CME to shuttle iron ore from Ferrominera's mines to a transfer station. Ferrominera failed to make payments, and CME sought arbitration pursuant to the Charter Agreement, which included a mandatory arbitration agreement with a choice-of-law selection of U.S. maritime law. The arbitration panel awarded CME more than \$12 million for unpaid invoices, lost profits, and attorneys' fees. When CME sued to confirm the award, Ferrominera opposed, arguing that the district court lacked personal jurisdiction because CME never served a summons on Ferrominera in connection with its motion to confirm the arbitral award. Ferrominera also contended that the district court erred in confirming the arbitral award because 1) the arbitration agreement was invalid under Venezuelan law; 2) the panel exceeded its authority by improperly allocating payments made under other contracts; 3) the award was obtained through corruption in violation of U.S. public policy; and 4) the attorneys' fees award was unreasonable. The court confirmed the award, and Ferrominera appealed.

The United States Court of Appeals, Second Circuit, affirmed in part and vacated in part, holding that a party is not required to serve a summons to confirm a foreign arbitral award under the New York Convention. The Court affirmed that the arbitration agreement was valid and enforceable. Under the Convention, an arbitration agreement's validity is determined according to "the law to which the parties have subjected it." Here, the arbitration agreement expressed the parties' agreement for arbitration to be governed by U.S. maritime law, rendering the application of Venezuelan law irrelevant. As Ferrominera presented no arguments that the contract was invalid under U.S. maritime law, the arbitration agreement was valid and enforceable. Ferrominera's claim that the panel had improperly allocated his payments did not fall within any of the New York Convention's seven allowable defenses to confirmation and amounted to "nothing more than a quarrel over how much it owes in damages," which was "properly a question for the arbitrators." Ferrominera's public policy argument constituted an attack on the Charter Agreement itself, not the award or its enforcement, and was merely an attempt to relitigate corruption arguments the panel had considered and rejected below. Finding that the court erred in awarding attorneys' fees and costs, the Court vacated the portion of the judgment that awarded such fees and costs.

- **ARBITRATOR EXCEEDED POWERS**

Honchariw v FJM Private Mortgage Fund, LLC
Court of Appeal, First District, Division 3, California
2022 WL 4544812
September 29, 2022

Nicholas and Sharon Honchariw took out a \$5.6 million dollar secured loan from FJM at 8.5% interest per annum. Nine months into the loan, the Honchariws defaulted on one of their monthly payments. Under the loan's late-payment provisions, this single default triggered not only a one-time fee of 10% of the overdue payment but an interest increase to 9.9 % per annum on the remainder of the principal for the continued life of the loan. The Honchariws filed an arbitration demand under the loan agreement alleging that the interest increase constituted an "unlawful penalty" in violation of Cal. Bus. Code § 1671. The arbitrator rejected their claims and denied arbitration. The Honchariws filed a petition to vacate the award, which the court denied. The Honchariws appealed.

The Court of Appeal, First District, Division 3, California, reversed. Although an arbitrator's decision is not generally reviewable for errors of fact or law, Cal. Code of Civil Procedure § 1286.2 provides an exception where arbitrators have exceeded their powers and "the award cannot be corrected without affecting the merits of the decision upon the controversy submitted." Arbitrators may exceed their powers if an award "contravenes an explicit legislative expression of public policy," provided that policy is "well-defined and dominant" and ascertainable "by references to the laws and legal precedents." Bus. Code § 1671 sets forth just such a "well-defined and dominant" public policy that liquidated damages must bear a "reasonable relationship" to actual damages anticipated to result from breach of contract. Absent a "reasonable relationship," liquidated damages will be construed as a coercive penalty reflecting an imbalance of bargaining power. Here, FJM presented no evidence to support its conclusory assertion that the late fee was "reasonable." Prior case law establishes that assessing a higher interest rate against the entire remaining principal for the remainder of the loan because of one missed payment is "not rationally calculated to merely compensate the injured lender." The late fee, therefore, constituted an unlawful penalty, and the Honchariws could not be legally bound by an agreement to pay a late fee that violates public policy.

District of Columbia

- **ARBITRATION RIGHTS NOT WAIVED BY ACTION FOR INJUNCTIVE RELIEF**

BDO USA, LLP v Jia-Sobata & A2Z Associates, Inc.
District of Columbia Court of Appeals.
2022 WL 5237479
October 6, 2022

Eric Jia-Sobata left his partnership at accounting firm BDO to form his own firm. Jia-Sobata's Partnership Agreement contained an arbitration clause but expressly permitted either party to "seek provisional remedies from a court." BDO believed that Jia-Sobata was soliciting BDO clients and using proprietary information in violation of his Partnership Agreement's non-compete provision. BDO sued for a TRO and preliminary injunction. Ten days later, BDO filed an arbitration demand, to which Jia-Sobata demurred. BDO pursued aggressive discovery in its injunctive action, serving interrogatories, document requests, and seeking eight depositions from parties and non-parties. Jia-Sobata answered BDO's complaint with six counterclaims, and the court denied BDO's TRO request without waiting for BDO to respond. Twelve days later, BDO moved to compel arbitration of four of Jia-Sobata's counterclaims and to dismiss the remaining two claims – one for False Claim Act violations and the other for declaratory judgment that the arbitration agreement was unconscionable -- as non-arbitrable. Jia-Sobata then moved to stay all arbitration, claiming that BDO had waived its arbitration rights. The court agreed, holding that BDO had waived its arbitration rights by 1) requesting a ruling on the merits of the two allegedly non-arbitrable counterclaims; 2) causing "unexplained delay" by waiting until after the TRO denial

before moving to compel arbitration, demonstrating “gamesmanship and manipulation” of the litigation process; and 3) engaging in “substantial amounts” of discovery. BDO appealed.

The District of Columbia Court of Appeals held that BDO had not waived its right to arbitrate. BDO had not caused “unexplained delay” but acted with “reasonable promptness” by filing its arbitration demand ten days following its complaint and moving to compel arbitration of Jia-Sobata’s counterclaims six days after the TRO denial. BDO had made clear from the outset that its requests for injunctive relief were “in aid of arbitration,” so the court below was “well aware” that BDO intended to arbitrate. BDO’s motion to dismiss Jia-Sobata’s non-arbitrable claims was not a manipulative motions strategy intended to procure a “second bite” at a favorable judgment on the merits. Case law makes clear that a motion for judgment on the merits of non-arbitrable claims does not constitute waiver of arbitrable claims, and here, BDO requested only injunctive relief authorized by the terms of the arbitration agreement. BDO’s aggressive discovery was not intended to circumvent the limitations of arbitral discovery but was necessary to procure information in support of its TRO request. The Court rejected Jia-Sobata’s claim that he was prejudiced by the need to spend time and resources litigating BDO’s injunction action and because BDO had access to greater discovery in that action than would have been allowed in arbitration. Any such prejudice was incurred by BDO’s compliance with the arbitration provision, and a party “does not waive a contractual right simply because exercising that right turns out to disadvantage the other party.”

Maryland

- **PLAINTIFFS’ VOLUNTARY CASE DISMISSAL DID NOT DIVEST COURT OF JURISDICTION OVER ARBITRATION AWARD**

Nesbitt v Mid-Atlantic Builders of Davenport, Inc.

Court of Special Appeals of Maryland

2022 WL 4494163

September 28, 2022

Gwendolyn and Leeroy Nesbitt filed a class action alleging that their contractor, Mid-Atlantic, failed to make statutorily required disclosures. Mid-Atlantic moved to dismiss or compel arbitration pursuant to their Purchase Agreement’s mandatory arbitration agreement, under which the filing of any legal action in violation of that provision automatically gave the opposing party “the right to have such legal action dismissed and to recover the costs of obtaining the dismissal.” The court stayed the case and ordered arbitration. The arbitrator held for Mid-Atlantic but declined to award attorneys’ fees, finding that the costs provision, by its terms, was not triggered until dismissal, at which point the court would be better placed to assess “the costs of obtaining the dismissal.” The Nesbitts then preemptively filed a Notice of Dismissal with Prejudice, which was entered by the clerk, taking the position that since they, rather than Mid-Atlantic, had “obtained” the dismissal, Mid-Atlantic could recover no “costs of obtaining the dismissal.” Mid-Atlantic moved to strike the Notice, confirm the award and award attorneys’ fees. The Nesbitts argued that the court lacked authority to strike the Notice, as Maryland Rule 2-506(a) allows a plaintiff to voluntarily dismiss a case any time before the adverse party files an answer, and Mid-Atlantic had not answered the complaint. The court granted Mid-Atlantic’s motion to strike the Notice, lifted the stay, confirmed the award, and awarded Mid-Atlantic attorneys’ fees. The court reasoned that the clerk lacked authority to dismiss a case that had been stayed, as such dismissal would nullify both the court’s grant of the motion to compel and the resulting arbitration. The Nesbitts challenged the decision in a Motion to Alter Judgment, arguing for the first time that Mid-Atlantic was not entitled to attorneys’ fees because it had failed to claim fees in its initial pleading. The court denied the motion, and the Nesbitts appealed.

The Court of Special Appeals of Maryland affirmed on different grounds, holding that the lower court erred in striking the Notice. So long as Mid-Atlantic left the complaint unanswered, the Nesbitts were free under Rule 2-506(a) to voluntarily dismiss the case. That dismissal did not, however, divest the court of jurisdiction over the arbitration award. Under Maryland’s UAA, as under the FAA, the court that compels arbitration retains jurisdiction to confirm the arbitration award and has authority to “vacate, modify, or correct an award” in accordance with the UAA.

The court below, therefore, properly retained jurisdiction to confirm the award and to consider the attorneys' fees claim that the arbitrator had "expressly reserved" for the court to decide. The Court rejected the Nesbitts' claim, made only in their Motion to Alter Judgment, that the court had erroneously exercised jurisdiction over claims not raised in initial pleadings. The Court applied a "highly deferential standard" to find that the judge did not abuse his "almost boundless" discretion "not to indulge" post-trial motions raising after-the-fact objections made in hindsight.

Case research and summaries by Deirdre McCarthy Gallagher and Rene Todd Maddox.

Contact Information

David Brandon
Program Manager
JAMS Institute
415-774-2648

DBrandon@jamsadr.com