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## Redefining Inherent Power: Belated Thoughts on the Second Circuit’s Decision in *Reliastar*

By

Hon. Timothy K. Lewis and Bradley A. Nankerville\*

Federal courts have “inherent power” to sanction those who appear before them.<sup>1</sup> This power, “shielded” as it is “from direct democratic controls,”<sup>2</sup> is said to have vested in courts “by their very creation” under Article III.<sup>3</sup> Typically constrained only by basic notions of procedural due process, federal courts may invoke their inherent power to hand out all manner of sanctions, including *sua sponte* dismissal of a case with prejudice.<sup>4</sup>

Arbitrators, on the other hand, can claim no analogous power. “[A]rbitration is simply a matter of contract between the parties; it is a way to resolve those disputes – *but only those disputes* – that the parties have agreed to submit to arbitration.”<sup>5</sup> In stark contrast to a federal court’s sovereign, virtually unassailable inherent power,<sup>6</sup> an “arbitrator’s authority to impose sanctions is completely dependent on” – and thus may be readily limited by – “the arbitration

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<sup>1</sup> *Chambers v. NASCO, Inc.*, 501 U.S. 32, 43 (1991).

<sup>2</sup> *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 764 (1980).

<sup>3</sup> *Anderson v. Dunn*, 19 U.S. 204, 227 (1821).

<sup>4</sup> *See Link v. Wabash R.R. Co.*, 370 U.S. 626, 629-33 (1962).

<sup>5</sup> *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995) (emphasis added).

<sup>6</sup> *See Chambers*, 501 U.S. at 47 (acknowledging that “the exercise of the inherent power of lower federal courts can be limited by statute and rule,” but reiterating that “we do not lightly assume that Congress has intended to depart from established principles such as the scope of a court’s inherent power”) (quotation marks and citation omitted).

agreement.”<sup>7</sup> “[I]t follows then that if the agreement is silent as to sanctions, the arbitrator may not impose them.”<sup>8</sup>

That was the prevailing wisdom, at least. Although it is nothing new to say that arbitrators possess “flexibility” in formulating remedies,<sup>9</sup> including sanctions,<sup>10</sup> the idea that they can draw on “inherent authority” in doing so seems to have only recently seeped into the case law.<sup>11</sup> The Second Circuit’s decision in *Reliastar Life Ins. Co. v. EMC Nat’l Life Co.* contains perhaps the most detailed discussion to date of this so-called inherent arbitral authority to sanction.<sup>12</sup> This article takes a quick look at the *Reliastar* decision and offers a few thoughts on its apparent import of a distinctly judicial concept – inherent power to sanction – into the arbitration field.<sup>13</sup>

In *Reliastar*, the arbitration clause in the parties’ agreement provided that “[i]n the event of any disputes or differences arising hereafter between the parties with reference to any transaction under or relating in any way to this Agreement as to which agreement between the

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<sup>7</sup> Georgene M. Vairo, *Sanctions and Arbitration Proceedings*, in AAA HANDBOOK ON COMMERCIAL ARBITRATION 419, 420 (2d ed. 2010).

<sup>8</sup> *Id.*

<sup>9</sup> *United Steelworkers of Am. v. Enter. Wheel & Car Corp.*, 363 U.S. 593, 597 (1960).

<sup>10</sup> *See, e.g.*, *Forsythe Int’l, S.A. v. Gibbs Oil Co.*, 915 F.2d 1017, 1023 n.8 (5th Cir. 1990) (“Arbitrators may . . . devise appropriate sanctions for abuse of the arbitration process.”).

<sup>11</sup> *See, e.g.*, *Hamstein Cumberland Music Group v. Williams*, 532 Fed. App’x 538, 543 (5th Cir. 2013) (“[A]rbitrators enjoy inherent authority to police the arbitration process and fashion appropriate remedies to effectuate this authority, including with respect to conducting discovery and sanctioning failure to abide by ordered disclosures.”).

<sup>12</sup> 564 F.3d 81 (2d Cir. 2009).

<sup>13</sup> A few words of caution: this article speaks in broad – *very* broad – strokes and does not touch upon the many factors other than an arbitrator’s inherent authority that might impact the power to sanction, including state arbitration statutes, the parties’ choice of law, and rules of arbitration organizations like the AAA. Even as to an arbitrator’s inherent authority, this article consists only of our musings on a single decision; it is not a comprehensive discussion of the topic.

parties hereto cannot be reached, the same shall be decided by arbitration.”<sup>14</sup> The agreement further provided that “[e]ach party shall bear the expense of its own arbitrator . . . and related outside attorneys’ fees.”<sup>15</sup> Despite the parties’ agreement to each bear their own arbitrator’s and attorneys’ fees, the arbitration panel awarded those amounts – totaling nearly \$3.2 million – to the respondent, finding the claimant’s conduct “lacking in good faith.”<sup>16</sup>

The claimant petitioned the district court to vacate that portion of the award, arguing that the arbitration panel had exceeded its authority by shifting fees where the agreement explicitly provided that each party would bear its own. The district court agreed and vacated the award, finding the parties’ agreement “clear as a bell” in its prohibition on fee shifting.<sup>17</sup> “Although [the agreement] contains a broad arbitration clause,” the district court reasoned, “it unmistakably provides that the parties are to bear the fees of their respective arbitrators . . . and outside counsel.”<sup>18</sup>

The Second Circuit reversed. The Court explained “that a broad arbitration clause, such as the one in this case, . . . confers inherent authority on arbitrators to sanction a party that participates in the arbitration in bad faith and that such a sanction may include an award of attorney’s or arbitrator’s fees.”<sup>19</sup> The Court was untroubled by the parties’ explicit agreement to bear their own fees, which the Court found “simply state[d] the general American Rule that each

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<sup>14</sup> 564 F.3d at 84.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* at 85.

<sup>17</sup> *Reliastar Life Ins. Co. v. EMC Nat’l Life Ins. Co.*, 473 F. Supp. 2d 607, 609 (S.D.N.Y. 2007).

<sup>18</sup> *Id.*

<sup>19</sup> 564 F.3d at 86.

party will bear its own attorney's fees . . . in the expected context of *good faith* dealings.”<sup>20</sup>

Observing that “bad faith dealings create a recognized exception to the American Rule” and that “a covenant of good faith and fair dealing” implies in every contract, the Court reasoned that the agreement did not “signal[] the parties’ intent to limit the arbitrators’ inherent authority to sanction *bad faith* participation in the arbitration.”<sup>21</sup> The Court therefore reversed the district court’s judgment and ordered it to confirm the arbitration panel’s award of fees.

A dissent raised a host of interesting concerns with the majority’s analysis. First, the dissent “note[d] [her] unease with concept of what the majority terms ‘the arbitrators’ inherent authority to sanction . . . .”<sup>22</sup> That a broad arbitration clause could confer such authority was “a flat contradiction in terms,” she reasoned, for “inherent authority is authority which is not conferred; inherent authority is possessed regardless of the intentions of those who have the power to confer authority.”<sup>23</sup> The dissent accordingly found the very “notion of authority inhering in an arbitral panel, whose authority is derived from the agreement of the parties before it, [to be] problematic,” particularly since, in her opinion, the majority had “made little effort to define the scope and limits of this authority.”<sup>24</sup>

The dissent also took issue with the majority’s invocation of the bad-faith exception the American Rule, blasting the majority for citing “no authority for the proposition that an

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<sup>20</sup> 564 F.3d at 88.

<sup>21</sup> *Id.* at 89.

<sup>22</sup> *Id.* at 94 (Pooler, J., dissenting).

<sup>23</sup> *Id.* at 93 (Pooler, J., dissenting).

<sup>24</sup> *Id.* at 94 (Pooler, J. dissenting).

exception which is properly recognized by a *court* is equally recognizable by an arbitrator.”<sup>25</sup> In the end, the dissent found it “close to self-evident” that the parties’ agreement to each bear their own fees was unqualified, specific, and controlling over the broad arbitration clause: “the arbitral award could not properly include an award of attorney’s fees . . . because the contract between [the parties] *divested* the arbitral panel of any authority to make an award of attorney’s fees.”<sup>26</sup>

The contrast between *Reliastar*’s majority and its dissent is intriguing. On the one hand, the majority’s approach is sensible and appeals to the practical justifications for inherent judicial authority to sanction. Courts must be able “to manage their own affairs so as to achieve the orderly and expeditious disposition of cases.”<sup>27</sup> To that end, inherent authority serves as “a flexible tool that enables courts to respond to the changing realities of litigation without requiring a prolix code of procedure.”<sup>28</sup> Insofar as arbitration is a quasi-judicial proceeding, an arbitrator’s invocation of inherent powers seems as justifiable as a judge’s, if not more so. Arbitration is, after all, “a less rule-governed proceeding than is litigation in a judicial forum.”<sup>29</sup> Faced with a managing a proceeding that is “likely to have something of a rough and tumble character,”<sup>30</sup> arbitrators must be able to adapt to the very unexpected, quickly and often without clear

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<sup>25</sup> 564 F.3d at 93 (Pooler, J., dissenting).

<sup>26</sup> *Id.* at 90 (Pooler, J., dissenting).

<sup>27</sup> 370 U.S. at 630-631.

<sup>28</sup> Joseph J. Anclien, *Broader is Better: The Inherent Powers of Federal Courts*, 64 N.Y.U. ANN. SUV. AM. L. 37, 48 (2008).

<sup>29</sup> 564 F.3d at 94 n.5 (Pooler, J., dissenting).

<sup>30</sup> *Id.*

guidance, lest the benefits of arbitration be lost.<sup>31</sup> Moreover, there is nothing wrong with the idea that inherent authority is conferrable. Inherent judicial authority does not just exist; the American people conferred it through Article III's broad grant of "judicial Power."<sup>32</sup> Likewise, it is reasonable to conclude that parties to an agreement can confer similar authority through a broad arbitration clause.<sup>33</sup> It thus seems perfectly appropriate that arbitrators might possess inherent authority to sanction.

On the other hand, it is hard to shake the feeling that the *Reliastar* majority simply rewrote the parties' agreement. As explained, arbitration agreements are contracts. And courts typically interpret contracts according to their *express* terms, loath to imply language at all, much less contrary to an express term or under the nebulous guise of "good faith."<sup>34</sup> Imbuing arbitrators with inherent authority arguably runs afoul of that principle. As one commentator noted, "[t]aken to an extreme, the *ReliaStar* holding supports the view that arbitrators confronted

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<sup>31</sup> 564 F.3d at 87 ("[T]he underlying purposes of arbitration, *i.e.*, efficient and swift resolution of disputes without protracted litigation, could not be achieved but for good faith arbitration by the parties. Consequently, sanctions, including attorney's fees, are appropriately viewed as a remedy within an arbitrator's authority to effect the goals of arbitration.").

<sup>32</sup> Anclien, *supra* note 28, at 54-56; *see also* 501 U.S. at 58 (Scalia, J., dissenting) ("Article III courts, as an independent and coequal Branch of Government, derive from the Constitution itself, once they have been created and their jurisdiction established, the authority to do what courts have traditionally done in order to accomplish their assigned tasks.").

<sup>33</sup> 564 F.3d at 86 n.2 (noting that the dissent "misunderstands our point," which is that "the authority to sanction inheres in [a grant of] comprehensive arbitral authority"). This conclusion is further supported by the widespread acknowledgment that Article I courts, which derive their powers entirely from statute, possess inherent power to sanction. *See, e.g.*, *Caldwell v. Unified Capital Corp.*, 77 F.3d 278, 283-85 (9th Cir. 1996).

<sup>34</sup> *See, e.g.*, *Higgs v. Columbia Univ.*, No. 05 Civ. 2642, 2009 WL 77880, at \*12 (S.D.N.Y. Jan. 6, 2009) ("[T]he implied covenant of good faith and fair dealing cannot be used to add to a party's substantive obligations or to contradict express terms of the agreement.").

with bad faith conduct have the equitable authority to diverge from fundamental components of an arbitration agreement.”<sup>35</sup>

The holding also puts parties to an arbitration agreement in a tough spot, pulled in one direction to draft an agreement that fully empowers an arbitrator to resolve the dispute but pulled in another to essentially predict the future and constrain an arbitrator who might invoke his or her inherent authority in totally unforeseen circumstances. Obtaining meaningful review on the back end is just as thorny. Because “courts apply inherent powers without specific definitional or procedural limits,” it is difficult to review such decisions.<sup>36</sup> Couple that difficulty with the extremely deferential standard of review applied to arbitration awards, and it is easy to see how the judicial concept of inherent authority could be a poor fit in the arbitration context.

Though we don’t attempt to solve this problem here, we tend to agree with the *Reliastar* majority that some sort of inherent authority is necessary to make arbitration work. As the Supreme Court has recognized, arbitral “flexibility” is required precisely because “[t]he draftsmen [of an arbitration agreement] may never have thought of what specific remedy should be awarded to meet a particular contingency.”<sup>37</sup> *Reliastar*’s notion of inherent authority to sanction is, we think, really just a variation of that flexibility. We presume it will be the rare instance where parties choose to forgo litigation in favor of arbitration simply on the basis of possible sanctions, but *Reliastar*’s finding that arbitrators can possess inherent authority to sanction nonetheless demonstrates another crossover between the two arenas.

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<sup>35</sup> Thomas W. Walsh, *International Decision: Reliastar Life Insurance Co. of New York v. EMC National Life Co.*, 104 AM. J. INT’L L. 94, 99 (2010).

<sup>36</sup> 501 U.S. at 67-70 (Kennedy, J., dissenting).

<sup>37</sup> 363 U.S. at 597.