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Arbitration vs. Litigation in the United States

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Introduction

As those in the shipping industry are well aware, contracting parties are regularly afforded the option of choosing the United States, and, specifically, New York, as a forum to resolve disputes arising out of their charter parties and other maritime contracts. For example, the NYPE Time Charter remains in wide use throughout the world, allowing for the election for parties to arbitrate of disputes in New York. Other agreements may, instead, invoke the admiralty subject matter jurisdiction of the United States District Courts, and permit parties to litigate their disputes in the U.S. federal court system. New York arbitration and litigation are very different from each other, and each has its own distinct advantages and disadvantages that should be considered by parties looking for the fair disposition of disputes in the United States.

I. Maritime Litigation in the United States

The United States District Courts have original and exclusive subject matter jurisdiction over all civil cases of admiralty or maritime jurisdiction. *See* 28 U.S.C. § 1333 and FED. R. CIV. P. 9(h). There are ninety-four (94) federal judicial districts, including at least one (1) district in each state, the District of Columbia, and Puerto Rico. In addition, three (3) territories of the United States (*i.e.* – the Virgin Islands, Guam, and the Northern Mariana Islands) each have district courts that hear federal cases, including bankruptcy cases. The ninety-four (94) U.S. judicial districts are organized by region into twelve (12) circuits, each of which has a United States Court of Appeals, which hears appeals from the district courts located within its circuit, as well as appeals from decisions by United States administrative agencies.

Parties seeking to litigate their disputes in the United States will frequently designate the United States District Court for the Southern District of New York (*i.e.* – the federal courthouse in New York City) in the forum selection clauses of their contracts. While maritime lawsuits may be commenced in any federal court throughout the United States (provided that personal, *in rem*, or *quasi in rem* jurisdiction exists over the defendant or its property), the United States District Court for the Southern District of New York is uniquely suited to hearing maritime disputes. From 2002 until 2009, the Southern District of New York was a hotbed for the Rule B attachment of electronic fund transfers ("EFTs") as they passed through intermediary and/or Clearinghouse banks located in New York City.[1] Due to the sheer volume of maritime cases filed in the Southern District of New York during this time frame, the district judges in New York City have developed expertise in all facets of maritime law, from substantive charter party disputes or cargo claims to ancillary Rule B attachment and Rule C arrest actions to obtain security.

As with other jurisdictions, litigation in the U.S. federal court systems has both advantages and disadvantages for maritime claimants.

A. Benefits of Litigation

Litigation in the United States district courts offers many benefits to maritime claimants. As a preliminary matter, litigation in the federal courts is significantly cheaper than other options, including many alternative dispute resolution mechanisms. Parties seeking access to the federal courts need only pay a one (1) time fee of USD 350.00 to file their verified complaint or petition to commence an action and seek judicial relief. Unlike New York arbitration (discussed in greater detail below), there are very few other "hard" costs of litigation in the United States. While each party is to bear its own attorneys' fees

[1] As the Second Circuit Court of Appeals noted in its landmark decision in *The Shipping Corporation of India v. Jaldhi Overseas Pte. Ltd.*, 585 F.3d 58, 62 (2d Cir. 2009), the Clearing House Association L.L.C. reported in its amicus brief that from October 1, 2008 to January 31, 2009 alone, "maritime plaintiffs filed 962 lawsuits seeking to attach a total of $1.35 billion. These lawsuits constituted 33% of all lawsuits filed in the Southern District . . ."

(except in certain limited cases), the Federal Rules of Civil Procedure and United State Code permit certain litigation costs to be taxed to the losing party (*i.e.* – clerk or U.S. marshal's fees; transcript fees; printing fees; witness fees; and, often, expert fees).

Moreover, as discussed briefly above, the United States court system consists of hundreds of experienced district judges, appointed to the judiciary by the President of the United States of America. These judges are well versed in all facets of litigation. In addition to the district judges, each federal district has a number of magistrate judges, to whom cases are frequently referred for resolution of all pre-trial matters. These experienced magistrate judges are excellent in helping parties resolve their disputes, and will often conduct mediation and/or other settlement conferences with the parties – free of charge – in an effort to resolve matters amicably in advance of trial.

Litigation can also be much faster than arbitration, particularly in cases where the defendant has not appeared. Each district court has detailed default judgment practices and procedures which enable a litigant to obtain a judgment against a defaulting party both expeditiously and inexpensively. Many issues are resolved through pre-trial motion practice, which enables both the parties and the Court to streamline the issues to be decided at trial.

Finally, perhaps the most significant benefit of litigation over arbitration is the losing party's guaranteed right of appeal. Under the Federal Rules of Appellate Procedure, a party against whom judgment been entered is entitled to seek appellate review of the final order and judgment against it as of right, on <u>any</u> issue raised before the district court, provided that such appeal is taken within thirty (30) days from entry of judgment. As discussed below, this is very different from U.S. arbitration, where there are only very limited grounds available for judicial review of an arbitration panel's award.

B. Disadvantages of Litigation

Despite the many benefits of litigating disputes in the United States, there are also many disadvantages to bear in mind. While the United States district judges are highly

intelligent and experienced, judges will have less expertise in discreet issues of maritime law in land-locked districts, with no nearby port, that do not handle many maritime claims. While maritime cases made up nearly one third (1/3) of all cases heard in the Southern District of New York in 2008-2009, other districts may only hear two (2) or three (3) maritime cases per year. As a result, there are far less opportunities for the Circuit Courts of Appeals in such regions to speak on certain issues and district courts are left without binding precedents to apply to their decisions. This may increase the risk of unpredictable decisions on seemingly straightforward issues.

Another disadvantage to litigation is that each judge approaches a case with his or her own unique experiences and biases, and has his or her own unique set of practices and procedures. To the extent that a Circuit Court of Appeals has not yet ruled on a particular issue, it is not uncommon for different district court judges sitting within the same courthouse to reach diametrically different results, even when faced with identical legal issues and factual predicates. Frequently, whether or not a maritime claimant will prevail on its claim will be largely dependant on the judge that is randomly assigned to hear the matter.

Finally, litigation can be a very long process, particularly in busy courthouses such as the Southern District of New York or the Northern District of California. How quickly (or slowly) a matter will proceed will depend on the judge's trial schedule and the demands of other matters pending before that Court. In the Federal Court system, criminal matters always take priority over civil maritime matters.

II. Maritime Arbitration in the United States

For parties looking for an alternative dispute resolution mechanism for the fair disposition of maritime disputes in the United States, arbitration in New York before the Society of Maritime Arbitrators, Inc. ("SMA")[2] offers a practical alternative to litigation. As

[2] Information on the SMA and its roster of arbitrators may be found on the SMA website, located at http://www.smany.org.

with litigation, maritime arbitration in the United States offers both benefits and disadvantages that should be considered by contracting parties seeking a forum to resolve disputes arising out of their charter parties and other maritime contracts.

A. SMA Arbitration Procedures

The SMA offers a roster of arbitrators who are recognized as leaders in their respective sectors of the industry, and who are well-versed in maritime areas including, *inter alia*, charter parties, vessel and terminal operations, ship sales and purchases, cargo sales and purchases, ship construction and repairs, stevedoring, cargo loss or damage, brokerage, agency, finance, engineering, naval architecture, surveying, salvage, towage, maritime insurance and general average, collisions, liner agreements, management agreements, small craft and offshore drilling.

SMA arbitration, like all arbitration in the United States, is governed by the U.S. Federal Arbitration Act ("FAA"). In addition, the SMA has promulgated its own SMA Arbitration Rules.[3] The SMA Rules provide general guidelines for arbitrators in conducting maritime arbitration proceedings and conform to the requirements contained within the FAA. The FAA allows an aggrieved party to compel another party to arbitrate, provided that the parties agreed to arbitrate their disputes in a written agreement. Parties may agree to the arbitration of disputes in New York under SMA rules by including an SMA arbitration clause in their commercial contracts.[4]

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[3] The SMA Arbitration Rules may be viewed at http://www.smany.org/sma/about6-1.html.

[4] The SMA has promulgated a Model Arbitration Clause, which provides:

> *Should any dispute arise out of this Charter, the Matter in dispute shall be referred to three persons at New York, one to be appointed by each of the parties hereto, and the third by the two so chosen; their decision or that of any two of them shall be final, and for the purpose of enforcing any award, this agreement may be made a rule of the Court. This Charter shall be governed by the Federal Maritime Law of the United States. The proceedings shall be conducted in accordance with the Rules of the Society of Maritime Arbitrators, Inc. The arbitrators shall be members of the Society of Maritime Arbitrators, Inc.*

Under the standard SMA arbitration procedure, a claimant may initiate arbitration by appointing an arbitrator. The respondent must then appoint its own arbitrator. The two (2) party-appointed arbitrators then appoint a third, who will act as the Chairman of the panel for procedural matters. If the respondent does not appoint an arbitrator within twenty (20) days of receiving the requisite notice of the claimant's appointment of its own arbitrator, the claimant may then appoint the second arbitrator. The parties are, of course, free to agree to have the matter heard by a sole arbitrator.

A typical arbitration under the standard procedure consists of one (1) or more hearings, and parties may offer such evidence as they wish. The rules of evidence that apply to judicial proceedings need not apply to a New York arbitration proceeding, and the SMA arbitrators are afforded a great deal of discretion in determining what evidence may be offered. Witnesses may be called to testify under oath and be cross-examined by the opposing party. In addition, the arbitrators have the power to order discovery in the same manner as judges, and can subpoena non-party witnesses or documents on their own initiative or at the request of any party.

Once all of the evidence has been presented to the Panel, the parties may either simultaneously exchange written post-hearing briefs and reply briefs or may present their final arguments in a Final Oral Hearing. Under the SMA Rules, the Panel has a duty to issue its Award no later than one hundred twenty (120) days after the parties have been notified that the proceedings have been closed (*i.e.* – after the Final Oral Hearing has been conducted or reply briefs have been exchanged). Awards rendered by SMA arbitrators are always supported by fully reasoned written opinions.

In addition to its standard arbitration procedure, the SMA has also established rules which allow for shortened arbitration. The shortened arbitration procedure was designed to provide parties with a quick and inexpensive method to resolve small, simple disputes.

Under SMA's shortened arbitration procedure, a claimant must nominate an SMA arbitrator to act as sole arbitrator and simultaneously request the respondent's agreement. The respondent has ten (10) days to respond, failing which the claimant's nominated arbitrator will act as sole arbitrator. If the parties cannot agree on the sole arbitrator, the SMA's president will appoint the sole arbitrator. The shortened procedure provides short deadlines for submission of the claim and defense and any counterclaims. The arbitration proceeds on written submissions alone; no oral hearings are permitted, and no discovery is allowed except as requested by the arbitrator. In addition, the procedure provides for a limit of four (4) items of dispute to be presented (although this limitation may be raised at the arbitrator's discretion). A decision must be issued within thirty (30) days of the closing of the proceeding. Finally, the shortened arbitration procedure specifically limits the fees and expenses of the arbitrator to no more than USD 3,500 (unless there is a counterclaim, in which case the arbitrator's fees shall not exceed USD 4,500). Legal expenses incurred by the prevailing party may be awarded, but may not exceed USD 4,000. This shortened arbitration procedure allows for simple disputes to be resolved both expeditiously and cost-effectively.

B. Benefits of SMA Arbitration

One of the most important features of American maritime arbitration is that its arbitrators are empowered to order security. Section 8 of the FAA expressly permits a claimant to obtain security for his claim by the arrest or attachment of the opposing party's assets, such as its bank accounts or vessels. Such an attachment or arrest can be obtained at the start of the arbitration, or any time during its course.

In addition, New York courts have held that that the arbitrators may require both parties to post security for the panel's anticipated fees, either by asking for escrow deposits to be made to the SMA escrow account or to be held by the parties' attorneys. Unlike other forums, SMA arbitrators do not charge an appointment fee, nor does the SMA charge

administrative fees. Similarly, unlike London arbitrators, SMA arbitrators do not charge booking fees to reserve hearing dates. Under the standard arbitration procedure, there is no set arbitrator's fee; rather, Section 37 of the SMA rules provides that "[e]ach Panel member shall determine the amount of his/her compensation . . . [taking] into account the complexity, urgency, and time spent on the matter." Because of the speed and finality of New York arbitration, costs tend to be significantly reduced in comparison to court proceedings.

Another important benefit of SMA arbitration for prevailing claimants is the finality of SMA awards, which are subject to judicial review only under very limited circumstances. Under Section 10 of the FAA, an award may only be vacated:

> (1) where the award was procured by corruption, fraud or undue means; (2) where there was evident partiality or corruption in the arbitrators, or either of them; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

FED. ARBITRATION ACT, 9 U.S.C. § 10. The finality of SMA awards effectively resolves the dispute without the need for (or availability of) lengthy appellate proceedings and limits the expenses of obtaining a final, binding and enforceable decision.

Finally, under the FAA, an arbitration award received from an SMA arbitration panel may be recognized and confirmed as a judgment by a New York Court (provided that confirmation is sought within one (1) year of the date of the award). Once the award has been confirmed as a judgment, it is enforceable in the same manner as any decision rendered by the court itself. In addition, the United States is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the Inter-American Convention on International Commercial Arbitration. Accordingly, SMA awards may be enforced in any country that is a signatory to these conventions.

C. Disadvantages of SMA Arbitration

While the finality of an arbitration award rendered in the United States is an important benefit for prevailing claimants, this feature of U.S. arbitration is, conversely, a significant disadvantage for a losing party that is dissatisfied with the arbitrators' decision. As noted above, there are very limited grounds for judicial review of a U.S. arbitration award. Unless the losing party can establish fraud or corruption by its counterparty or bias, misconduct, or abuse of power by the arbitrators, there are no other grounds on which a final arbitration award will be vacated. As such, a losing party has no meaningful opportunity to appeal an arbitration panel's decision thought to be wrongly decided on the merits.

Arbitration can also be far more expensive than litigation in many cases. In addition to both parties paying their respective attorneys' fees, the fees of the arbitrators may also be very costly. Frequently, the parties will be required to make substantial escrow deposits in order to secure the arbitrators' fees. This is very different from the U.S. court system, where parties are entitled to free access to the courts after paying a *de minimis* filing fee.

The arbitration process can also be very slow, even in matters where the respondent has not appeared. Moreover, the arbitrators' decisions are highly unpredictable. Unlike the district court judges, who are guided by the decisions of the Circuit Courts of Appeals, the decisions of other arbitration panels provide only persuasive authority. As there are no binding precedents on which the panels may rely, it is difficult, if not impossible, to predict how an arbitration panel will decide any given issue.

Conclusion

Both arbitration and litigation in the United States offer many different benefits to the maritime community worldwide. Contracting parties seeking to resolve their disputes in the United States should carefully weigh the benefits and disadvantages of each in deciding which dispute resolution mechanism will be right for them.

For more information regarding maritime arbitration or litigation in the United States, or for general inquiries on any other issues of U.S. law, please contact CHALOS & CO, P.C. – INTERNATIONAL LAW FIRM at info@chaloslaw.com.