

NEW YORK COURT OF APPEALS ROUNDUP

DECISION DEMONSTRATES COURT'S RESPECT FOR ARBITRATION PARAMETERS

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The Court of Appeals recently reaffirmed New York's public policy favoring arbitration and the ability of parties to consensually define the parameters of their dispute resolution process. In *American International Specialty Lines Insurance Company v. Allied Capital Corporation*, a unanimous court rejected a challenge to an arbitral award from a party who claimed that the arbitral panel had exceeded its authority by reconsidering an initial determination that decided some, but not all, of the issues submitted by the parties.

Background

Ciena Capital LLC (Ciena) and its majority owner Allied Capital Corporation (Allied and, collectively with Ciena, the insureds) settled qui tam claims brought by the federal government arising out of the insureds' alleged participation in a loan origination fraud. The settlement required the insureds to make a \$10.1 million payment to the government. The insureds then sought payment of their defense costs and indemnity for the settlement payment under two insurance policies issued by American International Specialty Lines Insurance Company (AISLIC).

AISLIC denied coverage and the insureds demanded arbitration pursuant to the terms of the policies. The insureds asserted that AISLIC breached the policy terms by not paying the insureds' defense and indemnity demands. AISLIC asserted in response that the settlement payment was not a covered loss and that the defense costs were incurred, in part, in connection with unrelated legal work not covered by the policies.

The insureds and AISLIC all moved for summary disposition in the arbitration. The insureds' submission to the arbitral panel suggested that the amount of defense costs to which they were entitled could be determined in a subsequent evidentiary proceeding if the panel granted them summary disposition on the issue of AISLIC's liability for those costs. At oral argument on the parties' respective summary disposition applications, one of the arbitrators raised the possibility of a partial summary disposition. The insureds' counsel responded that a partial summary disposition would make sense, but AISLIC's counsel did not comment on the issue. Moreover, the panel did not state on the record that it would be issuing a partial summary disposition, and there was no discussion as to whether any partial summary disposition deciding some, but not all, of the issues submitted by the parties would be considered a "final" award.

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The Panel's Findings

The arbitral panel then issued what it denominated a “partial final award” finding, with one arbitrator dissenting, that only one of the policies (under which Allied was the only insured) was applicable, that the qui tam settlement was not a covered loss, and that Allied was not entitled to indemnification but that it was entitled to reimbursement of defense costs. Because there was a factual dispute not appropriate for summary disposition as to the amount of legal expenses, the panel ruled that there would be a subsequent evidentiary hearing to determine the quantum of damages.

Before that evidentiary hearing was held, the insureds petitioned the panel for reconsideration of the partial final award arguing that the panel erred in ruling that the settlement was not a covered loss. AISLIC argued in response that the panel’s ruling was correct and that the arbitrators lacked authority to reconsider a final award under the doctrine of *functus officio*—a historical common law doctrine denying arbitrators the authority to take additional action after issuing a final award.

Two members of the arbitration panel, with the third member dissenting, rejected AISLIC’s argument that the *functus officio* doctrine prevented them from reconsidering their decision and issued a corrected partial final award finding that the qui tam settlement was a covered loss under the applicable Allied policy. The panel conducted an evidentiary hearing at which it determined the amount of covered defense costs and then issued a “final award” granting the insureds damages for the settlement and defense cost amounts minus certain offsets.

AISLIC commenced an action in the Supreme Court, New York County seeking an order vacating the corrected partial final award and the final award, and reinstating the initial partial final award. The Supreme Court denied AISLIC’s petition and confirmed the final award. The Appellate Division, First Department reversed the Supreme Court’s ruling and found that the parties had agreed to an immediate determination as to liability that they expected to be final. Accordingly, under the doctrine of *functus officio*, the arbitration panel exceeded its authority in reconsidering that determination. The First Department granted leave to appeal and certified the question of whether its order was properly made.

The Court of Appeals reversed in a unanimous decision written by Judge Leslie Stein. The court recognized the strong public policy favoring arbitration in New York and discouraging court intervention in arbitral proceedings. While the insureds argued that the *functus officio* doctrine was no longer valid in New York and was a vestige of historic anti-arbitration sentiments that had been rejected by state courts and by federal law, the court found that it did not need to address this argument because the doctrine applied only to final awards.

The court noted the existence of federal case law holding that partial determinations of less than all the issues in an arbitration can be considered final when the parties have expressly agreed to a separate and final determination. Again, the court found that it did not need to decide whether that federal case law applies in New York State court proceedings. It distinguished the cases cited by AISLIC on the grounds that the parties in those cases expressly agreed to the issuance of a partial and final award, but there was no such express agreement here. The insureds’ counsel did suggest a separate proceeding to determine the amount of defense costs if the panel granted them a summary disposition on liability for those costs, but AISLIC never consented to such a bifurcation.

There was no discussion as to whether any severance of damages and liability proceedings would result in a final award as to liability. Because there was no express agreement that the arbitral panel could issue a partial award that would be deemed final, the arbitration panel did not exceed its authority in reconsidering the original

partial final award. The court accordingly reversed the First Department's order and reinstated the Supreme Court's ruling denying the application to vacate the corrected partial final award and the final award and confirming the final award.

Conclusion

Although the court's decision in this matter was based on facts specific to the case, it demonstrates the court's continued respect for the public policy favoring arbitration and enforcing litigants' agreements as to how arbitral proceedings should be conducted. The decision also guides arbitration participants to be explicit in their procedural agreements as to the scope of the tribunal's authority. If parties wish to have bifurcated arbitration proceedings, or to obtain final rulings on some but not all issues, they should stipulate to express language authorizing such proceedings and making clear whether such rulings will be treated as interim or final.

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