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News & Types: Commercial, Competition & Trade Update

Effort to Reverse Arbitration Award Fails

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In a recent Risk Management Update, we described the "arbitration from hell" in which the 6th Circuit Court of Appeals reversed and vacated an arbitrator's decision. But vacating an arbitration award is still challenging and rarely successful. For a good example, see a recent 7th Circuit Court of Appeals decision. (*Johnson Controls, Inc. v. Edman Controls, Inc.*, 7th Circuit Court of Appeals Nos. 12-2308 and 12-2623 decided March 18, 2013)

Johnson Controls is a well-known manufacturer and seller of building management systems and HVAC equipment. In March 2007, Johnson Controls and Edman Controls entered into an agreement granting Edman the exclusive rights to distribute Johnson products in Panama. The agreement provided that any dispute arising from the agreement would be resolved through arbitration applying Wisconsin law. The agreement also included a "loser pays" provision in which the losing party would be responsible for the prevailing party's attorneys' fees. The court specifically noted that Johnson Controls knew Edman planned to distribute Johnson Control products through two subsidiaries of Edman, collectively referred to as Pinnacle.

Edman claimed that Johnson Controls breached the agreement in 2009 when Johnson Controls began to sell its products directly to customers in Panama, offered to sell its products directly to Edman's primary customer in Panama, and even instructed its managers in Panama to "keep Edman away from Johnson."

In August, 2010 Edman filed an arbitration claim against Johnson Controls and won. The arbitrator found that Johnson Controls had breached the obligation of good faith and fair dealing under Wisconsin law and found that Johnson Controls had been unjustly enriched by the capital investments made by Edman to establish Johnson Controls' presence in Panama. So the arbitrator awarded Edman $457,986.39 in lost profits, $244,530.25 for expenditures made in reliance upon the agreement, and $30,825 in administrative fees and expenses, totaling $733,341.64. Attorneys' fees added another $252,127.93, based on a 33% contingent fee for the award plus pre-judgment interest of $23,042.16, and costs added another $39,958.80.

As the court put it, "[L]osers sometimes cannot resist the urge to try for a second bite at the apple." So Johnson Controls vigorously appealed the arbitration award. The court was not sympathetic.

As an aside, the court noted that the parties had based their arguments on Chapter 1 of the Federal Arbitration Act (FAA). But the court reminded the parties (and us) that there are two other chapters which implement international conventions that enforce arbitration awards. Chapter 2 implements the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of June 10, 1958 commonly called the New York Convention, which now has 148 state parties. Chapter 3 implements the Inter-American Convention on International Commercial Arbitration of January 30, 1975, known as the Panama Convention, which now has

nineteen state parties. The U.S. is a party to both conventions. The court concluded that the arbitration award in this case would almost certainly fall within one of the conventions. Under the conventions, the grounds for vacating an arbitration award are slightly different from the FAA. But, since the case was not a close one, the court did not feel it necessary to send the parties back for further arguments under the applicable convention. Nevertheless, the court's need to detour to explain arbitration procedures reminds parties to apply the correct arbitration law or convention when seeking to vacate an arbitration award.

As noted, the court did not consider this a close case. Johnson Controls main assertion was that the damages, if any, were sustained by Pinnacle (Edman's subsidiaries) and not by Edman. Of course, Pinnacle was not a party to the distributor agreement. But the court responded that the arbitrator in fact dismissed one of Edman's claims as being only applicable to Pinnacle and not to Edman. In addition, Edman was still in the chain of distribution, as the direct purchaser from Johnson Controls. So Edman was clearly damaged by Johnson Controls.

Johnson Controls even contested Edman's attorneys' fees. The arbitrator held, and the court confirmed, that the 33% contingency fee was commercially reasonable. Johnson Controls did not provide evidence that 33% was higher than the fee typically charged for comparable work. And, in an interesting turnabout, the court even pointed out that Johnson Controls had declined to disclose the fees it incurred (presumably reasonable to Johnson Controls) to compare with the fees claimed by Edman!

The decision even got dangerous for Johnson Controls. The court concluded that, whether the FAA or any of the international conventions applied, the decision to uphold the arbitration award was not close. Even factual or legal errors do not authorize courts to annul awards. An award will not be overturned even if the arbitrator "committed serious error" or the decision is "incorrect or even whacky."

Based on this, Edman sought sanctions against Johnson Controls for filing a frivolous appeal. The court said, "Although we have decided to deny Edman's motion [for sanctions], this is largely because the fee-shifting clause in the contract already assures that Edman will not bear the costs of this appeal. We note, however, that challenges to commercial arbitral awards bear a high risk of sanctions." So, by appealing the arbitration award, Johnson Controls not only increased its own expenses, it also had to fund the costs and attorneys' fees of Edman for defending the appeal.

So the lesson for international practitioners is to know the applicable arbitration law. The other lesson is to understand the finality of arbitration awards and the risk, as the court put it, of trying to take another bite at the apple.