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TABLE OF CONTENTS

FACT FINDING AND *IURA NOVIT CURIA* IN ARBITRATION: HOW FAR DO ARBITRATORS' POWERS REACH?

ITA IN REVIEW

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PARTY AUTONOMY AND ARBITRATOR'S LACK OF REASONING BRING DOWN SUBWAY AWARD

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I. INTRODUCTION

Senior District Judge Rakoff in the US District Court for the Southern District of New York recently vacated an international arbitration award on the grounds that the arbitrator exceeded her powers by deciding a claim that "was not presented by the parties and was not addressed in the underlying opinion."[1] This decision reinforces the principle of party autonomy by confirming that New York courts will enforce the agreement to arbitrate as written and offers important considerations for arbitration parties and practitioners in New York-seated international arbitrations. The relevant background, the court's reasoning, and a few key takeaways are addressed below.

II. BACKGROUND

The arbitration arose out of a dispute under a Master Franchise Agreement ("MFA") between Subway International B.V. ("SIBV" or "Respondent"), the international franchisor for the Subway quick service restaurant chain, and Subway Russia Franchising Company, LLC ("Subway Russia" or "Claimant"), its Russian franchisee. Subway Russia commenced an arbitration before the International Centre for Dispute Resolution ("ICDR") seeking a declaration that it had the right to renew the MFA for a two-year renewal term and that SIBV's notice of termination of the MFA was invalid (the "Renewal Claim"). In the alternative, Subway Russia argued that in July 2020 it had formed a new MFA, separate and apart from any renewal rights allegedly vested in the MFA, by accepting SIBV's December 2019 counter-offer to renew the MFA on new terms (the "Offer-Acceptance Claim").

The arbitrator found in Respondent SIBV's favor. In a partial final award, the arbitrator decided that "Claimant ha[d] no right to renew the MFA, in light of its existing defaults under the MFA at the time that Claimant provided notice of its intent

[1] *Subway Int'l, B.V. v. Subway Russ. Franchising Co., LLC*, 21-cv-7362 (JSR), 2021 WL 5830651, at *4 (S.D.N.Y. Dec. 8, 2021).

to renew and thereafter."[2] The arbitrator made no findings of fact and did not expressly rule on Subway Russia's alternative Offer-Acceptance Claim. In her Final Award issued without any further substantive proceedings, the arbitrator stated that the award was "in full settlement of all claims and counterclaims submitted to this Arbitration."[3]

Subway Russia opposed SIBV's petition in the District Court to confirm the award which, "if enforced, would result in a loss to Subway Russia of its $60 million business."[4] The District Court vacated the award under 9 U.S.C. § 10(a)(4) pursuant to which an award may be vacated "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."[5]

III. SUBWAY RUSSIA DID NOT SEEK THE ARBITRATOR'S DETERMINATION ON THE OFFER-ACCEPTANCE CLAIM

First, the District Court found that the arbitrator erred by purporting to determine Subway Russia's Offer-Acceptance Claim when the Parties had not presented that issue to the arbitrator for determination as part of their cross-motions for partial summary judgment.[6] Subway Russia submitted a motion for summary judgment[7] seeking declaratory relief from the arbitrator that SIBV invalidly terminated the MFA and Subway Russia was entitled to renew the MFA on the same terms and conditions.[8] Subway Russia, however, reserved its alternative Offer-Acceptance Claim "for determination in further proceedings in this arbitration."[9] The arbitrator, however, issued the Final Award, following the Parties' motions for

[2] Subway Int'l, B.V. v. Subway Russ. Franchising Co., LLC, ICDR, Partial Final Award, 22 (July 14, 2021).

[3] Subway Int'l, B.V. v. Subway Russ. Franchising Co., LLC, ICDR, Final Award, 3 (July 26, 2021).

[4] Respondent's Answer to Petition and Cross-Petition to Vacate Arbitration Award at ¶ 3, *Subway Int'l, B.V. v. Subway Russ. Franchising Co., LLC*, 21-cv-7362 (JSR), 2021 WL 5830651 (S.D.N.Y. Dec. 8, 2021).

[5] 9 U.S.C. § 10(a)(4).

[6] *Subway Int'l, B.V.*, 2021 WL 5830651 at *4.

[7] The Case Management Order allowed the Parties to file dispositive motions. *Subway Int'l, B.V.*, ICDR, Partial Final Award, 1–2.

[8] *Subway Int'l, B.V.*, ICDR, Partial Final Award, 2–3.

[9] *Id.*, at n.14.

summary judgment and without any evidentiary hearing "in full settlement of *all claims* and counterclaims submitted to this Arbitration,"[10] therefore including the Offer-Acceptance Claim. According to the District Court, the Final Award "decided a claim that the [Partial Final Award] had expressly acknowledged was not presented by the parties."[11]

The District Court's decision to set aside the award for deciding the Offer-Acceptance Claim is consistent with *Matter of Colorado Energy Mgmt., LLC v. Lea Power Partners, LLC*. In that case, the court held that the arbitrator exceeded his authority by finding that respondent breached an Engineering Procurement and Construction contract and awarding damages for cost overruns where claimant only presented a claim alleging a gross negligence theory for recovery.[12]

IV. THE ARBITRATOR MADE NO FACTUAL FINDINGS OR LEGAL CONCLUSIONS ON THE OFFER-ACCEPTANCE CLAIM

Second, the District Court held that the Arbitrator "provide[d] no findings of fact or conclusions of law that support the decree in SIBV's favor on the question of whether Subway Russia consummated a new MFA via acceptance of the allegedly open offer extended on December 19, 2019."[13] In other words, the arbitrator decided the Offer-Acceptance Claim without setting forth in the award any legal or factual basis for the determination. Because the Arbitrator did not "provide . . . even a barely colorable justification for the arbitrator's interpretation of the contract," the District Court vacated the award under 9 U.S.C. § 10(a)(4).[14]

Judge Rakoff's decision is noteworthy because it navigates a path that courts have

[10] *Subway Int'l, B.V.*, ICDR, Final Award, 3 (emphasis added).

[11] *Subway Int'l, B.V.*, 2021 WL 5830651, at *4.

[12] *Matter of Colorado Energy Mgmt., LLC v. Lea Power Partners*, LLC, 114 A.D.3d 561, 564 (1st Dep't 2014); *see also Fahnestock & Co., Inc. v. Waltman*, 935 F.2d 512, 515 (2d Cir. 1991) ("if arbitrators 'rule . . . on issues not presented to [them] by the parties, [they have] exceeded [their] authority and the award must be vacated'"). *See also Emilio v. Sprint Spectrum L.P.*, 508 F. App'x 3, 4 (2d Cir. 2013) ("A district court may vacate an arbitral award under §10(a)(4) if 'the arbitrator[] exceeded [her] powers,' which may be evidenced by (1) consideration of issues beyond those submitted by the parties, or (2) resolution of issues 'clearly prohibited by law or by the terms of the parties' agreement'").

[13] *Subway Int'l, B.V.*, 2021 WL 5830651 at *5.

[14] *Id.*

"consistently accorded the narrowest of readings" to vacate an award under 9 U.S.C. § 10(a)(4).[15] "It is only when [an] arbitrator strays from interpretation and application of the agreement and effectively dispense[s] his own brand of industrial justice that his decision may be unenforceable."[16] For Judge Rakoff, not including any factual or legal basis to decide a claim met the standard to vacate an award under 9 U.S.C. § 10(a)(4).

V. SUBWAY RUSSIA REQUESTED AN EVIDENTIARY HEARING

Third, the District Court found that Subway Russia was entitled to an evidentiary hearing on its alternative Offer-Acceptance Claim, "rather than a decision on the papers,"[17] which it did not get. Arbitration is a creature of contract and, here, the Parties' arbitration agreement expressly provided that "an award should be made on the basis of the files and records unless one of the parties expressly desires an oral hearing."[18] Subway Russia requested an evidentiary hearing in its Statement of Claim[19] and, then again, asked for an evidentiary hearing on the Offer-Acceptance Claim during the hearing on the cross-motions to dismiss.[20] But the arbitrator ruled on Subway Russia's Offer-Acceptance Claim without an evidentiary hearing, noting in a footnote that "the parties agreed that if it [was] determined that Subway Russia was properly terminated or had no right to renew, then there would be no need to proceed to the evidentiary hearing on any other claims."[21]

Judge Rakoff's decision to set aside the award based on the language of the arbitration agreement and Subway Russia's repeated requests that an evidentiary hearing be held, is consistent with the recognition by US courts of party autonomy

[15] *ReliaStar Life Ins. Co. of NewYork v. EMC Nat'l Life Co.*, 564 F.3d 81, 85 (2d Cir. 2009).

[16] *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 671 (2010) (internal quotation marks and citations omitted; alterations in original).

[17] *Subway Int'l, B.V.*, 2021 WL 5830651 at *5.

[18] Master Franchise Agreement between Subway International B.V. and Subway Russia Franchising Company, LLC ¶ 23(A)(2) (July 25, 2013).

[19] Respondent's Answer to Petition and Cross-Petition to Vacate Arbitration Award, ¶ 114 at *Subway Int'l, B.V., 21-cv-7362 (JSR)* (Oct. 4, 2021).

[20] Hearing on the Dispositive Motions, 8–9 at *Subway Int'l, B.V., LLC*, 21-cv-7362 (JSR) (July 1, 2021).

[21] *Subway Int'l, B.V.*, ICDR, Partial Final Award, n.4.

and a party's right to a hearing as fundamental principles in arbitration.[22]

VI. IMPACT OF THE DECISION

The District Court's decision is an instructive reminder of the importance of the concept of party autonomy in international arbitration. In *Subway International, B.V. v. Subway Russia Franchising Co., LLC*, the applicable arbitration agreement provided a streamlined procedure for a determination without a hearing unless one of the parties requested a hearing. By setting aside the arbitration award where the arbitrator did not hold a hearing as requested by one of the parties during the proceedings, the District Court recognized the parties' freedom to define and control the procedural aspects of the arbitration.

The District Court's decision also sets parameters for arbitrators, counsel, and courts in relation to future applications to confirm and vacate arbitration awards. In particular, under 9 U.S.C. § 10(a)(4), arbitrators should be mindful to draft an award determining only the issues presented by the parties and including findings of fact or conclusions of law to support each decree. In *Subway International, B.V. v. Subway Russia Franchising Co., LLC*, the District Court decided that the Offer-Acceptance Claim was not presented by the parties and concluded that the arbitrator's award which was "in full settlement of all claims and counterclaims submitted to this Arbitration" contained no reasoning sufficient to support any factual or legal basis to decide Russia Subway's alternative Offer-Acceptance Claim.

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[22] *Smaligo v. Fireman's Fund Ins. Co.*, 247 A.2d 577, 580 (PA. 1968) ("an award is not binding where there has been a denial of a hearing."); *see also* RESTATEMENT (THIRD) OF INT'L COM. ARB. § 4-19, Rep. n.c (2019) ("Generally, denial of a party's request to have even a single oral hearing may be grounds for denying recognition or enforcement.").

substantial experience with all aspects of arbitration-related litigation, including discovery and enforcement proceedings and strategies.

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Table of Contents

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