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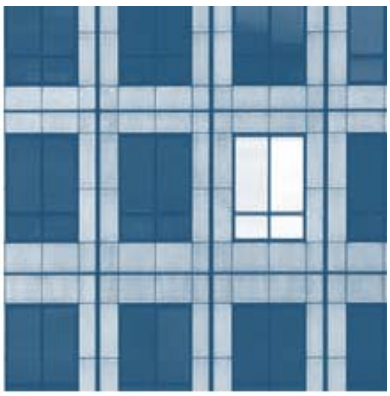
On the Subject



Trial

October 7, 2010

The recent decision in *Nachmani v. By Design, LLC*, issued by the First Department Appellate Division of New York, has potentially undermined the effect of arbitration clauses commonly used to designate an arbitration organization as the administrator of an arbitral dispute. As a result of *Nachmani*, arbitration provisions should not merely provide that disputes under a contract are to be governed by the rules of a particular arbitration organization; they should also explicitly state that the arbitral dispute is to be "administered" by that organization.

New York State Court Decision Potentially Undermines Effect of Commonplace Arbitration Clauses

A decision recently issued by the First Department Appellate Division of New York has potentially undermined the effect of boilerplate arbitration clauses commonly used to designate an arbitration organization for the administration of an arbitral dispute.

In *Nachmani v. By Design, LLC*, 2010 N.Y. Slip Op. 04847 (1st Dep't 2010) (Index No. 600110/10), the First Department held that language providing for arbitration "in accordance with the AAA [i.e., American Arbitration Association] commercial rules" was nothing more than a "choice of law" clause and, as such, was insufficient to designate the AAA as *the administrator* of the arbitration. The court's decision challenges language long relied upon by lawyers who draft arbitration provisions. Indeed, such language was recognized by other courts as sufficient for designating an arbitration organization prior to the Nachmani decision. See, for example, *York Research Corp. v. Landgarten*, 927 F.2d 119, 123 (2d Cir. 1991) (arbitration language specifying that disputes "shall be determined and settled by binding arbitration . . . pursuant to [AAA rules]" is an agreement that the AAA should administer the arbitration process).

The First Department's holding declined to follow the AAA's opinion in the same dispute. Specifically, after the parties in *Nachmani* commenced the process of selecting their arbitrators—but before either had filed a formal demand for arbitration with the AAA—one party (By Design, LLC) sought guidance from the AAA regarding the partiality of an arbitrator selected by the other party (Mr. Nachmani). Responding to the inquiry, the AAA explained that it would administer the arbitration once either of the parties filed a formal demand. The AAA further noted as follows: "AAA rules provide that when parties agree to arbitrate under [AAA] rules . . . they thereby authorize the AAA to administer the arbitration" (internal quotes omitted). The AAA's opinion reflected AAA Commercial Arbitration Rule 2, which provides that parties that agree to arbitrate under the AAA's rules implicitly "authorize the AAA to administer the arbitration."

The First Department disagreed with the AAA. In its decision, the court explained: "Petitioner correctly interpreted the provision requiring that the decision be in accordance with the AAA Commercial Rules as a choice of law rather than a forum selection clause, *the AAA's view on the issue notwithstanding*" (emphasis added and citation omitted).

The ramifications of the *Nachmani* decision for parties that have already entered into commonplace arbitration agreements could be significant. Contracting parties normally elect to have their arbitrations administered by private organizations, such as the AAA, the International Centre for Dispute Resolution and the International Chamber of Commerce, in order to reduce the uncertainty inherent in "*ad hoc* arbitration" (*i.e.*, arbitration without the administrative overview of an arbitration organization). Now, in light of the *Nachmani* decision, parties that have entered into commonplace arbitration agreements—with the expectation that such provisions provide for administered arbitration—may find themselves forced into an unintended *ad hoc* arbitral process.

The important lesson from *Nachmani* is this: lawyers responsible for drafting arbitration provisions should, on a going-forward basis, include language that explicitly provides that disputes arising under an agreement are not only to be governed by the

rules of a particular arbitration organization, but are also to be "administered" by that organization. For example: "Any controversy or claim arising out of or in connection with this Agreement shall be settled and administered by the American Arbitration Association in accordance with its Commercial Arbitration Rules." Moreover, although the *Nachmani* decision only covers New York's First Department, it is recommended that all arbitration provisions now include this "administered" language, both as a matter of prudence and in recognition of the fact that arbitration awards issued outside New York may one day have to be enforced inside New York.

McDermott Will & Emery's International Arbitration Group is continuing to monitor this matter, and will report on new developments as they arise.

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