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"The Value of Peach Orchards" The Perils of Arbitrator Subject-Matter Expertise

The ability to select and appear before arbitrators with factual subject-matter expertise is often proclaimed as a great advantage of arbitration over litigation. However, expert/arbitrators can also present perils to natural justice and to arbitral award enforcement. Those perils, particularly for international arbitrations that are governed by prevalent English or New York law[1] or that are seated in the ever-popular London or New York City[2], should be considered by all parties – German, British, American, all – if appointing or facing an expert/arbitrator.

Most legal traditions and many international standards deem it a matter of natural justice that a party be told what evidence – particularly expert evidence – is being offered against it and that a party be given an opportunity to confront that evidence. The UNCITRAL Model Law on International Commercial Arbitration, for example, explicitly requires that "any expert report or evidentiary document on which the arbitral tribunal may rely in making its decision shall be communicated to the parties."[3]

Particularly in England and the United States, though, the courts are indulgent of expert/arbitrators "evaluating" the evidence or using their "general" knowledge, and arbitral awards are likely to be upheld, even if an expert/arbitrator makes a mistake. On occasion, the judges are explicit as to why they are indulgent: when the parties appointed an expert as arbitrator, as far as the judges are concerned, the parties "took the risk that errors of fact might be made or invalid inferences drawn without prior warning."[4]

Contrariwise, if an expert/arbitrator creates new evidence intracranially or uses "specific" factual knowledge, the losing party may successfully challenge an award, justly complaining that it was "unable to present its case."[5]

The Chartered Institute of Arbitrators, in the 2017 update to their international arbitration practice guideline "Party-Appointed and Tribunal-Appointed Experts," adverts to that second peril of arbitrator expertise. The Commentary to Article 2 of the updated guideline includes this warning:

> *"Use of the arbitrators' own expertise*
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> *Arbitrators are often chosen, in part, because of their expertise in the subject matter, lex arbitri or the substantive law of the contract (lex causae) and, in such circumstances, expert evidence may be unnecessary.*

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English law is the most frequently used by corporations for international arbitrations; New York law is second. English law and US law combined govern an estimated 62% of international corporate transactions. *See 2010 International Arbitration Survey: Choices in International Arbitration*; Queen Mary, University of London/White & Case LLP, page 14.

2 London is corporations' most preferred international arbitration seat; New York City is sixth. The law in four of the top seven seats (London, Paris, Singapore, Hong Kong, Geneva, New York, Stockholm) is based on English law. *See 2018 International Arbitration Survey: The Evolution of International Arbitration*; Queen Mary/White & Case LLP, page 9.

3 *UNCITRAL Model Law on International Commercial Arbitration* 1985 (adopted with amendment in 2006), Article 24(3). *See also IBA Rules on the Taking of Evidence in International Arbitration* (2010), Preamble ("3. The taking of evidence that be conducted on the principles that each Party shall act in good faith and be entitled to know, reasonably in advance of any Evidentiary Hearing or any fact or merits determination, the evidence on which the other Parties rely.")

4 *London Underground Ltd v Citylink Telecommunications Ltd* [2007] EWHC 1749 (TCC).

5 *See Convention on the Recognition and Enforcement of Foreign Arbitral Awards* (New York 1958), Article V(1)(b).

However, care should be taken by arbitrators when basing their arbitral award on their own individual analysis, because in some jurisdictions this could result in a challenge on the ground that arbitrators have overreached their powers, if such analysis has not been raised, and/or discussed, previously with the parties."

I. "The value of peach orchards"

Gary Born, in his international commercial arbitration treatise, cites the United States federal court case of *Gramling v. Food Machinery and Chemical Corporation*, 151 F.Supp. 853 (W.D.S.C. 1957) as supporting the perception of both business and some national courts that arbitrators offer a "more expert, experienced means of resolving commercial disputes."[6] But, *Gramling* is actually not so straightforward, and the lesson to be learned from it is not so sweeping or so stirring.

According to Henry Gramling, a peach grower in Spartanburg, South Carolina, chemical sprays he purchased from the Food Machinery and Chemical Corporation damaged his orchards. An arbitration panel agreed and awarded Mr. Gramling US $130,015 in damages. The chemical company challenged the award in the United States District Court for the Western District of South Carolina, with counsel arguing that the award was arbitrary and excessive. Chief Judge Charles Cecil Wyche rejected the challenge, saying:

"To do what counsel ask me to do, I would have to take judicial notice of the value of each of the peach orchards and its productivity and earning power, both before it was damaged and afterwards. I never saw the peach orchards before or after the damage was done. I do not know anything about the productivity, the value or the earning power of the peach orchards in this case or any other peach orchard. I cannot, therefore, take judicial notice that the award was so grossly excessive as to amount to a legal fraud. The Arbitrators know more about the value of peach orchards, their productivity and earning power than I do."

The complication of the *Gramling* case arises – as many complexities do – from the arbitration agreement itself. Pursuant to that agreement, the parties appointed six arbitrators (two horticulturists, a pathologist, two peach growers, and a real estate broker) who were required to "make their determination under stipulated instructions of law, but without resort to evidence." That is, in modern parlance, the *Gramling* dispute was resolved by a process that resembles an expert determination[7] more than it resembles an arbitration. In many expert determinations, including this one, the parties were neither required nor allowed to offer evidence; the decision was to be made by experts, based solely on their own expertise.

In that regard, the *Gramling* case is a simpler situation than that faced by actual arbitrators who have both expertise *and* evidence, for the tricky bit is deciding when, if ever, those arbitrators can rely on their own expertise rather than the evidence before them.

II. Bamboo skewers and pecan nuts in the United States courts

The United States' Federal Arbitration Act provides that the courts may vacate an arbitration award if the arbitrators "refus[ed] to hear evidence pertinent and material to the controversy; or [were guilty of] any other misbehavior by which the rights of any party have been prejudiced."[8]

Two of the most respected jurists in American legal history – Benjamin Cardozo and Learned Hand – addressed when arbitrator "evidence independence" becomes "misbehavior" in decisions concerning defective bamboo skewers (Justice Cardozo) and concerning a shortfall of pecan nuts (Judge Hand).

In *Stefano Berizzi Co., Inc. v. Krausz*, 239 N.Y. 315 (1925), Justice Cardozo set aside an arbitration award in favor of an American importer who refused to pay for 8,000 cases of bamboo skewers delivered to it by a Chinese manufacturer. The importer claimed that the skewers (used in cooking kebabs) were defective because they were "roughly and irregularly wrought." The New York courts appointed one Theodore Metzeler as sole arbitrator. Mr. Metzeler, who was also a "manufacturer and importer of banquet souvenirs, novelties, and paper goods"[9] in New York City during the early 1900s, was apparently dissatisfied by the evidence offered by the parties at the arbitration hearing, so he undertook "a personal investigation at West Washington market and other centers of use of the skewers involved in this transaction, and learned from all of these sources that the skewers…were not useable, unsaleable, and consequently without value to the [importer]."[10] The award was challenged in the New York courts by the Chinese importer, who alleged arbitrator "misbehavior." Mr. Metzeler submitted an affidavit, opposing the challenge, saying that he made his decision "on the strength of this personal investigation … in addition to the testimony and facts presented on the actual arbitration before him." *Id.*

Justice Cardozo found that Mr. Metzeler had "misbehaved" and set aside his award:

"True, the arbitrator in this proceeding acted in good faith, but misbehavior, though without taint of corruption or fraud, may be borne of indiscretion… [P]rejudice resulted. The [manufacturer], knowing nothing of the evidence, had no opportunity to rebut or even to explain it."

Nineteen years after Justice Cardozo's decision, Judge Hand also addressed an "extra-evidence" challenge to an arbitration award, in *American Almond Products Co. v. Consolidated Pecan Sales Co.*, 144 F.2d 448 (2d Cir.1944). Consolidated Pecan had agreed to deliver 30,000 pounds of pecan nuts to American Almond in 1943, but there was a short crop and

6 Born, G.B. *International Commercial Arbitration* §1.02[B] at 81-82 (2d ed. 2014).

7 In essence, an expert determination is a contractual referral of a disputed fact, usually a highly technical or industry-specific fact, to experts for binding determination. Expert determinations are not governed by national arbitration law, and, unless the contract so specifies, there is no requirement that the experts hear the parties or rely on anything other than their own expertise. See Martin Valasek and Frédéric Wilson, "Distinguishing Expert Determination from Arbitration: The Canadian Approach in a Comparative Perspective," *Arbitration International*, Volume 29 Number 1 (2013) page 63-87, at 87. *See also Wilky Property Holdings PLC v. London & Surrey Investments Limited* [2011] EWHC 2226 (Ch) (High Court of England and Wales); *Sport Maska Inc. v. Zittrer* [1988] 1 S.C.R. 564 (Supreme Court of Canada).

8 9 *United States Code* §10(a)(3).

9 *The Tammany Times*, June 22, 1912, page 88.

10 Affidavit of Theodore Metzeler, dated 23 March 1923, records of the New York Supreme Court Appellate Division, available at https://books.google.com/books?id=MN3gRbSkPjAC&pg=RA1-PA143&lpg=RA1-PA143&dq=berizzi+krausz&source=bl&ots=TU48GaMf1h&sig=ahO7fpkihA2al7BdylVfAeM7YjA&hl=en&sa=X&ved=0ahUKEwigxoTmt4jbAhVp4YMKHU7nD5wQ6AEIQzAI#v=onepage&q=berizzi%20krausz&f=false

Consolidated Pecan could only deliver a *pro rata* share of its commitments to its customers. American Almond claimed as damages the difference between the market price and the contract price, which its lawyers said was 88 cents per pound. American Almond, however, submitted no evidence to the arbitral tribunal as to what the market price was, and no evidence to support its lawyer's argument. Nonetheless, the tribunal awarded American Almond $12,960 in damages. Consolidated Pecan challenged the award in the New York courts, saying that it was arbitrator "misbehavior… to make an award in money without any evidence of market price." *Id.* at 450.

Judge Hand disagreed and confirmed the arbitral award:

> *"Although it does not appear that the arbitrators were in the nut trade and obliged to keep familiar with the market in pecans, on the other hand it nowhere appears that they were not; and [Consolidated Pecan] has the burden of proof also on the issue of "misbehavior." If they were of that trade, they were justified in resorting to their personal acquaintance with its prices. In trade disputes one of the chief advantages of arbitration is that arbitrators can be chosen who are familiar with the practices and customs of the calling, and with just such matters as what are current prices, what is merchantable quality, what are the terms of sale, and the like."*

Of course, Justice Cardozo's earlier decision in *Stefano Berizzi v Krausz* was cited to Judge Hand by Consolidated Pecan's lawyers, but Judge Hand distinguished it, saying:

> *"Had the parties at bar submitted evidence upon the issue of damages, and the arbitrators looked elsewhere, it might have been misbehavior; but it was not misbehavior to settle a controversy meant to be finally disposed of, by the only means open to the arbitrators, as the case stood. Arbitration may or may not be a desirable substitute for trial in courts; as to that the parties must decide in each instance. But when they have adopted it, they must be content with its informalities; they may not hedge it about with those procedural limitations which it is precisely its purpose to avoid. They must content themselves with looser approximations to the enforcement of their rights that those that the law accords them, when they resort to its machinery."*

In the United States, the courts still regularly uphold arbitrators' right to rely on their own expertise in reaching a decision. For example, US federal judge Robert Sweet *In re APEX Towing Co.*, No. 82 Civ. 8324, 1984 U.S. Dist. LEXIS 23985, at *10–11 (S.D.N.Y. August 30, 1984) rejected a challenge to an arbitration award that, according to the losing party, was "based on expert opinions that were not produced at the hearing, namely the views of the participating arbitrators." Judge Sweet, relying on Judge Learned Hand's decision in *American Almond Products*, held that, since the parties' arbitration agreement had specified that the arbitrators shall be "experienced in the shipping business," the arbitrators were "chosen for their expertise [and] were entitled to rely upon their cumulative experience in evaluating the evidence and reaching a decision." *See also Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 629 (1985) ("adaptability and access to expertise are hallmarks of arbitration."). There does not appear to be compelling on-point authority in the United States, yet, as to how far is too far when arbitrators rely on their own expertise.

III. Submerged buoys in the English courts

Section 33 of the English Arbitration Act 1996 requires that an arbitral tribunal shall give "each party a reasonable opportunity of putting his case and dealing with that of his opponent."[11] Should a tribunal fail to comply with that "general duty," Section 68 of the Act deems that a "serious irregularity," which subjects the award to challenge.

That arbitrator duty is not new to English law, however; it was well established long before 1996. The revered English jurist Lord Tom Denning put it this way in *Fox v Wellfair Ltd.* [1981] Vol. 2 Lloyd's Rep. 514, 522:

> *"His [the arbitrator's] function is not to supply evidence for the defendants but to adjudicate upon the evidence given before him. He can and should use his special knowledge so as to understand the evidence that is given . . . [b]ut he cannot use his special knowledge – or at any rate he should not use it – so as to provide evidence on behalf of the defendants which they have not chosen to provide for themselves . .. At any rate he should not use his own knowledge to derogate from the evidence of the plaintiff's experts – without putting his own knowledge to them and giving them a chance of answering it and showing that his view is wrong."*

In a recent English High Court case, known only as *A v B*,[12] a ship suffered a tear in its hull when berthing in an Italian port. The ship's owner commenced an arbitration against the charterer, claiming breach of the safe berth warranty. An "experienced maritime arbitrator" received numerous written submissions from the parties, but he held no hearing and heard from no expert witnesses. The parties submitted two sets of data: 1) GPS coordinates for an uncharted steel buoy, submerged on the seabed in the berth, as recorded by the diver who found the submerged buoy (with hull paint on it) after the vessel's hull damage was discovered, and 2) a GPS position recorded on the ship's Automatic Identification System (AIS). From those two sets of data, the arbitrator himself concluded that the submerged buoy was in the berth, "which was contrary to the common ground between the parties." The arbitrator, based on his own finding, then issued an award in favor of the ship's owner, for a "safe berth" warranty can be breached without fault. The charterer challenged the award, arguing that the arbitrator had breached his duty under the English Arbitration Act 1996 §33, requiring that the parties be given a reasonably opportunity to put their cases.

Ali Malek QC (sitting as a Deputy High Court Judge) rejected the challenge, holding that the arbitrator was entitled to draw an inference from the two pieces of primary evidence before him and reach a conclusion as to the location of the submerged buoy that was different from the parties' conclusion. Indeed, Mr. Malek relied upon and agreed with *London Underground v. Citylink Telecommunications*, *supra*, saying: "Where a tribunal had been appointed because of its commercial or technical expertise, the parties took the risk that errors of fact might be made or invalid inferences drawn without prior warning." In any event, Mr. Malek concluded, the arbitrator would have concluded that the ship hit the submerged buoy in the berth, even if he was wrong about his GPS interpretations, because of the hull paint on the buoy,

11 *Arbitration Act 1996*, Article 33(1)(a).

12 *A v B* [English High Court of Justice, Queen's Bench Division, Commercial Court], unreported (23 March 2017). A copy of the case report is available from the author upon request.

the impact felt by those on board during the berthing, and the "absence of any other plausible cause of the holing."

IV. "Code Productivity" in the Canadian courts

All of Canada's provinces, except Quebec, have adopted arbitration legislation based on the UNCITRAL Model Law, and Quebec's law is consistent with the Model Law. So, the Model Law's requirement that parties have access to expert evidence against them applies in Canada.

That requirement was not met in *Xerox Canada Ltd. v. MPI Technologies Inc.*, [2006] O.J. No. 4895 (QL), Xerox argued after it lost US$ 89,000,000 in an arbitration, because Brian Platte (an arbitrator with computer expertise, serving on a three-member arbitral panel) conducted his own investigations and research, and then supplied "evidence" not led by the parties regarding the issue of software "code productivity."[13] Xerox's challenge to the arbitration award was rejected, though, because Justice C. L. Campbell of the Ontario Superior Court found that Mr. Platte used his technical expertise appropriately, *i.e.*, to evaluate evidence, not create it, and because Mr. Platte and the Panel disclosed what he was doing during the hearings, and because the Panel gave the parties' counsel an opportunity to comment upon and challenge it, and because Mr. Platte did not finish his independent investigation of the evidence, and because Mr. Platte's independent work "did not form any part of the decision-making process of the Panel" and because there was ample other evidence in the record to support the award. *Id.* ¶¶82, 94–95, 105, 115, 118.

Justice Campbell rejected Xerox's challenge, but he did accept Xerox's statement of the applicable law:

> *"The use of specialized training by an arbitrator cannot be a substitute for evidence adduced by the parties. Accordingly, while specialized training may be of assistance in understanding and evaluating record evidence, it may not be used to bridge a gap in evidence adduced by a party or as a substitute for existing evidence. An arbitrator may not use expertise that he or she may have to create new "evidence" by extrapolating from record evidence, nor can an arbitrator use such expertise as a basis for conducting independent factual investigations."*

V. Evaluate vs. Extrapolate … Specific vs. General

Justice Campbell, it seems, believes that one can determine whether an arbitrator is "evaluating" evidence or "extrapolating" from it. But, as soon as an expert/arbitrator departs from the bare record, how does one tell whether that is an "evaluation" or an "extrapolation"? For example, if an arbitrator concludes that a respondent's expert understated a claimant's actual damages because the expert plugged the wrong data into the proper calculation, is an award based on plugging the correct data (also in the record) into the expert's calculation an "evaluation" or an "extrapolation"?

Courts often say that arbitrators may rely on their "general" knowledge of an industry or technology, but that they may not rely on their "specific" knowledge of facts material to a dispute without disclosing their knowledge and offering the parties an opportunity to comment.[14] But, how easy is it to distinguish "general" knowledge from "specific" knowledge?

In *Fox v. Wellfair Ltd.*, the other two English Court of Appeals judges who decided the case (that is, in addition to Lord Denning) were Lord Dunn and Lord O'Connor, both of whom followed a long line of English jurists who thought it proper for an expert arbitrator to use "the knowledge which they chose him for possessing" but not knowledge of "special facts." Lord Dunn wrote:

> *"A distinction is made in the cases between general expert knowledge and knowledge of special facts relevant to the particular case... If the arbitrator is relying on general expert knowledge, there is no need to disclose it. O'Connor LJ gave a good example in argument. An arbitrator is required to value a bull killed by the negligence of one of the parties. If the expert arbitrator relies on his general knowledge of the value of bulls, including fluctuations in the market known to anyone who studies the market, there is no need to disclose it. But if he has recently sold an identical bull for a certain sum, it is necessary to disclose that to the parties."*

But, is that really a good example of "general" vs. "special"? After all, knowledge of what the price of a particular bull would be is no more "specific" than knowledge of what the price of an identical bull was.

Both linguistic efforts (evaluating vs. extrapolating, and general vs. special) suffer from another problem: they are both false dichotomies. That is, evaluations and extrapolations are not discrete; they overlap. Some evaluations are extrapolations (*e.g.*, calculations of future damages), and vice versa. And, "general" and "specific" are vague and flexible terms, precluding strict separation. [15] As Justice Ward of the English Court of Appeal confessed in *Checkpoint Ltd. v. Strathclyde Pension Fund* [2003] EWCA Civ. 84: "The distinction between the general and the specific is easy to state in a broad way, but it tends to break down when analysed with care."

VI. Fair vs. Unfair

As Justice Ramsey finally says in *London Underground Ltd v Citylink Telecommunications Ltd* [2007] EWHC 1749 (TCC): "The underlying principle is that of fairness or, as it is sometimes described, natural justice." *See also Interbulk Ltd v Aidan Shipping Co Ltd, The "Vimeira"* [1984] 2 Lloyd's Rep 60 (Goff, LJ) ("In truth, we are simply talking about fairness."). That is, implicitly or explicitly, the linguistic efforts to distinguish appropriate expert/arbitrator behavior from "misbehavior" are abandoned, and it all devolves to a question of what's "fair."

13 The *Xerox v MPI Technologies* decision is discussed in more detail in Klaas, P., "Technical Expertise of Advocates and Arbitrators in International Technology Arbitrations: Benefit or Burden?" in Rovine, A. (ed.) *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers* (2013), Chapter 21, pp. 429-444 (reprint available from the author upon request)

14 *See, e.g., Methanex Motunui v Spellman* [2004] 1 NZLR 95, in which Judge Robert Fisher of the New Zealand High Court wrote: "An expert arbitrator is entitled to draw on his or her knowledge and experience to supplement the facts drawn from party-sourced evidence, and without prior notice to the parties, provided that the additional facts are ones of general application as distinct from those specific to the particular dispute."

15 Or, as put by the favorite contemporary English philosopher of a co-editor of this journal: "I'm just sittin' on a fence; You can say I got no sense; Trying to make up my mind; Really is too horrifying; So I'm sittin' on a fence." Richards, K. with Jagger, M., "Sitting on a Fence" (1965).

What is "fair," in turn, devolves into an "intuitive judgment … [which is] not immutable [and] may change with the passage of time … not to be applied by rote identically in every situation … [and] dependent on the context …"[16] The determination as to what's fair, therefore, is the opposite of what corporate executives prefer (*e.g.*, precision, certainty, predictability). And, that fairness determination will usually be made by courts either at the seat or in jurisdictions where the loser has assets, all of which may be far away or hostile, by judges who may agree (as far as the executive can tell) with Macbeth's witches: "Fair is foul, and foul is fair / Hover through the fog and filthy air."[17]

So, what is a corporation – German, British, American, any – to do?

If considering appointing an expert/arbitrator, parties and their counsel should weigh the apparent benefits of an expert/arbitrator (efficiency, knowledge, understanding) versus the perils presented by an expert/arbitrator (surprise decisions based on mistaken "evaluations/extrapolations" of the evidence that are then either excessively indulged or wastefully vacated by the courts).

And, if appearing before an expert/arbitrator, parties and their counsel should relentlessly insist that they be told of, and allowed to deal with, any "evaluations/extrapolations" that the expert/arbitrator is inclined to make, even if that inclination arrives after the hearing and during the drafting of the Award.

One consistently-emphasized element of the intuitive judgment as to whether an expert arbitrator has "misbehaved," and hence whether an arbitration award is "fair or foul," is whether the losing party knew what evidence (and evaluations or extrapolations) were against it and had a reasonable opportunity to deal with them. Particularly if a losing party has consistently asked to be told and was refused, the courts may grant a do-over – not ideal, but better than an unjust defeat.

16 As summarized by Lord Mustil of the United Kingdom House of Lords in *R v Secretary of State for the Home Department Ex p. Doody* [1994] 1 A.C. 531, 560.

17 Shakespeare, W. *Macbeth*, Act 1, Scene 1.