ALM | LAW.COM

New York Law Journal

INTERNATIONAL ARBITRATION

US Supreme Court Continues Its Pro-Arbitration Approach

July 5, 2023

In late June, the U.S. Supreme Court issued back-to-back pro-arbitration decisions in two separate cases. *Coinbase v. Bielski*, 599 U.S. __ (June 23, 2013) involved a disagreement between the parties at the beginning of the arbitration process about whether a dispute should be resolved in court or in arbitration. The court held that when a party appeals an interlocutory order denying a motion to compel arbitration, that appeal automatically stays the pending lawsuit. This means that even after a district court has ruled that a dispute should proceed as a lawsuit in the courts rather than in arbitration, a party seeking to arbitrate can put a pause on that lawsuit simply by appealing that ruling. *Yegiazaryan v. Smagin,* 599 U.S. __ (June 22, 2013) involved the end of the process, and concerned the enforcement of an international arbitration award. The court held that a foreign resident was not, by virtue of that status, precluded from relying on the RICO statute to enforce an international arbitration award in the United States. Because RICO provides for the recovery of treble damages and attorney fees, this decision gives a powerful weapon to those seeking to enforce international arbitral awards in the United States.

JOHN FELLAS *is an arbitrator with Fellas Arbitration and an adjunct professor of law with New York University School of Law. He can be reached at fellas@fellasarbitration.com.*

'Coinbase': Disputes About Whether a Case Should Be In the Courts or Arbitration

By John Fellas

Sometimes a party files a lawsuit in court, advancing claims that the opposing party asserts should be in arbitration. In such circumstances, the party seeking to arbitrate will typically ask the court to stay the litigation in favor of arbitration or to compel arbitration. How courts deal with such applications at the beginning of a dispute—the degree to which courts are involved, the scope of the inquiries they make, the length of the judicial process—impacts the efficacy of the arbitration process. If a party is required to spend a lot of time and money in the courts at the inception of a dispute simply to get an arbitration proceeding off the ground, arbitration would lose its appeal. Indeed, the federal policy in favor of arbitration is animated precisely by the desire "to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible." See *Moses H. Cone Memorial Hospital v. Mercury Construction,* 460 U.S. 1, 22 (1983).

Certain provisions of the Federal Arbitration Act (FAA) are designed to limit court involvement in an arbitration at the inception of a dispute. Thus Section 16 of the FAA—which governs appeals of court decisions about whether a dispute should be resolved in court or arbitration—is structured in a way that seeks to reduce court involvement. To put it somewhat crudely, Section 16 does not permit appeals of orders that favor arbitration. Thus, Section 16(b) prohibits the losing party from appealing a district court's order granting a stay of litigation in favor of arbitration or granting a motion to compel arbitration

That this is favorable to arbitration can be illustrated by considering a hypothetical example. Imagine A sues B in court, and B ask the court to compel arbitration on the ground the dispute belongs in arbitration. If the court grants B's motion to compel, the parties' dispute will go forward in arbitration. But, under Section 16(b) of the FAA, A cannot immediately appeal that decision. Rather it is required to wait until the end of the arbitration. The effect is to cut off court involvement in the question of whether a case should be in arbitration immediately after a district court grants a motion to compel. This avoids what would otherwise be parallel proceedings—the simultaneous pendency of B's arbitration and A's appeal on whether the dispute should be resolved in court instead of arbitration.

Because RICO provides for the recovery of treble damages and attorney fees, this decision gives a powerful weapon to those seeking to enforce international arbitral awards in the United States.

While the FAA does not permit appeals of orders favoring arbitration, Section 16(a) allows appeals of orders hostile to arbitration, such as those denying a request for a stay or a motion to compel. Thus, imagine, again, that A sues B in court, and B asks the court to compel arbitration. If, this time, the court denies B's motion to compel, the case will remain in court. However, by contrast to the FAA's prohibition of an appeal of a court order granting a motion to compel, when a court denies such a motion, the losing party, B, is entitled to appeal. This is favorable to arbitration because it allows a party seeking to arbitrate to obtain immediate review of a decision denying its motion to compel, rather than requiring it to wait until a final judgment in the lawsuit.

However, while Section 16(a) permits an interlocutory appeal of a decision denying a motion to compel, it is silent on the question of whether court proceedings should be automatically stayed pending the resolution of that appeal. Without a stay, however, the result is parallel proceedings — the simultaneous pendency of both A's lawsuit before the district court and B's appeal in the circuit court claiming that the dispute actually belongs in arbitration. This could result in a waste of resources. If, ultimately, the appellate court determines that the case properly belongs in arbitration, the parties would unnecessarily have expended time and money litigating in court.

The question before the Supreme Court in *Coinbase* boiled down to this: when B appeals a decision denying its motion to compel, does that automatically stay A's lawsuit on the merits?

The Court's Decision In 'Coinbase'

Coinbase operates an online platform on which users can buy and sell cryptocurrencies and government-issued currencies. Coinbase's user agreement contains a provision requiring that disputes be resolved by arbitration. Notwithstanding this, Abraham Bielski filed a class action in the U.S. District Court for the Northern District of California alleging that Coinbase failed to replace funds fraudulently taken from users' accounts.

Relying on the arbitration clause, Coinbase moved to compel Bielski to arbitrate. The district court denied

that motion. Coinbase appealed to the U.S. Court of Appeals for the Ninth Circuit under Section 16(a) of the FAA, and, at the same time, asked the district court to stay the pending putative class action until the resolution of that appeal. The district court denied that request. Coinbase then asked the Ninth Circuit to stay the proceeding in the district court. Relying on its decision in *Britton v. Co-op Banking Group,* 916 F. 2d 1405 (9th Cir. 1990), the Ninth Circuit denied that application.

The Supreme Court accepted Coinbase's appeal in order to resolve a circuit split on the question of whether there is an automatic stay of proceedings following an appeal of an order denying a motion to compel. While the Second, Fifth and Ninth Circuit had held that an appeal from the denial of a motion to compel arbitration does not automatically stay district court proceedings, the Third, Fourth, Seventh, Tenth, Eleventh, and D.C. Circuits have held that a district court must stay its proceedings in such circumstances. See, e.g., *Bradford-Scott Data v. Physician Computer Network,*128 F. 3d 504, 506 (7th Cir. 1997); *Blinco v. Green Tree Servicing,* 366 F. 3d 1249, 1253 (11th Cir. 2004) ("It makes little sense for the litigation to continue in the district court while the appeal is pending").

However, a non-U.S. resident's ability to use RICO to enforce an international arbitration award in its favor has to overcome a particular hurdle.

Justice Brett Kavanaugh, writing for the majority, began by asking and answering the question before the court: "The sole question before this court is whether a district court must stay its proceedings while the interlocutory appeal on arbitrability is ongoing. The answer is yes."

In addressing the question, Kavanaugh noted Section 16's different treatment of appeals, depending on the underlying court decision: "Notably, Congress provided for immediate interlocutory appeals of orders denying—but not of orders granting—motions to compel arbitration." But he went on to highlight that "Section 16(a) does not say whether the district court proceedings must be stayed."

After rehearsing certain authorities that led him to conclude that "the common practice in Section 16(a) cases ... is for a district court to stay its proceedings while the interlocutory appeal on arbitrability is ongoing," Kavanaugh pointed to efficiency considerations that weighed in favor of a mandatory automatic stay of appeals of denials of motions to compel arbitration:

"That common practice reflects common sense. Absent an automatic stay of district court proceedings, Congress's decision in Section 16(a) to afford a right to an interlocutory appeal would be largely nullified. If the district court could move forward with pretrial and trial proceedings while the appeal on arbitrability was ongoing, then many of the asserted benefits of arbitration (efficiency, less expense, less intrusive discovery, and the like) would be irretrievably lost—even if the court of appeals later concluded that the case actually had belonged in arbitration all along."

Justice Ketanji Brown Jackson (joined by Justices Elena Kagan and Sonia Sotomayor and, in part, by Justice Clarence Thomas) dissented largely on the ground that they saw no basis for the court to adopt a rule imposing a mandatory automatic stay. They held, instead, that the decision of whether to stay or not to stay should be left to the discretion of the courts, as it is in the typical case. "This mandatory-general-stay rule for interlocutory arbitrability appeals comes out of nowhere. No statute imposes it. Nor does any decision of this court. Yet today's majority invents a new stay rule perpetually favoring one class of litigants—defendants seeking arbitration ... I see no basis here for wresting away the discretion traditionally entrusted to the judge closest to a case."

'Smagin': The Enforcement Of International Arbitration Awards

While most international arbitration awards are voluntarily complied with, there are, and inevitably will be, cases where an award debtor fails to comply with its obligations under an award. In such circumstances, the award creditor will typically seek recognition and enforcement of the award under the New York Convention in a country where the award debtor has assets. However, even after the award creditor has secured recognition of an award, the award debtor may nonetheless refuse to pay and take steps to conceal its assets. In cases involving a U.S.-based debtor, such steps may give rise to claims under the Racketeering Influence and Corrupt Organizations Act (RICO).

When it was passed in 1970, RICO was designed as a weapon to fight organized crime. Over the years following its enactment, however, it evolved into an instrument to challenge conduct well beyond that traditionally undertaken by mobsters and gangsters such as, for example, securities fraud. This is, in part, because RICO allows private parties to bring civil actions and because its authorizes the recovery of treble damages and attorney fees. While space limitations preclude a detailed discussion of the elements of a RICO claim, it is sufficient to note that a RICO claim can be based on, among other predicate acts, "mail fraud" and "wire fraud"— that is the use of the U.S. mail or phone, texts or email to engage in a pattern of fraud. Thus, if a U.S.-based award debtor takes fraudulent steps in the United States to conceal its assets, that might give rise to a RICO claim.

However, a non-U.S. resident's ability to use RICO to enforce an international arbitration award in its favor has to overcome a particular hurdle. In *RJR Nabisco v. European Community,* 579 U. S. 325 (2016), the Supreme Court had held that RICO's private cause of action applies only to a "domestic injury." This raises the question of whether a non-U.S. resident is able to allege a "domestic injury" for the purpose of RICO when an award creditor takes steps in the United States to thwart its ability to collect on an award. That was the question in *Smagin.*

The Court's Decision In 'Smagin'

In 2014, Vitaly Smagin, a Russian citizen, secured an arbitration award of over $84 million in a London-seated arbitration against Ashot Yegiazaryan, who resided in California. Smagin brought an action under the New York Convention in the U.S. District Court for the Central District of California and obtained a judgment recognizing and enforcing that award. Smagin also sought and obtained a preliminary injunction in the same action freezing Yegiazaryan's assets.

Yegiazaryan, who later received almost $200 million in settlement proceeds in connection with an unrelated arbitration while the asset freeze was in effect, allegedly sought to avoid compliance with the California judgment by accepting the money through the London office of an American law firm headquartered in Los Angeles, creating "a complex web of offshore entities to conceal the funds," and then transferring the funds to a bank account with CMB Monaco. In addition, after being found in contempt by the district court for failing to comply with certain post-judgment orders barring him from preventing collection on the judgment, Yegiazaryan allegedly submitted a forged doctor's note to the district court claiming he was too ill to comply with the contempt order, and used "intimidation, threats, or corrupt persuasion" to get the doctor to avoid service of a subpoena by Smagin.

In 2020, Smagin, brought a separate RICO lawsuit also in the California district court against Yegiazaryan and others, including CMB Monaco and a U.S.-based lawyer, alleging that they worked together under Yegiazaryan's direction to frustrate Smagin's collection on

the California judgment through a pattern of wire fraud and other RICO predicate racketeering acts, including witness tampering and obstruction of justice.

The district court granted the defendant's motion to dismiss the action on the ground that Smagin, as a Russian resident, had failed to allege a "domestic injury"—an essential prerequisite to a claim under RICO—because it found that Smagin was injured only where he resided, Russia. The Ninth Circuit reversed, adopting a "context-specific" approach to the domestic-injury inquiry, and finding that Smagin had alleged a domestic injury notwithstanding his Russian residency.

The Supreme Court accepted the case to resolve a circuit split on the proper test for a domestic injury for the purposes of RICO. The Seventh Circuit had adopted a rigid, residency-based test for domestic injuries involving intangible property, such as a court judgment. *Armada (Sing.) PTE v. Amcol International,* 885 F. 3d 1090 (7th Cir. 2018)). Under that test, Smagin would be unable to show a domestic injury because any injury would be deemed to have occurred where he resides—in Russia. The Ninth Circuit, which used a "context-specific" approach, also used by the Third Circuit, found a domestic injury because Smagin's "efforts to execute on a California judgment in California against a California resident were foiled by a pattern of racketeering activity that largely 'occurred in, or was targeted at, California' and was 'designed to subvert' enforcement of the judgment in California."

The Supreme Court adopted the test used by the Ninth Circuit with the result that Smagin's status as a foreign resident did not alone preclude him from relying on RICO. Sotomayor, who wrote the opinion of the majority, noted that "courts should look to the circumstances surrounding the alleged injury to assess whether it arose in the United States. In this suit, that means looking to the nature of the alleged injury, the racketeering activity that directly caused it, and the injurious aims and effects of that activity." Based on that approach, Sotomayor concluded that: "Smagin's interests in his California judgment against Yegiazaryan, a California resident, were directly injured by racketeering activity either taken in California or directed from California, with the aim and effect of subverting Smagin's rights to execute on that judgment in California. On the court's contextual approach, those allegations suffice to state a domestic injury in this suit."

Justice Samuel Alito (joined by Justices Thomas and, in part, by Justice Neil Gorsuch) dissented largely on the ground that they thought it to preferable to have a bright line test for a "domestic injury" (which the residency test was) rather than having a contextual approach which provided little guidance to lower courts. "The only rule of law that the court announces today is that there is no rule, and despite offering such minimal guidance regarding how to site a RICO injury, the court nonetheless manages to sow confusion regarding our broader law of extraterritoriality."

Conclusion

The court's decisions in both *Coinbase* and *Smagin* are unequivocally favorable to arbitration: *Coinbase*—because it holds that, even after a district court rules that a proceeding belongs in court rather than in arbitration (by denying a motion to stay a lawsuit or denying a motion to compel), the court proceeding is automatically stayed once an interlocutory appeal is taken against the district court's ruling; *Smagin*—because it permits a foreign award creditor seeking to enforce an international arbitration award in the United States to use a powerful weapon—RICO, which permits the recovery of treble damages and attorney fees—against an obstructive award debtor.