Arbitration: the Italian perspective and the finality of the award

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Abstract

The aim of the paper is to analyse the arbitration as an instrument to resolve the disputes and sharing some thoughts on the main challenges that parties and professionals face in divesting the Courts of the power to adjudicate the dispute. A brief overview will be given on the reasons for the interest in arbitration and on the main provisions of Italian arbitration law that were reformed in March 2006. The paper then focuses on the major finality of the award as a consequence of the more limited grounds for setting aside under the reform of Italian arbitration law and compares such particular aspect with the developing praxis of the U.S. Courts of enlarging the grounds for setting aside an award to the manifest disregard of the law. We conclude that the manifest disregard of the law ground will not very likely find room for application within the Italian framework due to the deep differences between Italian and U.S. arbitration system.

Key words

Arbitration; finality of the award; manifest disregard of the law

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1. Introduction

During recent years, an increase in recourse to arbitration has been reported in Italy.

The latest report on the diffusion of ADR in Italy, published in 2010 by ISDACI (the research centre of the Milan Chamber of Commerce), indicates that applications for arbitration in Italy - and managed by arbitration institutions - numbered 681 in 2008, up from 557 in 2007. On the other hand, there are no statistics on the actual use of ad hoc arbitration. The Chamber of National and International Arbitration of Milan, one of the leading permanent commercial arbitration institutions in Italy, managed 118 cases in 2008, a significant level of growth over the past 10 years compared to the 39 cases managed in 1998.

Arbitration is the only alternative instrument to judicial litigation that provides binding awards.

Recourse to arbitration is consensual; only the parties can decide to submit their future or existing disputes to arbitration. By choosing arbitration, the parties make the serious decision to divest the courts of the jurisdiction over their dispute. This means that - if a party to a valid arbitration agreement files a lawsuit with a national court - the other party may request to dismiss the claim on the basis of the existence of an arbitration agreement.

The reasons for the interest of the parties in arbitration are extensive and may differ from country to country. Generally recognized advantages of arbitration include the possibility for the parties to choose the arbitrators (from experts in the particular field relative to the dispute). The confidentiality and flexibility afforded through arbitration are also reasons for the increasing use of this legal option in recent years.

Moreover, arbitration plays a key role in international transactions due to the neutrality and independence of the arbitration process as well as the possibility for the parties to find a neutral venue that is not linked to any national system (Lew, Mistelis, Kroll, 2003, p.6).

However - at least in Italy - the main advantage of a recourse to arbitration remains the possibility to have a quicker decision with limited room for appeal. Litigation requires more time, and awards can be appealed at different levels of jurisdiction, thereby implying delays. In Italy, the average duration of an arbitration proceeding in 2008 was less than 171 days\(^1\) while, in comparison, legal proceedings can drag on for years.

The growing crisis of the Italian legal system has also led Italian legislators to promote the use of arbitration by increasing flexibility and efficiency of the legal framework\(^2\) while also providing for increased stability of the award. The legislator has, in fact, provided - by means of the recent reform of the regulatory system pertaining to arbitration - that challenging the arbitration award for invalidity by reasons of law is an exception, given that it is only possible where the parties or the law explicitly allow for it, and no longer a rule as in the past.

This solution certainly encourages greater stability of the award, thus making it more difficult to challenge and involves the risk that an arbitration decision that makes a serious legal error remains in force.

An evaluation of potential advantages and critical aspects of the recourse to arbitration - as well as the effect of the major stability of the award following the

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1 ISDACI, Terzo rapporto sulla diffusione della giustizia alternativa in Italia, 2010: this data refers to arbitration procedures administered by arbitration institutions.

2 Law Decree 80/2005 of 14 March, 2005 granted to the Government the power to amend the provisions of Italian Civil Code of Procedure on arbitration. As a result, Italian provisions on arbitration have been modified by Legislative Decree no. 40/2006, which entered into force on March 3, 2006.
2006 reform - require a preliminary overview of the legal framework and, in particular, a review of the most significant amendments to Italian arbitration law.

2. The Italian Law on Arbitration: an overview

Italian provisions on arbitration are contained in Articles 806 through 840 of the Italian Code of Civil Procedure, which was most recently amended by means of Legislative Decree no. 40 of 2 February 2006 (the “Arbitration Law”). Such provisions - whose purpose to modernize and internationalize Italy’s arbitration system - apply without distinction to both national and international arbitration. An exception is only provided for the recognition and enforcement of foreign awards.

The most important features of the Italian law on arbitration can be summarized as follows.

2.1. Arbitration agreements and conditions for arbitration

As described in the explanatory report relative to the Arbitration Law, one of the aims of this law was to extend the areas subject to arbitration in order to include all disposable rights. This was done in order to assign greater priority to the parties’ freedom to choose a course of action. Such a role is also noted with respect to the conduct of the proceedings.

The effect of these changes is that the parties may now agree to arbitrate both contractual and non-contractual matters. The Arbitration Law establishes two cases where disputes cannot be solved by means of arbitration, i.e. (i) the disputes regarding rights that can not be disposed and (ii) cases that are explicitly prohibited by law.

Rights which may not be disposed of are mainly those affecting a specific collective interest. To give an example: provisions that regard the status of a person, or interpretation of antitrust provision. Such rights are usually not related to assets. Employment disputes can be submitted to arbitration only if a provision of law so states or if collective labour agreements so provide.

Both the arbitration clause (related to disputes arising out of a contract) and the submission to arbitration (related to an existing dispute) must, under penalty of invalidity, be made in writing and must identify the subject of the dispute. The written deed requirement represents evidence of the choice of the parties to divest the Courts of their natural jurisdiction over the disputes.

Consent is also considered given when the will of the parties is expressed by telegram, telex, telecopier or online message, in accordance with legal rules which may also be issued through regulations regarding the transmission and receipt of documents which are sent electronically. In any case, if the arbitration agreement is included in the general conditions, the parties must undersign this clause. Simply signing the agreement is not sufficient for providing valid consent to the arbitration.

The validity of the arbitration clause must be evaluated independently from the underlying contract. This provision makes it clear that the agreement to arbitrate is separate from and independent of the main contract. As a result, allegations of

3 Namely, whether - for the awards issued in Italy - it is sufficient to file a request to the effect of the enforceability with the registry of the Court of the district in which the arbitration has its seat. The court will only ascertain whether the award meets all formal requirements; the recognition and enforcement in Italy of a foreign award is subject to special proceedings set forth by Articles 839 and 840 of the Code. The party wishing to enforce a foreign award in Italy must file a petition with the Chief Judge of the Court of Appeal of the district in which the other party has its domicile or of the Court of Appeal of Rome in case that party has no domicile in Italy. The Chief Judge of the court, after having ascertained the formal regularity of the award, shall declare, by means of a decree, the validity of the foreign award in Italy unless: (i) the subject matter cannot be settled by arbitration under Italian law, (ii) the award contains provisions that are in conflict with public policy.

4 See par. II, letter c.
contractual invalidity made against the main contract do not necessarily affect the arbitration agreement.

Arbitrators are entitled to rule on the validity, content and extension of the arbitration agreement.

The arbitration agreement may be considered the “DNA” of the proceedings since the parties may determine the rules that the arbitration court shall follow and may either provide for the appointment of arbitrators or for the method of appointment.

The parties may also refer to a set of arbitration rules by consent (eg, rules issued by an association or institution). If they choose to do so, the applicable rules are those in force at the beginning of the proceedings unless otherwise agreed by the parties.

2.2. Arbitrators

Failing the choice of the parties, the appointing authority (the Chief Judge of the court of the seat of arbitration) shall appoint three arbitrators.

There are no explicit requirements regarding the arbitrators' nationality, qualifications or impartiality. However, the Arbitration Law provides that the nationality of arbitrators may be subject to a specific agreement between the parties, or to rules referred to by them. The parties may also agree on certain qualifications or criteria for determining the appointment of certain individual arbitrators. In this case, the lack of such qualifications or criteria constitutes grounds for challenge.

Circumstances that lead the parties to suspect that an arbitrator is not neutral, impartial and/or independent also constitute grounds for challenge. Even if there are no specific provisions concerning the obligation of arbitrators to disclose circumstances that may affect their status of independence, the main arbitration institutions require that the arbitrator (before the appointment) must supply a disclosure in writing. The Arbitration Law also introduced cases of liability for the arbitrators.

The explanatory report relative to the Arbitration Law shows that the intent of the legislator was to rationalize the provisions related to arbitrators in order to free the parties from cases of bias.

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5 The separability principle is also stated by the relevant case law. For instance, Supreme Court no. 16332, of 24 July 2007 (Fall. Lucania Cavi SpA v. Ministero delle attività produttive) confirmed that the validity of the arbitration clause has to be evaluated separately from the validity of the contract.

6 If the seat has not been identified, it shall be deemed to be the place where the arbitration agreement was stipulated. If the agreement was stipulated outside Italy, the Chief Judge of the Court of Rome will make the appointment, unless the arbitration agreement is non-existent or the arbitration must be conducted abroad. Similar provisions apply to the replacement of arbitrators. If a specific number of arbitrators is not indicated, three arbitrators shall be appointed.

7 The Arbitration Law requires that an odd number of arbitrators be appointed.

8 In particular, and in compliance with Article 813 bis, the arbitrator shall be liable for damages caused to the parties if he or she: has omitted or delayed acts that he or she was bound to carry out due to fraud or gross negligence, and has been removed for this reason, or has renounced his/her office without a justified reason; has omitted or prevented the issuing of the award within the time limit fixed by the Code due to fraud or gross negligence.

If the liability is not due to fraud of the arbitrator, the amount of damages may not exceed a sum equal to three times the agreed fee or, failing an agreed determination, three times the fee established by the applicable tariff.

In cases of liability of the arbitrator, neither the fee nor the reimbursement of expenses shall be due to the arbitrator; in the case of partial invalidity of the award, they will be decreased. Each arbitrator shall only be liable for his or her own actions.
2.3. Arbitration proceedings

Flexibility of arbitration proceedings was increased by the Arbitration Law. Under the Arbitration Law, the parties are free to establish, in the arbitration agreement, the principles and the rules that should be followed. Unless specified otherwise by the parties, the arbitration court may manage the arbitration as it deems appropriate, including: determination of the admissibility and relevance of evidence as well as the appointment of expert witnesses provided that the due process is observed. The court may also decide to hear the witnesses by requesting them to provide written answers to questions within the time limit.

On the other hand, the arbitration court does not have coercive power, and therefore the Court has an important role in granting the attendance of witnesses and requiring the production of documents.

With regard to the confidentiality of the proceedings, there are no specific provisions under the Arbitration Law. However, the parties (as stipulated in the arbitration agreement or in a separate deed) or the arbitration institution (through its regulations) may provide for the confidentiality of all information while also ensuring confidentiality in relation to the existence of the arbitration itself.

2.4. The Award

The Arbitration Court has to issue an award no later than 240 days after the last date of acceptance of an arbitrator's appointment. This deadline may be postponed either by a written statement issued by all of the parties, or by order of the Court.

The award must be issued in writing. If the court is a panel, a majority decision suffices, provided that it is taken with the participation of the entire panel; the decision must be dated and signed by all of the arbitrators or by a majority. The award must contain the reasons for the decision and the award. An award by consent is not excluded under Arbitration Law.

The solutions that arbitrators can propose are those that are in compliance with Italian public policy. These include the following: compensation for damages classified either as financial damages or non-financial damages. 9

The award is deemed to be issued when the last signature is added by the arbitrators; at this point, it is as legally binding as a court sentence. Foreign awards are recognized in accordance with the arbitration conventions to which Italy is a party, namely the New York Convention 1958, the Geneva Convention 1961 and the Washington Convention 1965.

3. The finality of the award

Special emphasis should be given to the setting aside of the award. The decision to set aside the effectiveness of an award is important because of the practical impact it may have on the parties’ rights. Both the final and the partial award that is decided on the merits of the dispute may be challenged for purposes of invalidity, revocation or third party opposition. Revocation is an extraordinary means of cancelling the validity of the award due to serious defects in the award itself; third party opposition is the legal avenue which parties may use to request the invalidity of the award that prejudices their rights.

The challenge for invalidity is only allowed on limited grounds, as listed by the Arbitration law. More specifically, these include:

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9 Arbitrators can neither propose punitive damages nor exemplary damages because these two kinds of damages are considered contrary to Italian public policy.

10 None of the above grounds may be challenged in advance. However, challenge on the grounds of invalidity is only possible if the interested party had promptly raised an objection regarding the existence of grounds for nullity during the arbitration proceedings and had not caused a ground for nullity or
i) If the arbitration agreement is invalid;
ii) If the arbitrators have not been appointed in the form provided by the Code;
iii) If the award has been rendered by a person who could not be appointed as arbitrator;
iv) If the award exceeds the limits of the arbitration agreement;
v) If the award does not contain (i) a brief statement of the reasons, (ii) the decision of the issues or (iii) the signature of the arbitrators or of the majority of the arbitrators in the case it is mentioned that the award was deliberated with the participation of all the arbitrators;
vi) If the award has been issued after the expiry of the prescribed time-limit;

vii) If the formalities prescribed by the parties under express sanction of nullity have not been observed during the proceedings;
viii) If the award is contrary to a previous award which is no longer subject to recourse or to a previous sentence which is res judicata between the parties, provided such an award or sentence has been submitted in the proceedings;
ix) If the principle of contradictory proceedings has not been respected in the arbitration proceedings;
x) If the award contains contradictory provisions;
i) If the award has not settled some of the issues and objections raised by the parties in accordance with the arbitration agreement.

The reform enacted in 2006 includes an important change of such grounds. It provides that parties may challenge an award for violation of rules of law related to the merit of the dispute only if the arbitration agreement allows it or if so provided for by the law.

In particular, prior to the reform, Art. 829, second paragraph, provided that:

“A recourse for invalidity may also be filed where the arbitrators did not decide according to the law, unless the parties have authorized them to decide ex aequo et bono or have declared that there may be no recourse against the award”.

The Arbitration Law now provides that:

“The recourse for violation of the rules of law relating to the merits of the dispute shall be admitted if so expressly provided by the parties or by the law. Recourse against decisions which are contrary to public policy shall be admitted in any case”.

As a consequence, a recourse for invalidity of an award on such grounds can currently only be invoked by way of exception if it is provided by the arbitration agreement, or by the law. That is: i) with regard to disputes pursuant to Article 409 (employment law) or ii) if the violation of the rules of law concerns the solution of a preliminary issue over a matter which may not be made subject to an arbitration agreement. Recourse against decisions that are contrary to public policy shall be admitted in any case.

The impact of such reforms is relevant. A quantitative survey - made just before the enactment of the reform through the Milan Court of Appeal - showed that one of the main grounds for challenging an award was the violation of rules of law, and that in 25% of the cases, the Court cancelled the award on such grounds (Bossi, 2006, p.54).
The aim of the legislator in enacting a modification of the grounds for challenging the award seemed to essentially be the assignment of more stability to the arbitration decision. Such a policy choice is in line with international law since the grounds for cancelling an award for invalidity under Italian Law are now substantially the same as provided by the UNCITRAL Model law on international Commercial Arbitration.

The arguments in favour of a “binding”, final arbitration award are easily understood: to save time and to be able to allow the parties to “turn the page” on their differences and quarrels so that they can ultimately resume their normal commercial relations (Lalive, 2008, p.6).

However, the absolute and binding finality of the award results in the risk that an award which violates rules of law affecting the merit of the dispute could be enforced. Some authors (Rubino Sammartano, 2010, p.29) have highlighted the idea that, if the revision is provided for Court decisions, it is even more important for the award to be rendered by professionals who are generally not only arbitrators.

The question of the finality of the award due to violation of the law was heavily debated in the United States.

4. A glance overseas12

The law governing arbitration in the United States legal system is the Federal Arbitration Act (FAA).

Within the United States, individual states are free to create their own substantive and procedural rules and regulations regarding arbitration agreements. However, those rules and regulations can not directly conflict with the federal substantive law set out in the Federal Arbitration Act.

The Federal Arbitration Act, similarly to the Italian Arbitration Law, provides for limited grounds for cancelling the validity of an award.

More specifically, these include:

(1) if the award was issued by corruption, fraud, or undue means;
(2) if there is an evident partiality or corruption in the arbitrators, or in either of them;
(3) if the arbitrators were guilty of misconduct in refusing to postpone the hearing, and sufficient cause is shown, or in refusing to hear evidence that is pertinent and material to the dispute; or any other misbehavior which violated the rights of any party; or
(4) if 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.13

These grounds do not include violations of the law concerning the merit of a dispute so that the recourse against awards that are contrary to the law shall not in principle be admitted.

In addition, the parties to arbitration in the United States do not even have the possibility to add other grounds for cancelling the validity of the award. The so-called “opt-in” provision - which subjects a “final” arbitration decision to specific or

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12 The author acknowledges the contribution of Sarah Mac Runnels, Juris Doctor Candidate 2011, Hamline School of Law.
general review by the Court upon appeal by either of the parties - is in principle not allowed.\textsuperscript{14}

In any case, and in order to guarantee the parties, the case law provides for the option of the parties to challenge the award in the case of manifest disregard of the law.

Some authors have noted that: "Although 9 U.S.C.A. § 10 does not contain the words 'manifest disregard of the law', courts in recent years have recognized that if an award is found to be in "manifest disregard" of the law, it can be vacated upon judicial review, pursuant to § 10.” (Shulenberger, 1974) However, the Supreme Court\textsuperscript{15} stated that "interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation”.

As it was further noted by authors "Since arbitration is an alternate method to judicial determination which disputing parties have agreed to use in settling their dispute, it is the position of the courts that arbitration awards are presumed to be valid and that the courts will consider vacating such awards only with great hesitancy. Accordingly, awards are not reviewed for errors or misinterpretations of fact or law, and arbitration proceedings are not invalid for failure to apply the rules of evidence or to meet other procedural requirements which would be applicable to court trials. These limitations on the power of courts to review arbitration awards have been recognized as applicable to arbitrations under the Federal Arbitration Act, the courts frequently stating that only the grounds specifically enumerated in 9 U.S.C.A. § 10 can be considered as a possible basis for vacating an arbitration award.” (Shulenberger, 1974).

The Courts - in keeping with the general rule that the only grounds for cancelling the validity of arbitration awards are set forth in the Federal Arbitration Act - have difficulty attempting to pigeonhole “manifest disregard of the law” within any of the vacating statutory grounds set forth therein and are hesitant to use the concept in any possible decisions to vacate arbitration awards.

In a recent judgment, the Supreme Court held that "under the Federal Arbitration Act, parties to an arbitration agreement may not contract for broader judicial review".\textsuperscript{16}

The manifest disregard of the law was therefore intended to be more than an error in applying the law by the arbitral tribunal: "An arbitration decision must fly in the face of established legal precedent to constitute a manifest disregard of the law. Manifest disregard of the law, as a basis for vacating an arbitration award, means more than an error, simple legal mistake, or a misunderstanding with respect to the law. Rather, there must be a willful inattentiveness to the governing law. It must be shown that the arbitrator was aware of the applicable law but did not follow it, or

\textsuperscript{14} However, as noted authors "Those parties that did provide for a special standard of review beyond those contained in the text of section 10 of the FAA should consider the likely possibility that courts may invalidate these special review provisions. Those who wish to create some form of enhanced review must do so by creating or using an existing appeal procedure within the arbitration system or by using the blunt instrument of tailoring the scope of the arbitration clause to leave some matters to court determination entirely.” (TYLER, PARASHARAMI, "Finality over Choice: Hall Street Associates, L.L.C. v. Mattel, Inc. (U.S. Supreme Court).", in Journal of International Arbitration, 2008).

\textsuperscript{15} Wilko v. Swan, 346 US 427, (1953). The Supreme Court also stated that: In Wilko v. Swan, the court said that: “while it may be true that the failure of arbitrators to decide in accordance with the Securities Act would constitute grounds for vacating the award under § 10 of the Arbitration Act, such failure would need to be made clearly to appear.” The court further added that in reviewing arbitration awards, the federal courts may not review for error in interpretations of the law, “in contrast to manifest disregard.” As Shulenberger has noted, "[the term] 'Manifest disregard' was not further clarified or expounded upon by the Supreme Court. [...] Consideration of 'manifest disregard' of the law as a possible ground for vacating pursuant to 9 U.S.C.A. § 10 has raised certain problems for the courts, one of which is the possible conflict with the general rule that arbitration awards are not subject to judicial review for possible misinterpretation of the law.”\textsuperscript{15}

ignored it. A two-pronged test applies to ascertain whether an arbitrator has manifestly disregarded the law. One prong considers whether the governing law alleged to have been ignored by the arbitrator was well defined, explicit, and clearly applicable. Under the other prong, the arbitrator must appreciate the existence of a clearly governing legal principle but may decide to ignore or pay no attention to it. Some authorities add a third prong—that the error was obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator.” (Grossman, Harnad, Shampo, 2008). Manifest disregard of the law, as defined above, is a very narrow ground for cancelling the validity of an arbitration award. No colourable justification for a conclusion made by the arbitrator, or the arbitration panel, must be found. It is a standard of limited applicability.

5. Conclusion

Arbitration Law places Italy’s arbitration system in a median position since the more limited grounds for challenging the award are balanced by the prevailing role assigned to the parties’ will and by the increased protection from arbitrator bias through the introduction of cases of liability of the arbitrators.

The possibility granted to the parties under the Arbitration Law to opt-in for a review on the merit of the dispute and on the potential misapplication of the law by the arbitration court suggests that the manifest disregard of the law ground for challenging the award is not very likely to find room for application within the Italian framework.

Under the US system, manifest disregard of the law ground represents the only possibility for the parties to challenge the award in cases of violation of the law since the opt-in provisions are, in principle, not allowed. In addition, the purposes for creating such grounds for challenge (that is, to grant the parties with a possible review - in exceptional circumstances - for cases concerning critical areas such as employment and consumer disputes), does not have a comparable equivalent under the Italian legal framework. As a matter of fact, the Arbitration Law itself provides that the recourse for violation of the rules of law relating to the merits of the dispute shall always be admitted with regard to the employment area and/or rights affecting a collective interest.

In addition, Arbitration Law also provides (with the main purpose of granting control to consumers) that – if the arbitration agreement is included in a standard term and condition form - the parties have to specifically add their signatures to the arbitration agreement. In the US legal system - in cases in which the arbitration agreement was included in the box containing the goods sold to a consumer by virtue of a distance sale agreement - the arbitration agreement contained therein was also considered to be a valid arbitration agreement.17

In the framework of the Arbitration Law, it seems to be sufficient that the parties who enter into an arbitration agreement - and thereby divest the Court of its jurisdiction over their dispute - are aware of all the possible consequences of such a choice. This seems more important given that the Arbitration Law provides for the possibility to only challenge the award for violation of the law by exception.

From a practical point of view, it often happens that - during the course of negotiations - the parties do not even know the jurisdiction of the contract, which is often an issue decided at the end of the negotiations. Professionals (negotiators and lawyers) - even more now than in the past - have the duty to advise the parties on this issue as well as on the aforementioned other pertinent issues relating to arbitration.

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