A Private Affair: The Use of Arbitration Clauses in EB-5 Investments

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In the United States, litigation in courts is by its very nature a public exercise. Pleadings filed in U.S. courts are publicly available, which means attorneys, investors and the press may have access to potentially scurrilous allegations that not only can damage one's business reputation but also can invite additional litigation and regulatory scrutiny. Compounding matters, litigation in U.S. courts can be commenced with little expense, yet become time-consuming and costly as the parties proceed to resolution of their disputes.

These exposures are amplified in the context of actions involving EB-5 investments. The identities of litigants, who often have little understanding of the workings of the legal system in the United States and who may wish to remain anonymous, soon become public knowledge. Given the recent spotlight on the EB-5 program by the press in the United States, a garden-variety lawsuit of little merit can soon become fodder for stories in newspapers, magazines and television, all preserved for eternity on the internet. Participants in the EB-5 industry and investors alike have a common need to efficiently and privately resolve legal disputes.

Despite this alignment of interests, the EB-5 industry has been somewhat slow in employing arbitration as a means of resolving disputes. Unlike the practice of the majority in the alternative investment community, many EB-5 offering documents and attendant subscription documents omit the ability of the issuer to frame the mechanisms for dispute resolution at the outset. This oversight is unfortunate for industry participants and investors alike. The solution, of course, is to consider the placement of arbitration clauses in operative EB-5 investment documentation. Not only are arbitration clauses generally valid under the laws of the United States, they also make good business sense.

A BRIEF SYNOPSIS OF U.S. ARBITRATION LAW

Arbitration in the United States is generally governed by the Federal Arbitration Act of 1925 (FAA), 9 U.S.C. § 1 *et seq*., which provides that written agreements to arbitrate disputes arising out of transactions in interstate commerce "shall be valid, irrevocable and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." This provision "is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983). Recognizing this federal policy, courts in the United States have consistently held that statutory claims may be the subject of an arbitration agreement and enforceable pursuant to the FAA. See, *e.g., Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 30-33 (1991); *Rodriguez de Ouijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 479-85 (1989); *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 225-26 (1987) ("*McMahon*"). See also *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628-640 (1985) ("*Mitsubishi*"). (statutory claims generally arbitrable). More importantly, Section 2 of the FAA commands that an agreement to arbitrate is valid, irrevocable and enforceable as *a matter of federal law. Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987) (emphasis added).

Consistent with strong policy favoring arbitration of disputes, courts in the United States also have recognized that arbitration is faster and less expensive than court-based litigation. Inherent in this policy is the term "revocation" in Section 2 of the FAA appearing in virtual lockstep with the term "enforceable." That is, absent grounds for "revocation," the

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enforcement of an arbitration agreement entails its immediate application to honor strong public policy concerns. See *Cleveland Bd. of Education v. Loudermill*, 470 U.S. 532, 542-43 (1985) (even if Petitioners' rights to arbitration are not ultimately denied, delay in vindicating constitutional rights can amount to a deprivation of due process).

The United States Supreme Court in *Mitsubishi* affirmed that arbitration generally is a more efficient and streamlined process:

> [I]t is often a judgment that streamlined proceedings and expeditious results will best serve their needs that causes parties to agree to arbitrate their disputes; it is typically a desire to keep the effort and expense required to resolve a dispute within manageable bounds that prompts them mutually to forgo access to judicial remedies.

Mitsubishi, 473 U.S. at 633.

In *McMahon*, the Supreme Court noted the progression of its arbitration decisions since *Wilko v. Swan*, 346 U.S. 427 (1953), in which the Court had held that a predispute agreement to arbitrate could not be enforced to compel arbitration of a claim arising under § 12(2) of the Securities Act of 1933:

> It is difficult to reconcile *Wilko's* mistrust of the arbitral process with this Court's subsequent decisions involving the Arbitration Act.
>
> Indeed, most of the reasons given in *Wilko* have been rejected subsequently by the Court as a basis for holding claims to be non-arbitrable. In *Mitsubishi*, for example, we recognized that arbitral tribunals are readily capable of handling the factual and legal complexities of antitrust claims, notwithstanding the absence of judicial instruction and supervision. Likewise, we have concluded that the streamlined procedures of arbitration do not entail any consequential restriction on substantive rights.

McMahon, 482 U.S. at 232 (citations omitted).

Further, the expression of the United States Congress to provide for due process and the protection of contract rights is, as a matter of law, supreme over attempts in courts of equity to abrogate such rights. See *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 274 (1995) (FAA "embodies Congress' intent to provide for the enforcement of arbitration agreements within the full reach of the Commerce Clause") (citing *Perry v. Thomas,* 482 U. S. 483, 490 (1987)).

> Like any statutory directive, the [FAA's] mandate may be overridden by a contrary congressional command. The burden is on the party opposing arbitration, however, to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue [citations omitted]. If Congress did intend to limit or prohibit waiver of a judicial forum for a particular claim, such an intent 'will be deducible from [the statute's] text or legislative history,' or from an inherent conflict between arbitration and the statute's underlying purposes.

McMahon, 482 U.S. at 226-27 (citations omitted).

Thus, assuming that one's arbitration clause is not outside the bounds of reason, there are few grounds upon which potential litigants may avoid an arbitration clause. Even class action relief may be abrogated through a properly drafted arbitration clause. In *DIRECTV, Inc. v. Imburgia,* 577 U. S. __ (2015), the United States Supreme Court held that a class action waiver contained in an arbitration clause was valid, even though the contract incorporated state law standards that would have voided the waiver at the time at which the contract was consummated. *DIRECTV* stands as the latest expression of strong policy in the United States toward enforcement of arbitration clauses, including those containing a waiver of class action proceedings in arbitration. See, e.g., *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011).

CHOOSING A FORUM

Numerous forums offer compelling reasons for designation in an arbitration clause for use in an EB-5 securities offering. These reasons include the experience of one's counsel in the forum, the ability to select from a large pool of arbitrators and the ability to accommodate litigants who may not be from the United States. Another primary factor to consider may be the capacity of the forum to entertain requests for equitable relief.

Many businesses in the United States insist on the use of the arbitration facilities of the American Arbitration Association (AAA) (www.adr.org), which is one of the world's largest arbitration forums. Most litigators in the United States are familiar with the nuances of arbitration with the AAA, including rules concerning discovery. Depending on one's point of view, the filing fee for a commercial arbitration with AAA is either a governor of or a hindrance to, vexatious litigation, as the filing fee for a claim above $10 million is north of $14,000 (versus filing fees of less than $500 in courts). The AAA also maintains arbitrator rosters in virtually all states and in major metropolitan markets.

Likewise, JAMS (www.jamsadr.com) is based in the United States and has arbitrators in London and Toronto. JAMS frequently is used as an arbitration forum of choice by hedge fund managers and others in the alternative investment industry. JAMS imposes significant fees on litigants (sum certain of 12 percent of all arbitration forum costs and arbitrator fees imposed on each side), but unlike AAA, it has lower upfront filing costs.

Finally, the London Court of International Arbitration (LCIA) (www.lcia.org) is recognized as a sophisticated forum for the resolution of international disputes among private litigants and others. LCIA maintains a roster of arbitrators not only in the United States but also worldwide, including in China and India. Like JAMS, LCIA imposes significant fees on litigants, depending on the involvement of LCIA staff in case management and other factors.

Other arbitration forums that compete with AAA, JAMS and LCIA for designations in agreements among parties are not only experienced in the administration of complex litigation matters but also offer a relative level of predictability in the application of their rules and procedures. In particular, those funds utilizing a broker-dealer may, whether unknowingly or otherwise given the circumstances, be subject to the FINRA arbitration obligations of their broker-dealer.

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Whatever the case, industry participants should consider the characteristics of these forums and others in ultimately choosing a designation in fund offering documents. Each of the websites for these forums have standard arbitration clauses that may modified to suit specific needs of EB-5 securities offerings.

CHOOSING ARBITRATORS

One particularly helpful aspect of arbitration in the context of EB-5 is that industry participants can designate the number of arbitrators to hear matters and the qualifications of those arbitrators. In many cases, draftsmen will include specific characteristics of the arbitrators as a condition of being a candidate for an arbitration panel. The most common of these is the designation of a former judge as an arbitrator. In the EB-5 context, draftsmen can specifically designate that the arbitrators have experience in immigration law or have particular knowledge of the laws of a specific jurisdiction. Be aware, however, that arbitrators often charge fees akin to hourly fees of attorneys for their conduct of hearings and the disposition of motions. These fees are disclosed during the arbitrator selection process along with the experience of each of the candidates for the arbitration panel. While cost issues also may compel the draftsman not to designate more than one arbitrator to hear a case, the complexity of EB-5 and the litigation matters it has spawned should make the appointment of three arbitrators (not two due to the potential of a "tie") the rule rather than the exception.

LOCATIONS OF HEARINGS

Another excellent aspect of having an arbitration clause in EB-5 investments is the ability to designate the location of the hearings. While much of the litigation activity up until the hearing is done telephonically, designation of an arbitration location near one's headquarters or nearest to one's pool of investors may be prudent. Of particular note is that arbitrators do not necessarily have to apply the law of the jurisdiction in which they sit. For example, while a fund document may be governed by Delaware or New York law, the hearing of that matter may take place anywhere in the world so long as the arbitration clause (a) states that the arbitrators are to apply the law specifically designated in the arbitration clause and (b) has a permissive forum situs clause . This is particularly useful in EB-5 matters. Namely, EB-5 fund documents often invoke the laws of a state of the United States, while investors in that fund may be predominantly present in another country. Thus, a panel of arbitrators designated to have experience in New York or Delaware law can serve for hearings abroad if the arbitration clause provides accordingly. Clauses can also contain conditions on the language in which the proceedings will be conducted, including allocating costs and burdens of translation.

ASSESSMENT OF FEES AND COSTS

Yet another benefit of using an arbitration clause in an EB-5 securities offering is that the parties can specifically state that the prevailing party in the arbitration is entitled to recover costs and expenses from the other side. Akin to the "English Rule" of litigation, the judicious use of cost assessment clauses can act as a governor against abusive litigation tactics. As a matter of practice, the alternative investments industry uses such a clause, which of course causes the parties bringing the action to fully ascertain their litigation risks prior to proceeding.

LIMITATIONS ON DISCOVERY

Most major arbitration forums have specific guidelines and limitations on discovery. Of particular note, while most arbitrators provide for the production of documents, other burdensome discovery mechanisms such as interrogatories, requests for admissions and even depositions, are often not favored or available only under specific circumstances. Given that disputes in the EB-5 context will often involve multiple individual parties, the streamlining of discovery may provide a degree of litigation economy versus that of garden-variety court proceedings.

CONFIRMATION OF ARBITRATION AWARDS

An award in an arbitration proceeding is generally private and not available to the public unless it is not paid. Under the FAA, arbitration awards rendered in the United States may be "confirmed" and thereafter converted into a judgment through public filing in a federal court of competent jurisdiction if not paid. 9 U.S.C. § 9. There is little opportunity to appeal an arbitration award under the FAA, except for instances of gross arbitrator bias and misconduct. While extensive discussion of the grounds on which an arbitration award may be "vacated" is beyond the scope of this article, EB-5 industry participants should be aware that the burden to vacate an arbitration award is one of the highest civil burdens a litigant may face, and will require specific documentation and references to the record. Arbitrators do not have to give reasons for their award, unless the arbitration clause so states. *Montana Power Co. v. Federal Power Comm.*, 445 F.2d 739, 755 (D.C. Cir. 1970) (citing *United Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 598 (1960)). Aggrieved litigants may well be tempted to test these high burdens, but at least one court in the United States has permitted a party to seek "arbitrage" damages where their arbitration award was appealed without reasonable basis. *Tucker Anthony v. Baird*, 12 F. Supp. 2d 23 (D.D.C. 1998). While many parties desire reasoned awards, most arbitration clauses do not compel arbitrators to render them. Whether reasoned awards are desired should be carefully considered, given the increased likelihood of having that award vacated by a court on behalf of a disgruntled litigant.

While awards from arbitrations that may take place abroad generally follow much of the jurisprudence derived from the FAA, the confirmation of such awards in courts in the United States is governed by the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 21 U.S.T. 2517, 330 U.N.T.S. 3, and enforced by statute under the FAA. 9 U.S.C. §§ 203, 205. Parties who wish to designate foreign jurisdictions for the arbitration of disputes should take particular care to review the New York Convention and other international treaties to ensure that award confirmation is properly addressed in their arbitration clauses.

CONCLUSION

Industry participants and investors may resolve disputes efficiently in private in a manner specific to their needs by employing arbitration clauses in EB-5 investment documentation. The use of such arbitration clauses also may serve as a governor of vexatious litigation. These clauses need to be carefully drafted to address choice of law, choice of forum and the method by which disputes may be resolved. Rather than face public scrutiny and the burden of court proceedings, EB-5 industry participants and investors alike should strongly consider the use of arbitration to privately resolve disputes.