

Optional Appellate Arbitration Rules: Are They Good For Your Case?

ANÍBAL SABATER, CHAFFETZ LINDSEY LLP, WITH PRACTICAL LAW ARBITRATION

There are various appellate rules available in institutional arbitration and counsel should consider them when drafting the arbitration agreement. The article gives an overview of the goals behind these rules and practical tips for when parties evaluate using them.

Bad arbitral awards can and often by law must be judicially confirmed and enforced. A court annuls or vacates an award only in extreme cases when a tribunal exceeds its authority or otherwise misbehaves.

This limited judicial review of awards can be an advantage or a disadvantage. It can be an advantage because it minimizes post-award disputes and the losing party's ability to delay enforcement by initiating time and cost-consuming appellate proceedings. On the other hand, it can be frustrating for parties not to have a way for review of a flawed award.

CHALLENGES TO ARBITRAL AWARDS IN COURT

The Federal Arbitration Act (FAA) (9 U.S.C. §§ 1-16; 9 U.S.C. §§ 201-208; 9 U.S.C. §§ 301-307), sets out only four limited grounds for vacating an award (9 U.S.C. § 10). They require, for example, that "the arbitrators exceed[] their powers, or so imperfectly execute[] them that a mutual, final, and definite award upon the subject matter submitted was not made" (9 U.S.C. § 10(a)(4)). The other three grounds for vacatur similarly impose high burdens, such as that the award be "procured by corruption, fraud, or undue means" or that the arbitrators exhibit "evident partiality" or "misconduct." Interpreting section 10(a)(4), the US Supreme Court recently stated that, "convincing a court of an arbitrator's error—even his grave error—is not enough. So long as the arbitrator was 'arguably construing' the contract [...] a court may not correct his mistakes [...]. The arbitrator's construction holds, however good, bad, or ugly." (*Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064, 2070-71 (2013).) The Court further interpreted the grounds listed in sections 10 and 11 as being the exclusive bases on which to review an award under the FAA, even if the parties agree by contract that a broader review should apply (*Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 590 (2008)).

The Fifth Circuit's opinion in *Executone Info v. Davis* is a classic example of the prevailing judicial deference to arbitration (26 F.3d

1314 (5th Cir. 1994)). The court expressed misgivings about the arbitrator's findings and suggested that it disagreed with them but still confirmed the award. The court noted that "[a]lthough we are not free from doubt regarding the arbitrator's interpretation of the scope of its mandate, 'we resolve all doubts in favor of arbitration,'" and added that "[e]ven if this is a case in which the arbitrator may have read the contract differently than we would have read it ... we cannot say that the arbitrator ignored plain contractual language en route to its final decision." (26 F.3d at 1328.)

Attacks in court against the merits of an award, including manifest disregard challenges, are rarely successful. In the US, for example, courts have made clear that an arbitral tribunal's interpretation and application of the law are not subject to judicial second-guessing. In 2012, the New York City Bar Report of its International Commercial Disputes Committee (ICDC) explained that the concern about manifest disregard is purely theoretical in international arbitration, noting that it was unable to find a single international award that was vacated on those grounds in any US court.

A SUCCESSFUL COURT CHALLENGE USUALLY REQUIRES A NEW ARBITRATION

The unlikelihood of success is not the only issue a party should consider before challenging an award in court. Among others, there is also the risk of reaping a pyrrhic victory. When a court annuls an award, the dispute is left undecided and the litigants are sent back to square one, often times after a significant investment of time, money and effort in trying to resolve the dispute.

Under the FAA, for example, the standard court remedy for a successful challenge is to vacate the award, but not to replace it or re-adjudicate the dispute (9 U.S.C. § 10(a)). The court may, in its discretion, direct a rehearing by the arbitrators (9 U.S.C. § 10(b)), but that results in further delay before the dispute is finally resolved on the merits (see, for example, *Tempo Ahin Corp. v. Bertek, Inc.*, No. 96 CIV. 3354 (LAP), 1997 WL 580775, at *4 (S.D.N.Y. Sept. 17, 1997) (rehearing before the same arbitrators) and *Montes v. Shearson Lehman Bros.*, 128 F.3d 1456, 1464 (11th Cir. 1997) (remanding to a new arbitration panel).

Similarly, if a court challenge succeeds under English law, the court may only set aside the award, declare it to be of no effect or remit it to the tribunal. (See *Practice Note, Challenging the Award under section 68 of the English Arbitration Act 1996: Serious Irregularity* (<http://us.practicallaw.com/7-205-3998#a307725>).



THE EMERGENCE OF OPTIONAL ARBITRAL APPELLATE RULES

Arbitration users have long been aware of and expressed concerns about these limitations. Respondents to the 2011 Cornell-Pepperdine/Straus Institute-CPR Survey of corporate counsel in Fortune 1,000 companies were asked whether they used arbitration and if not, why. Nearly 52% of those who did not use arbitration said it was because there is hardly an effective way to appeal awards, which was by and large the most frequently given reason for not using arbitration. (See *Thomas J. Stipanowich & J. Ryan Lamare, Living with ADR: Evolving Perceptions and Use of Mediation, Arbitration, and Conflict Management in Fortune 1000 Corporations*, 19 *Harv. Negot. L. Rev.* 1, 53 (2014) (Table P. Reasons Why Companies Have Not Used Arbitration).)

Practice Tip: The limited judicial review of arbitral awards is an advantage only where the tribunal has rendered a sound award. A classic way to try to minimize the risk of an irrational or unjust award is for the parties to agree on three arbitrators instead of one. However, a panel of three arbitrators triples the arbitrator compensation and can lead to delays, dysfunctionalities, and other problems.

In response to these issues, the following major arbitral institutions have adopted these appellate arbitral procedures:

- The joint Optional Appellate Arbitration Rules of the American Arbitration Association (AAA) and the International Centre for Dispute Resolution (ICDR).
- JAMS Optional Arbitration Appeal Procedure.
- The International Institute for Conflict Prevention & Resolution (CPR) Appellate Arbitration Rules.

For an explanation of how these rules differ, see AAA, *JAMS and CPR Comparison Chart for Optional Appellate Procedures* (<http://us.practicallaw.com/7-604-7026>).

Under rules like these, the appellate panels do not have the authority to remand to the original panel. Instead, they approve, reverse and modify the first instance award themselves. (See AAA *Optional Appellate Arbitration Rule Article A-19(a)*; JAMS *Optional Arbitration Appeal Procedure Paragraph D*; CPR *Arbitration Appeal Procedure Rule 8.2 and 8.3*.)

WHO SHOULD AGREE TO USE APPELLATE ARBITRAL PROCEEDINGS?

Optional appellate procedures are devised for users whose primary concerns are obtaining a correct, extensively considered adjudication of their case and minimizing mistakes in the final award, even if this means undergoing longer proceedings. Therefore, appellate procedures are particularly useful for parties who are or may soon be involved in a case deemed significant, due to either:

- Its legal and factual complexity.
- Its practical repercussions.
- Its amount.

Bet-the-companies disputes that have traditionally been litigated for lack of appellate rights and remedies can now be more confidently arbitrated under arbitral appellate procedures.

APPELLATE AND FAST-TRACK RULES USED TOGETHER

Users of the appellate procedures typically have the opposite type of need from users of the expedited procedures (variations of which the AAA/ICDR, CPR and JAMS presently offer) for whom speed is a key concern (see *CPR Global Rules for Accelerated Commercial Arbitration (2009)*; *ICDR International Expedited Procedures (2014)*; and *JAMS Comprehensive Arbitration Rules & Procedures (2014)* 16.1 and 16.2 (Expedited Procedures)). This does not mean, however, that users are legally precluded from agreeing to apply both the expedited and the appellate proceedings to the same arbitration. (A dispute may even have an expedited first arbitral instance, subject to potential appellate review.) That type of agreement may pose some practical difficulties to implement, but helps balance the needs of users seeking both to receive a good award and abbreviate the proceedings.

EFFECTS OF CHOOSING AN ARBITRAL APPEAL

Users who may agree to optional arbitral appellate rules must consider how these rules will affect their case strategy, including their advocacy, as well as how they will affect the tribunal's decision.

EFFECT ON THE PARTIES

Perhaps counter-intuitively, a significant effect of the appellate rules is that they add an element of uncertainty. When litigation starts, the parties are able to identify the judge, appeal court and potentially the Supreme Court that is likely to adjudicate the dispute.

Admittedly, the exact identity of jurors or of the court of appeal members cannot yet be known, and during the case, judges may retire, be replaced or become incapable of discharging their functions. Overall, however, once identifying the court that will hear the lawsuit, a pre-established and, to a degree, predictable machine to render justice is activated.

Arbitration operates quite differently. When commencing arbitration, the tribunal or sole arbitrators have not yet been appointed and there is rarely an assurance of who they might be. Their identity, however, matters greatly because different arbitrators approach cases differently. Factors likely to influence the outcome of the case include:

- Whether the arbitrators are attorneys.
- Whether they are inclined to grant broad document exchange.
- Whether they are acquainted with:
 - the laws applicable to the case;
 - the industry involved in the dispute; and
 - the type of contract at issue.
- If there is more than one arbitrator, whether they can effectively work together and operate collegially or may instead be dysfunctional as a panel.

Because the decision-makers are unknown at the outset and there can be wide variations in a case's outcome depending on those appointed, arbitration can be harder to plan for than court litigation.

When an appeal is added to the arbitral process, a second layer of variables comes into play. It is then not one but rather two previously unknown dispute resolution bodies that may eventually

rule on the dispute. The careful party should be ready to adjust its case presentation to the particular profile, experience, preference and dynamics of the first panel and then repeat the exercise when the second instance panel is named. At the same time, the party should be ready to argue the case in the first instance in a way that can still be effective in appeal, despite not knowing who the appeal arbitrators may be. This is a notable contrast with court litigation, in which the parties know from the beginning how often and on what grounds the court of appeals usually reverses the trial court judge.

Practice Tip: In court, the litigant can argue a case in a way likely to be ineffective with the first instance judge, but then potentially persuasive for the already-anticipated judges that may hear the appeal. The party to an arbitration does not have this advantage.

The unknowns an appeal introduces in the arbitration, however, are not to be exaggerated. First, the parties can mitigate these unknowns by in the clause, agreeing on :

- The profile, qualifications and characteristics of the first instance and appeal arbitrators.
- Discovery or information exchange protocols.
- The applicable substantive and procedural laws.
- A deadline for the award to be issued.
- A pool of appeal arbitrators.
- A mechanism for arbitrator appointments that ensures party involvement.

Second, despite the unpredictability they introduce, appellate rules offer an increased probability that the final award provides sound legal and factual foundations, benefiting from the work of two panels.

Third, a party knowing that it is likely to appear in the same matter before two separate panels of whose composition it is unsure, has even more incentive than usual to prepare a reasonable, easier-to-sell legal strategy. It is also more likely to stay away from scorched earth conduct and indefensible allegations with which reasonable adjudicators are unlikely to sympathize. To the extent it incents parties to adopt more rational positions in the course of the case, an agreement to use appeal arbitral rules can indirectly promote settlement.

EFFECT ON THE TRIBUNAL

Independent, impartial and unbiased arbitrators should address the dispute exactly the same way, whether or not their ruling is subject to appellate review. Ultimately, if someone is sure that the case must be resolved in a certain way, then the possibility of an appellate arbitral review should be immaterial.

However, arbitrators concerned about their own reputation, unsure about what the right outcome of the case is or are less decisive generally, may soften their ruling. They may adopt a less controversial solution, perhaps splitting the baby in a misguided effort to dis-incent the filing of an appeal and avoiding an award reversal.

The possibility of the appeal, however, should serve as a good reminder for arbitrators that the file must be read fully, the evidence carefully considered and any reasoning and rulings solidly crafted,

lest the award be annulled by the appeal tribunal. (An interesting question is whether the arbitral tribunal can be kept in the dark about the party agreement to have the appellate procedures apply, so that the agreement does not taint or influence the outcome of the case in the first instance. The answer is most likely "yes," but the matter is complex and well beyond the scope of this article.)

The choice of appellate arbitral review may discourage certain types of arbitrators from adopting an overly personal approach to proceedings. Users worried about unbridled arbitrator personalities, prima donna approaches to cases and excessively discretionary or erratic outcomes, may find comfort in the fact that this risk is less pronounced in a first instance where the arbitrators know their award may fall under the supervision of an appeal tribunal.

As for the effect on the appeal tribunal itself, the parties should diligently consider appeal arbitrator candidates to ensure the correct outcome to the case. The purpose of the appeal process may be defeated by appeal arbitrators, who out of friendship, temperament or another reason are unduly deferential to their first instance peers, or by arbitrators who misunderstand collegiality and are thereby disinclined to review or annul what a peer has done.

WHAT NOT TO EXPECT FROM THE APPEAL PROCESS

In court litigation, appeals serve, among others, the important goal of trying to promote jurisprudential consistency. If opinions from trial courts are reviewed by the same appeal court, then similar cases eventually tend to be resolved similarly. This is not the case with an arbitral appeal.

Arbitral appeal tribunals typically have different compositions, and appeal arbitrators sitting in one case may not know, and generally are not bound by, how other appeal arbitrators resolved a related dispute.

Example: Consider a product manufacturer who, on similar facts, terminates 20 distributors, each of whom has a contract with the manufacturer providing for arbitration under the same set of rules. As a result, 15 of those distributors choose to challenge the termination, each in a separate arbitration. Even though the grounds for termination and the contractual language may be identical, there is no guarantee that the 15 first instance arbitral tribunals will adjudicate the matter in the same way. If an appeal process follows, 15 different appeal arbitral tribunals may be constituted and each may rule on the case differently (among other things, confidentiality provisions, may prevent one tribunal from knowing how the others have ruled).

It is for users to decide based on their preferences whether the impossibility to demand and expect consistency from the arbitration system is a concern to them. It can be a concern for users who want their cases to be resolved uniformly and want to discourage arbitrators from taking unjustifiable positions, knowing that they are not bound by arbitral precedent. However, it can be favorable for users who value a tribunal's independent and fresh eyes approach to cases, allowing for their adoption of new perspectives.

LOGISTICAL CONSIDERATIONS

The parties who opt into appellate rules must ensure that the arbitration clause and further agreements are consistent with that choice.

For instance, the appellate rules of U.S. arbitral institutions require that the underlying award, at a minimum, be reasoned. (Otherwise, the appeal panel may not have findings or substance to review.)

The parties also should consider whether the appellate panel should consist of one or three arbitrators. The default rule calls for three-member appellate panels (AAA/ICDR Optional Appellate Arbitration Rule A-5(c), JAMS Optional Arbitration Appeal Procedure Paragraph A and CPR Arbitration Appeal Procedure Rule 1.2 and 4.1).

A sole appeal arbitrator may review the work of a sole first instance arbitrator quite effectively, provided the appellate sole arbitrator has the experience, training and temperament necessary for the role.

The analysis is different when there have been three first instance arbitrators. It is typically easier for three arbitrators to review what a sole arbitrator or three other arbitrators did than for a sole arbitrator to review what three others did. However, that may not always be the case. A sole appellate arbitrator may be appropriate to review the work of a three-member first instance panel when the parties just want to try to avoid too prominent or significant mistakes by the first instance tribunal but are more forgiving in case smaller and less detectable mistakes are involved.

Timing also plays a part. Theoretically the parties can agree to have the appellate rules apply to their case at any time before the deadline to file the appeal against the award expires (see, for example, AAA/ICDR *Optional Appellate Arbitration Rules A-1, A-3*). In most cases, however, it is easier to agree to the appellate rules in the clause itself or in any event before arbitration proceedings commence. Once the dispute arises, the parties' interests may be too divergent for them to agree on almost anything, far less an appeal process that may lengthen the proceedings and be viewed by one party as giving too much of a second opportunity to the other.

Similarly, parties wishing to use the appellate procedures as a tool to remind the tribunal that their approach to the case and decision are subject to review may lose that effect if the agreement to use appellate rules comes after the award. Therefore, parties determined to have the appellate rules apply to their case and fully avail themselves of their benefits are well advised to insist on their inclusion in the arbitration clause.

WEIGH THE CHOICE OF APPELLATE ARBITRATION CAREFULLY

Arbitration appeals differ from those in court litigation. They add some uncertainty to the parties' strategy and do not ensure overall arbitral, systemic consistency. They can also be time consuming, a risk that can be mitigated partially through the adoption of expedited first instance proceedings.

However, arbitration appeals offer undisputed benefits as well. They increase the chances the parties may receive a legally and factually sound award. They promote reasonable party conduct in the course of the case and may ultimately encourage settlement.

Appellate rules, however, are not appropriate for every type of case and also require significant party knowledge and involvement. For example, additional party effort is recommended in the drafting of the arbitration clauses involving appellate rules and in the arbitrator selection process both for the underlying arbitration and the arbitral appeal.

The author would like to thank his law firm colleague Justinian Doreste, for his assistance with the research necessary for this article and comments to a draft of it.

ABOUT PRACTICAL LAW

Practical Law provides legal know-how that gives lawyers a better starting point. Our expert team of attorney editors creates and maintains thousands of up-to-date, practical resources across all major practice areas. We go beyond primary law and traditional legal research to give you the resources needed to practice more efficiently, improve client service and add more value.

If you are not currently a subscriber, we invite you to take a trial of our online services at practicallaw.com. For more information or to schedule training, call **888.529.6397** or e-mail training.practicallaw@thomsonreuters.com.