

# Merits-Based Review of Arbitration Awards: A Potentially “Appealing” Option

By Theodore K. Cheng

An arbitration proceeding is intended to arrive at a final and binding resolution of a dispute in a fair, expeditious, and cost-effective manner. Consistent with that intention, it is generally not possible to obtain a comprehensive merits-based review of an arbitration award, as one might expect in an appeal of a federal or state court judgment. Rather, subsequent review of an arbitration award is severely limited in scope with one notable exception: where the parties elect to apply appellate arbitration rules to the underlying award. This article will discuss the availability of these optional rules and some considerations for practitioners and disputants in considering whether to adopt them.

## The Lack of Merits-Based Review Over Arbitration Awards

Under the Federal Arbitration Act (FAA),<sup>1</sup> which generally governs disputes involving interstate commerce and broadly preempts state arbitration laws, an aggrieved party may only petition a court to vacate an arbitration award on discrete, enumerated grounds:

- where the award was the product of corruption, fraud, or undue means;
- where the arbitrators exhibited evident partiality or corruption;
- where the arbitrators committed “misconduct,” such as refusing to postpone the hearing or hear relevant evidence; or
- where the arbitrators exceeded their powers.<sup>2</sup>

Moreover, in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, the Supreme Court of the United States held that these grounds are exclusive and may not be supplemented by an agreement of the parties.<sup>3</sup>

Because review of arbitration awards by courts is narrowly circumscribed, the arbitration process generally suffers from the criticism that parties have limited recourse in the face of an adverse award. Parties often exhibit reluctance in even contemplating arbitration as a dispute resolution mechanism, espousing that one of arbitration’s shortcomings is that the arbitrators simply get the law wrong, leading to incorrect results with no availability of appellate review. Risk-adverse parties view such a system as potentially problematic, decrying the absence of meaningful checks and balances in the arbitration process, namely, that the arbitrators are relatively unconstrained by statutes, case law, or rules of evidence, and that their subjective notions of fairness can lead to one-sided awards. Thus, notwithstanding the finality

that arbitration can provide (saving parties both time and expense), many will not accept the risk accompanying the extraordinarily wide latitude given to arbitrators to render decisions because it is virtually impossible to know the outcome in advance and how much it will cost. This risk may be particularly poignant in so-called “bet-the-company” cases (or high-stakes litigation) where the fate of an entire business may be at issue and the risk of an irrational award has dire consequences.

## Arbitration Providers Offer Merits-Based Review of Awards

In response to these concerns and to encourage more parties to use arbitration as a dispute resolution mechanism, over the years many arbitration providers have offered parties the option to agree upon an appellate review process as part of their agreement to resolve their dispute in an arbitral forum. Such an optional appellate review process would generally provide for a different set of arbitrators (usually a panel of three, but sometimes a single arbitrator) to review the award on the merits with the ability to correct erroneous decisions.

For example, in 1999 the International Institute for Conflict Resolution and Prevention (CPR) first promulgated its Arbitration Appeal Procedure, to which it has made editorial revisions over time.<sup>4</sup> In 2003, JAMS issued its Optional Arbitration Appeal Procedure.<sup>5</sup> Most recently, in 2013, the American Arbitration Association (AAA) set forth its own Optional Appellate Arbitration Rules.<sup>6</sup> These rules prescribe how, when, and on what grounds the parties may appeal an arbitration award. Under all three sets of rules, the providers require a record of the original, underlying arbitration proceeding, prohibit the appellate tribunal from remanding to the original arbitrator(s), and include proposed language for parties wishing to agree to an appeal process. However, there are marked distinctions between the rules, especially on the grounds for appeal.

Under the CPR appellate rules, an appeal of an award rendered in any binding arbitration conducted in the United States (regardless of whether it was administered

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by CPR or conducted under CPR's arbitration rules) may be filed where (a) the arbitrators "were required to reach a decision in compliance with the applicable law and rendered a written decision setting forth the factual and legal bases of the award"; and (b) there is a record that includes all hearings and evidence from the underlying proceeding.<sup>7</sup> Unless the parties agree on a different time period, the appeal must be commenced within thirty (30) days of the date on which the original award was received by the parties. CPR will then arrange for the appointment of an Appeal Tribunal (comprising three members, unless the parties agree to only one), with input from the parties, from a roster composed of former federal judges or such others as CPR deems appropriate. The rules also address the specifics of briefing and oral argument, and even permit the Tribunal to request that the parties supplement the record as it may deem appropriate in order to fulfill its function.

The Tribunal may issue an appellate award that modifies or sets aside the original award, but only if the original award (a) "contains material and prejudicial errors of law of such a nature that it does not rest upon any appropriate legal basis"; (b) "is based upon factual findings clearly unsupported by the record"; or (c) is subject to one or more of the grounds for vacatur under the FAA.<sup>8</sup> The Tribunal's decision (which may simply be a reinstatement of the original award) must be set forth in writing and include a concise explanation for the decision, unless all parties agree otherwise. Notably, the rules also provide for the appellant to reimburse the appellee's attorneys' fees and costs if the original award is affirmed, as well as permit the Tribunal to apportion fees and costs if the award is modified or reversed. They further maintain the confidentiality of the appellate proceedings. As to timing, the rules only call for the parties and the Tribunal to use their best efforts to avoid delay and assure that the appeal will be concluded within six months of its commencement. Although the parties may not pursue judicial review while the appellate arbitration is pending, they reserve the right to petition a court to judicially review the appellate award under the FAA once the appeal process has concluded. However, and in keeping with the cost-shifting paradigm of the rules, if that judicial review does not result in the vacatur or substantial modification of either the original award or the appellate award, the party seeking judicial review must reimburse the opposing party for its attorneys' fees and costs incurred in connection with that additional review.

A similar procedure is afforded under the JAMS appellate rules, including the appointment of a three-member Appeal Panel and the specifics of preparing the record on appeal, briefing, and oral argument. Notably, however, these rules only apply to awards that have been rendered under the JAMS arbitration rules. The appeal must be served on JAMS and the opposing party within fourteen (14) calendar days after the original award has become final, although the original award would not

be considered final during the pendency of the appellate process for purposes of further judicial review. As to the standard of review, the rules account for differences in geography and jurisdiction: "The Appeal Panel will apply the same standard of review that the first-level appellate court in the jurisdiction would apply to an appeal from the trial court decision."<sup>9</sup> Moreover, "[t]he Appeal Panel will respect the evidentiary standard set forth in Rule 22(d) of the JAMS Comprehensive Arbitration Rules," which generally affords wide discretion to the arbitrators on evidentiary issues.<sup>10</sup> The Panel is authorized to affirm, reverse, or modify the original award, and it may re-open the record in order to review evidence that had been improperly excluded by the original arbitrators or evidence that may now be necessary in view of the Panel's interpretation of law. Absent good cause, the Panel must render its decision in a concise written explanation within twenty-one (21) calendar days of the date of either the oral argument, the receipt of new evidence, or the receipt of the record and all briefs, whichever is applicable or later. At that point, the award will be deemed final for purposes of further judicial review.

Like the CPR appellate rules, the AAA appellate rules may, by stipulation or contract, apply to awards regardless of whether it was administered by AAA (or its international division, the International Centre for Dispute Resolution). The appeal must be commenced within thirty (30) days of the date on which the original award is submitted to the parties and only on the grounds that the original award is based upon "(1) an error of law that is material and prejudicial; or (2) determinations of fact that are clearly erroneous."<sup>11</sup> AAA will then arrange for the appointment of an appellate Tribunal of three arbitrators (unless the parties opt for a single arbitrator) from its Appellate Panel (or, for an international dispute, from its International Appellate Panel). The AAA appellate rules also address the specifics of preparing the record on appeal, briefing, and oral argument. Within thirty (30) days of service of the last brief, the day following the conclusion of oral argument, or other good cause for modification, the Tribunal must issue its decision, which must be in writing and include a concise summary of the decision and an explanation for it. Like the CPR appellate rules, the appellant may be assessed the appellees' attorneys' fees and costs if the Tribunal does not determine that the appellant is the prevailing party. They also likewise maintain the confidentiality of the appellate proceedings. Before the conclusion of the appeal process, the original award is not considered final for purposes of any subsequent judicial proceedings, but once the appeal process has completed, the tribunal's decision then becomes the final award for those purposes.

Thus, in varying ways, with emphases on setting forth certain incentives and disincentives, the three main domestic arbitration providers offer disputants the option to have a merits-based review in advance of, or in place of, subsequent judicial review under the FAA. Of course,

as is the case with all of the above rules, the parties may contractually alter the provisions to suit their particular needs, circumstances, and approaches. For example, they may elect to waive entirely the right to seek statutory vacatur, require the appellate panel to issue a reasoned award, only trigger an appellate process if the original award exceeds a certain floor monetary amount, or even bar the appellate procedure from applying to awards that had been rendered unanimously by the original arbitration panel. The parties can also choose to incorporate these rules into their original pre-dispute arbitration clause or agree to an appellate arbitration process in a separate post-dispute agreement. However, it seems unlikely that the parties would agree to do so after the original award has been issued, unless either both sides are dissatisfied with the award or the prevailing party has doubts about whether the award can be confirmed, or, conversely, whether the award is vulnerable to vacatur.

### Considerations Before Agreeing to Adopt an Appellate Arbitration Process

The parties and their counsel should consider various issues and their practical ramifications before pursuing an appellate arbitration process so that, if such a process is adopted, it will best serve their needs, as well as more likely be accepted by the other disputant(s) and their counsel. For example, the selection of the applicable appellate arbitration rules can have significant consequences. The grounds on which an appeal may be filed differ markedly and should be appropriate for the nature of the dispute. At least in the case of the CPR and AAA rules, cost-shifting to the prevailing party can also occur, affecting not only the likelihood of whether an appeal will be filed, but also how the underlying arbitration itself is conducted. At bottom, an appellate arbitration process will likely incur some additional cost and delay, as an entirely separate process will be invoked, with its own attendant fees and cost structures, and with the finality of the arbitration award postponed until the appellate tribunal renders its award.

However, for those parties who seek an additional level of review short of the limited remedies available in the courts, an appellate process is worth considering. Indeed, focusing attention on possibly incorporating an appellate arbitration process can permit the parties to contemplate the propriety of using a single arbitrator for disputes that might have ordinarily counseled the use of a three-member panel (such as in a bet-the-company case) precisely because of the availability of an additional merits-based review and concomitant remedies that would not be available in court. A single decision maker in the underlying arbitration, perhaps even coupled with a single appellate arbitrator, could also potentially reduce both the time and cost to finality, somewhat counterbalancing the additional cost and delay of adopting an appellate process in the first instance.

In the end, the balance is one of trading off the usual expeditiousness of a straightforward arbitration process against possibly increasing the parties' comfort in reaching the correct result. Adopting an appellate arbitration process may not be appropriate in every case, but it should certainly be one consideration in the overall dispute resolution strategy. Any discussion amongst the parties of a possible appellate process would undoubtedly lead to additional negotiations over the scope of the pre-dispute arbitration clause or at least serious discussions before entering into a separate post-dispute agreement that adopts such a procedure. Those discussions alone would be worthwhile, as they could potentially increase confidence in the arbitration process as a whole.

### Endnotes

1. 9 U.S.C. § 1 *et seq.*
2. 9 U.S.C. § 10(a). Even a modification of an arbitration award is limited to very narrow grounds. *See* 9 U.S.C. § 11.
3. *See* 552 U.S. 576, 581-84 (2008). For a discussion on whether parties could increase the level of judicial review or, alternatively, limit the scope of judicial review or even waive or eliminate it altogether (questions left open by *Hall Street*), *see* Theodore K. Cheng, *Developments on Judicial Review Under the FAA After Hall Street*, ABA Alternative Dispute Resolution, Vol. 19, No. 2 (July 30, 2015), available at <http://apps.americanbar.org/litigation/committees/adr/articles/summer2015-0715-developments-judicial-review-under-faa-hall-st.html>. *See also* Paul Bennett Marrow, *A Practical Approach for Expanding the Review of Commercial Arbitration Awards: Using an Appellate Arbitrator*, AAA Handbook on Commercial Arbitration, Chapter 28 (3d ed. Juris Net, L.L.C. 2016) (arguing that, providing for an arbitral appeals process would help overcome the risks in having an arbitrator's award become final without a merits-based review), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2754455](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2754455).  
Additionally, state and common law bases for vacatur also exist, such as for manifest disregard of the law or for irrationality. *See, e.g., Stolt-Nielsen SA v. AnimalFeeds Int'l Corp.*, 548 F.3d 85, 95 (2d Cir. 2008) (holding that arbitrators who manifestly disregard the law have "exceeded their powers" under section 10(a)(4)), *overruled on other grounds*, 559 U.S. 662 (2010); *Wein & Malkin LLP v. Helmsley-Spear, Inc.*, 6 N.Y.3d 471, 477-78 (2006) (permitting vacatur of arbitral awards (under CPLR 7511) that are irrational, violate a strong public policy, or clearly exceed an express limitation on the arbitrators' authority). However, even under those bases, the review is far less than that to which parties are generally accustomed on appeal in federal and state courts.
4. CPR Arbitration Appeal Procedure and Commentary (as revised 2015) ("CPR App. Rules"), available at <https://www.cpradr.org/resource-center/rules/arbitration/appellate-arbitration-procedure>.
5. JAMS Optional Arbitration Appeal Procedure (effective 2003) ("JAMS App. Rules"), available at [http://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS\\_Optional\\_Appeal\\_Procedures-2003.pdf](http://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS_Optional_Appeal_Procedures-2003.pdf).
6. American Arbitration Association Optional Appellate Arbitration Rules (effective November 1, 2013) ("AAA App. Rules"), available at <https://www.adr.org/sites/default/files/AAA%20ICDR%20Optional%20Appellate%20Arbitration%20Rules.pdf>.
7. CPR App. Rule 1.3.
8. CPR App. Rule 8.2.
9. JAMS App. Rule (D).
10. *Id.*
11. AAA App. Rule A-3(a)(i), A-10.