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Making Arbitration More Appealing

Commercial and Contracts

CHEAT SHEET

- ***Downsizing.*** The presence of an enhanced review empowers both parties to choose a single arbitrator instead of a three-person panel — which is largely considered to be inefficient and expensive.
- ***The convention standard.*** The New York Convention sets arbitration standards for roughly 160 signatory nations regarding when a court can refuse the enforcement of an international arbitral award.
- ***The local level.*** It is permissible for parties to choose the law of different jurisdictions to apply to different parts of an agreement or review process. This should apply internationally, and allow parties to work around strict arbitration guidance.
- ***Draft carefully.*** Ensure that any agreement expressly outlines the powers of the arbitrator to render an award that will ultimately be satisfactory to both parties. This expands the arbitrator's power as well as the scope of review.

Any business faced with a dispute seeks "to secure the just, speedy, and inexpensive determination of" that dispute, as the language of US Federal Civil Rule 1 puts it. Put another way, parties hope for "a plain, speedy, and efficient" resolution. In England and Wales, the Civil Practice Rule 1.1 states: "These Rules [have] the overriding objective of enabling the court to deal with cases justly and at proportionate cost."

Given the lengthy delays in trial of civil cases in court (median time to trial in US federal courts is 25 months), parties often turn to alternate dispute resolution (ADR). One common ADR method, arbitration, sometimes leaves participants feeling that the process was not as speedy, efficient, or inexpensive as they had hoped. The efficiency of the process (described as the time/cost to achieve outcome) is the single greatest priority of dispute resolution participants, according to the interim 2016 results of the *Global Pound Conference Series*.

In 2016-17, a global series of meetings — the Global Pound Conference — is soliciting opinions of clients, neutrals, advocates, and academics on dispute resolution. The interim results as of yearend 2016 have been published as of the date of this writing. (See Session 1, Q. 2).

Counterintuitively, this article's view is that drafting an arbitration clause that widens the scope of review for an arbitration award after it is rendered will promote speedier, cheaper, and more efficient results in the average case. Simply stated, in-house counsel can greatly improve the arbitration process by providing a broader scope of review than allowed domestically by the Federal Arbitration Act (FAA) (and many similar state statutes), or internationally by the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards. Why?

Article V of the New York Convention

1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:

1. The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or
2. The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or
3. The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or
4. The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or
5. The award has not yet become binding, on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:
    1. The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or
    2. The recognition or enforcement of the award would be contrary to the public policy of that country.

Adding the safety value of an arbitral appeal allows efficiencies at first hearing

The reason for this apparently counterintuitive result, which makes the overall process more efficient, is that the presence of enhanced award review empowers parties to choose a single arbitrator instead of a three-person panel to hear the matter more often. A single arbitrator’s fee is obviously smaller. More importantly, having to accommodate the schedule of only one busy arbitrator increases the chances of a speedy hearing. This furthers a disposition in one continuous session followed promptly by an award. Speedy processes should also reduce attorney fees (which often expand to fill the time available) and shorten the period of distraction required to resolve the dispute.

Given these advantages, why do parties prefer three-member panels? If two heads are better than one, as we learn growing up, many believe that three will be even better. More importantly, while two might tie, three won’t.

Central to the thesis of this article, parties choose a three-person panel because it reduces the chances of a wrong result and even more strongly reduces the chances of a bizarre result. No business professional wants to explain to their superior that to save some money and time, they agreed to a procedure that produced a bizarre result. Much less that the result can’t be undone, given the narrow scope of judicial review provided both in treaty (New York Convention) and in most

statutes (including the FAA and many similar state statutes).

In a study of 46 large countries, the US Bureau of Justice Statistics found that about one third of civil trial judgments internationally were reversed on appeal. On its face, this implies that trial courts reached the wrong result in about one third of the cases in the 46 countries studied (although it is possible that the appellate court and not the trial court got it wrong). In light of these judicial statistics, it seems unlikely that arbitrators get it wrong in fewer than 15 to 20 percent of the cases. Even if one assumes that arbitrators are less likely to make a mistake (in part because they are specifically selected for the case and often have more background in the subject matter of the dispute than a randomly assigned judge), being wrong half as often seems likely. That percent is big enough to include more than a few bizarre results that are not just wrong, but badly so.

In general terms, the grounds to overturn an award are procedural: an award in excess of arbitral power, bias, prejudice, or material procedural unfairness. Error of law or fact, even when obvious, plain, clear, or indisputable, is not usually sufficient to vacate an award.

A panel of three thus seems required to reduce the chances of the bizarre. But it is a protection that comes at a price.

Significant extra costs in time and money are incurred in most cases, all to protect against the extraordinary bizarre in a very few. Depending on the arbitral forum, fees for three arbitrator panels are between US$48,000 and US$115,000, greater than for single arbitrators. The London Court of International Arbitration (LCIA) and the Stockholm Chamber of Commerce (SCC) report that the median duration of three arbitrator cases is respectively four months and five-and-a-half months longer than for a single arbitrator.

SIAC data suggests only half a month longer; no explanation is apparent for this outlier.

In most cases, a single arbitrator will get it right, and certainly most cases will not culminate in a bizarre result. In many cases, a single arbitrator will produce the same award as three would have (consider the rarity of arbitral, or even judicial, dissents), and at significant savings of time and money.

But the presence of some enhanced “appellate” review protects against the possibility of an incorrect or bizarre result. In those rare cases of error, providing one of the three relief valves discussed below can prevent disaster. Even when appellate review confirms an award, review by a panel of three on the record created before a single arbitrator is likely less costly and time consuming than a full hearing on the merits before three arbitrators from the start would have been. When there has been some arbitral “appellate” review, the likelihood that a court would vacate the award goes down as well. Not often will a court be persuaded that a single trial arbitrator and three appellate arbitrators get wrong an issue that permits vacating the award under the narrow statutory or treaty standards.

Thus, the cumulative cost, after hearing and appeal, while greater than a three-member panel to try the case, is not likely to be materially greater because of the taking of live testimony, as opposed to reading a transcript or record on appeal. This process is materially slower and costlier when done in front of three instead of one.

Participants in ADR believe that the outcome of commercial disputes is primarily determined by the rule of law: findings of fact, and law or other norms. Appeal promotes the ensurance that an arbitral outcome has been determined by the rule of law.

The narrow scope of judicial review

Absent implementation of one of the techniques described below, Article V of the New York Convention only permits the courts of any of its roughly 160 signatory nations to refuse enforcement of an international arbitral award on five grounds.

Section 10 of the FAA permits vacating a domestic US award on four grounds. The US Supreme Court has held those grounds cannot be expanded even by consent of the parties. The English Arbitration Act of 1999, §68 has similar procedural grounds for domestic UK awards, but §69 permits an appeal on a material point of law if all parties agree.

Section 10 of the FAA states:

In any of the following cases the US court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration —

1. where the award was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption in the arbitrators, or either of them; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where 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.

How can parties get the safety value of wider judicial review of the award?

There are three ways to expand the default legal standard of review described above:

- Choose an arbitral forum with rules that allow for an appeal to a panel of three arbitrators or draft such rules in the arbitration agreement.
- Choose to invoke the local law of a jurisdiction that allows enhanced review and explicitly exclude the FAA or the New York Convention.
- Draft the arbitration clause in a way that limits the power of the arbitrator to enter an erroneous award.

Let’s look at each structure in turn.

Arbitral appellate rules. Several of the major arbitral forums, CPR, JAMS, and AAA/ICDR (ICDR is the international affiliate of the American Arbitration Association or AAA) have an optional appeal procedure that the parties can invoke in their agreement to arbitrate. ICSID, an affiliate of the World Bank for investor-state disputes, provides an optional appellate body as does the World Trade Organization. On the other hand, UNCITRAL, the Chartered Institute of Arbitrators, the London Court of International Arbitration, the World Intellectual Property Organization, and the International Chamber of Commerce do not have rules permitting arbitral appellate practice.

Parties can provide for three arbitrators and then an appeal, but that seems only to add delay and expense with little reason to expect it will produce a better result.

Arbitration is voluntary; it requires the agreement of the parties to a dispute to be invoked. As noted above, if the parties want an appeal, the safest of the three courses advocated in this article is for them both to choose an arbitral forum with appellate rules and specifically invoke those appellate rules. Each organization that has appellate rules requires specifically invoking the appellate process in addition to the arbitral process. Each has some difference in the degree to which the default rules can be varied by party agreement. Further, each imposes a slightly different standards to undo the award. For example, CPR provides that in addition to the grounds found in the FAA Section 10, it is grounds to overturn the award if it "(i) contains material and prejudicial errors of law of such a nature that it does not rest upon any appropriate legal basis, or (ii) is based upon factual findings clearly unsupported by the record."

The others differ in detail, and therefore the parties should choose the forum with care. However, whatever the differences in detail, each set of appellate rules provides an effective remedy against a bizarre result by a single arbitrator.

In principle, the parties could lay out the details of an appeal in their arbitration agreement, including the scope of review and the process. The advantage is that this maximizes the ability to tailor the process to what they want. The disadvantage is that it will most likely to lead to mischief. The rules have been vetted by committees of experienced practitioners, who may use some precedent on arbitral interpretation. A bespoke provision may have a problem that the parties don't see and lacks familiarity to the other players (arbitrators and staff).

Local law: When drafting an agreement that provides for arbitration, it is likely the parties will also choose the law of a specific jurisdiction to apply to the agreement. It is perfectly permissible for parties to choose the law of different jurisdictions to apply to different parts of the agreement. Thus, the substantive provisions of the agreement can be governed by one jurisdiction's law and the dispute resolution provisions by the law of another jurisdiction entirely. Indeed, it is even perfectly possible to have the dispute resolution process governed by one jurisdiction's law, and the enforcement process for the outcome of the dispute resolution process governed by another jurisdiction's law.

The consequence of these principles is that the parties, if they desire more extensive review than the New York Convention's or the FAA's limited review described earlier, can choose to exclude those laws and have the review subject exclusively to the law of a jurisdiction that provides for a wider review. This should be possible in most jursidictions internationally.

In the United States, at least California, Texas, Alabama, New Jersey, Connecticut, Pennsylvania, Rhode Island, and New Hampshire have cases allowing broader judicial review than the FAA or the New York Convention.

For example, in *Cable Connection v. DirectTV*, the California Supreme Court concluded that the US Supreme Court's Hall Street decision (cited above) did not preclude it from interpreting the California Arbitration Act differently. It went on to do so, and concluded that the CAA's standards of judicial review of awards (identical with the FAA's) were not exclusive. The court held that CAA did not preclude the parties from choosing a broader scope of judicial review where the CAA is governing law. It therefore sent the case back to the trial court to apply the parties' agreed standard of review to the award. Later cases suggest California does not believe that its common or statutory law creates a

standard of review different from the FAA, only that it permits the parties contractually to choose a different standard of review.

Texas seems to follow the same rule in 2011's *Nafta Traders v. Quinn*, and that decision notes that Alabama, New Jersey, and Connecticut do also.

Rhode Island has interpreted "manifest disregard" (a standard explained below) much more broadly than other courts that have accepted that standard and thus has broader review than the FAA.

Pennsylvania, in certain instances, allows setting aside an award any time a court would enter judgment notwithstanding a jury verdict.

New Hampshire seems to go further and holds that its state law is not preempted by the FAA, and that state common law permits review of an award for "plain mistake" even if the parties' agreement only invokes New Hampshire law and is silent on scope of review.

New York also allows invocation of its law without contact for large commercial matters (see NY GOL 5-1401) but it has not yet permitted expanded review of awards.

As noted above, §69 of the English Arbitration Act (1999) permits the parties to empower the court to review an award for errors of law. English law permits invocation in commercial transactions even when the transaction has no connection to England.

The question of whether a contract that had no contact with one of these broader review jurisdictions could none the less invoke the law of that jurisdiction is complex and beyond the present scope — some jurisdictions allow that, some don't. But when the parties can find a connection (perhaps even agreeing the actual arbitration hearings will be held within such a jurisdiction) or comfort themselves that, like England, the law of those jurisdictions can be invoked even if there is no other connection, 20 they surely should consider the question of expanding the scope of review to facilitate a single arbitrator hearing and deciding at first instance.

None of these cases deal with the law of a jurisdiction preempting the New York Convention instead of the FAA, but the same result may follow — particularly in the United States where the FAA implemented the New York Convention.

Careful drafting. The FAA, and the New York Convention, recognize that arbitration is a creature of party consent and the only source of power for the arbitrator is the parties' agreement. Awards have been set aside as in excess of the arbitrators' power.

Suppose, then, that the parties agree that the arbitrator is not empowered to render an award that is contrary to the law of a chosen jurisdiction (or alternatively only empower the arbitrator to render an award that is consistent with a jurisdiction's law).

A simple error of law is not grounds for vacation of an award under either the FAA or the New York Convention. Whether "manifest disregard of the law" (which at least requires that the law have been drawn to the arbitrator's attention by the party now aggrieved, that the law be clear, and that the award could not have been reached except by ignoring the clear law drawn to the attention of the arbitrator) can lead to vacating an award is a question the US Supreme Court has expressly deferred to the future.

But if the parties say the arbitrator is not empowered to render an award contrary to law, or must render one in conformity with the law or with the facts, are they limiting the arbitrator's power or expanding the scope of review? A court is not being asked to expand grounds for review; it is using the familiar "power" ground in a new way. This analysis is suggested by the Texas Supreme Court decision in *Nafta Traders v. Quinn.*

Whether this talismanic use of the power concept or word will change the result in any place other than Texas is an untested question.

Contract clause examples

Here's what each of the three major providers suggest as a contract clause to invoke arbitral appellate rule.

ARBITRATION CLAUSE WITH APPELLATE OPTION [CPR]

Any dispute arising out of or relating to this contract, including the breach, termination, or validity thereof, shall be finally resolved by arbitration in accordance with the International Institute for Conflict Prevention and Resolution (CPR) Rules for Administered Arbitration (the Administered Rules or Rules) by a sole arbitrator designated by [CPR] [the parties] under the Rules. The arbitration shall be governed by the Federal Arbitration Act, 9 U.S.C. §§ 1 et seq., and judgment upon the award rendered by the arbitrator(s) may be entered by any court having jurisdiction thereof. The place of the arbitration shall be (city, state).

An appeal may be taken under the CPR Arbitration Appeal Procedure from any final award of an arbitral panel in any arbitration arising out of or related to this agreement that is conducted in accordance with the requirements of such appeal procedure. Unless otherwise agreed by the parties and the appeal tribunal, the appeal shall be conducted at the place of the original arbitration.

APPELLATE CLAUSE ASSUMING STANDARD ARBITRATION PROVISION IN PLACE [AAA]

Notwithstanding any language to the contrary in the contract documents, the parties hereby agree: that the underlying award may be appealed pursuant to the AAA's Optional Appellate Arbitration Rules (Appellate Rules); that the underlying award rendered by the arbitrator(s) shall, at a minimum, be a reasoned award; and that the underlying award shall not be considered final until after the time for filing the notice of appeal pursuant to the Appellate Rules has expired. Appeals must be initiated within 30 days of receipt of an underlying award, as defined by Rule A-3 of the Appellate Rules, by filing a Notice of Appeal with any AAA office. Following the appeal process the decision rendered by the appeal tribunal may be entered in any court having jurisdiction thereof.

APPELLATE CLAUSE ASSUMING STANDARD ARBITRATION PROVISION IN PLACE [JAMS]

The Parties adopt and agree to implement the JAMS Optional Arbitration Appeal Procedure (as it exists on the effective date of this agreement) with respect to any final award in an arbitration arising out of or related to this agreement.

Conclusion

Agreement by the parties to some form of review of an arbitral award greater than the extremely limited scope in the New York Convention, the FAA or similar sources, promotes the ability of the parties to have the case heard by a single arbitrator. Because expanded review provides comfort against seriously erroneous results, there is no need for two additional arbitrators in every case to prevent serious error. Shifting to a single arbitrator, as the LCIA and SCC data show, produces speedier and less expensive results on average: time and money often correlate in dispute resolution. Thus, providing for an appellate process in drafting the arbitration agreement with a single arbitrator at first instance is likely to promote the parties' shared goal of securing a "just, speedy, and inexpensive determination of" their dispute.

Further Reading

Tax Anti-Injunction Act. (28 U.S.C. §1341).

The median time to resolve US federal civil cases is about 8.5 months but this includes defaults, motions, and other early resolutions. Nearly 15 percent of federal civil cases last more than three years. Federal Court Management Statistics. For those cases that actually get tried, the median time to begin a trial is 24.9 months. A 1999 World Bank Publication, "Court Performance Around the World," reports Germany is among the speediest internationally at five months. France and Singapore are speedy, while Panama, Ecuador, and Chile are slow, per the World Bank.

On the virtues of arbitration generally, see, e.g., Sussman and Wilkinson, "Benefits of Arbitration for Commercial Disputes (2012)."

Hall Street Associates. v. Mattel, 552 US 576 (2008).

See generally, Robertson, Carson and Harrell, "Appealing an International Arbitration Award," *Corporate Counsel* (July 2015).

Smith Barney Shearson Inc. v. Sacharow, 91 N.Y.2d 39 (1997) (esp. Section IV).

Nappa Construction Management, LLC v. Caroline Flynn, 2017 WL 281812.

Trombetta v. Raymond James Financial Services, Inc., 907 A.2d 550 (Pa. Super. 2006) (holding parties' agreement to use de novo review of JNOV invalid).

Finn v. Ballentine Partners, 169 N.H. 128 (N.H. 2016).

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