CHAPTER 41

A PRACTICAL APPROACH TO AFFORDING REVIEW OF COMMERCIAL ARBITRATION AWARDS: USING AN APPELLATE ARBITRATOR

Paul Bennett Marrow[*]

I. Introduction

This chapter focuses on an option suggested by Judge Richard Posner in *Chicago Typographical Union v. Chicago Sun-Times,*[1] that appellate review of arbitral awards be handled as part of the arbitration process itself, without the involvement of the judiciary. This proposal has received little attention in the literature. Here the practical implications of implementing appellate arbitral review are discussed in detail.

I do not advocate providing for arbitral appellate review for every dispute.[2] Appellate review, in some form is appropriate only when the nature of the claim requires the arbitrator to resolve legal issues. The failure of an arbitrator to follow the law can lead to an appearance of "lawlessness"[3] and in some extreme cases can even be characterized as a "manifest disregard" of the law. The problem is that while manifest disregard for the law may be grounds for vacatur,[4] mere error in the

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[*] Paul Bennett Marrow is an arbitrator on the commercial panel of the American Arbitration Association, FINRA and is a Fellow of The Charter Institute of Arbitrators, London, England. He can be reached at 914-238-3689 or by e-mail at *pbmarrow@optonline.net*.

[1] 935 F.2d 1501, 1505 (7th Cir. 1991).

[2] I do advocate it for disputes under standard form contracts raising commonly encountered issues unique to a particular business (*e.g.*, credit card, insurance and securities disputes), or for disputes that are notoriously fact-based and usually decided by specialized panels (*e.g.*, construction, elections, employment, insurance, labor and patent disputes, to name a few).

[3] Robert Scott, *The Lawlessness of Arbitration*, 9 CONN. INS. L.J. 355 (2002/2003); Rex P. Perschbacher & Debra Lyn Bassett, *The End of Law*, 84 B.U.L. REV. 1, 28-32 (2004).

[4] *See* for example, Portiz v. Dresdner, Kleinwert, Benson, North America, LLC., 497 F 3d 133, 139 (2nd Cir 2008). However, the holding in *Hall v. Mattel*, *infra* note 10 has raised

application or understanding of the law is not.[5] While the finality of arbitration awards is a clear benefit of arbitration, the risk that the law might not be applied correctly is of sufficient concern to some attorneys to cause them to recommend against arbitration as a vehicle for dispute resolution. Providing for an arbitral appeals process would help overcome such concerns.

II. Authority for a Non-Judicial Appellate Process

Neither the Federal Arbitration Act (FAA) nor the Uniform Arbitration Acts (both the 1955 UAA and the 2000 revision UAAs) provides for an appeal of an arbitral award. These statutes limit judicial review to vacatur on specific grounds, most of which involve wrongdoing or over-reaching by an arbitrator.[6] At the same time, neither statute prohibits the parties from crafting their own mechanism for the review of an award.

Both the FAA and the UAAs deem any agreement to arbitrate valid and enforceable "save upon such grounds as exist at law or in equity for

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serious questions about the viability of the doctrine. *See* American Fin. Services v. Oxford Mgmt. Services, 627 F. Supp 2d 85, 93-94 (E.D.N.Y. 2008); Jill Gross, *Hall Street Blues: The Uncertain Future of Manifest Disregard,* 37 Securities Regulation L. J. 232 (2009).

[5] "A federal court cannot vacate an arbitral award merely because it is convinced that the arbitration panel made the wrong call on the law. On the contrary, the award 'should be enforced, despite a court's disagreement with it on the merits, if there is a barely colorable justification for the outcome reached.'" Banco de Seguros del Estado v. Mutual Marine Office, Inc., 344 F.3d 255, at 260 (2d Cir. 2003). *See also* Hoeft, 343 F.3d 57at 70-71 (2d Cir. 2002) (confirming award and stating that it 'is of no consequence' that arbitrator's decision did not apply the 'clear majority view' of a certain principle of accounting law); Westerbeke Corp. v. Daihatsu Motor Co., Ltd., 304 F.3d 200, 216, n. 10 (2d Cir. 2002) (award would be confirmed regardless of the court's 'serious reservations about the soundness of the arbitrator's reading' of the contract at issue); St. Mary Home, Inc. v. Service Employees Int'l Union, Dist. 1199, 116 F.3d 41, 44-45 (2d Cir. 1997) ("Internal inconsistencies in the [arbitrator's] opinion are not grounds to vacate the award notwithstanding the [movant's] plausible argument that the arbitrator's decision was misguided or our own concerns regarding the arbitrator's conclusion."); Wallace v. Buttar, 378 F. 3d 182, 189-90 (2d Cir. 2004); Paul Bennett Marrow, *Arbitration Awards: Understanding the Limitation of Vacatur and the Possibilities of an Appeal*, 33 Westchester Bar Journal 68 (2006) *reprinted in* 7 The Icfai University Journal of Alternate Dispute Resolution 49 (2008).

[6] Vacatur is a right that is available to any party by virtue of statute. Appeals, on the other hand are not available as of right and can only come about by virtue of an agreement between the parties or the rules of a provider of arbitration services to whom the parties have agreed upon. *Marrow*, *id.* at 69-73.

the revocation of any contract."[7] The courts have given a liberal interpretation to this statutory language.[8] To date no court has held an appeals provision in an arbitration agreement to be unreasonable per se and it is hard to envision a court doing so.[9] Similarly, there is no statutory prohibition against including such a provision in an arbitration agreement.

How would one go about establishing a contractual procedure for the appeal of an award? One possibility is a provision conferring appellate jurisdiction on a court. Until *Hall v. Matell*[10] the issue provoked a great deal of controversy and comment.[11] The federal courts were split on the

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[7] FAA § 2 provides:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

UAA § 1 (1955) provides:

> A written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract. This act also applies to arbitration agreements between employers and employees or between their respective representatives [unless otherwise provided in the agreement].

UAA § 6 (a) (2000) provides:

> An agreement contained in a record to submit to arbitration any existing or subsequent controversy arising between the parties to the agreement is valid, enforceable, and irrevocable except upon a ground that exists at law or in equity for the revocation of a contract.

[8] One court aptly observed that "short of authorizing trial by battle or ordeal or, more doubtfully, by a panel of three monkeys, parties can stipulate to whatever procedures they want to govern the arbitration of their disputes; parties are as free to specify idiosyncratic terms of arbitration as they are to specify any other terms in their contract." Baravati v. Josephthal, Lyons & Ross, 28 F.3d 704, 709 (7th Cir. 1994).

[9] *See* for example, discussion in Life Receivables Trust v. Goshawk Syndicate 102 at Lloyd's, 2008 NY Slip Op 32626U (Sup. Ct. N.Y. Cty.).

[10] 552 U.S. 576, 128 S.Ct. 1396 (2008).

[11] Much has been written on this topic, so there is no need to repeat the various arguments. *See* D.P. Wood, *Brave New World of Arbitration*, 31 CAP. U. L. REV. 383 (2003); Lee Goldman, *Contractually Expanded Review of Arbitration Awards*, 8 HARV. NEGOT. L. REV. 171 (2003); William H. Knull III & Noah D. Rubins, *Betting the Farm on International Arbitration: Is it Time to Offer an Appeal Option?*, 11 AM. REV. INT'L ARB. 531 (2000); Michael H. LeRoy & Peter Feuille, *The Revolving Door of Justice: Arbitration Agreements that Expand Court Review of an Award*, 19 OHIO ST. J. DISP. RESOL. 861

issue of whether or not private parties have such a power.[12] State court rulings, few in number, evidenced concerns similar to those raised by the federal judiciary.[13] *Hall* put the issue to rest with the Court holding federal courts can not vacate an award based on jurisdiction arising from a private agreement to arbitrate. The *Hall* Court noted that its decision was confined to the Federal Arbitration Act leaving it to the state courts to decide if a similar rule might exist under state statutes authorizing arbitration or under common law.[14] Subsequent to *Hall*, a split has developed concerning the question of whether the *Hall* rule applies to state statutes providing for arbitration.[15] All this suggests that trying to contractually bind the judiciary is chancy and unpredictable.

(2004); Richard C. Solomon, *Appeals of Arbitration Awards by Agreement: Why They Should be Allowed*, 58 DISP. RESOL. J. 58 (2003); Margaret Moses, *Party Agreements to Expand Judicial Review of Arbitral Awards*, 20 J. INT'L ARB. 315 (2003); James B. Hamlin, *Defining the Scope of Judicial Review by Agreement of the Parties*, 13 MEALEY'S INT'L ARB. REP. 25 (1998); Stephen Hayford & Ralph Peeples, *Commercial Arbitration Evolution: An Assessment and Call for Dialogue*, 10 OHIO ST. J. DISP. RESOL. 343 (1995).

[12] The Fourth and Fifth Circuits gave recognition to such contracts. Syncor Int'l Corp. v. McLeland, 120 F.3d 262 (4th Cir. 1997); Gateway Techs. v. MCI Telecomms. Corp., 64 F.3d 993 (5th Cir. 1995); *see also* New England Utils. v. Hydro-Quebec, 10 F. Supp. 2d 53 (D. Mass. 1998). The Seventh, Eighth and Tenth Circuits have refused to recognize contractual provisions for expanded judicial review. *Chicago Typographical Union*, *supra* n. 1; UHC Mgmt. Co. v. Computer Sci. Corp., 148 F.3d 992 (8th Cir. 1998); Bowen v. Amoco Pipeline Co., 254 F.3d 925, 935 (10th Cir. 2001).

[13] *Compare* Crowell v. Downey Cmty. Hosp. Found., 95 Cal. App. 4th 730 (Cal. Ct. App. 2002) (interpreting the California Arbitration Act); In Re County of Chemung, 277 A.D.2d 792 (N.Y. App. Div. 2000) (interpreting N.Y. C.P.L.R. art. 75); Dick v. Dick, 534 N.W.2d 185 (Mich. Ct. App. 1994) (interpreting Michigan's Arbitration Act); Chicago, Southshore & South Bend R.R. v. Northern Ind. Commuter Transp. Dept., 682 N.E.2d 156 (Ill. App. 1997) *rev'd other grounds*, 184 Ill. 151 (1998) (interpreting the Illinois Arbitration Act) *with* Primerica Fin. Serv. v. Wise, 217 Ga. App. 36 (1995) (interpreting the FAA).

[14] "In holding that §§ 10 and 11 provide exclusive regimes for the review provided by the statute, we do not purport to say that they exclude more searching review based on authority outside the statute as well. The FAA is not the only way into court for parties wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable. But here we speak only to the scope of the expeditious judicial review under §§ 9, 10, and 11, deciding nothing about other possible avenues for judicial enforcement of arbitration awards." *Supra* note 10 at 1406. *See* J. Berger and C. Sun, *Practitioner Note: The Evolution of Judicial Review Under the Federal Arbitration Act*, 5 N.Y.U.J.L. & Bus. 745 (2009).

[15] *Compare* Cable Connection, Inc. v. Direct TV, 44 Cal. 4th 1334 (2008); Brookfiled Country Club v. St. James Brookfield , 2009 Ga. App. Lexis 865; Feeney v. Dell, 23 Mass L. Rep. 651 (Superior Ct. 2008) reversed on other grounds, 2009 Mass. Lexis 328 ; Falcon Steel Co., Inc. v. HCB Contractors, et al, 1991 Del. Ch. Lexis 69; Matter of Johnson

The alternative is to provide for an appeal to an appellate arbitrator or panel. This approach has a number of advantages:

- Consistent with the philosophical underpinnings of arbitration, the approach extends the flexibility afforded contracting parties seeking to resolve disputes through arbitration.
- It eliminates the uncertainty of trying to involve the judiciary in a manner not otherwise provided for by arbitration statutes.
- It eliminates concerns about confidentiality presented by an appeal through the judicial system.
- It allows the parties to structure the appeals process so as to maintain the goals of speed and efficiency.

In order to implement this suggestion in a meaningful way, arbitral institutions would have to allow the parties to provide for an appellate procedure. The arbitration rules of two major ADR organizations, the International Institute for Conflict Prevention and Resolution (CPR) (formerly the CPR Institute for Dispute Resolution) and the Judicial Arbitration and Mediation Services (JAMS), envision some kind of appeals process while the rules the National Arbitration Forum (NAF), acknowledge the possibility of such a process.

The CPR[16] and JAMS[17] Arbitration Rules provide a formal structure for "internal" appellate review. Both sets of rules permit an appeal based on law and/or fact (similar to judicial appeals). They require timely notice of appeal and compliance with rules governing the selection of the appellate arbitrator, arbitrator challenges, the record on appeal, the exchange and length of briefs, oral argument, arbitrator compensation, and confidentiality of proceedings. Their rules also define the powers of the appellate arbitrator. CPR Rule 8.2 allows the appellate arbitrator to modify or set aside the original award because of an error of law "of such a nature that it does not rest upon any appropriate legal basis"[18]or fact, or because it is subject to one of the grounds for vacating an award in FAA § 10. JAMS Rule D authorizes the appellate arbitrator to affirm, reverse,

(Summit Equities, Inc.), 22 misc. 3d 631 (Supreme Ct. N.Y. Cty 2008); Pugh's Lawn Landscape Co. v. Jaycon Dev. Corp., 2009 Tenn. App. 189; Ancor Holdings LLC v. Petereson, Goldman & Villani, Inc., 2009 Tex. App. Lexis 6657.

[16] International Institute for Conflict Prevention and Resolution Arbitration Appeal Procedure available at *www.cpradr.org/*.

[17] JAMS Optional Arbitration Appeal Procedure (2003), available at *www.jamsadr.com/*.

[18] Rule 8.2(a).

or modify the original award. Both schemes require the appellate arbitrator to prepare a written statement explaining the appellate decision.

There is nothing objectionable about these rules. Moreover, the parties can deviate from them if they choose. But the fact that special rules already exist in the JAMS and CPR schemes suggests that to obtain uniform administration, it would be better not to depart from them. However, the complexity and formality of these appellate schemes could create unwanted delay and expense.

The rules of the NAF[19] do not establish an appeals process. But they do acknowledge the possibility that the parties may want to have an appeals process. Rule 1(D) states:

> Parties may modify or supplement these rules as permitted by law. Provisions of this Code govern arbitrations involving an appeal or a review de novo of an arbitration by other Arbitrators.

NAF Rule 43 (E) further provides:

> An order or award is reviewable by a court of competent jurisdiction as provided by applicable law.

Read together, the NAF's rules appear to envision two alternatives. One is an appeal de novo before an arbitrator with no restrictions as to the scope of the appeal. The other is an appeal directly to a court with jurisdiction. Both procedures could be costly and time-consuming because they are not limited to issues of law. Moreover, an appeal to a court may be problematic given the *Hall* decision and the current state of case law that evidences judicial resistance to the concept of private agreements conferring jurisdiction.[20]

Most of the AAA Arbitration Rules (take the Commercial Rules as an example) neither authorize nor prohibit appeals. Instead, the rules judiciously favor giving the parties maximum flexibility to provide for procedures that serve them best. AAA Rule R-1(a) provides in part: "The parties, by written agreement, may vary the procedures set forth in these Rules." This broad authorization makes it possible to mix and match the rules to serve the specific needs of those seeking to construct a viable

[19] Officially called the Code of Procedure (2003), available at *www.arbitration-forum.com/*.

[20] *See* cases *supra* note 15.

and efficient appellate process. I believe that this rule would authorize the parties to craft an arbitral appeals process limited to determinations about the application and interpretation of law. These are issues that can be decided within weeks of the issuance of the award that is the subject of the appeal. This type of appeal process could give counsel and their clients the comfort they need to prevent an aberrant award.

III. Rationale for Limiting Appeals to Issues of Law

Why do I propose limiting the appeal to issues of law (*e.g.*, their application and interpretation), rather than de novo review? True, an errant award could involve a misunderstanding of facts. But de novo review would undermine the purpose of arbitration to provide an expeditious and cost-effective dispute resolution procedure.

Arbitration is first and foremost about resolving issues of fact. A party whose presentation of facts is not accepted by the arbitrator will always conclude that the arbitrator's factual findings are just plain wrong. However, the possibility that another fact finder might view the facts differently doesn't mean that the first arbitrator was wrong or rendered an unfair award. Allowing de novo review would open the door to the proverbial "second bite at the apple"[21] (*i.e.*, a second hearing on the facts and law). Once that door opens, the cost of resolving the dispute could greatly increase, as could the time needed to decide the matter (with attendant opportunities for delay).

By contrast, an appeal on the law alone does not require a complete and accurate record, so it gives the parties an opportunity for a fair but limited hearing without extra cost and time. If the award is reversed on a legal ground (either because the original arbitrator applied the wrong law or misapplied the right law), the appellate arbitrator could issue a correct award so that the parties do not have to go back and arbitrate again.

IV. Drafting the Agreement to Arbitrate

The AAA (Commercial) rules allow the parties "to vary the procedures" set forth therein. This presumably includes adding an arbitral appeal process since there are no default procedures for conducting an appeal. Still, the AAA might hesitate to administer an

[21] UAA § 201(b) (2000), Reporter's Notes B (B)(5).

appeal without specific procedures crafted by the parties.[22] Therefore consideration might be given to including at least the following:

- A statement of the arbitration law and the substantive law to be applied to any dispute to be resolved by arbitration.
- A requirement that all rulings by the arbitrator(s) shall be reasoned and in writing explaining the basis for the award and the principle facts and law on which it is based.
- A statement that a party may appeal an award to an AAA arbitrator or panel (Appellate Arbitrator) only on the ground that the arbitrator(s) misapplied or misinterpreted the law.
- A statement that while an appeal is pending, no party shall enter judgment on the original award or seek vacatur as permitted by law.
- A declaration that the appeal to an Appellate Arbitrator is to be treated as an Expedited Procedure under the AAA (Commercial Arbitration) rules.[23]
- A statement that the final ruling of the Appellate Arbitrator shall be final and binding.
- A statement of the powers of the Appellate Arbitrator.

For example, the clause could read as follows:

> Any controversy or claim arising out of or relating to this contract shall be governed by the substantive laws of _____ and any arbitration of this dispute shall be conducted under the arbitration law of _____.
>
> All awards in this matter shall explain the basis therefore in writing, including the principle facts on which the awards are based.

[22] All is not lost if the AAA were to decline to administer the appeal. Rule 1.1 of the CPR Arbitration Appeals Procedure suggests that CPR would facilitate an appeal from an award granted pursuant to the rules of another facilitator.

[23] AAA Rule R-1 (b) gives parties the option of employing the Expedited Procedures in situations of their choosing. It provides in part: "Unless the parties or the AAA determines otherwise, the Expedited Procedures shall apply in any case in which no disclosed claim or counterclaim exceeds $75,000, exclusive of interest and arbitration fees and cost. Parties may also agree to use these procedures in larger cases…."

> Within 20 days of receiving the final award, any party may appeal an issue of law (that is, a claim that the arbitrator misapplied or misinterpreted the law) to an AAA Appellate Arbitrator by notifying the AAA Case Manager of the desire to appeal. The appeal shall be considered an Expedited Procedure and therefore subject to AAA Expedited Procedure E-3 (Serving of Notices),[24] E-4 (Appointment and Qualifications of Arbitrator),[25] E-9 (Time of Award)[26] and E-10 (Arbitrator's Compensation).[27]
>
> There shall be no record of the appeal and there shall be no exchange of documents other than briefs supporting or opposing the appeal. Each party may file and exchange one brief no longer than 10 pages. There shall be no other briefs.
>
> Upon the exchange and filing of these briefs, the matter shall be submitted for decision to the AAA Appellate Arbitrator(s). There shall be no oral argument. While the appeal is pending no party shall seek to enforce the final award or seek to enter judgment thereon under federal or state law.

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[24] AAA Expedited Procedure E-3 (Serving of Notices) allows notice as provided by Section R-39(b), and telephone notice subsequently confirmed in writing to the parties. E-3 states that "[s]hould there be a failure to confirm in writing any such oral notice, the proceeding shall nevertheless be valid if notice has, in fact, been given by telephone."

[25] AAA Expedited Procedure E-4 (Appointment and Qualifications of Arbitrator) describes a "list procedure" for the appointment of the arbitrator. First, the AAA sends each party a list of five proposed arbitrators. The parties are supposed to agree on one, but if they can't agree, they are to use the "strike" method of selection. This means each party may strike two names from the list. If the arbitrator can't be appointed from the list, the AAA will make the appointment. The parties can object to the appointment of an arbitrator for cause. If the parties wish to have three arbitrators selected under the procedure in E-4, they must so provide in their contract.

[26] AAA Expedited Procedure E-9 states with respect to the timing: Unless otherwise agreed by the parties, the award shall be rendered "not later than 14 days from the date of the closing of the hearing or, if oral hearings have been waived, from the date of the AAA's transmittal to the arbitrator." Because there are no statements or proofs on an appeal, the clause would have to indicate an intention by the parties that in the place and stead of statements and proofs, the parties intend "final briefs and the relevant portions of the hearing transcript, if there is one. . . ."

[27] E-10. Arbitrator's Compensation provides that arbitrators will receive compensation at a rate to be suggested by the AAA regional office.

> The Appellate Arbitrator(s) shall have the power to (1) affirm the original award in whole or in part; (2) dismiss some or all of the claims or counterclaims that were the subject of the original award; and (3) vacate the original award in whole or in part and issue a new award based on the factual findings set forth in the original award.
>
> The award of the Appellate Arbitrator(s) shall explain the basis for the award in writing and it shall be final.

This language should make it possible to appeal an issue of law without offending AAA Commercial Arbitration Rule R-46 (Modification of Award), which prohibits the redetermination of the merits of a claim once the hearing has been closed. Given that the parties have the power under AAA Rule R-1 (a) to vary the AAA rules, there appears to be no need to amend Rule 46, since any reversal by the Appellate Arbitrator would not alter the factual findings in the original award.

The proposed 20 days' notice of intent to appeal is consistent with the time requirement in Rule 46 governing requests for modification of an award. In its totality, the proposed arbitration clause would likely achieve a fair, expeditious and cost-effective arbitration with the ability to appeal issues of law.

V. Conclusion

A properly drafted arbitration clause could provide for an appeal of alleged errors of law in an award to an Appellate Arbitrator. If the clause outlined the appellate procedures to be followed, I believe the appeal could be heard under the existing AAA rules. The ability to appeal to an Appellate Arbitrator could eliminate (or at least reduce) attorneys' resistance to arbitration based on the finality of awards. It seems sensible to expect arbitral institutions to support an optional arbitral appeals process as a response to reasonable objections to arbitration and make it more attractive to attorneys.