

Arbitration - USA

AAA issues optional appellate arbitration rules

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In November 2013 the American Arbitration Association (AAA) issued its new Optional Appellate Arbitration Rules, which afford parties the ability to appeal arbitral awards to specialised appellate tribunals. The appellate rules are significant for international arbitration practitioners because they offer an arbitral structure – outside of judicial enforcement regimes – for reviewing awards alleged to suffer from serious factual or legal defects.

Finality and US judicial trend supporting it

Finality is often cited as one of the advantages of arbitration as a dispute resolution mechanism.⁽¹⁾ Indeed, as commentators have noted, "anecdotal evidence and empirical research indicate that business users generally consider the efficiency and finality of arbitral procedures favorably, even at the expense of foregoing appellate rights".⁽²⁾

Over the past several years, US federal courts have issued several key decisions that support and advance the notion of arbitral finality. For instance, in 2008, the Supreme Court held in *Hall Street Associates, LLC v Mattel, Inc* that the grounds stated in Sections 10 and 11 of the Federal Arbitration Act for vacating or modifying arbitral awards, which largely mimic the grounds set forth in Article V of the New York Convention, are exclusive and cannot be contractually altered or expanded by the parties.⁽³⁾ The *Hall Street* decision not only invalidated those portions of arbitration clauses, which permitted US courts to review awards for factual or legal error,⁽⁴⁾ but also led certain US federal appellate courts to conclude that the controversial doctrine of manifest disregard of the law was no longer a valid basis for challenging enforcement of awards.⁽⁵⁾

Beginning with the Eleventh Circuit Court of Appeal's decision in *BL Harbert International LLC v Hercules Steel Co*⁽⁶⁾ US federal courts have also been much more stringent and willing to punish parties (or their counsel) who undermine arbitral finality by attempting to revisit the merits of a dispute at the enforcement stage. Those courts generally reason that unwarranted challenges during enforcement proceedings destroy the benefits that finality offers by unnecessarily prolonging disputes and increasing costs.⁽⁷⁾

Despite the benefits that finality can offer, some parties avoid arbitration because it does not provide them with an effective means of redressing serious factual or legal errors that influence the outcome of an award. For those parties, the appellate rules furnish an avenue for alleviating their concerns while still giving them access to arbitration's other advantages.

Option for consensual review of arbitral awards

The option to use the appellate rules is voluntary and consensual. As the AAA notes in its introduction to the appellate rules, both parties must agree to use the rules for an appeal to be possible, and "[a] party may not unilaterally appeal an arbitration award... absent agreement with the other party(s)".⁽⁸⁾ Accordingly, parties that wish to preserve the benefits of finality do not lose that right under the appellate rules merely by choosing

the AAA or International Centre for Dispute Resolution (ICDR) rules.⁽⁹⁾

Should the parties voluntarily agree to the appellate rules, which they can do in the underlying arbitration clause or by post-dispute agreement,⁽¹⁰⁾ their appeals will be heard by an appellate tribunal comprised of three arbitrators, unless the parties agree to a sole appellate arbitrator.⁽¹¹⁾ The members of the appeals tribunal will be chosen from panels maintained by the AAA or the ICDR,⁽¹²⁾ and will be appointed by the AAA or the ICDR via the list method if the parties cannot agree.⁽¹³⁾

Standard of review under appellate rules

The standards of review imposed by the appellate rules are relatively high, and appeals must satisfy one of two alternatives to succeed. Specifically, appeals must be based on either:

- "an error of law that is material and prejudicial"; or
- "determinations of fact that are clearly erroneous".⁽¹⁴⁾

While it is clear from the express language of the appellate rules that legal errors must affect the outcome of an award for an appeal to succeed, it is not facially apparent from the 'clearly erroneous' standard that factual mistakes must do so as well. The clearly erroneous standard is regularly applied by US courts, however;⁽¹⁵⁾ and US courts impose a harmless error exception on that standard which requires courts to overlook mistakes that do not affect a substantial right or influence the outcome.⁽¹⁶⁾ Presumably, appellate tribunals formed under the appellate rules will follow a similar approach so that meaningless factual errors do not undermine otherwise valid awards.

Procedure for lodging appeals under appellate rules

The procedures and timeframes for lodging appeals under the appellate rules are designed to ensure that appeals are concluded within approximately three months of commencement.⁽¹⁷⁾ Consequently, appeals should not materially lengthen the life of most disputes when the parties have opted into the appellate rules.

Either party may initiate an appeal by lodging it within 30 days of the underlying award being issued.⁽¹⁸⁾ Upon receipt of a notice of appeal and satisfaction of certain filing requirements (including payment of any outstanding amounts owed by the party lodging the appeal),⁽¹⁹⁾ the AAA will provide notice to the other party, who may then file a cross-appeal within seven days.⁽²⁰⁾ The filing of an appeal stays the finality of the underlying award for enforcement purposes and tolls the time for commencing enforcement proceedings as well.⁽²¹⁾

The appellate rules presume that appeals will be dealt with only by written submission and that no oral argument will be permitted.⁽²²⁾ If oral argument is allowed, however, it must be held within 30 days of the last written submission, which could lead to a longer appellate procedure.⁽²³⁾

Potential outcomes of appeals

The appellate rules set forth three potential outcomes for appeals:⁽²⁴⁾

- The appellate tribunal may adopt the underlying award as its own.⁽²⁵⁾
- The appellate tribunal may issue a new award (adopting those portions of the underlying award that it chooses to accept).⁽²⁶⁾
- The appellate tribunal may request additional information and extend the period for issuing a final decision by 30 days.⁽²⁷⁾

In recognition of the need for finality, the appellate tribunal may not "order a new arbitration hearing or send the case back to the original arbitrator(s) for corrections or further review".⁽²⁸⁾ By removing the possibility for remand, which would require further substantive action from a tribunal that has ostensibly discharged its duties, the appellate rules not only lead to a final result, but also avoid potential arguments that appellate awards cause the underlying tribunal to violate the *functus officio* (a matter cannot be reopened before the same tribunal) doctrine.⁽²⁹⁾

Lastly, while appellants are required to pay the costs of an appeal,⁽³⁰⁾ tribunals may assess the appellee's costs against the appellant if the appellant does not prevail.⁽³¹⁾ The ability to assess costs against an unsuccessful appellant should provide some incentive against misguided appeals that are unlikely to succeed or that are brought for an improper purpose.⁽³²⁾

Analysis

The appellate rules provide an option for those parties that want the potential to review an award for serious factual or legal error. Given the contractual nature of arbitration, a consensual option for such review seems consistent with notions of party-autonomy and procedural flexibility.

The notion of appellate review of arbitral awards is not unprecedented either. For several years, the AAA has offered an appellate language option in its clause drafting materials.⁽³³⁾ The International Institute for Conflict Prevention and Resolution,⁽³⁴⁾ the Court of Arbitration for Sport⁽³⁵⁾ and the Grain and Free Trade Association⁽³⁶⁾ similarly offer appellate procedures. The International Centre for Settlement of Investment Disputes has annulment proceedings that offer a form of arbitral appellate review.⁽³⁷⁾

Certain national arbitration laws allow for some form of post-award appellate review as well. For instance, under Section 69 of the English Arbitration Act 1996, parties may appeal questions of English law to English courts.⁽³⁸⁾ Under Article 205 of the Qatari Civil and Commercial Procedural Code, arbitral awards can be appealed and heard *de novo* in certain circumstances.⁽³⁹⁾ Consequently, the appellate rules enjoy more historical precedent than may be appreciated at first.

Appellate rules' impact on enforcement

It remains to be seen what impact, if any, the appellate rules could have on enforcement proceedings. While one might presume that courts would more readily enforce awards that have been reviewed under the appellate rules (or appellate awards themselves), that may not always be the case, particularly where an appellate award is substituted in whole or in part for the underlying award under Article A-19(a)(2). Accordingly, the affect that the appellate rules might have on enforcement proceedings is an area practitioners should closely follow.

Comment

The appellate rules offer an intriguing option for parties that want to arbitrate, but who also want appellate oversight. As such, the appellate rules constitute a positive development for appropriate parties and demonstrate institutional responsiveness to end-user needs.

For further information on this topic please contact [JP Duffy](mailto:JP.Duffy@klgates.com) or at K&L Gates by telephone (+1 212 536 3900), fax (+1 212 536 3901) or email (JP.Duffy@klgates.com). The K&L Gates website can be accessed at www.klgates.com.

Endnotes

(1) See Gary B Born, *International Commercial Arbitration*, pg 81 (Kluwer Law International 2009) (noting that finality is one of the salient features of international arbitration); William H Knull, III and Noah D Rubins, *Betting the Farm on International Arbitration: Is it Time to Offer an Appeal Option?*, 11 American Review of International Arbitration 531 (2000) (discussing the perceived advantages that finality offers in international arbitration).

(2) Gary B Born, *International Commercial Arbitration*, pg 82 (nothing further that "international businesses generally choose speed and finality over the opportunity for appellate review").

(3) 552 US 576 (2008). For further background on the *Hall Street* decision, see JP Duffy, *Hall Street One Year Later: The Manifest Disregard Debate Continues*, 19 American Review of International Arbitration 193 (2009).

(4) *Hall Street Associates, LLC*, 552 US at 584.

(5) See, for example, *Citigroup Global Mkts Inc v Bacon*, 562 F.3d 349, 350 (5th Cir 2009); *Affymax, Inc v Ortho-McNeil-Janssen Pharms, Inc*, 660 F.3d 281, 285 (7th Cir 2011); *Med Shoppe Int'l, Inc v Turner Invs, Inc*, 614 F.3d 485, 489 (8th Cir 2010); *Frazier v Citifinancial Corp, LLC*, 604 F.3d 1313, 1324 (11th Cir 2010); but see *Giller v Oracle USA, Inc*, 512 Fed Appx 71, 72 (2d Cir 2013) (recognising continued viability of manifest disregard post-*Hall Street*); *Wachovia Sec, LLC v Brand*, 671 F.3d 472, 482 (4th Cir 2012) (concluding that manifest disregard continues to exist); *Coffee Beanery, Ltd v WW, LLC*, 300 F. Appx 415, 418 (6th Cir 2009) (finding that manifest disregard survived *Hall Street*); *Johnson v Wells Fargo Home Mortg, Inc*, 635 F.3d 401, 415 (9th Cir 2011) (continuing to recognise manifest disregard post *Hall Street*); see also *Bangor Gas Co, LLC v HQ Energy Servs United States*, 695 F.3d 181, 187 (1st Cir 2012) (noting that *Hall Street* called the continued viability of manifest disregard into question but then considering its application); *Rite Aid NJ, Inc v United Food Commer Workers Union, Local 1360*, 449 Fed Appx 126, 129 n3 (3d Cir 2011) (noting that the Third Circuit has not concluded whether manifest disregard survived *Hall Street*); *Abbott v Law Office of Patrick J Mulligan*, 440 Fed Appx 612, 620 (10th Cir 2011) (noting circuit split and declining to decide whether manifest disregard survived *Hall Street*).

(6) 441 F.3d 905 (11th Cir 2006).

(7) See *id* (relating that protracted enforcement proceedings destroyed one of the benefits of arbitration by making "it... take longer than it would have to decide the matter without arbitration").

(8) *Introduction*, appellate rules.

(9) Conversely, parties may agree to apply the appellate rules in arbitrations that are not administered by the AAA or ICDR. See appellate rules, Article A-1 (stating that if parties "have otherwise provided for these Appellate Arbitration Rules, they shall be deemed to have made these Rules... a part of their agreement").

(10) Appellate rules, Article A-1 (providing that parties may agree to the appellate rules "by stipulation or in their contract").

(11) *Id.*, Article A-5(c) (relating that appellate tribunals will be comprised of three arbitrators unless the parties agree to a sole arbitrator).

(12) *Id.*, Article A-4(a) ("The appeal tribunal shall be selected from the AAA's Appellate Panel, or, if an international dispute, from its International Appellate Panel").

(13) *Id.*, Article A-5(a)-(b).

(14) *Id.*, Article A-10.

(15) See *Wells Fargo Secs LLC v Senkowsky*, 512 Fed Appx 57, 58 (2d Cir 2013) ("A finding of fact is clearly erroneous if the appellate court is 'left with the definite and firm conviction that a mistake has been committed'").

(16) See *Shinseki v Sanders*, 556 US 396, 407 (2009) (explaining that on appeal, US federal courts must overlook harmless errors that do not affect a substantial right or influence outcome); 28 USC § 2111 (2011) (codifying the harmless error rule); 19-206 Moore's Federal Practice § 206.07[2] (explaining the rationale behind the harmless error rule and relating that "[a]n error is harmless if it caused no prejudice to a substantial right of the party complaining of the error" or influence the outcome).

(17) *Introduction*, appellate rules ("The [A]ppellate [R]ules anticipate an appellate process that can be complete in about three months...").

(18) Appellate rules, Article A-3(a)(i).

(19) *Id.*, Article A-12(a).

(20) *Id.*, Article A(3)(b)-(c).

(21) *Id.*, Article A-2(a).

(22) *Id.*, Article A-15(a).

(23) *Id.*, Article A-15(b).

(24) *Id.*, Article A-19(a) (setting forth potential outcomes that must be reached within thirty days of the final written submission).

(25) *Id.*, Article A-19(a)(1).

(26) *Id.*, Article A-19(a)(2) (relating that the new award may incorporate "those aspects of the Underlying Award that are not vacated or modified").

(27) *Id.*, Article A-19(a)(3).

(28) *Id.*, Article A-19(a).

(29) See *Trade & Transport, Inc v Natural Petrol Charterers, Inc*, 931 F.2d 191, 195 (2d Cir 1991) (directing that "once arbitrators have finally decided the submitted issues, they are, in common-law parlance, 'functus officio,' meaning that their authority over those questions is ended"); Gary B Born, *International Commercial Arbitration*, pg 2514 (explaining that most national arbitration legislative regimes recognize some form of the *functus officio* doctrine and "generally provide that arbitrators complete their mandate after making a final award, and thereby lose the authority to take further actions in the arbitration, save for specific, narrowly-prescribed authority with regard to correcting or interpreting the award").

(30) Appellate rules, Article A-12(b).

(31) *Id.*, Article A-11 (allowing the tribunal to assess costs against appellants that do not prevail); Article A-12(d) (permitting the appellate tribunal to reallocate a party's share of costs).

(32) Notably, however, any post-award interest that might have been imposed in the underlying award is presumably stayed under Article A-2 while the appeal is pending.

(33) *Introduction*, Optional Appellate Arbitration Rules.

(34) See International Institute for Conflict Prevention and Resolution Appeal Procedure

and Commentary (noting that International Institute for Conflict Prevention and Resolution published the Arbitration Appeal Procedure in 1999).

(35) See Procedural Rules for the Court of Arbitration for Sport, R47 (providing for appeals of awards).

(36) See Grain and Free Trade Association Arbitration Rules, Article 10.1 (allowing either party to appeal an award to board of appeal).

(37) See Article 52, Convention On the Settlement of Investment Disputes Between States And Nationals of Other States; International Council of Societies of Industrial Design Rules for Arbitration Proceedings, Rules 50, 52.

(38) English Arbitration Act 1996, Section 69(1)-(2).

(39) Qatari Civil and Commercial Procedural Code (Law 13 of 1990), Article 205.

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