Contemplating the 'Appeal Option' In Arbitration

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Abstract

One of the foremost reasons for adopting arbitration as a mode of dispute resolution is the aspect of finality attached to it. However, the finality aspect may sometimes be a limitation in itself where the award is granted in disregard of or incorrect appreciation of applicable law or existing facts, and thus, causing grave prejudice. An arbitral award under current laws may be vacated on limited grounds, such as corruption, fraud, misconduct, *etc*. Hence, an error of law or fact by itself in the award may not preclude enforcement even if it causes prejudice to either party.

The last decade has seen the emergence of an appellate process in arbitration to cater to the possibility where the determination by the arbitrator could be seriously flawed. By agreeing at the outset to the use of an internal appeal within the arbitration forum in which errors of law or fact could be corrected, the parties seek to avoid an irrational result.

The Supreme Court of India gave a judgment in December 2016, which found that parties may provide for an appeal in their arbitration clause and such a choice would not be contrary to the laws of India.

In order to implement this option in a meaningful way, it is imperative that the appeal process and its application be properly assessed, especially in light of international jurisprudence.

Key Words: Arbitration, Finality, Appeal, Award, Procedure, Grounds

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I. Introduction

The aspect of finality attached to arbitration as opposed to litigation is one of the foremost reason for preferring arbitration as a mode of dispute resolution by its proponents. Review and vacation of an arbitral award is possible under law on limited grounds, such as corruption, fraud, misconduct, evident partiality, prejudice, misconduct, exceeding of powers, *etc*. The focus in allowing review and vacation is where there are glaring departures from the agreed upon arbitration procedure compromising the very integrity of the arbitration process; however, the focus is not on the propriety of the result *i.e.*, defects that taint the arbitration procedure as opposed to the result. This also means that grounds for rectifying an incorrect arbitral award are extremely limited. Therefore, if an arbitral award is erroneous due to reasons based on fact or law, then the parties may not have an option for vacation of such an erroneous award. An error of law or fact by itself would not suffice to vacate an arbitral award.

Herein lies the allure of an appellate mechanism within the arbitration proceedings. The last decade has seen the emergence of an appellate process in arbitration to cater to the possibility where the determination by the arbitrator could be seriously flawed. Supplementing the limited grounds for modification and vacatur through the private remedy of an internal appellate mechanism provides the parties an option to avoid an irrational result.

II. Jurisprudence

Scholars and commentators have been discussing the option of an appellate mechanism in arbitration for a considerable period of time.[1] It is pertinent to note that the UNCITRAL Report of the Working Group on International Contract Practices on the Work of its Third Session in 1982, specifically records the following:

> Question 6-1: Should the model law recognize any agreement by the parties that the arbitration award may be appealed before another arbitral tribunal (of second instance)?

1. *See* Hon. David B. Saxe, *An Appellate Mechanism In Arbitration*, 85 N.Y. ST. B.J. 44 (2013); Paul Bennett Marrow, *A Practical Approach to Affording Review of Commercial Arbitration Awards: Using an Appellate Arbitrator*, *in* AMERICAN ARBITRATION ASSOCIATION HANDBOOK ON COMMERCIAL ARBITRATION 485-91 (2d ed. 2010); 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, 557-58 (2000).

> 106. There was wide support for the view that parties were free to agree that the award may be appealed before another arbitral tribunal (of second instance), and that the model law should not exclude such practice although it was not used in all countries. However, the Working Group agreed that there was no need to include in the model law a provision recognizing such practice. It was noted, however, that this conclusion might have to be reconsidered in the light of the ultimate contents of the model law, and in particular, its chapter on means of recourse against an award.[2]

Similarly, in this context, the view expressed in the Explanatory Note by the UNCITRAL Secretariat on the 1985 Model Law on International Commercial Arbitration as amended in 2006 should also be referenced.[3]

Lately, since the last decade, the appeal process has come to be recognized and applied in several jurisdictions.[4] As far as India is concerned, the issue

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2. Int'l Trade Law Comm'n, Rep. of the Working Grp. on Int'l Contract Practices of Its Third Session, U.N. Doc. A/CN.9/216 (Mar. 23, 1982), https://documents-dds-ny.un.org/doc/UNDOC/GEN/V82/252/94/PDF/V8225294.pdf?Open Element (last visited Aug. 9, 2017).
3. U.N. Secretariat, 1985 Model Law on International Commercial Arbitration, Explanatory Note by the Secretariat, Int'l Trade Law Comm'n, U.N. Doc. A/CN.9/264 (Mar. 25, 1985), http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/MLARB-explanatoryNote20-9-07.pdf (last visited Aug. 9, 2017) ("44. The disparity found in national laws as regards the types of recourse against an arbitral award available to the parties presents a major difficulty in harmonising international arbitration legislation. Some outdated laws on arbitration, by establishing parallel regimes for recourse against arbitral awards or against court decisions, provide various types of recourse, various (and often long) time-periods for exercising the recourse, and extensive lists of grounds on which recourse may be based. That situation (of considerable concern to those involved in international commercial arbitration) is greatly improved by the Model Law, which provides uniform grounds upon which (and clear time periods within which) recourse against an arbitral award may be made. 45. The first measure of improvement is to allow only one type of recourse, to the exclusion of any other recourse regulated in any procedural law of the State in question. Article 34 (1) provides that the sole recourse against an arbitral award is by application for setting aside, which must be made within three months of receipt of the award (article 34 (3)). In regulating "recourse" (i.e., the means through which a party may actively "attack" the award), article 34 does not preclude a party from seeking court control by way of defence in enforcement proceedings (articles 35 and 36). Article 34 is limited to action before a court (i.e., an organ of the judicial system of a State). However, a party is not precluded from appealing to an arbitral tribunal of second instance if the parties have agreed on such a possibility (as is common in certain commodity trades).").
4. *See, e.g.*, *JAMS Optional Arbitration Appeal Procedure*, JAMS, https://www.jamsadr.com/appeal/ (last visited Aug. 9, 2017); *CPR Appellate Arbitration Procedure*, CPR, https://www.cpradr.org/resource-center/rules/arbitration/appellate-arbitration-procedure(last visited Aug. 9, 2017); *AAA/ICDR Optional Appellate Arbitration Rules*, AAA, https://www.adr.org/ aaa/faces/rules/searchrules/rulesdetail? (last visited Aug. 9, 2017); *see*

remained undecided until December 2016 when the Hon'ble Supreme Court finally decided the issue in *Centrotrade Minerals & Metal Inc. v. Hindustan Copper Ltd.* dated December 15, 2016.[5] In this case, a three-judge bench of the Supreme Court of India considered whether two-tier arbitration procedure is permissible in India. The arbitration clause provided for a first instance institutional arbitration in accordance with the Rules of Arbitration of the Indian Council of Arbitration to be held in India and a second instance right of appeal to both parties before an appellate tribunal to be constituted in accordance with the Rules of Conciliation and Arbitration of the International Chamber of Commerce to be held in London. The Court took note of the UNCITRAL Working Group Report, the Indian Arbitration Act of 1940, various commentaries, and previous judgments and found that appellate arbitration had jurisprudential support. Moreover, based on these documents as well as the analysis of the Act, the Court found that since the legislature would be well aware of such a practice at the time of drafting the 1996 Act, it would indicate that there was no expressed or implied prohibition of appellate arbitration contained in the Indian Arbitration & Conciliation Act of 1996.[6] The Court gave primacy to party autonomy and their intention while entering the arbitration agreement and held that an appeal procedure contained in an arbitration agreement was a substantive right created by the parties through mutual consensus. The Court further held that an arbitration award that is "final and binding" does not necessarily preclude appellate arbitration. The Court focused on the aspect that a balance had to be maintained strongly in favor of finality, against judicial review, except in few circumstances, and without much delay or much intervention of the court. The decision of the Hon'ble Supreme Court thus adds to the jurisprudence of assessment of appellate arbitration clauses, especially as the Indian Arbitration & Conciliation Act of 1996 is modeled on the UNCITRAL Model Law. Furthermore, this is another step towards promoting India as a pro-arbitration destination particularly for international commercial arbitration.

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also Arbitration Act 1996, c. 23 (Eng.), http://www.legislation.gov.uk/ukpga/1996/23/pdfs/ukpga_19960023_en. pdf(Section 69 of the (of England) allows appeal for review of substantive errorsoflaw with the consent of the parties or leave of the court. Further, only questions of law and not factscan be agitated).

5. Centrotrade Minerals & Metal Inc. v. Hindustan Copper Ltd., (2016) 12 SCALE 1015 (India).

6. The Arbitration & Conciliation Act, 1996, No. 26, Acts of Parliament, 1996 (India).

III. Appellate Arbitration Mechanism: Scope Structure and Procedure

Under the appellate mechanism, an appellate review could be vested either in the judiciary or with an arbitrator. However, judicial interpretation remains unpredictable regarding whether parties can contractually expand the scope of grounds available for appeal and authorize a court to vacate or modify arbitral awards based on such expansive jurisdiction. For example, in the U.S., the federal courts are split over the issue and the U.S. Supreme Court has yet to speak on the subject. Trachtenberg encapsulates the legal position in U.S. in this context:

> There is a significant split of opinion on this issue among the federal circuits. The *Gateway* holding permitting an expanded scope of review has been adopted by the First, Third, and Fourth Circuits, which, like the Fifth Circuit, reason that arbitration is a creature of contract and that parties should be free to tailor the scope of review to fit their particular needs and circumstances. However, *Gateway* has been rejected by the Seventh, Ninth, and Tenth Circuits on the grounds that the Federal Arbitration Act's grounds for vacatur are mandatory, not default rules, and that parties do not have the power to determine the scope of judicial review. This split ultimately will require resolution by the U.S. Supreme Court.[7]

Therefore, in current circumstances, a private appellate arbitration mechanism is preferable because it avoids unpredictability, and at the same time, it retains the advantages of the arbitration system.

A pertinent question concerning the scope, structure and procedure of appellate arbitration mechanism arises.

As already mentioned, several arbitration institutions have started providing the option of appellate mechanism within the last decade. Therefore, as with arbitration in general, the issue of selection between institutional and ad hoc arbitration has arisen with the appellate process. If opting for institutional arbitration, the parties should, before entering into the main arbitration agreement, peruse the appellate process rules and make a decision whether they want an option of appeal and whether the appeal rules as set out by the arbitration institution suit their needs.

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7. Mark R. Trachtenberg & Christina F. Crozier, *Risky Business: Altering the Scope of Judicial Review of Arbitration Awards by Contract*, 69 TEX. B.J. 868, 868-69 (2006).

If the parties decide upon ad hoc arbitration procedure, then in a private appellate arbitration mechanism, the arbitration agreement foremost would need to include a specific option of appeal in proper language. The agreement would need to safeguard against the contingency that it may be challenged as not being a specific enough reference of dispute to appellate arbitration. Such a clause would necessarily have to be in writing. The clause should include a statement of the arbitration law (lex arbitri) and the substantive law to be applied. It should also include a statement that the ruling of the appellate panel shall be "final and binding." In this context, it also needs to consider that even where the appeal process and reference is recognized, there may exist an option of deemed waiver of appeal under the laws of the governing jurisdiction, and therefore, the implication of such a waiver should be considered beforehand.[8]

Prior to filing an appeal, two preliminary checks need to be done. First, there must be a determination whether the first arbitration award is indeed an arbitration award on merits, sets forth the factual and legal basis of the award, and is in compliance with the applicable law to the dispute. Second, it is imperative that the entire record including hearings and all evidence of the first arbitration be present before the appellate panel. Non-existence of such record would lead to an immediate ground for challenging the maintainability of the appeal, or otherwise, it would amount to conducting a *de novo* arbitration.

In order to prevent the appellate procedure from being misused to protract the settlement of the dispute, the scope of appeal needs to be defined. Not all disputes should be appealable. The party at a loss in the arbitration proceeding would always attempt to agitate errors in both factual findings as well as in law. However, this may not actually be the true scenario. Also, just because a different conclusion is possible, it may not mean that the first arbitrator was wrong.[9] The arbitration clause needs to determine the scope of the appeal; whether only issues of law or fact or both should be entitled to appeal. "If an appeal is to include a review of factual determinations, as well as legal ones, there is a real risk that the final resolution of the dispute will be delayed, and that the overall cost for the proceedings will escalate."[10] However, it is preferable that both issues of law and fact be agitated in appeal with proper safeguards. An appellate mechanism needs to be limited in nature in order to avoid a *de novo* proceeding or a second hearing entirely on merits. Restrictions in the form of grounds for appeal and scope of appeal needs to be structured with specific emphasis on the aspect that no new findings of fact would be brought about in appeal and to preclude new evidence at the appellate stage or

8. *See* Arbitration Act, amended by S.O. 1991, c 17, § 3 (Can.); *see also* Arbitration Act 1996, c. 23, § 4 (Eng.).
9. Trachtenberg & Crozier, *supra* note 7.
10. Paul Bennett Marrow, *Appealing an Arbitrator's Award*, 77 N.Y. ST. B.J. 14 (2005).

to challenge an already tendered evidence at the first stage. Thus, the emphasis of the grounds for appeal should be on grave errors of law without any legal basis and prejudicial in nature and factual findings unsupported by record.

An important aspect that needs to be addressed is whether an annulment, modification, or enforcement proceedings can be entertained by the Court in respect to the first arbitral award pending the appeal. It would be better for arbitral as well as judicial discipline if this is not allowed. Otherwise, an appeal process could be effectively frustrated by a parallel proceeding on the first award. Upon proper and timely filing of an appeal, it is imperative that the original award is not considered final and judicial confirmation, enforcement, vacation, annulment, or modification not be sought. The original award should be considered final only if the appeal is withdrawn or dismissed. Another ensuing issue would be a determination of commencement of the limitation period. The question is whether it is to be counted from the first award or the appellate award. The best practice is for the limitation period to commence from the appellate award.

Procedural requirements also includes the generally acceptable procedure of arbitration including timely notice, selection of a panel, challenges and replacement of the panel, the record on appeal, exchange of briefs, oral argument, remuneration, confidentiality of the proceedings, and other administrative matters.

An appeal should commence by an appropriate notice to the opposite party setting out a proper timeline for all involved steps. The notice should be complete in form in that it contains the entire statement of appeal with specific reference to the elements of the original award under challenge. The opposite party should also have the option of a cross-appeal.

The arbitral panel should comprise of a greater number of members than the panel of the original award to be mutually selected by the parties and hold appropriate and preferably greater qualifications. It is important that the appellate panel not be comprised of the same members as the panel of the first award.

Post exchanges of briefs, the proceedings should immediately proceed towards oral arguments. However, oral arguments should remain optional. It should be carried out only if the panel desires any clarifications. The option of submitting additional material should not be allowed in order to curtail the possibility of a *de novo* review. The appellate arbitration should be based only on the record of the initial hearing, appellate briefs, and oral argument, if any. It is imperative that if a party refuses to participate in the appeal process after having agreed to do so, the appeal panel should continue with the proceedings ex-parte and pass its order accordingly. The arbitral decision should be in writing, clearly recording the reasons for affirming, modifying, or setting aside the original award.

IV. Conclusion

Arbitration process has evolved considerably since its early stages and an appellate mechanism, as an option, certainly needs to be considered to address the interests of parties accordingly.

Practitioners make varied arguments in favor and against promoting an appellate mechanism in arbitration.[11] The primary focus of the arguments is on potential increase in costs and time, lack of finality of the first arbitral award, no assurance of the quality of the award, procedural issues, and scope of arbitration.[12] On the other hand, the counter arguments focus on existence of legitimate reasons to challenge an award and the assurance that an appellate mechanism provides to the parties in sustaining a relationship beyond the arbitration proceeding, thus, ensuring future performance of the contract.[13] Further, an appeal mechanism could provide a certain discipline to the arbitration process.[14]

It needs to be noted that an appellate mechanism cannot replace the need for judicial review. Therefore, an appeal mechanism would add a layer between the arbitral proceeding and the judicial proceedings in court and bring with it the associated increase in expenses. It can be argued that it would, in essence, put in place a two-step appellate process where the aggrieved party first may go to an appeals arbitrator and then to court. However, it is also true that an appellate mechanism may render judicial review unnecessary altogether or minimize the grounds for judicial review.

The option of appeal in arbitration could reduce or eliminate resistance towards arbitration based on finality and conclusiveness of the award and limited options of challenge. The counter, of course, is that the very foundation of arbitration is the conclusiveness attached to it and an option of appeal that makes arbitration akin to litigation. However, this is not the case. A properly structured mechanism, if put in place, would make the appeal a truly time bound process. Also, if an effective appellate process is in place, it could render judicial review unnecessary altogether or minimize the grounds for it. This

11. *See* Jonathon DeBoos, *Arbitration Awards: Is Review on the Merits Desirable?*, 3 Const. L. Int'l 31 (2008) (discussing at length the views of various practitioners in the field for and against an appellate mechanism in arbitration and summarizing that "while at first the views expressed were all very clearly against merits review of arbitral awards, the tone of the debate later shifted with a number of respondents identifying situations in which it might be desirable. That being said, nobody seemed to be in favour of merits review for all arbitrations --only where it suited the circumstances of the parties involved.").
12. *Id.*
13. *Id.*
14. *Id.*

would also curtail the slowly expanding scope of judicial review of arbitral awards. A structured appellate process would truly bring finality of proceedings to the arbitration process by making the courts extremely strict in entertaining second appeals. The Court would have little reason to perceive a need to accept a case for review that raises the same grounds. Most importantly, if this additional layer were perceived as a hindrance in effective arbitration, the parties would always have the option of not including an appeal clause.

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