To Appeal or not to Appeal? Appellate Proceedings under the AAA

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Arbitration clauses are common in commercial contracts, particularly because arbitration tends to be more efficient, cost-effective, and confidential. The finality of arbitration awards is also an advantage, but parties may worry about the risks posed by the lack of transparency and potential biases of arbitration proceedings, especially when the stakes of an arbitration dispute are particularly high. In light of these concerns, parties may consider including in their arbitration agreements the optional appellate procedures provided by the American Arbitration Association ("AAA").

AAA Appellate Proceedings

The applicability of the AAA appellate rules is predicated upon an agreement by the parties, whether that be through contractual terms or by stipulation. The right to an appeal in AAA proceedings is, in essence, a matter of contract. If the parties agree to the AAA's optional appellate procedures, the appeals process is somewhat similar to that of a typical judicial proceeding. Any party may initiate an appeal by filing a notice of appeal with the AAA. The parties may then agree upon who will make up the "appeal tribunal," or the AAA can appoint the appellate tribunal on its own from its Appellate Panel.

Notably, the scope of appeals under the AAA rules is limited. A party may only appeal the underlying award on the grounds that it is based upon:

1. an error of law that is material and prejudicial; or
2. determinations of fact that are clearly erroneous.

The appellate tribunal may then:

1. adopt the underlying award as its own; or
2. substitute its own award for the underlying award.

Unlike an appellate court, the appellate tribunal may not, under the optional AAA appellate rules, order new arbitration proceedings or send the dispute back to the original arbitrator(s) for corrections or further review.

Judicial Review of Arbitral Awards

Under Texas state law, the grounds for vacating an arbitration award are limited to those set forth in the Texas Arbitration Act ("TAA"); there are no common law grounds for vacating an award. Generally, those statutory grounds consist of the absence of an arbitration agreement or the existence of specific impermissible actions taken by the arbitrator, such as:

1. evident partiality, corruption, or misconduct;
2. exceeding his or her powers;
3. refusing to postpone a hearing upon a showing of sufficient cause; or
4. refusing to hear material evidence or conducting the hearing in a manner that substantially prejudiced the rights of a party.[1]

In fact, because Texas law favors arbitration, the Texas Supreme Court recognized that judicial review of arbitral awards is "extraordinarily narrow."[2] The TAA states that courts "shall confirm" awards unless the grounds identified above are proven.[3]

Under federal law, judicial review of arbitral awards is also limited in scope. An arbitration award may only be vacated under the Federal Arbitration Act ("FAA"):

1. where the award was procured by corruption, fraud, or undue means;
2. where there was evident impartiality or corruption in the arbitrators, or either of them;
3. where the arbitrators were guilty of misconduct in refusing to postpone the arbitration hearing even where sufficient cause was shown, or in refusing to hear evidence pertinent and material to the controversy; or any other misbehavior by which the rights of any party have been prejudiced; or
4. where the arbitrators exceeded their power, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.[4]

The United States Supreme Court held that the FAA enumerates the only grounds for judicial review of an arbitration award and that those grounds cannot be expanded by contract.[5] In contrast, the Texas Supreme Court has held that the TAA "presents no impediment to an agreement that limits the authority of an arbitrator in deciding a matter and thus allows for judicial review of an arbitration award for reversible error."[6] The court also

held that the "FAA does not preempt enforcement of an agreement for expanded judicial review of an arbitration award enforceable under the TAA."[7] Thus, it appears that parties may contractually agree to an expanded judicial review of an arbitration award under Texas law but not federal law.

Both the TAA and the FAA also limit judicial *modification* of awards to instances where there was an evident and material miscalculation of figures, where the arbitrators have issued an award upon a matter not submitted to them, or where the award is imperfect in a matter or form that does not affect the merits of the controversy.[8]

In sum, the avenues to obtain judicial review of arbitral awards under both the FAA and TAA are narrow. Parties with disputes governed by Texas law may consider incorporating language in their arbitration clauses allowing for an expanded judicial review of arbitral awards. However, parties should be wary of potential preemption issues. If an arbitration agreement falls within the scope of the FAA, any contractual language attempting to expand judicial review of an arbitral award may be ineffective.

Should Parties Include the Optional Appellate Proceedings in their Arbitration Clauses?

The short answer: it depends. The optional appellate rules provided by the AAA can provide extra protection against potentially flawed arbitral awards. They also provide a more robust review of arbitral awards than parties can typically obtain through the court system. However, agreeing to an expanded appellate process under the AAA appellate rules comes with its own caveats. For example, appealing an arbitral award is necessarily more expensive. The AAA's initial administrative fee for an appeal is $6,000, and the appellant must pay a deposit to cover the anticipated expenses of the appellate tribunal at the commencement of the appeal. Although these expenses can be reallocated, the appellant needs to be prepared to shoulder a majority of the expenses if its appeal is unsuccessful. Appealing an award also undermines the inherent finality of arbitration by exposing initial arbitral awards to modification.

In general, when deciding whether to include an optional appellate process in an arbitration clause, parties should consider the size and scope of the dispute. If the stakes are especially high, parties may want a substantive review on the merits of an arbitration award, and the language in their arbitration agreement should provide for one. On the other hand, if the stakes are relatively low, parties may want to forego the additional costs of the AAA's optional appellate procedures.

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ENDNOTES

(1) *See* TEX. CIV. PRAC. & REM. CODE § 171.088(a)(2–3) (West).

(2) *See Hoskins v. Hoskins*, 497 S.W.3d 490, 494 (Tex. 2016).

(3) TEX. CIV. PRAC. & REM. CODE § 171.087 (West).

(4) 9 U.S.C. § 10.

(5) *See Hall Street Assoc., LLC v. Mattel, Inc.*, 552 U.S. 576 (2008).

(6) *Nafta Traders Inc., v. Quinn*, 339 S.W.3d 84, 97 (Tex. 2011).

(7) *Id.* at 101.

(8) *See* 9 U.S.C § 11; TEX. CIV. PRAC. & REM. CODE § 171.091 (West).