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Contractual Modifications of the Arbitral Process

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In the beginning, arbitration was straightforward. Once a dispute had arisen, the parties agreed to submit it for resolution to a third party. The courts stayed out of the process. They did not even enforce the agreement to arbitrate. But they did enforce the arbitrator's decision.[1]

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1. On the status of the law prior to the adoption of the state and federal arbitration laws, see Alan S. Rau, *Fear of Freedom*, 17 AM. REV. INT'L ARB. 469, 488 at n.60

The next step was to enforce the agreement to arbitrate. The courts were not enthusiastic about enforcing a substitute for their exclusive prerogative. The legislature had to push it, one might say, down their throats.[2]

And then the Supreme Court went even further and ruled that, if the arbitration agreement so provided, the arbitrators were the ones to determine whether the dispute was arbitrable.[3]

This development of the legislative form of arbitration became more than matched by those using the process. And as the popularity of arbitration has grown, so has the inventiveness of its users to adopt it to their purposes. Since arbitration is a creation of contract, the general perception that the freedom to contract created limitless opportunities for adapting arbitration to the contracting parties' purposes gained general ground. And thus the many modifications of the arbitral process that have emerged in recent times were introduced in contemporary arbitration practice.

In the following, I will address a number of these modifications without any claim to completeness. Their permissibility remains largely unsettled. It is only recently that the Supreme Court ruled impermissible contractual expansion of judicial review of arbitral award.[4] But the fate of many other modifications still awaits final judicial adjudication.[5] I will here address some of the more prominent ones without making any claim to completeness.

Contractual modifications of arbitration as we know it include the following: modification of the scope of review of arbitral awards; modification of the bilateral character of arbitration by granting the option to arbitrate to only one of the parties; modification of the composition of the tribunal; modification of the arbitral procedure by excluding procedures such as class actions; and modification of the applicable law by excluding punitive or consequential damages.

(2006), contradicting assertions by Justice Stevens in *Hall Street Associates v. Mattel, Inc.*, 128 S. Ct. 1396 at 1409 n.3 (2008) and by Tom Cullinan in *Contracting for an Expanded Scope of Judicial Review in Arbitration Agreements*, 51 VAND. L. REV. 395, 409 (1998).

2. The state and federal statutes provide for enforcement of both agreements to arbitrate present and agreements to arbitrate future disputes. *See* 9 U.S.C. 2 (1925) and the Revised Uniform Arbitration Act, §6(a) (2000).

3. In *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 US 395 (1967), the Supreme Court ruled that, when the arbitration agreement so provided, the issue of whether the arbitrator had jurisdiction was for the arbitrator.

4. Hall St. Assocs., L.L.C. v. Mattel, Inc., 128 S. Ct. 1396 (2008).

5. Thus far, the U.S. Supreme Court has not ruled on the legal status of any of the forms of contractual modification here discussed.

I. CONTRACTUAL MODIFICATION OF REVIEW OF ARBITRAL AWARDS

A. Contractual Expansion of Judicial Review

Arbitration is essentially a one-stage process. Everything is adjudicated in a single instance. There are only two means of obtaining judicial review of an arbitral award. Annulment can be sought under the law of the place or law of arbitration.[6] And the award may be denied recognition and enforcement under the provisions of the New York Convention.[7] The means for attack on an award under either procedure are most limited.[8] Specifically, arbitral errors in making determinations

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6. The New York Convention on the Recognition and Enforcement of Arbitral Awards [hereafter N.Y. Convention], under Article V(1)(e), permits for annulment of awards at the place of arbitration or under the law of the country in which the arbitration is conducted or under the law of which the award has been made. On this provision, see Hans Smit, *Annulment and Recognition of Annulled Awards*, 18 AM. REV. INT'L ARB. 297 (2007). Postscript at 309 of the same issue.

7. The New York Convention provides in Art. 5(1)(e) that an annulled award may be refused recognition. On this provision, see Smit, H., note 6 *supra*.

8. The grounds for non-recognition or enforcement are limited and stated in Art. V(1) and (2) of the N.Y. Convention, which reads as follows:

> Article V
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> 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:
>
> (a) 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
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> (b) 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
>
> (c) 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
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> (d) 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
>
> (e) 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:

of fact or law are not reviewable. The limited review available under prevailing law has created tensions, especially in cases in which the errors committed by the arbitral tribunal appeared to be obvious. This had led lower courts to seize upon a remark by Justice Reed in *Wilko v. Swan* that an award might be reviewed for manifest disregard of the law.[9] That remark had no bearing on the final disposition of the case, but no attention was paid to the fact that the award was obiter dictum and was interjected in a case in which the law potentially disregarded was of a mandatory nature.[10] And the attacks upon arbitral awards based on alleged manifest disregard of the law increasingly filled the pages of reported court cases and the law reviews.[11]

More sophisticated courts have tried to suppress the urge to run to court when the award turned out to be unsatisfactory by ruling that manifest disregard was present only when the arbitrators knew what the law was, but deliberately disregarded it,[12] but even the Second Circuit, which had formulated this very narrow ground, has not applied it consistently.[13] It properly did not apply it when the law disregarded was of a mandatory nature and in that case properly also paid little attention to the requirement that the disregard be manifest. But some courts, including the First Appellate Division of the New York Supreme Court, vacated arbitral awards even for manifest disregard of the contract.[14]

Indeed, it is rather surprising that a dictum without any statutory foundation, pulled, as it were, out of the air by a Justice who had no need for it, had such a long life. Perhaps appropriately, it was recently dealt what may well be a death blow by another Justice of the Supreme Court, who, again superfluously, questioned its legal existence in a case in which contractual expansion of judicial review of an arbitral award was ruled impermissible. I had argued earlier, rather emphatically, that the

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(a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or

(b) The recognition or enforcement of the award would be contrary to the public policy of that country.

9. 346 U.S. 427, 437 (1953).

10. The applicable statute was The Securities Act of 1933, 15 U.S.C. 77a (1933).

11. For law review treatments of the doctrine, see Hans Smit, *Manifest Disregard of the Law in the First Department of the Appellate Division*, 15 AM. REV. INT'L ARB. 111 (2004); Hans Smit, *Manifest Disregard of the Law in New York Court of Appeals*, 15 AM. REV. INT'L ARB. 315 (2004); Hans Smit, Hall Street Associates, L.L.C. v. Mattel, Inc.: *A Critical Comment*, 17 AM. REV. INT'L ARB. 513 (2006); Christopher Drahozal, *Codifying Manifest Disregard*, 8 NEV. L.J. 234 (2007).

12. Halligan v. Piper Jaffray, Inc., 148 F.3d 197 (2d Cir. 1988).

13. *See Halligan*, 148 F.3d 197; Hans Smit, *Is Manifest Disregard Of The Law Or The Evidence Or Both A Ground For Vacatur Of An Arbitral Award?*, 8 AM. REV. INT'L ARB. 341 (1997).

14. *See* authorities cited in note 11 *supra*.

doctrine had no proper legal footing, but the courts had continued to apply the doctrine until Justice Souter, in *Hall Street Associates v. Mattel, Inc.* questioned its validity.[15] At the present time, the doctrine is probably dead or awaiting a proper internment.

The burial of the doctrine, although not in case of disregard of mandatory law, has only increased the desire to obtain review of arbitral awards not subject to attack in an annulment or denial of confirmation proceeding.

One way of obtaining review of an otherwise final arbitral award was by contractual expansion of the statutorily provided grounds of review. Provisions used for that purpose often provided that the award to be rendered could be reviewed on the grounds available in a federal appeals court for review of district court decisions.[16] The Supreme Court's decision in the *Mattel* case put an end to such expansions.[17] Thus, the *Mattel* case put an end to both contractual expansion of judicial review and manifest disregard of the law as devices for obtaining judicial review of arbitral awards on non-statutory grounds. No wonder the bar started to look with renewed vigor for other means of reviewing arbitral awards. Intra-arbitral review appears to be the new favorite. It will be addressed below.

B. Contractual Restriction of Judicial Review

Parties to an arbitration agreement have not only attempted to expand judicial review of arbitral awards, they have also provided for its restriction or elimination altogether. Some countries like Switzerland and Belgium, explicitly permit this provided neither of the parties is a national.[18] In the United States, the issue has not been statutorily addressed.

I have elsewhere argued that it is incompatible with the statutory regime of arbitration to modify statutorily provided judicial review of

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15. For a criticism of Justice Souter's ruling in this regard, see Hans Smit, Hall Street Associates, L.L.C. v. Mattel, Inc.: *A Critical Comment*, *supra* note 11. The doctrine was applied, post *Mattel*, in *Cable Connection, Inc. v. DIRECTV, Inc.*, 190 P.3d 586 (Cal. 2008). The fact that the law to which Justice Reed referred in *Wilko v. Swan* was of a mandatory nature has generally been overlooked. In the *Mitsubishi* case, in which the Court noted that an erroneous ruling by the arbitral tribunal was subject to a "second look" in court, the applicable antitrust law was also of a mandatory nature. 473 U.S. 614 (1985).

16. A contractual provision to that effect was the subject of the *Mattel* case. Hall St. Assocs., L.L.C. v. Mattel, Inc., 128 S. Ct. 1396 (2008).

17. *See* Hans Smit, *Contractual Modification of the Scope of Judicial Review of Arbitral Awards*, 8 AM. REV. INT'L ARB. 147 (1997).

18. *See* the statutes cited in BORN, G., INTERNATIONAL COMMERCIAL ARBITRATION: COMMENTARY AND MATERIALS 765 (2001).

arbitral award, whether by expanding or restricting it,[19] but Justice Souter, in the *Mattel* case, rejected, although improperly, the notion that contractual modification of judicial review would affect the court's subject matter jurisdiction.[20] In both my prior and subsequent publications I have defended the view that the scope of judicial review prescribed by law raises an issue of subject matter adjudicatory authority, which, under established principles, cannot be modified by contractual arrangements.[21] Under that view, the scope of judicial review of arbitral awards can be neither expanded nor reduced. A provision in an arbitration agreement providing for reduced judicial review is therefore, in my view, invalid and not enforceable. Acceptance of this view raises the question of whether an arbitration clause providing for such review would be enforced as if it contained no such provision or whether its partial invalidity would invalidate the entire clause.[22] An agreement providing for enhanced judicial review would probably be enforced as providing for arbitration with the normal statutorily prescribed judicial review on the theory that the parties that wanted expanded review would have consented to the review they could receive rather than not arbitrate at all. The same assumption is not necessarily warranted when judicial review is contractually reduced or precluded, since the parties might well have preferred no arbitration rather than arbitration plus any judicial review. Nevertheless, in the case of both types of clauses, I would argue that the strong statutory endorsement of arbitration should decide the issue on favor of arbitration with the statutory form of judicial review.

C. Intra-Arbitral Review

1. Introduction

The limited judicial review of arbitral awards statutorily available has stimulated the search for other methods of review. The recent death blow administered to the judicially created review for manifest disregard of the law has only further stimulated this search. As recourse to

19. For a more detailed criticism, see Hans Smit, Hall Street Associates, L.L.C. v. Mattel, Inc.: *A Critical Comment*, *supra* note 11.

20. *See id.*; Hans Smit, *Contractual Modification of the Scope of Judicial Review of Arbitral Awards*, *supra* note 17.

21. The courts appear to agree. The ICC International Arbitration Rules provide, in Article 28(6), that the parties agree that an award rendered pursuant to those rules shall be final and conclusive, but the parties and the courts have generally failed to seek to enforce it. *See also* Hans Smit, *Contractual Modification of the Scope of Judicial Review of Arbitral Awards*, *supra* note 17.

22. The effect of the invalidity of such a provision on the remainder of the arbitration clause has also escaped attention.

arbitration has grown, so has the possibility that arbitrators erred in their assessment of the facts and the law. But any such errors, except for the now probably defunct review for manifest disregard of the law, remained beyond the reach of any, whether arbitral or judicial, review. Arbitrators could not correct errors of facts or law, because the ad hoc and institutional rules generally limit review by the arbitrators themselves to "any errors in computation, any clerical or typographical errors, or any errors of a similar nature,"[23] the description used in the UNCITRAL Rule, or "clerical, computational or typographical errors, or any errors of a similar nature," the description found in the Rules of Arbitration of the International Chamber of Commerce.[24] Some courts have given these terms an elastic interpretation in cases of obvious arbitral mistakes that did not fit into the narrow borders of the applicable institutional rules,[25] but, generally, these very narrowly defined categories of errors have precluded review of obvious arbitral errors of fact or law. This has led potential users to forego arbitration and to opt for recourse to the courts.

Since arbitration is of a consensual nature and owes its existence to the efforts of those it is designed to serve, attempts are being made to provide for review of arbitral awards within the bounds of arbitration itself. These efforts have taken two forms.

2. Review of the Award by the Tribunal Itself

The first is to broaden the scope of review of an arbitral award by the arbitral tribunal itself by providing in the arbitration agreement in what circumstances and conditions the tribunal may correct properly defined errors. In cases in which I have sat as a single arbitrator, I have, upon occasion, provided for review, going beyond the narrow limits set by the applicable rules, of both facts and law to be asserted by the parties within a very short time limit after I disclosed a proposed draft award, but excluding factual or legal issues that had been argued before the award was rendered. I can report that this has worked very well and that this procedure has in some instances led to corrections that could not have been made under the institutional rules under which the arbitration was conducted.

Of course, deviation from institutional rules of this nature may create its own problems, because a party may attack the award on the

23. ICC International Arbitration Rules, Art. 29(1); *see also* AAA International Rules Art. 27(1) and Rule 14.6 of the CPR Rules on Non-Administered Arbitration.

24. UNCITRAL Rules, Art. 29.

25. *See* Halligan v. Piper Jaffray, Inc., 148 F.3d 197 (2d Cir. 1988), discussed in Hans Smit, *Is Manifest Disregard Of The Law Or The Evidence Or Both A Ground For Vacatur Of An Arbitral Award?*, *supra* note 13.

ground that the arbitrator went beyond the procedural rules the parties had agreed to be applicable. In the cases in which I followed the described procedure, I sought and obtained from the parties a stipulation that they would not attack the award on that ground. If they had refused that stipulation, I would not have proceeded. And, when there is a three member tribunal, it may be impossible to obtain agreement to proceed on that basis. It is therefore desirable to address the problem in the arbitration agreement itself or, better yet, in the institutional or ad hoc rules.

It should be noted that the need for new rules for review of arbitral award is less pressing when the applicable institutional rules provide for review of the award before it is communicated to the parties. The ICC International Arbitration Rules provide for such review. However, the ICC Court may require the arbitrators to modify their award on procedural issues, but may only recommend changes on substantive issues. While most arbitrators will give appropriate consequence to recommendations by the ICC Court, unfortunately my own experience is that they may not. In any event, even the ICC Court may miss errors that cannot be rectified under existing rules.

a. Review Provided For in the Arbitration Agreement

At the present time, an obvious way of providing for appropriate review by the tribunal itself is to provide for such review in the arbitration agreement. But this may not be an effective way, because the parties who negotiate an arbitration agreement may not realize that it is desirable that they do so or because, not knowing which party may benefit from such review, they do not agree upon providing for it.

Furthermore, a contractual provision for review more extensive than that provided for in the institutional or ad hoc rules raises a question of its effectiveness. An agreement to arbitrate under institutional or ad hoc rules that provide for the usual very limited review is incompatible with a contractual provision providing for more extensive review. This conflict will have to be resolved. Will the courts recognize that the arbitral tribunal is the final adjudicator on this issue or will the institution or the court finally decide it? That issue may also be contractually addressed, preferably by giving the tribunal the final authority to determine its own competence. But what if the institution rules, either explicitly or upon construction, that its rules prevail over conflicting rules formulated by the parties? It would therefore appear preferable to address the issue by amendments in the institutional or ad hoc rules.

b. Review Provided For in the Institutional or Ad Hoc Rules

In order to provide for arbitrators' review of their own awards, the relevant provisions in presently effective institutional and ad hoc rules awards may be amended to provide for the parties' adopting their own rules if they so wish. Under such a provision, the presently effective rules would provide a fall-back provision.

However, for a variety of reasons, parties may not address the issue at the time of drafting the arbitration agreement. They may not realize at the time the desirability of doing so or they may be uncertain about what scope of review will best serve their interests. They may even exclude any review, which would be socially undesirable.

It would therefore appear preferable for the institutional and ad hoc rules to provide themselves for the proper scope of review for errors by the arbitrators themselves. The crucial question would then become what the scope of that review should be. Proper balancing of the social interest in promoting final arbitral decisions in a single instance against the social interest in avoiding errors that may cause injustice would appear to support a provision for arbitral review of both errors of fact and law the occurrence of which the parties could not reasonably have anticipated, and therefore addressed, before making their final submissions. In particular, they should not have an opportunity to rehash previously made arguments of law or fact, unless the arbitrators rendered a decision that could not have been, and was not, anticipated.

If provision for such review is made, most persuasive arguments could be made for not permitting the parties to deviate from it and to substitute their own provision. The latter would necessarily raise questions as to how far this deviation could be permitted without leading to socially unacceptable results.

However, if review of both unanticipated errors of law and fact by the tribunal itself is permitted, safeguards against misuse of this opportunity should be provided. In the first place, the opportunity for review should be subject to very short time limits with a maximum of at most thirty days. Second, in order to prevent abuse, the applicant for such review, and all other parties, should be limited to a single submission in writing. Third, the opponent may request, and should normally be granted, security in a sum to be determined by the tribunal to cover the tribunal's and the opponent's cost in the event the request is denied and, as the case may be, the relief awarded in the original award. Fourth, the tribunal must render a decision within at most thirty days unless it states, in a reasoned written decision before the expiration of that period, that its proper decision on the request requires an additional specified period. Fifth, if no decision on the request is rendered within

the time allowed, the request is deemed denied and any decision out of time is disregarded and null and void. Sixth, no award is final until a decision on the request is rendered.

It is submitted that provisions to these effects in the prevailing institutional and ad hoc rules would go a long way towards meeting the concerns of those who decide against arbitration on the ground that it is a one-instance proposition with too high a risk of incorrigible errors. Nevertheless, this form of expanded review by the tribunal itself cannot deal with cases of obstinate, arrogant, or incompetent arbitrators. To deal with them, intra-arbitral review must be performed by a different tribunal.

3. Review of Arbitral Awards by Appellate Arbitral Tribunals

This form of intra-arbitral review is provided for in the International Convention on the Settlement of Investment Disputes (ICSID). However, the scope of ICSID review appears to be unduly limited.[26] And the resulting award is not subject to any review in domestic courts.[27] Both limitations, whatever their merits in the context of arbitration of state-investor disputes, appear inappropriate in the usual form of commercial arbitration. In commercial arbitration the means of review allowed in domestic annulment actions and in recognition and enforcement actions under the New York Convention should remain available as statutorily prescribed means of review deemed appropriate by the bodies politic.[28]

If it is decided to provide for a second instance intra-arbitral review, the crucial questions are two: First, how is the appellate tribunal to be composed; and second, what should be the scope of review?

There appears to be an emergent view that an arbitral appellate tribunal should be composed of truly neutral arbitrators and should exclude party-appointed arbitrators. At least I hold that view. The

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26. Under Article 52(1) of the ICSID Convention, appeals are limited to the following grounds:

(a) that the Tribunal was not properly constituted;

(b) that the Tribunal has manifestly exceeded its powers;

(c) that there was corruption on the part of a member of the Tribunal;

(d) that there has been a serious departure from a fundamental rule of procedure; or

(e) that the award has failed to state the reasons on which it is based.

27. Article 52(3) of the ICSID Convention. I have elsewhere argued that, in N.Y. Convention countries, annulment actions should be limited to grounds specified for non-recognition in the N.Y. Convention, but, as long as that has not been done, the usual annulment actions continue to be permitted. *See* Hans Smit, *Annulment and Recognition of Annulled Awards*, *supra* note 6.

28. *See* text at note 11 *supra*.

present CPR rules relating to intra-arbitral review provide for the panel to be composed of former federal judges.[29] However, this appears to be too limited a category. But much can be said in favor of selecting appellate arbitrators from groups of persons who have experience in arbitration, possess significant special qualifications, and are appointed by a neutral party. I would favor institutional initiatives toward forming pools of prospective appellate arbitrators whose names and qualifications are published and from which the institution will select a panel for each particular case. The institution will select the appellate arbitrators on its own. It may consult with the parties on the special qualities the parties deem desirable, but the parties may not propose their own candidates.[30] This method of selection will be likely to enhance confidence in the appellate process.

The scope of the arbitral process review presents the second crucial question. Various possible answers present themselves. Here again, the institutional and ad hoc rules face a choice: They can provide their own definition of the scope of review; they can provide their own definition as a fall-back from the definition of the scope of review in the individual arbitration agreement; or they can leave the scope of review to be determined in the individual arbitration agreement. In the latter case, they can offer the parties who provide for intra-arbitral review a number of options.

In my opinion, the better arguments favor a single and exclusive definition of the scope of review in the institutional or ad hoc rules. The considered judgment of the drafters of institutional and ad hoc rules as to the most desirable scope of review is likely to be better than ad hoc determinations by drafters of contracts who are unlikely or unable to give the question the consideration it deserves. Furthermore, a single definition of the scope of review is likely to promote consistency in, and foreseeability of the results of, its application by appellate tribunals, especially if, as I would like to provide, appellate arbitral decisions will be published as a matter of course.

However, if it is deemed preferable to permit the parties to choose the scope they deem most appropriate, it will still be appropriate to provide them with options as between possible scope definitions. I will therefore discuss both a preferred scope of review and possible alternatives.

The essential nature of arbitration as an efficient and flexible substitute for litigation would be put in jeopardy if provisions were made

29. CPR Rules for Appellate Review, Rule 1.2.

30. List procedures are to be avoided, since they go in the direction of a party's appointing its own-arbitrator.

for plenary review on the facts and the law. An assigned error approach such as that of the federal system would appear far preferable. If that approach is adopted, the next question is whether both errors of fact and errors of law are to be reviewable and what the standard of review is to be. It may be regarded as desirable to adopt the standard of review applied in federal appellate courts. The advantage of adopting that standard is that there is a developed body of law on the application of that standard. The clearly erroneous standard applied in reviewing findings of fact would not permit de novo review of such findings, but limit review to findings of fact that no reasonable arbitrator would make. A similar limitation could be applied in reviewing findings of law. Arbitrators have desirable leeway in developing and applying law to fit the circumstances of the individual case and it would appear appropriate to interfere with that freedom only when they have clearly strayed from their appointed task.

Certainly, the manifest disregard of the law standard, probably precluded for the courts by the *Mattel* case, should be considered as a standard for arbitral appellate review. And manifest disregard of the contract, introduced into at least some of the pre-*Mattel* court decisions, should also be considered. Indeed, the clearly erroneous standard may well come close to the manifest disregard standard, but would offer the advantage of not necessarily importing the case law developed in regard to the manifest disregard standard.[31]

An advantage of introducing a manifest disregard of the law or the terms of the contract standard in arbitral rather than judicial review is that it will avoid the problems caused when the disregard of the law standard is used to annul an award in court. Under the New York Convention, an award so annulled may nevertheless be recognized and enforced. This uncertainty is eliminated when an award is reversed by an appellate arbitral tribunal. That tribunal's award must be recognized and enforced in all countries bound by the N.Y. Convention.

All in all, a standard of review that is limited to clearly erroneous findings of fact or law appears to be the most appropriate in the circumstances and to send a clear message to the appellate tribunal that it should reverse only in limited circumstances.

If institutional or ad hoc rule makers were to wish to import more flexibility into the system, they could provide for additional optional standards of review. They could permit review of clearly erroneous

31. Appropriate provision must be made for the case in which an annulment or recognition action is brought before intra-arbitral review is sought. The applicable arbitration agreement or institutional or ad hoc rules should provide that the original arbitral tribunal's award in that case should not be considered final. *See* text at note 33 *supra*.

findings of law only and exclude review of the facts on the reverse. Or they could permit review of clearly erroneous findings of fact only. And they could permit review only if the decisions appealed from are clearly unjust. Clearly, the possible variations are numerous.

The notion that arbitration is contractual and designed to meet the desires of its customers argues for a great deal of flexibility. But a single standard would promote predictability and a reasonable control of the arbitral process so as to avoid its degenerating into a duplicate of litigation.

If, as argued here, intra-appellate review under institutional and ad hoc rules would be limited to clearly erroneous conclusions of fact or law, parties might nevertheless provide for different kinds of review in their arbitration agreements. The question then arises whether such individual clauses would prevail over the relevant institutional or ad hoc rules. If that were deemed undesirable, the institutional or ad hoc rules should specifically exclude provision for a different scope of review. That would result in the arbitral appellate procedure to become entirely ad hoc with the consequence that the parties would have to regulate the entire appellate process in their arbitration agreement.

a. The Particulars of the Appellate Arbitral Process

The permissible scope of review is only one of the elements of the intra-arbitral process of review. The relevant rules or provisions in the arbitration agreement must also deal with the time period within which the appeal must be perfected, how is it to be perfected, how the appellate tribunal is to be constituted, what the appellate procedure will be, what decisions the appellate tribunal may render, whether it must render a reasoned decision, and how its decision is to be communicated to the parties. I will not address here all particulars to be worked out with regard to these subjects, but highlight only the more important ones.

Since the constitution of the appellate tribunal is of particular importance, I would argue that its members should not be appointed by the parties, but by the supervising institution and, even in ad hoc arbitration, by a competent third party, such as a leading arbitration institution. This, I believe, will lead to more even-handed and consistent decision-making. And, if, as I would advocate, the decisions of the appellate tribunals would be published as a matter of course and not only upon the consent of the parties, a significant step forward would be made towards desirable transparency in arbitration.

The rules of procedure should also address the appellate tribunal's authority to require adequate security for costs and ultimate recovery and to suspend enforcement of the first-instance award.

The task of the appellate tribunal must also be defined. Must the appellate tribunal, in the case of reversal, remand the case or can it finally adjudicate the controversy itself and, if necessary, receive additional factual evidence? It is submitted that it is more in the spirit of arbitration, as a self-contained efficient process, to permit the appellate tribunal to dispose of the entire case itself and not to permit it to send the case back to the original tribunal. In any event, the ICSID model of having an appellate tribunal annul the original award and then to require a de novo arbitration as a third stage deserves no emulation.[32] Nor does, by the way, the unusually narrow review permitted by the ICSID Rules commend itself.

The ICSID example of not permitting judicial review by a domestic tribunal should not be followed either. The final award by the appellate tribunal should be subject to the usual review in municipal courts in annulment and recognition and enforcement actions.

D. Contractual Provisions Relating to the Class Action

The notion that arbitration is a contractually created mode of dispute resolution has give rise to efforts by those who use the process to contractually turn it to their advantage. Not only have providers of mass consumer products and services embraced arbitration as the preferred mode of dispute settlement, they have also sought to limit their exposure in the arbitral process. A significant advantage of arbitration is generally that a jury is avoided. Prevailing institutional and ad hoc rules do not provide for adjudication by a jury and, perhaps somewhat surprisingly, there appears to be no arbitrated cases involving the use of a jury, nor of contractual provisions precluding resort to a jury.

However, multiple users of arbitration have sought to use their contractual freedom to mold the arbitral process to serve their interests by other provisions. Now that it has been established that the class action device is, in principle, available in arbitration, contractual exclusions of recourse to class actions have made their appearance. And so have contractual provisions excluding awards of consequential and punitive damages. And, naturally, the appearance of such clauses have raised the question of whether they are permissible and enforceable.

Not surprisingly, there appears to be no authority for the view that class actions can be contractually excluded in normal litigation. However, intrepid lawyers have definitely attempted to do so. In my view, the class action reflects a judgment by the body politic as to how

32. On the recognition of annulled awards, see Smit, *Annulment and Recognition of Annulled Awards*, note 6 *supra*.

multiple claims with common characteristics can best be adjudicated. That judgment is not, and should not be, subject to private manipulation. Agreement to outlaw class actions in the courts are therefore unenforceable as against public policy.

The same conclusion appears warranted in regard to preclusion of class actions in arbitration if the consequence of such preclusion would be to preclude class actions altogether. The qualification appears appropriate, for, if preclusion of the class action in arbitration would lead to the conclusion that claims otherwise subject to arbitration can still be pursued in class actions in the courts, the class action avenue would remain preserved. But, at least at present, it is uncertain whether the courts would attach that consequence to contractual exclusion of the class action in arbitration.

Since the U.S. Supreme Court in the *Green Tree* case, in accordance with what I had previously argued, ruled that, in the absence of relevant provisions in the arbitration agreement, it was for the arbitration to decide whether a claimant could bring a class action,[33] drafters of institutional and ad hoc rules necessarily had to consider whether to include in their rules provisions on class actions. The American Arbitration Association has taken the lead in this regard and has adopted the AAA Class Action Rules. They deserve more elaborate discussion than would be appropriate here. But I would like to draw attention to one of its major defects. The AAA Rules follow in large measure the provisions of Rule 23 of the Federal Rules of Civil Procedure, which provides for the court's certification of the class and the court's approval of settlements. Under the AAA Rules, these functions are performed by the arbitral tribunal.[34] But since arbitral tribunals are normally composed of arbitrators designated by the parties, as soon as the parties agree on the proper class, and more importantly, on the settlement, the tribunal will normally also agree. A crucial safeguard will thus be removed. Since it will be difficult, if not impossible, to give the arbitral tribunal the detachment and authority needed for the proper administration of class actions, I would be inclined to argue that the administration of class actions should remain reserved for the courts. Appropriate legislation may be needed to accomplish this.

E. Exclusion of Consequential and Punitive Damages

Whether an award of consequential or punitive damages may be contractually excluded is a question that arises in both ordinary litigation

33. Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444 (2003).
34. AAA Supplementary Rules for Class Arbitrations, Rule 4(a).

and arbitration. In my view, it should be answered the same way, regardless of the forum in which it arises. And since the issue arises in the context of defining contractual relations which, in principle, the parties may fashion as they see fit, the parties should be free to exclude whatever kinds of damages they wish. Of course, otherwise applicable principled of contract law, such as mistake, fraud, duress, unconscionability and the like should continue to be applicable, but a straightforward outlawing of clauses precluding awards of consequential or punitive damages would appear inappropriate.

F. The Unilateral or Optional Arbitration Clause

Increasingly used by providers of mass services or products is the unilateral or optional arbitration clause. In its most frequently occurring form, it gives one of the parties a choice between arbitration and litigation. But the optional feature may be attached to other parts of the contract. Thus, for example, more expansive review of the arbitral award may be allowed to only one of the parties, exclusion of particular types of damage clauses may benefit only one of the parties, and a choice of law clause may be invoked by only one of the parties. As a general principle, whatever benefit may be provided for in the arbitration agreement may be sought to be extended to only one of the parties.

The courts have generally been inclined to uphold the validity of such clauses, although unconscionability has appealed to some as ground for invalidity. I am strongly of the view that such clauses have no place in an evenhanded system of adjudication and should be held unenforceable in all circumstances. I intend to attempt a more extensive analysis of the unilateral arbitration clause and the potential grounds for its invalidity in the near future. But since the fate of the clause has not yet been authoritatively adjudicated, drafters of institutional and ad hoc rules may be well advised to consider outlawing the use of such clauses in arbitrations they administer by providing in their rules that any form of unilateral or optional clause will be converted in an arbitration clause without the optional or unilateral feature. A clause to this effect is particularly desirable since, in its absence, a ruling that the unilateral or optional clause is unenforceable may prompt an additional ruling that, in the absence of a valid arbitration clause, the parties are relegated to resolving their disputes in the courts.

II. CONCLUSIONS

Since arbitration is the product of the exercise of contractual freedom, parties will naturally be inclined to make the process fit their predilections. And, naturally, the economically stronger party will be

most likely to use that freedom to their advantage. This essay is a first attempt to explore the limits that the law does or should impose on that freedom. It endorses as its basic premise that the parties' freedom should be circumscribed when maintenance of arbitration as a socially acceptable form of dispute resolution for both parties so requires

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