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Is The Principle Of Finality “Losing Its Appeal”?

Alejandro I. Garcia (Herbert Smith Freehills LLP) · Wednesday, May 18th, 2011 · Herbert Smith Freehills

On 27 April 2011, the US Supreme Court in a 5-4 decision (*AT&T Mobility LLC v Concepcion* (563 US ____ (2011) 17)), concluded that due to the principle of finality, arbitration would be “poorly suited” to cases where the stakes are particularly high (class actions in the instant case). The US Supreme Court added: *“[w]e find it hard to believe that defendants would bet the company with no effective means of review […].”*

Elsewhere, on 15 March 2011, the Arbitration Rules of the Spanish Court of Arbitration introduced (on an opt-in basis) provisions on an internal appeal mechanism. This appeal mechanism vests an “appellate arbitral tribunal” with the power not only fully to review a “first-instance” award but also, in some circumstances, to hear new evidence.

Further, the draft rules of arbitration for investment disputes currently under consideration by the Union of South American Nations (UNASUR) also provide for an internal appeal mechanism including full review on the merits (see C Leathley’s 13 April 2011 post on Kluwer Arbitration Blog).

Do these developments mean that the principle of finality is “losing its appeal”?

Historically, many arbitration acts vested national courts with the power to review the merits of arbitral awards, which meant that the decisions of arbitral tribunals were subject to what was perceived as judicial second-guessing. During the 20th century, most arbitration acts and institutional rules addressed this issue by providing for the principle of finality. As a notable exception, s 69 of the English Arbitration Act 1996 (the “AA”) provides (on an opt-out basis) for a limited right of appeal on a point of English law.

The developments described above do not appear to challenge in general the view that arbitral awards should be free from judicial interference. Instead, these developments show (and probably highlight the fact) that, in some quarters, it is considered that the principle of finality may not be appropriate for all types of dispute. Such a view is not new, which is evidenced by the fact that some dispute resolution procedures (e.g. WTO claims) provide for appeal mechanisms.

I do not propose to discuss here whether, from a policy standpoint, the principle of finality should be revisited. I aim instead to discuss some considerations that could be taken into account by a party whose decision to conclude an arbitration agreement may be influenced by the principle of finality.

A potential user of international arbitration should first give some thought to the reasons underlying his or her concerns in relation to the principle of finality. Some concerns may be unwarranted, which is particularly the case where they rest on the underlying assumption that arbitral tribunals can be equated with first-instance courts. In this respect, it is important to take into account how litigation is conducted in a number of countries. In many civil law jurisdictions, first-instance courts are often composed of judges with limited experience. In those countries, quite often, only at the appellate level cases are handled by experienced judges.

In the USA, the outcome of many commercial disputes turns on the findings of jurors, who may not always be in a position to get to grips with complex issues of fact. As a result, many district court decisions are reversed on appeal on issues arising from the fact-finding process.

Consequently, in the context of national litigation, appellate review often enhances the quality of the decision-making process. The situation is different in international arbitration where parties can secure expertise and quality decision-making by appointing experienced arbitrators, particularly where they agree on a three-member tribunal. Further, an experienced arbitral tribunal will often be well-equipped to deal with the intricacies of the fact-finding process even in the most complex cases.

Some other concerns may arise from a lack of understanding of the effects of arbitral awards. By way of example, in the intellectual property field, some holders of intellectual property rights ("IPR") do not want to "risk" the validity of their IPR in "single-instance" arbitral proceedings. This view is largely inaccurate for the simple reason that, under most legal systems, arbitral tribunals cannot invalidate IPR with *erga omnes* effect (see C Cook & AI Garcia, *International Intellectual Property Arbitration*, Kluwer Law International, pp 39-40).

There are other concerns, however, that may have some force. To some extent, an appeal allows a defeated litigant to have a "second bite of the cherry". This can prove pivotal, which is demonstrated by the significant number of judgments that are reversed on appeal in many jurisdictions. In other words, an appeal can help "hedge" the risk of a potential unfavorable decision. Faced with the possibility of a significant or a bet-the-company case, arbitration with no appeal may be perceived as too risky by some parties. What can potential users of international arbitration do to address such concerns?

Obviously, an option is simply for a party not to conclude an arbitration agreement. Litigation, however, is not always a good option particularly where it may lead to legal proceedings in the home-jurisdiction of the other side or where enforcement in a number of countries is likely to be needed. Where litigation is not a suitable option, in theory, there are two ways in which a party can obtain the benefits of international arbitration and, at the same time, secure review on the merits: (a) he or she may agree on having recourse to national courts or (b) he or she may agree on an internal appeal mechanism.

The first potential solution consists of, as it were, "contracting out" the principle of finality by agreeing that relevant national courts (in most cases, those at the seat of the proceedings) would have the power to review the merits of the award. Whilst it appears that some jurisdictions are prepared to enforce such agreements (e.g. New Zealand and Switzerland), others are not (e.g. the USA in the light of the decision in *Hall Street Associates LLC v Mattel Inc* (2008) 552 US 576 (Sup Ct)).

Nonetheless, this option (where available) has several potential drawbacks. Obviously, the proceedings would be subject to increased judicial interventionism and the outcome of a dispute may depend on the findings of a national court. The length and expense linked to resolving the dispute are bound to increase (the decision on the appeal may be subject to further appeals or recourses in civil law parlance). In most cases, the interaction between national courts and the relevant arbitral tribunal is likely to be unclear (e.g. the court entertaining the appeal might not have fact-finding powers and therefore might need to request the assistance of the arbitral tribunal, which at that point would be *functus officio*). In turn, this can give rise to protracted litigation before national courts.

Secondly, the parties may resort to an internal or arbitral appeal mechanism. They could do so by agreeing ad hoc provisions or choosing the rules of an institution which provides for such a mechanism. This option has some potential drawbacks, for example, the costs and length of the proceedings will increase and, in some highly specialist fields, it might be difficult to find enough arbitrators to constitute two sets of arbitral tribunals. Further, designing an effective and workable arbitral appeal mechanism is complex. Without this being an exhaustive list, a number of issues that parties considering concluding such a mechanism may wish to address in advance are set out below:

• The parties should determine what would happen with the award made by the first-instance tribunal whilst an internal appeal is afoot. If the parties do not provide that the first-instance award will be suspended while the appeal is taking place, it appears that a party may be in a position to commence recognition and enforcement proceedings under the New York Convention or (although less likely) to file a setting aside action.

• The parties should address whether the appellate tribunal is to have fact-finding powers. If the appellate tribunal did not have such powers, it would have to request the intervention of the first-instance tribunal. This, in turn, may give rise to practical difficulties if the first-instance tribunal is not available. On the other hand, if the appellate tribunal did have fact-finding powers, there is the risk that most stages of the arbitration will have to be repeated before the appellate arbitral tribunal (particularly the evidentiary hearing).

• The parties may wish to discuss how the appeal should be filed (e.g. whether they should file a new request for arbitration with a relevant institution (if any) or an application before the first instance tribunal) and the way in which the proceedings on appeal are to be conducted.

• The parties may wish to discuss whether having an expedited or streamlined first instance before a sole arbitrator and an appeal before a three-member tribunal is appropriate.

• It is often difficult to ascertain in advance where a dispute will be a bet-the-company one. In this respect, the parties may wish to consider whether there should be a threshold or condition to trigger the relevant appeal mechanism, be that the amount of money at stake, the type of remedies requested or the rights in issue.

• If the parties are considering institutional arbitration, they should contact the relevant institution to confirm whether it would be willing to administer an arbitration with an appeal mechanism. If the relevant institution is willing to administer such proceedings, the parties may wish to discuss with the institution how the fees will be calculated especially where the institution employs an *ad valorem* method.

Institutional rules providing for internal appeals should at least provide specific guidance on the status of the award under appeal, the interaction between the two arbitral tribunals once an appeal has been filed and the powers of the appellate arbitral tribunal (for instance, the Arbitration Rules of the Spanish Court of Arbitration do not expressly indicate that awards under appeal are suspended).

There is no question that, in most cases, combining arbitration and review on the merits is likely to give rise to complex issues. In the light of the difficulties arising from reconciling review on the merits with the benefits of international arbitration, a party should resort to the options discussed above only if, after careful consideration, it concludes than an appeal is indispensable.

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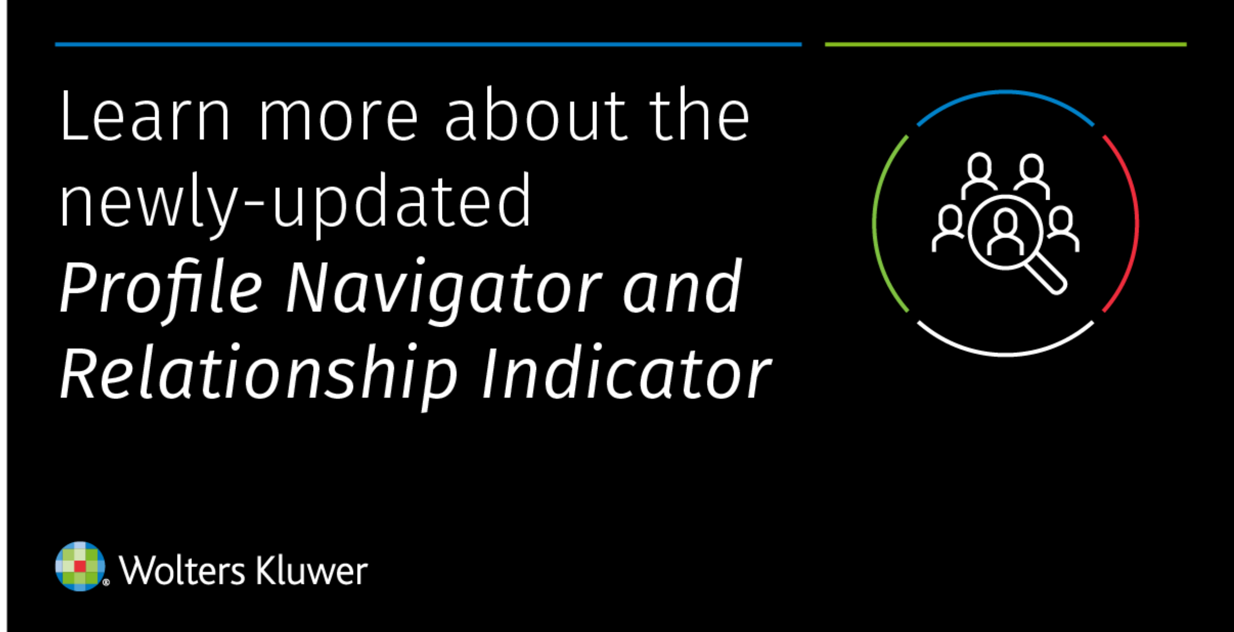

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