Arbitration and Mediation FAQs: Do Arbitrators Necessarily Exceed their Powers by Making an Award that Conflicts with the Unambiguous Terms of the Parties' Agreement?

We've addressed on many occasions the Enterprise WheelStolt-Nielsen/Oxford contract-based outcome review standard, which permits courts to vacate awards when they do not ?draw their essence? from the parties' agreement. Under that standard the ?sole question is whether the arbitrators (even arguably) interpreted the parties' contract, not whether [they] got its meaning right or wrong.? See Oxford Health Plans LLC v. Sutter, 133 S. Ct. 2064, 2068 (2013) (parenthetical in original). (See, e.g., Loree Reins. & Arb. L. F. posts here, here, here, here, here & here.)

While exceedingly deferential, the standard is not toothless. Arbitration awards that disregard or contravene the clear and unmistakable terms of a contract are subject to vacatur under it. See Stolt-Nielsen, S.A. v. AnimalFeeds Int'l Corp., 559 U.S. 662, 676 (panel had ?no occasion to ascertain the parties' intention in the present case because the parties were in complete agreement regarding their intent.?) (quotation omitted); United Paperworkers v. Misco, Inc., 484 U.S. 29, 38 (1987) (?The arbitrator may not ignore the plain language of the contract. . . .?). That's because an arbitrator who makes an award that lacks ?any contractual basis? has not even arguably interpreted the contract, and therefore has strayed from his or her task. See Oxford, 133 S. Ct. at 2069 (distinguishing Stolt-Nielsen); Stolt-Nielsen, 559 U.S. at 668-69, 672; Misco, 484 U.S. at 38.

An arbitrator whose award contradicts the unambiguous provisions of the parties' contract may?but will not necessarily?exceed her powers. The answer depends on what the agreement says, what the award says and whether the award is at least arguably grounded in the agreement.
Whether or not a contract or contract term is ?ambiguous? depends on whether it is reasonably susceptible to more than one meaning. See, e.g., White v. Continental Cas. Co., 9 N.Y.3d 264, 267 (2007); Greenfield v. Philles Records, 98 N.Y.2d 562, 570-71 (2002). When a contract is unambiguous, a court can interpret it as a matter of law; if it is ambiguous, its meaning is a question of fact for trial.

Can the Interpretation of the Arbitrators be "Unreasonable," yet still Colorable or Plausible?
The legal standard for lack of ambiguity is that there be only one ?reasonable? interpretation of the contract terms, not that there are no other at least barely plausible or barely colorable interpretations of what the contract might mean. In probably the majority of contract interpretation cases concerning alleged contract ambiguity, each litigant supports its position with good-faith, reasonable arguments for why the disputed contract terms are allegedly susceptible to one or more than one meaning. Whenever courts determine that a contract is unambiguous, that conclusion necessarily means that the losing party's interpretation of the contract is unreasonable as a matter of law.

Just as litigants frequently dispute in good faith whether a term is reasonably susceptible to more than one meaning, so too do appellate court judges. Cases concerning contract ambiguity sometimes result in dissenting or concurring opinions in which certain judges express divergent opinions about whether contract terms can be construed reasonably to have more than one meaning. Where a majority of the appellate court decides that only one interpretation is reasonable, the alternative interpretations advanced by the dissenting or concurring judges are, as a matter of law, deemed to be "unreasonable," no matter how persuasive and well-reasoned they may be.

Does that mean that the alternative interpretations unsuccessfully advanced by losing parties and outvoted judges in cases concerning contract ambiguity are off the rails? Of course not.

Strange as it may seem, reasonable minds may differ about whether a contract has more than one meaning, even though the law says or suggests otherwise. Unstated policy considerations and preferences may (and likely do) influence ambiguity determinations. In a perfect world, that would not be so. Contract interpretation questions would be resolved by an objective determination of what the text means, an exercise guided not by result-oriented policy considerations, but by language, usage, interpretive canons, linguistics and the like.

What is "reasonable" from an interpretive standpoint is thus, to some extent, within the eye of the beholder, a point that a recent New York Court of Appeals decision demonstrates well. See Ellington v. EMI Music, Inc., ___ N.Y.3d ___, 2014 NY Slip Op 07197, at *1 (N.Y. Oct. 23, 2014).

Taking the "A" Train to Albany. . .

Ellington concerned the interpretation of a 1961 United States copyright renewal agreements the late and great Jazz pianist and composer Edward Kennedy "Duke" Ellington (?Duke Ellington?) entered into with Mills Music, Inc. (now EMI Mills Music, Inc.). The parties to the agreement were Duke Ellington and his heirs and assigns (the ?Ellingtons?); and (b) a group of a music publishing companies including Mills Music, Inc. and ?any other affiliate of Mills Music, Inc.? Mills Music, Inc.'s successor was EMI Mills Music, Inc., part of the EMI Music, Inc. group of companies (collectively ?EMI?).

Paragraph 3(a) of the Agreement was a ?net receipts? royalty provision that required EMI to pay the Ellingtons "a sum equal to fifty (50%) percent of the net revenue actually received by the Second Party from . . . foreign publication" of Duke Ellington's musical compositions. (emphasis added by Court) In the music publishing industry, net receipts provisions ordinarily contemplate contemplate composers collecting royalties based on the income received by a U.S. publisher net of foreign subpublisher fees.

In 1961 foreign subpublishers were typically not affiliated with U.S. domestic publishers, so that domestic publishers would not ?receive? revenue until the unaffiliated subpublisher deducted its fee and paid the remaining funds over to the domestic publisher. See Slip op. at 3. Apparently, domestic music publishers, including EMI, have in more recent years affiliated with foreign subproducers. That corporate restructuring is what prompted Duke Ellington's grandson to sue EMI. See slip op. at 3-4.

The issue before New York's highest court turned on whether ?any other affiliate of Mills Music, Inc.? meant only affiliates of Mills Music in existence in 1961, or could also reasonably be construed to mean entities that became affiliates of Mills Music, Inc. at a later date. For if it could be construed to mean affiliates not in existence at the time of the contract, then foreign subproducer affiliates of EMI Mills Music would ?receive? 100% of the revenue generated by foreign sales rather than only 50%, as before, and the shares of both parties would, under the contract, double: both EMI and the Ellingtons would receive 50%, not 25%, of gross revenues from foreign sales. On the other hand, if the disputed contract language meant only affiliates of Mills Music in existence in 1961, then, as a result of corporate restructuring, EMI would receive 75% of gross revenue?three times as much as Mills Music Inc. and its then-in-existence affiliates would have received were it not for the restructuring?and the Ellingtons would receive the same 25% of gross revenue as before.

The 4 judge majority opinion found that the relevant contract terms unambiguously provided that affiliates of Mills Music, Inc. that did not exist when the contract was concluded were not bound by it. Associate Judge Robert S. Smith concurred, reasoning that the contract was ambiguous, but the ambiguity was resolved by practical construction evidenced by the parties' conduct. See Slip op. at 1-3 (Smith, J. concurring). Associate Judge Jenny Rivera dissented in an opinion joined by Chief Judge Jonathan Lippman, reasoning that the contract was ambiguous. See slip op. at 1-8 (Rivera, J. dissenting).

The principal rationale the majority gave for its conclusion was that the parties used the term ?affliliates? in the present tense. Judge Smith, however, said ?it seems wrong to me that, when a contract is written to bind ?any ... affiliate' of a party, its effect should be limited to affiliates in existence at the time of contracting. That invites parties to create new affiliates, and to have them do what the old affiliates are prohibited by the contract from doing.?

Judge Smith was also not persuaded by the majority's reliance on present tense usage: ?If I say ?I have three grandchildren' I am making a statement of fact. I am not restricting the definition of "grandchild" so as to exclude any who might later be born.? See slip op. at 1-2 (Smith, J. concurring). Judge Rivera's dissent likewise offered persuasive arguments for why the terms at issue were ambiguous. See slip op. at 1, 3-8 (Rivera, J. dissenting).

Our point here is not to explore the rationales of the various opinions in the Ellington case, but to underscore that reasonable minds can and often do differ on what is or is not a "reasonable" interpretation of text. And sometimes a contract that is "unambiguous" from a legal standpoint may be susceptible to other interpretations that are, at the very least, arguable. Those interpretations may be "unreasonable" as a matter of law, but that doesn't mean that they cannot provide a contractual basis for an arbitration award.

Jumping back onto the Federal Arbitration Act Caravan:
It Don't Mean a Thing (if it Ain't got that [Arguable] Swing). . .
Suppose the Ellingtons and EMI had agreed to arbitrate their dispute before a neutral arbitrator and that the arbitration fell under the Federal Arbitration Act (?FAA?). The arbitrator, without revealing the basis for her reasoning, rules that EMI's foreign subpublishers ?receive? revenue for purposes of the net receipts provision and that the Ellingtons are entitled to 50% of that revenue?that is, 50% of gross revenue. EMI moves to vacate the award, claiming that it contradicts the ?unambiguous? language of the contract. Would the Court in a case governed by the have undertaken the same kind of ambiguity analysis and concluded that arbitrator exceeded her powers? The answer, of course, is ?no.?

Had the dispute in Ellington been decided in the first instance by an arbitrator, then the issue before the Court would have been very different: whether there is any ?barely colorable? or barely plausible basis for the award in the law or the contract, not whether the award must have been based on what a court might consider to be a ?reasonable? interpretation of the contract were it interpreting the contract in the first instance to determine whether it was unambiguous. See, e.g., Oxford, 133 S. Ct. at 1068; Schwartz v. Merrill Lynch & Co., Inc., 665 F.3d 444, 452 (2d Cir. 2011) Otherwise courts would do what the Supreme Court has said they cannot: reivew awards for even very serious errors of law or contract interpretation. See 133 S. Ct. at 1068; Stolt-Nielsen, 559 U.S. at 668. And worse yet, courts would effectively reserve for themselves the right to decide independently what is a "reasonable" interpretation of a contract, something that parties delegate to the arbitrator when they agree to FAA-governed arbitration of contract-interpretation disputes, and which therefore must be reviewed with great deference.

Were Ellington an FAA Section 10(a)(4) case, then we suspect that it would have been a 7-0 decision. Irrespective of whether one believes the contract at issue was or was not reasonably susceptible to only one interpretation, it seems far beyond debate that it was at least arguably susceptible to more than one interpretation, including an interpretation that would have provided a contractual basis for our hypothetical arbitration award. In the circumstances we doubt any court would (or could) conclude that there was not at least a barely plausible contractual basis for the award and that the arbitrator thus must have at least arguably interpreted the contract.

Had the arbitrator set out her reasoning and made one or more of the points that Judge Smith or the dissenting judges made?or for that matter set forth anything in her award that would permit the court to conclude she had at least arguably interpreted the contract?then the case would have been even more straightforward (assuming that is possible). The parties bargain for the arbitrator's construction of the contract, and that ?construction holds, however good, bad or ugly.? See Oxford, 133 S. Ct. at 2071.

Author's Note:

I made obviously tongue-in-cheek references to certain of Duke Ellington's compositions in certain of the subtitles of this post. None of those references is intended to be disrespectful in any way to the music or memory of Duke Ellington, whom I believe to be one of the greatest composers and performers in jazz history.

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