What Happens when Arbitrators Exceed Clear Limitations on their Authority?

One advantage of arbitration is that parties can define and delineate the scope of disputes they agree to submit to arbitration, the basis on which disputes can or must be resolved and the scope of the arbitrator's remedial powers. If parties impose clear limits on an arbitrator's authority (usually by expressly excluding certain matters from arbitration or expressly providing that an arbitrator cannot or must grant certain remedies), then courts and arbitrators are supposed to enforce those limitations. See, e.g., Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 559 U.S. 662, 680-81 (2010).

Far too frequently, parties simply agree to a broad arbitration agreement that places no limitations on arbitral power, and when they end up on the wrong-end of an award they didn't expect, they discover to their dismay that they have no judicial remedy. Whether or not they understood that at the time they agreed to arbitrate is, of course, irrelevant. The only relevant consideration is whether their agreement could be reasonably construed to grant the arbitrator that authority, even if it could also be reasonably construed to withhold it. See, e.g., Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 62 (1995) (?when a court interprets such provisions in an agreement covered by the FAA, due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration") (quotation and citation omitted).

But suppose the parties take the time to consider whether they desire to limit arbitral authority, and their arbitration agreement unambiguously expresses an intention to limit arbitral authority to resolve certain disputes or impose certain remedies, or to expressly require that the arbitrators grant certain types of relief, such as fee shifting to a prevailing party. Should a court vacate the award if the arbitrator does not abide by the parties' unambiguously expressed intentions?

The answer should be obvious, and it certainly was to New York's Supreme Court, Appellate Division, First Department when ten days ago it decided Bowery Residents' Comm., Inc. v. Lance Capital, LLC, ___ A.D.3d ___, 2014 N.Y. Slip Op 06925 (1st Dep't Oct. 14, 2014). There, in a case governed by New York State arbitration law (codified in New York's Civil Practice Law and Rules (?CPLR?), Article 75), the parties' arbitration agreement contained the commercial arbitration equivalent of a labor-law ?zipper clause? coupled with a provision that entitled the prevailing party to recover attorney's fees, costs and disbursements:

The arbitrator will have no authority to make any ruling, finding or award that does not conform to the terms and conditions of this Agreement. Each party shall bear its own costs in any arbitration, with the prevailing party entitled to recover its commercially reasonable attorneys' fees, costs and disbursements.

The arbitrator ruled in favor of Party A, but the award ?directed each party to bear its own legal expenses. . . .? Slip op. at 1. There was no dispute that Party A was the prevailing party in the arbitration.

The trial court vacated the legal-expense-related portion of the award under CPLR § 7511(b)(1)(iii), which provides that an ?award shall be vacated. . . if the court finds that the rights of [the challenging party] were prejudiced by: . . . (iii) an arbitrator . . exceed[ing] his power. . . .? The trial court also vacated the ?arbitrator's denial of [Party A's] request for a modification of the award, and remand[ed] the matter to a different arbitrator for a determination of those [legal] expenses. . . .? Slip op. at 1.

Party B (the losing party) appealed, but the Appellate Division, First Department affirmed, concluding that ?the the arbitrator lacked any discretion under the agreement to decline to award [Party A] its reasonable legal fees, as the prevailing party, and the refusal to do so was clearly in excess of his power, thus warranting vacatur of the award.? Slip op. at 1-2 (citations omitted).

The Court did the right thing; indeed, it is difficult to imagine what Party B expected it to do. Had the Court confirmed the award it would have ignored the parties' arbitration agreement, something that certainly wouldn't make arbitration a very attractive alternative to litigation, and which would, in any event, have contravened Section 7511(b)(1)(iii) and controlling New York Court of Appeals authority interpreting it. See, e.g., Re Kowaleski, 16 N.Y.3d 85, 90-91 (2010) (cited by the Court, slip op. at 1).

Had the Federal Arbitration Act applied, the result would have been the same. FAA Section 10(a)(4), like its CPLR Article 75 counterpart, also authorizes vacatur where the arbitrators ?exceed their powers,? and arbitrators exceed their powers under Section 10(a)(4) when they make awards that exceed clear contractual limitations on their remedial authority. See Banco De Seguros Del Estado v. Mutual Marine Office, Inc., 344 F.3d 255 (2d Cir. 2003) (Under broad arbitration clause, ?arbitrators have the discretion to
order remedies they determine appropriate, so long as they do not exceed the power granted to them by the contract itself.

Bowery Residents illustrates the proper course for courts to take when confronted with situations where a limitation on arbitral authority is not only clear, but clearly applicable and clearly exceeded. Persons contemplating entering into arbitration agreements who want to include enforceable limitations on arbitral authority should consult with experienced and knowledgeable counsel to help ensure that the limitation is drafted in terms that can have only one meaning: that intended by the limitation's proponent. If there is even a barely colorable alternative meaning, then, in the event the limitation is asserted in a post-award challenge, the court will declare it ambiguous and construe it in favor of not limiting the arbitrator's power to make the challenged award. Put differently, it will not be enforced, at least not in the way the drafter intended.

Parties should also remember that courts frequently go to great lengths to find some technical or linguistic ambiguity on an authority limitation that will justify confirming the award. For a good example of this phenomenon, compare the majority and dissenting opinions in Reliastar Life Ins. v. EMC Nat'l Life Co., 564 F.3d 81 (2d Cir. 2009), or simply review the posts we published about that case when the U.S. Court of Appeals for the Second Circuit decided it more than five years ago (here, here, here, and here).

In a nutshell absolute clarity is essential, and perhaps even more so than it is in most other contractual contexts.