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Federal Appeals Court Upholds "Unsupported" and "Irrational" Arbitration Award

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Businesses frequently view arbitration as an efficient alternative to litigation in the courts. However, a recent decision by the United States Court of Appeals for the Ninth Circuit (which includes California) demonstrates that this assumption is often false, and that even unfounded arbitration decisions cannot be appealed. In *Lagstein v. Certain Underwriters at Lloyd's, London*, the Ninth Circuit refused to set aside an arbitration award that a lower court had found to be unsupported and irrational.

Lagstein, a cardiologist, purchased a disability insurance policy from Lloyd's. He developed heart disease and migraine headaches, which, he claimed, prevented him from practicing medicine. After two years, Lloyd's had not decided whether to pay out under the policy. Lagstein filed suit in federal court, claiming that Lloyd's had violated his policy in bad faith. At Lloyd's request, the court referred the case to a panel of three arbitrators, as provided in Lagstein's insurance policy.

In a two-to-one decision, the arbitration panel awarded Lagstein $2.4 million in compensatory damages, plus another $4 million in punitive damages. The third arbitrator, in dissent, would have awarded Lagstein only $11,000 in compensatory damages, and no punitive damages.

Lloyd's asked the district court to set aside the arbitration award. It argued, among other things, that the award was excessive and unsupported. For example, a majority of the panel concluded that Lagstein was completely disabled, even though it was undisputed that he returned to work to complete certain tasks. The district court agreed. It set aside the arbitrators' ruling on grounds that the award "'shock[ed] the Court's conscience,' suggested bias, was unsupported by the records, manifestly disregarded the law, and contravened public policy."

The Court of Appeals reversed the district court's ruling and reinstated the arbitration award. It explained, "[w]hether or not the panel's findings are supported by the evidence in the record is beyond the scope of our review." Furthermore, the appellate court held that arbitrators' legal errors are not subject to scrutiny unless it is "clear from the record that the arbitrators recognized the applicable law and then ignored it." The appellate court also refused to consider whether the panel's decision was "irrational," so long as the award "draws its essence from the agreement."

Conclusion. The decision starkly illustrates one of the chief drawbacks to arbitration – unlike court proceedings, arbitrators' decisions are not subject to substantive appellate review. The case also shows that, contrary to conventional wisdom, arbitration does not necessarily offer a quick and economical method to resolve disputes. More than six and a half years passed from the time Lagstein first filed suit until the Ninth Circuit issued its ruling upholding the arbitrators' award. During that time, the parties litigated various legal, factual, and procedural issues in the district court, before the arbitration panel, and before the Court of Appeals. Although the decision does not state the amount of attorneys' fees (and arbitrators' fees) that the parties incurred, one can be sure that they were substantial. Parties should bear these potential consequences in mind before including an arbitration provision in an agreement.