

Federal Appellate Decision Illustrates Downside of Arbitration

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Arbitration is generally assumed to be an efficient means of resolving business disputes, and one that mitigates the risk of unpredictable and volatile jury awards. A recent decision of the Ninth Circuit Court of Appeals demonstrates that these assumptions are not always true. The court's opinion in *The Matter of Brown* shows that arbitration can present the same disadvantages as a jury trial, without the protection of meaningful appellate review of the arbitrators' decisions.

Brown involved a dispute between a married couple and their former business manager. The three had formed two limited partnerships to manage their investments. The couple removed the manager from the partnerships after learning he had made "undocumented loans" from the partnership's assets to himself and his friends. The manager filed for arbitration, claiming that the couple had improperly removed him as the manager of the partnerships and that they had failed to provide an accounting of his partnership interests. As is often the case when parties seek to minimize the risk that a single arbitrator might reach an improper or unpredictable decision, a panel of three arbitrators heard the arbitration.

If the parties expected arbitration to provide a quick resolution of the dispute, they were disappointed. The arbitration lasted two years, including 60 days of hearings. More than 20 witnesses testified, and the parties introduced more than 500 exhibits. Ultimately, the arbitrators determined that even though the manager had breached his fiduciary duties, the couple had no right to remove him. The arbitrators also ruled that the couple had breached their obligations to the manager by failing to provide him a "prompt distribution of his partnership interest," which the panel valued at roughly \$1.5 million. The arbitrators found that the couple had "acted with malice and oppression," and ordered them to pay the manager nearly \$20 million dollars in punitive damages.

Over the couple's objections, the Court of Appeals confirmed the arbitrators' award. As the court explained, "[n]either erroneous legal conclusions nor unsubstantiated factual findings justify federal court review of an arbitral award." Furthermore, "[a]rbitrators are not required to set forth their reasoning supporting an award." As a result, the court refused to evaluate whether the arbitrators' factual or legal conclusions were correct.

If the case had proceeded in court, rather than in arbitration, the outcome would very likely have been different. As the couple pointed out, the arbitrators' punitive damages award substantially exceeded the limits imposed by the United States Supreme Court. Further, the award was based on inherently inconsistent factual findings and, in violation of California law, the arbitrators appear to have based the punitive damages award on the couple's conduct during the proceedings.

None of this mattered. The court reminded the couple that no matter how erroneous the result may have been, they "accepted this risk when they consented to arbitration; they cannot now claim the benefits of expanded judicial review simply because the awards were unfavorable to them."

Conclusion. Parties contemplating including an arbitration provision in their agreements should remember this admonition, and should not assume that arbitration will provide a more desirable forum to resolve their disputes.