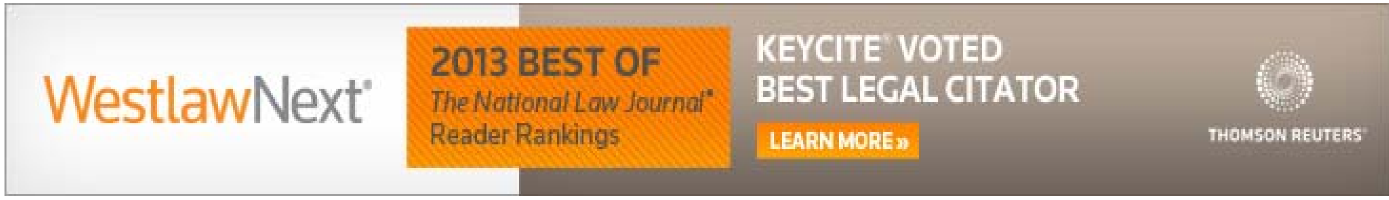

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In Practice: Appellate Arbitration Isn't a Game Changer

Israel's experience suggests appellate option being rolled out in U.S. won't make arbitration that much more attractive, writes Eric Sherby.

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The American Arbitration Association recently announced rules that will, for the first time, permit parties to AAA arbitrations to appeal arbitral awards before an AAA appellate panel.

These rules also will be applicable with respect to the international arm of the AAA, the International Centre for Dispute Resolution. The new rules became effective Nov. 1. (JAMS announced its own optional appellate rules months earlier.)

Writing recently in Lexology, one law firm has described the adoption of the appellate rules as "a move that is bound to revolutionize both domestic and international arbitration."

Not so fast. If the experience over the past five years of Israel is any indication, the appellate option probably won't lead more business people to choose arbitration.

In Israel, for the past five years, it has been possible to appeal arbitral awards (subject to certain conditions, described below). The appellate option in Israel exists irrespective of any arbitral institution. Parties to any Israeli arbitration may agree that the arbitral award will be subject to an appeal.

Our law firm recently completed a survey of in-house lawyers at Israeli companies involved in international commerce. Our survey shows that such lawyers are no more likely today to recommend arbitration than they were five years ago, when Israeli law was amended to incorporate the possibility of appellate arbitration. In other words, in Israel, the appellate arbitration option hasn't made arbitration any more attractive.Why look at Israel? Two reasons: (a)Te overall similarities between the legal systems of the United States and Israel, and (b) there are not many jurisdictions that have adopted the "appellate" arbitration option.

Israel is generally categorized as both a common law jurisdiction and a pro-arbitration jurisdiction.

Yet for many years, the "arbitration community" in Israel has felt that arbitration is underutilized.

As a result, in the middle of the last decade, some in the Israeli arbitration community decided that the way to increase the use of arbitration would be by affording parties the opportunity to appeal an arbitral award. Those efforts culminated in amendments that were passed in 2008 to Israel's arbitration statute.

The 2008 amendments now permit the possibility of an appeal (not to be confused with a motion to vacate) of an arbitral award, via two different "routes":

1) an appeal to an appellate arbitrator but only if the parties have expressly agreed to it in the arbitration agreement;

2) an appeal, to a district court, subject to three conditions: (a) the arbitration agreement expressly provides for an appeal; (b) the agreement provides that the arbitrator is to be bound by substantive law; and (c) the court is of the view that, in applying the law, the arbitrator made a fundamental error that would cause a miscarriage of justice.Our firm surveyed in-house lawyers employed by Israeli companies that hold themselves out as active in international commerce. The survey was sent, via email, to approximately 300 such lawyers, and 12 percent responded. The respondents represented a broad cross-section of the Israeli business community.

What The Survey Tells About The 2008 Amendments

One survey question asked respondents to estimate the extent by which their views concerning the inclusion of an arbitration clause in a contract have changed over the past five years. Thirty-nine percent said they are no more or less likely to recommend an arbitration clause than they were five years ago. Eleven percent said they are slightly more likely to recommend *against* the inclusion of an arbitration clause.

So half of the in-house lawyers responding to our survey said they aren't more likely to opt for arbitration.

Undoubtedly those who predicted that the 2008 amendments would improve perceptions concerning arbitration expected that such improvement would be seen and felt in the Israeli business community. Among corporate decision-makers, in-house lawyers presumably have a role second to none in deciding, at the contracting stage, whether to include an arbitration clause.

As for those respondents who said that they are either slightly more likely or significantly more likely to recommend the inclusion of an arbitration clause (collectively, the More Likely to Recommend Group), it is far from clear that their change is attributable to the 2008 amendments.

Another question asked: *In those cases over the past five years in which your company has been involved in a business-to-business international negotiation, and the issue of including an arbitration clause in the contract was raised but ultimately rejected, the PRIMARY REASON that it was rejected was . . .*

Five reasons were provided, one of which was the lack of appealability (in the international context) of an arbitral award. If we were to assume that the More Likely To Recommend Group owes its existence (in whole or in part) to the 2008 amendments, then we would expect that the reasons given for rejecting arbitration by that specific group would be noticeably different from the reasons given by respondents overall.

But that was not the case—at all. Overall, 22 percent of respondents cited "lack of appealability" as the reason they had rejected arbitration clauses—the same percentage seen in the More Likely to Recommend Group.

Thus, even though we might have expected the More Likely To Recommend Group to cite in great numbers the lack of appealability as the reason for failing to reach agreement to arbitrate, that group cited the lack of appealability at the same rate as those respondents who are no more likely to recommend arbitration than they were five years ago.

In summary, the answers to these two questions constitute clear evidence that the 2008 amendments have failed to have the desired effect upon the most likely potential consumers in Israel of arbitration services.

Why Didn't It Work In Israel?

Why has the appellate option not increased the willingness of Israeli business people to arbitrate? In addressing this question, we cannot ignore the costs issue.

When we asked about the primary reason arbitration had been rejected, 38 percent identified cost as the biggest factor. It's not surprising that over a third of respondents would cite the expected costs of arbitration as the primary reason for deciding against an arbitration clause.

An appellate level to the arbitration process adds costs, and it is likely that many in-house lawyers have not been persuaded that there is additional value for that additional cost.

Although there are legal and cultural differences between the United States and Israel, any differences as to the arbitration law of the two countries are minor insofar as they relate to the considerations of a (corporate) litigant that is contemplating including an arbitration clause.

Israel is second only to Canada as the non-U.S. country having the most companies traded on American stock exchanges, and a significant number of respondents to our survey are attorneys in the legal departments of corporations that are publicly traded in the United States. Also, many of the respondents were educated in the U.S. These facts further marginalize any legal or cultural differences between the US and Israel.

What do our survey results mean for the AAA? At the least, they suggest that the inclusion of an appellate option is not a quick fix to the problem that arbitral institutions face in "selling" their services.

The silver lining for the AAA (insofar as a comparison to Israel is concerned) is that the 2008 Israeli amendments do not set forth a clear standard of review to be applied by appellate arbitrators. It is possible that such lack of clarity has (to some extent) been a reason that Israeli lawyers and business people have not yet seen the appellate option as a significant attraction to arbitration.

To the extent that the AAA can convince the business community that there will be a clear standard of review to be applied by appellate arbitrators, then it might be possible to convince the business community that the added costs associated with an arbitral appeal translate into added value.

Eric S. Sherby is the founding partner of Sherby & Co. Advs., the Israeli law firm that he founded in 2004. Mr. Sherby specializes in international litigation and arbitration. Sherby & Co. Advs. will make the full survey results available upon request, which may be sent to info@sherby.co.il.

In Practice articles inform readers on developments in substantive law, practice issues or law firm management. Contact Greg Mitchell with submissions or questions at gmitchell@alm.com.

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