Another Look at Remedies in Arbitration

by: Harvey W. Berman
(Thomas Breutsch assisted in researching this article.)

It is widely recognized that arbitrators have broad authority to order any type of relief, even if the relief could not be awarded by a court.[1] This flexibility can be understood to result, in part, from expansive arbitration clauses that often expressly or impliedly provide the arbitrator with a broad power to design remedies, and from the limited appealability of arbitration awards.[2] Yet many attorneys and arbitrators don't realize how much flexibility arbitrators have in crafting awards. While monetary damages are most often awarded in commercial cases, arbitrators have frequently awarded equitable and other forms of relief, including specific performance, injunctive relief, consequential damages, liquidated damages, attorneys' fees and punitive damages.[3]

Because of the confidentiality of arbitration, the only opportunity to examine commercial arbitral remedies occurs when an award is in court. In this article we will examine some cases in which arbitral remedies have been specifically challenged for the purpose of seeing how arbitrators craft remedies they believe are appropriate, and how the courts have responded to these challenges.[4]

The Arbitration Agreement

We begin with a brief look at the arbitration agreement, an important source of the arbitrator's authority in the arbitration. It goes without saying that because arbitration is almost always a contractual matter, the agreement to arbitrate usually determines the scope of the arbitrator's authority, including the authority to grant remedies. The authorized remedies may be expressly provided in the arbitration agreement or incorporated by reference. Other remedies may be implied from the specific or general terms of the arbitration agreement or any contract relating to the arbitration. If the arbitration agreement provides for broad remedial powers, courts generally interpret the agreement to allow the arbitrator great latitude in selecting an appropriate remedy.

If the arbitration clause calls for arbitration pursuant to the Commercial Arbitration Rules of the American Arbitration Association, Rules R-45 and R-36 will determine the scope of the arbitrator's remedial authority. AAA R-45(a) allows an arbitrator to award any remedy or relief that the arbitrator deems just and equitable and within the scope of the parties' agreement, including, for example, specific performance of a contract.

Most courts have interpreted this language to provide the arbitrator with very broad authority to award remedies.[5]

Rule R-45 also specifically authorizes the arbitrator to issue interim and interlocutory awards, and to assess fees, expenses, compensation, interest and attorneys' fees (the latter only if (1) the parties have requested such an award, and (2) they are authorized by law or in the arbitration agreement).

AAA Rule R-36 provides an additional grant of authority to take necessary interim measures, including injunctive relief and measures to protect or conserve property, and to require security for costs.

The AAA's commercial rules now also contain "Optional Rules for Emergency Measures of Protection," which enable the parties to obtain emergency relief before the tribunal is constituted. These rules empower the AAA to quickly select an emergency arbitrator who can award interim emergency relief.[6] To be applicable, however, the parties must provide for these rules to apply in their agreement to arbitrate.

An arbitration agreement (or another applicable agreement) may delineate or otherwise limit the remedies

An arbitration agreement (or another applicable agreement) may delineate or otherwise limit the remedies that an arbitrator may award. Courts generally find that arbitrators lack authority to award excluded forms of relief.[7] It should be remembered, however, that an apparent limit on the arbitrator's remedies is first subject to construction by the arbitrator, and thus could be deemed inapplicable in the circumstances of the case. For example an express exclusion of consequential damages could be ineffective if the arbitrator determines that the claimant's economic loss was a direct damage, not a consequential loss.[8]

Other Sources of Authority

The parties' submissions to the arbitrator are another source of authority for arbitral remedies. If the issues submitted to arbitration are limited in a way that could restrict the range of remedies that the arbitrator could award, a court could find that the arbitrator lacked authority to award a particular remedy.

For some types of remedies, statutory authority may be required. In some jurisdictions, unless a statute specifically authorizes the award of attorneys' fees or punitive damages, these remedies must be expressly authorized in the parties' arbitration agreement. Remedies involving attorneys' fees and punitive damages are beyond the scope of this article.

Judicial Approaches

It is against this backdrop that arbitrators must devise a remedy appropriate to the facts of the dispute before them. When a party is unhappy with the arbitrator's choice of award, it may seek vacatur, contending that the arbitrator exceeded his authority. Some courts have expressed frustration at parties who take this tack.[9] Nevertheless, as the cases below illustrate, the court will review the sources of the arbitrator's authority to determine whether the arbitrator acted properly in issuing the award.

Partnership disputes. In *EEC Property Co. v. Dr. Martin Kaplan*, which involved a partnership formed to own and operate a medical office building, the arbitrator ordered payment of money damages to two of the six partners and gave them the right to withdraw from the partnership and receive the value of their respective partnership interests according to the method specified in the partnership agreement.[10] The arbitrator also accelerated the payment schedule for the buyout so that it coincided with the completion of the office building's mortgage payment.

The partnership claimed that the arbitrator exceeded his authority because the buyout was not authorized in the partnership agreement, and because it was not specifically raised in the parties' submissions. The Minnesota Court of Appeals acknowledged that the award varied from the partnership agreement. Nevertheless, it found support for the award in the arbitration clause, the partnership agreement, and the parties' submissions. It cited the broad powers given to the arbitrator in the arbitration clause and the absence of any limitations on remedies. It noted that the partnership agreement provided a method of valuation for withdrawing partners; and that the parties' submissions indicated a desire to preserve the partnership through the buyout remedy. An important fact in this case was that before the award was issued the arbitrator informed the parties that he was considering the buyout. Since the partnership failed to object to that remedy prior to the hearing, the court found that the partnership had waived its objection to the remedy.

Buyer/seller disputes. In *Daniewicz v. Thermo Instrument Systems*, the arbitrator not only awarded monetary relief for breach of a contract to sell a manufacturing business, he incorporated some of the terms of the contract in the remedy.[11] The award required the buyer to make a $4 million lump sum payment for breach of the clause requiring the buyer to use its "best efforts" to promote the seller's products. The award also required the buyer to continue to pay royalties to the seller for the balance of the contract.

The buyer argued that the panel abused its authority because the remedies were not requested by either party. The Texas Court of Appeals rejected the contention that the remedy must be specifically requested by a party. The court found that since the arbitrators were asked to find a breach of contract and to award damages commensurate with the breach, the award did not exceed their authority. The court explained, "[T]he award remedied those wrongs that could no longer be reasonably governed by the original contract and incorporated the contractual terms for those areas that still fit."

In *Executone Information Systems v. Davis*, in which the buyer of a company challenged the accuracy of financial information given to determine the purchase price, the 5th Circuit upheld an award that included

money damages, the issuance, exchange and surrender of corporate stock, and the filing of a registration statement with the Securities and Exchange Commission registering all shares of stock issued to the defendants. In confirming these remedies, the court applied the "essence" test, concluding that the arbitrator's award "drew its essence" from the purchase agreement.[12] The court reasoned that the award was not contrary to the express terms of the parties' agreement. Moreover, it was rationally inferable from the parties' central purpose in reaching a purchase price based on a fair calculation of the adjusted pre-tax profits of the company being sold.

Shareholder disputes. The award in *Hayob v. Osborne* held one 50% shareholder personally liable for the corporation's debt to the other 50% shareholder, even though under Missouri law, shareholders are not liable for the debts of their corporations.[13] The plaintiff sued his co-shareholder, seeking reimbursement of expenses paid on the corporation's behalf and damages for the defendant's failure to produce certain corporate records. Subsequently, the plaintiff filed an amended petition seeking to hold the defendant liable individually. The parties agreed to submit the dispute to arbitration in accordance with Missouri law under the rules of the AAA. Their agreement provided that the arbitration shall determine the controversy and claims in the amended petition and answer, which were incorporated into the agreement. The arbitrator found the defendant was personally liable for the corporation's debt to the plaintiff.

The defendant claimed that the award violated Missouri law, which governed the arbitration. The Missouri Court of Appeals upheld the award because the issue of the plaintiff's personal liability was raised in the amended petition. The court cited in support the Missouri vacatur statute, which states that "the fact that the relief was such that it could or would not be granted by a court of law or equity is not a ground for vacating or refusing to confirm the award." It also noted that in Missouri, manifest disregard of the law is not a statutory basis to vacate an award. The court said:

> Arbitrators exceed their jurisdiction only when they decide matters beyond the scope of the arbitration agreement or which clearly were not submitted to them for arbitration. Since the issue of personal liability was submitted to the arbitrator in this case, the arbitrator did not exceed his authority even though the award was repugnant to state law.

In *Chandra v. Bradstreet*, the award combined treble damages for embezzlement with an order stopping those who benefited from the embezzlement from benefiting further.[14] The case arose out of two lawsuits involving a company providing medical services, and the professional associations that were its shareholders. Each side claimed the other owed it large sums of money. The company's operating agreement called for all disputes between members and/or the company to be submitted to binding arbitration. In the arbitration, a shareholder who was a defendant in the lawsuit alleged that one of the plaintiff shareholders had embezzled money from it. The defendant also alleged that two other plaintiff shareholders had misappropriated money from the company. Among other relief, the defendant sought dissolution of the company.

The arbitrator found that one plaintiff had embezzled funds and awarded treble damages against him for civil theft. The award also estopped this plaintiff from receiving any distributions from the dissolved company. The arbitrator also found that two other plaintiffs had benefited from the theft and the award estopped them from receiving a distribution of funds from the company to the extent of the first $75,000 recovered.

The plaintiffs argued that the arbitrator exceeded his authority because the company never made any affirmative claims for relief and because the estoppel award was contrary to the operating agreement. But the Florida Court of Appeals found the award was valid in all respects because the issues to which the remedies related were within the scope of the submissions to the arbitrator. In upholding the award, the court noted that its review of awards is very limited, and that it must avoid "judicialization" of the arbitration process. The court also stated:

> A high degree of conclusiveness attaches to the arbitration award. Such conclusiveness is required because the parties have, by agreement substituted a tribunal of their own choosing for the forum provided by law. To permit a dissatisfied party to set aside the arbitration award and invoke the judgment of the court on the merits would destroy the purpose of arbitration.

Intellectual property disputes. The current climate of judicial respect for arbitral remedies has enabled arbitrators to sometimes award extraordinary forms of relief. A good example is the award in *Advanced Micro Devices (AMD) v. Intel Corp.*[15] Here the arbitrator determined that it was appropriate to award one of

the parties a permanent, royalty-free license over certain intellectual property for the other party's breach of a software licensing agreement and for bad faith.

The dispute arose out of a 1982 agreement between computer chip makers AMD and Intel, which provided that either party could elect to be a "second source" for products offered to it by the other. Under this agreement, the non-developing company would receive technical information and licenses needed to make and sell the product, while the company that developed the product would receive a royalty and the right to be a second source for products developed by the other company. In the period before the contract was entered into, AMD was attempting to secure entry into the 16-bit microprocessor market, while Intel had already developed its own 16-bit microprocessor, the 8086, and needed another producer to second source that chip and its expected progeny.

Disagreements over product exchanges led AMD to seek arbitration pursuant to the parties' agreement. The parties agreed that "the arbitrator may grant any remedy or relief which the arbitrator deems just and equitable and within the scope of the agreement of the parties, including, but not limited to specific performance of a contract." The agreement also instructed the arbitrator to "interpret and apply" these rules insofar as they relate to his power and duties. A temporary judge who was also then chosen the arbitrator included in his order of submission the following with respect to each issue submitted: "[T]he arbitrator is authorized to fashion such remedy as he may in his discretion determine to be fair and reasonable but not in excess of his jurisdiction."

After lengthy arbitration proceedings, the arbitrator found that Intel had breached the implied covenant of good faith and fair dealing, as well as an implied covenant requiring the parties to negotiate reasonably to make their relationship work. The arbitrator found that Intel breached these covenants when it decided to frustrate the operation of the contract by taking no more products from AMD and by keeping this decision from AMD and the public.

The arbitrator also found that AMD was partially responsible for its own damages because it had unnecessarily delayed seeking alternative ways to enter the 32-bit chip market. The arbitrator said that AMD should have sought arbitration or begun reverse engineering the 32-bit chip much sooner. Since AMD did not produce its own 32-bit chip until 1991, the arbitrator declined to award the company the hundreds of millions of dollars it sought from Intel in lost 32-bit chip profits.

The arbitrator nevertheless ruled that AMD had lost profits and goodwill as a result of Intel's conduct, that actual damages were immeasurable, and that nominal damages were inequitable. Accordingly, the arbitrator decided that the proper remedy was to relieve AMD from legal harassment by Intel over AMD's alleged use of Intel intellectual property in the reverse engineered AMD 32-bit chip. Therefore, in addition to other relief that was not in dispute, the arbitrator awarded AMD a permanent, nonexclusive, royalty-free license to any Intel intellectual property embodied in AMD's 32-bit chip, and a further two-year extension of certain patent and copyright licenses previously provided by Intel to AMD to the extent they related to the AMD 386.

Before ruling on Intel's challenge to the award, the California Supreme Court, in a scholarly opinion, devised a specific standard of review for arbitral remedies. This standard calls for a court to determine whether the arbitrator's choice of remedy bears some rational relationship to both the contract and the breach. The court explained that unless expressly restricted by the agreement, arbitrators "enjoy the authority to fashion relief they consider just and fair under the circumstances existing at the time of the arbitration, so long as the remedy may be rationally derived from the contract and the breach." In the words of the court:

> [A]n award may not be vacated merely because the court is unable to find the relief granted as authorized by a specific term of the contract. The required link may be to the contractual terms as actually interpreted by the arbitrator (if the arbitrator has made the interpretation known), to an interpretation implied in the award itself, or to a plausible theory of the contract's general subject matter, framework, or intent.... Where the damage is difficult to determine or measure, the arbitrator enjoys the correspondingly broader discretion to fashion a remedy. The award will be upheld so long as it was even arguably based on the contract; it may be vacated only if the reviewing court is compelled to infer the award was based on an extrinsic source. In close cases the arbitrator's decision must stand.

Applying this standard of review, the California Supreme Court found that the challenged remedies were "rationally drawn from the arbitrator's conception of the contract's subject matter and the effect on AMD of

Intel's breach." Thus, the award did not exceed the arbitrator's powers. There was nothing to indicate that the arbitrator resorted to an extrinsic source in fashioning the remedy.

Helpful to the court's decision was the fact that the arbitrator gave a lengthy explanation of his understanding of the contract and the breach and his reasons for making the award. The court made a detailed comparison of the award and the breach but cautioned that this will not be required in all cases. "[I]n many cases the required rational relationship between the breach and the award may be found in the fact that the arbitrator has awarded the injured party relief or the same general type as that a jury or court could have provided had the claim been litigated, even if the quantity, extent or parameters of the award differ in some respects from that to which the party was legally entitled."[16]

Conclusion

Arbitrators should study the arbitration agreement for any limits on their remedial authority, as well as the parties' submissions. Given a broadly worded arbitration clause, and the absence of any limitations affecting remedies, arbitrators have the flexibility to award even unusual relief if appropriate to resolve the dispute. Parties who wish to circumscribe the arbitrator's authority with respect to remedies may, of course, address that issue in the drafting of the arbitration agreement.[17] However, limiting arbitral remedies through drafting may create problems of interpretation.[18]

Endnotes

1. Uniform Arbitration Act § 12. The fact that the arbitration agreement may have given the arbitrator great flexibility to afford remedies that a court could not, has not stopped litigants from arguing, on a motion to vacate the award, that the arbitrator exceeded his or her authority by granting a particular form of relief.

2. 9 U.S.C. § 10; U.A.A. § 12.

3. For example, arbitrators have required construction contractors to repair damage to the owner's property, complete punch list items, and obtain insurance for the remainder of the construction project. *Wright v. Land Developers Constr. Co.*, 554 So. 2d 1000 (Ala. 1989). They have enforced commercial agreements by requiring a breaching party to fulfill its contractual obligations. *Morris v. Zuckerman*, 69 Cal. 2d 686, 446 P.2d 1000 (Cal. 1968). They have even required a company to change its corporate name. *Engis Corp. v. Engis Ltd.*, 800 F. Supp 627 (N.D. Ill. 1992). And they have ordered two corporations to exchange their stock. See *Executone Information Sys, v. Davis*, 26 F.3d 1314, 1332-1333 (5th Cir. 1994), discussed *infra*.

4. This article deals with permanent relief, not interim remedies. Also, it does not deal with punitive damages or attorneys' fees, which have been the subject of prior articles in *ADR Currents*. See David Rivkin, "Courts Differ on Arbitrability of Time Limitations," 1 No. 2 *ADR Currents* 21 (Fall 1996)(punitive damages), and Mary A. Bedikian, "Attorneys' Fees in Arbitration," 2 No. 3 *ADR Currents* 20 (Summer 1997). See also Alan Rau, "Does State Arbitration Law Matter At All? Part I: Federal Preemption," 3 No. 2 *ADR Currents* 19 (June 1998)(discussing the extent to which the Federal Arbitration Act preempts state law restrictions on arbitral awards of punitive damages).

5. For example, in *Advanced Micro Devices v. Intel*, 885 P.2d 994 (Cal. 1994), discussed *infra*, the court upheld an award providing for an innovative equitable remedy, although the relief provided was not specifically authorized by law or by express agreement. The arbitration clause employed language identical to the AAA's R-45, which the court observed provided a "broad grant of authority" with respect to remedies. See also *In re Astey*, 19 Misc. 2d 1059, 189 N.Y.S.2d 2 (N.Y. Sup. Ct. 1959)(arbitrator did not exceed his power by granting equitable relief though the relief could not be awarded in a judicial proceeding); *Engis Corp. v. Engis Ltd.*, n. 3, *supra*. See also *Daniewicz v. Thermo Instrument Sys.*, 992 S.W.2d 713 (Tex. Ct. App. Austin, 1999), discussed *infra*.

6. An emergency arbitrator who is satisfied that the party seeking emergency relief has shown an entitlement to such relief and that immediate and irreparable loss or damage will result in its absence, may grant the relief in an interim award that states the reasons in support of the decision.

7. For example, in *In re Farkar Co.*, 583 F.2d 68 (2d Cir. 1978), the 2d Circuit held that when an agreement stated that "in no event shall RAHCO be liable for special or consequential damages," the arbitrator lacked power to include consequential damages in the award, even though the agreement also referenced AAA

rules.

8. See *Team Scandia, Inc. v. Greco*, 6 F. Supp. 2d 795 (S.D. Ind. 1998). Here the arbitration agreement stated that any award of damages "shall be limited to actual damages as derived from the terms and conditions of this Agreement…[T]here shall be no award of punitive damages, consequential damages…and/or the like." In a dispute involving allegations by a race car driver that the race team breached their agreement, causing him to lose sponsorships, the arbitrator awarded him damages for loss of sponsorship and economic loss. The arbitrator reasoned that these forms of damages were direct losses, not consequential losses. A federal district court concluded that the award did not exceed the arbitrator's authority because his decision, rightly or wrongly, was based upon a legal determination that the loss of sponsorship was not a consequential damage. The court explained that arbitrators do not exceed their powers by misconstruing a contract. The court also emphasized that "courts must not visit the merits of the arbitrator's decision and thus allow the disappointed party to bring his dispute into court by the back door, arguing that he is entitled to appellate review of the arbitrator's decision."

9. See *Chandra v. Bradstreet*, 727 So. 2d 372 (Fla. Ct. App. 5th Dist. 1999). "[T]he promise of arbitration is spoiled if parties disappointed by its results can delay the conclusion of the proceeding by groundless litigation in the district court followed by groundless appeal to this court; we have said repeatedly that we would punish such tactics and we mean it." *Team Scandia*, n. 8, *supra*.

10. 578 N.W.2d 381 (Minn. Ct. App. 1998). See also *Sharpe v. Lytal & Reiter*, 702 So. 2d 622 (Fla. 1997) (partnership dissolution).

11. See n. 5, *supra*.

12. 26 F.3d 1314 (5th Cir. 1994). The "essence" test is commonly used in labor cases, *i.e.*, does the award draw its essence from the collective bargaining agreement or was the arbitrator's award drawn from the letter or the purpose of the underlying contract, in this case, the purchase agreement. The court indicated that it had applied the essence test in other non-labor cases.

13. 992 S.W.2d 265 (Mo. Ct. App. W.D. 1999).

14. See n. 9, *supra*. The court reinstated the award that had been vacated by the trial court.

15. See n. 5, *supra*.

16. One judge dissented, preferring the rule than an award must fall within the range of remedies a court could award and bear a rational relationship to the contract. The dissenter found that the award failed both prongs of this test.

17. See Marshall H. Tanick, "Arbitration Agreements After Wright: The Importance of Drafting," 4 No. 3 *ADR Currents* 5 (Sept. 1999).

18. Cf. *Green v. Ameritech Corp*, 2000 WL 10606 (6th Cir. Jan. 6, 2000) (if a party wants a more detailed opinion from the arbitrator, the parties must be more specific in their arbitration agreement, and may be better off using familiar legal terms).

Copyright © 2000 American Arbitration Association, Inc. This article was originally published in* ADR Currents*, No. 5, No. 1, (March 2000), at page 20. It is reproduced here with permission.

Home