

Enforceability Of Agreements To Expand Or Restrict The Scope Of Judicial Review Of Arbitral Awards

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The Federal Arbitration Act (“FAA”) specifically enumerates very limited grounds upon which a court may vacate an arbitration award. These grounds include where the award was procured by fraud, where an arbitrator was evidently partial, where the arbitrators were guilty of misconduct in refusing to hear evidence, and where the arbitrators exceeded their powers. 9 U.S.C. § 10(a). Some courts also recognize the judicially-created ground of manifest disregard of the law. Companies that value arbitration as a means of dispute resolution may view the absence of meaningful appellate review of arbitral decisions as problematic. One way to address this issue is to contractually expand the scope of judicial review of arbitration awards beyond the level of review provided by the FAA by, for instance, including a provision requiring the court to vacate the award where the arbitrators’ findings of fact are not supported by substantial evidence or where the arbitrators erred in applying the law.

A company that wishes to expand the level of judicial review of an arbitral award should be aware that the Circuit Courts of Appeal are split as to the enforceability of such clauses. The Seventh, Eighth, Ninth, and Tenth Circuits have expressed the view that such clauses are unenforceable. *LaPine Tech. Corp. v. Kyocera Corp.*, 341 F.3d 988 (9th Cir. 2003) (en banc) (“[A] federal court may only review an arbitral decision on the grounds set forth in the Federal Arbitration Act. Private parties have no power to alter or expand those grounds and any contractual provision purporting to do so is, accordingly, unenforceable”); *Schoch v. Infousa, Inc.*, 341 F.3d 785, 798 n.3 (8th Cir. 2003) (expressing “skepticism as to whether parties can contract for heightened judicial review of arbitration awards, which would seemingly amend the FAA, crown arbitrators mini-district courts, force federal trial courts to sit as appellate courts, and completely trans-

form the nature of arbitration and judicial review.”); *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 937 (10th Cir. 2001) (“the purposes behind the FAA . . . do not support a rule allowing parties to alter the judicial process by private contract”); *Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc.*, 933 F.2d 1501 (7th Cir. 1991) (in dicta, stating that “[i]f that parties want, they can contract for an appellate arbitration panel to review the arbitration award. But they cannot contract for judicial review of that award.”). In rejecting expanded review, these courts have explained that private parties do not have the right to alter the balance struck by the FAA between preserving due process and discouraging undue public intrusion into a private dispute resolution proceeding. Moreover, private parties do not have the right to “determine the rules by which federal courts proceed, especially where Congress has explicitly prescribed those standards.” *Kyocera*, 341 F.3d at 1000.

The First, Third, Fourth, Fifth, and Sixth Circuits, on the other hand, favor the enforceability of expanded judicial review clauses, explaining that the primary purpose of the FAA is to enforce private arbitration agreements. *Puerto Rico Tel. Co. v. U.S. Phone Mfg. Corp.*, 427 F.3d 21, 31 (1st Cir. 2005) (“[P]arties can by contract displace the FAA standard of review, but that displacement can be achieved only by clear contractual language”); *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 293 (3^d Cir. 2001) (“[P]arties may opt out of the FAA’s off-the-rack vacatur standards and fashion their own.”); *Syncor Int’l Corp. v. McLeland*, 120 F.3d 262, 1997 WL452245 (4th Cir. 1997) (unpublished table opinion) (holding that district court should have reviewed the arbitrator’s legal conclusions de novo as required by arbitration agreement); *Gateway Tech., Inc. v. MCI Telecomm. Corp.*, 64 F.3d 993, 997 (5th Cir. 1995) (holding that district court should have reviewed the award for “errors of law” as the parties had agreed); *Jacada (Europe) Ltd. v. Int’l Marketing Strategies, Inc.*, 401 F.3d 701 (6th Cir. 2005)

(reviewing contract language to determine whether parties had agreed to opt out of FAA standard in favor of a more thorough standard of review). According to the reasoning of these cases, the FAA merely contains a set of default standards from which parties may opt out if they choose. Three of these courts addressed whether a “generic choice of law clause” was sufficient to opt out of the default standards and into a more expansive review required under state law. The courts uniformly concluded that a “generic choice-of-law clause, standing alone, is insufficient to support a finding that the contracting parties intended to opt out of the FAA’s default standards.” *Roadway*, 257 F.3d at 296; *Puerto Rico Tel. Co.*, 427 F.3d at 29; *Jacada*, 401 F.3d at 712.

An important issue to consider in drafting an arbitration agreement with an expanded judicial review clause, therefore, is what happens if a court decides that the attempted expansion of judicial review is improper. At least one court, in an unpublished decision, has held that the “terms of an arbitration agreement controlling the mode of judicial review are unenforceable and severable” from the rest of the arbitration agreement even where there is “evidence that the parties intended that the entire arbitration agreement should fail in the event the expanded standard of review provision failed.” *Hall St. Assocs., LLC v. Mattel, Inc.*, 113 Fed. Appx. 272 (9th Cir. 2004). Most courts addressing the issue have taken a “blue-pencil” approach and upheld the award so long as it meets traditional FAA review standards. *E.g.*, *Bowen*, 254 F.3d at 937; *Kyocera*, 341 F.3d at 994. Parties might be dismayed to learn that they are bound by the result of an arbitration that they never would have agreed to hold had they known the award would not be subject to meaningful judicial review. To avoid this possibility, the parties should ensure that the arbitration provision clearly provides that an arbitral award is ineffective without the expanded judicial review.

Some contracting parties would prefer to remove arbitral awards from any judicial scrutiny whatsoever. The Second Circuit has resoundingly rejected this approach, holding that minimal standards must exist for arbitration awards to be enforced. *Hoelt v. MVL Group, Inc.*, 343 F.3d 57 (2d Cir. 2003). In *Hoelt*, the Court of Appeals found that the FAA created “critical safeguards” for the arbitration process that represented a “floor for judicial review of arbitration awards below which the

parties cannot require courts to go.” *Id.* at 64. The court explained that these safeguards “respected the importance and flexibility of private dispute resolution mechanisms, but at the same time barred federal courts from confirming awards tainted by partiality, a lack of elementary procedural fairness, corruption, or similar misconduct.” *Id.* The Second Circuit extended its holding to include manifest disregard of the law, explaining that “[t]he fact that the manifest disregard standard is a product of common law, rather than statute, makes it no less essential to the judicial review of arbitration awards.” *Id.* at 65.

Other courts however, have been more receptive to such clauses. In *Bowen v. Amoco Pipeline*, 254 F.3d 925, 931 (10th Cir. 2001), the court stated that “the parties to an arbitration agreement may eliminate judicial review by contract, [but] their intention to do so must be clear and unambiguous.” See also *Aerojet-Gen'l Corp. v. Am. Arbitration Ass'n*, 478 F.2d 248, 251 (9th Cir. 1973) (“While it has been held that the parties to an arbitration agreement can agree to eliminate all court review of the proceedings, the intention to do so must clearly appear.”). In *Kyocera*, the Ninth Circuit explicitly refrained from reaching the enforceability of a contractual provision narrowing the standard of review, but implied it might enforce such a provision. 341 F.3d at 998 n.16 (“the decision to contract for a narrower standard of review than the courts generally apply in the absence of a statutory command is a decision that may be less troublesome than the attempt to contract for a broader standard of review than that authorized by Congress...”).

Thus, the freedom to craft an arbitration agreement is not absolute - but depends in large part on the jurisdiction in which the agreement will be enforced. Companies attempting to change the scope of judicial review should carefully consider where the arbitration will take place and the award reviewed to maximize the possibility of enforcement of the judicial review standard selected.

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