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feature

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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. This ground varies in its application depending on the judicial circuit involved. *Compare George Watts & Son, Inc. v. Tiffany & Co.*, 248 F.3d 577, 581 (7th Cir. 2001) (limiting manifest disregard to two situations: (1) where the arbitral order requires the parties to violate the law and (2) where the arbitrators exceeded their powers) *with Duferco Int'l Steel Trading v. T. Klaveness Shipping A/S*, 333 F.3d 383, 389-90 (2d Cir. 2003) (manifest disregard of the law exists where the "arbitrators were fully aware of the existence of a clearly defined governing legal principle, but refused to apply it"). *But see Ainsworth v. Skurnick*, 960 F.2d 939, 940-41 (11th Cir. 1992) (declining to adopt manifest disregard formula). However, the federal courts, as a matter of general principle, have recognized that the FAA provides only extremely limited grounds for vacating an award. *E.g., Bavrati v. Josephthal, Lyon & Ross, Inc.*, 28 F.3d 704, 706 (7th Cir. 1994) ("Judicial review of arbitral awards is tightly limited; perhaps it ought not be called 'review' at all.").

Companies that value arbitration as a means of dispute resolution have attempted nonetheless to alter the standard and even the existence of appellate review of arbitral decisions. Some contracting parties have attempted 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. Other contracting parties have sought to foreclose judicial review of arbitral awards altogether by contractually agreeing that the award will not be subject to appeal. The federal courts' treatment of such provisions varies considerably from circuit to circuit. Therefore, parties intending to include such provisions in their agreements should consider carefully the arbitration venue and place of confirmation of the award to determine if the provision they wish to use is likely to be enforced.

Agreements to Expand the Scope of Judicial Review

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. *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 1000 (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, legally 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 transform the nature of arbitration and judicial review."); *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 933 (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.*, 935 F.2d 1501, 1505

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(7th Cir. 1991) (in dicta, stating that "[i]f the 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; federal jurisdiction cannot be created by contract."). 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. *See Kyocera*, 341 F.3d at 998-1000; *Bowen*, 254 F.3d at 935-36. Moreover, private parties do not have the "power to determine the rules by which federal courts proceed, especially where Congress has explicitly prescribed those standards." *Kyocera*, 341 F.3d at 1000. Although parties are free to contractually agree on the arbitration process itself, that freedom does not extend, in the view of the courts in these circuits, to the standards governing federal court review. *Id.*

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 (3d Cir. 2001) ("[P]arties may opt out of the FAA's off-the-rack vacatur standards and fashion their own, (including by referencing state law standards)."); *Syncor Int'l Corp. v. McLeland*, 120 F.3d 262, 1997 WL452245, at *6 (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, 710-11 (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 scope of judicial review set forth in the FAA merely constitutes a set of default standards from which parties may opt out of if they choose.

The courts favoring expanded review have focused on the Supreme Court decisions emphasizing that courts must enforce arbitration agreements according to their terms. *E.g., Roadway Package*, 257 F.3d at 292-93 (citing, *inter alia, Volt Info. Sci., Inc. v. Bd. of Trustees of Leland Stanford Jr. Univ., 489 U.S.* 468, 109 S. Ct. 1248 (1989)[2] and *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 115 S. Ct. 1212 (1995))[3]; *Gateway Tech.*, 64 F.2d at 996 (same). The Court in *Puerto Rico Telephone* disagreed with the concern expressed in *Kyocera* that allowing expanded review would permit private parties to "create federal jurisdiction by contract." 427 F.3d at 30 (citing *Kyocera*, 341 F.3d at 999). In the opinion of the First Circuit Court of Appeals, "[m]odifying the review standard does not expand jurisdiction." *Id.* at 31. Having disposed of the jurisdictional concern, the Court downplayed the policy concerns raised in *Kyocera* and *Bowen*:

> the Supreme Court has emphasized on more that one occasion that the principal objective behind the passage of the FAA was enforcement of parties' agreements, and that efficient dispute resolution should not be favored over the FAA's primary goal of enforcing private agreements to arbitrate, given Congress's "preeminent concern in passing the Act... to enforce private arbitration agreements."

Id. at 31 (quoting *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221, 105 S.Ct. 1238, 1242 (1985).

Four of the federal Courts of Appeal (the First, Third, Fifth,, and Sixth Circuits) have addressed whether a "generic choice of law clause" is sufficient to opt out of the FAA's default standards and into a more expansive review required under state law. The courts have uniformly concluded that a "generic choice-of-law clause, standing alone, is insufficient to support a finding that contracting parties intended to opt out of the FAA's default standards." *Roadway Package*, 257 F.3d at 296; *Puerto Rico Tel. Co.*, 427 F.3d at 29; *Jacada*, 401 F.3d at 712; *Action Indus., Inc. v. U.S. Fid. & Guar. Co.*, 358 F.3d 337, 341-43 (5th Cir. 2004). In deciding this issue, the court in *Puerto Rico Telephone* focused on the federal policy "favoring final resolution of disputes by arbitration and, in particular,... the allocation of powers between the court and the arbitrators." 427 F.3d at 29. This federal policy

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requires "limited review" of arbitral awards. *Id.* The court decided that the federal policy mandating limited review of awards, in conjunction with the fact that the state law was specifically directed at arbitration agreements, militated against interpreting the choice of law provision to include the more expansive scope of review available under state law. *Id.* Similarly, in *Jacada*, the court expressed the view that applying the more expansive standard of review under Michigan law "instead of the more liberal federal standard limits the authority of arbitrators by applying greater judicial scrutiny to their decisions." 401 F.3d at 711. In light of the federal policy favoring arbitrator discretion, the court refused to interpret the generic choice of law provision as incorporating the Michigan standard for vacatur of arbitration awards. *Id.* at 711-12. The *Roadway Package* court, on the other hand, approached the issue as one of contract interpretation, finding that, as a matter of federal law, the choice of law provision did not evidence "a clear intent to incorporate Pennsylvania's standards for judicial review" into the contract. 257 F.3d at 294. The court thus held 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." *Id.* at 296. The court explained that it was creating this default rule to accomplish three purposes: (1) to minimize the frequency with which parties who did not intend to opt out of the FAA rules would be found to have opted out; (2) to allow arbitrators and district courts to determine easily whether parties have opted out of the FAA standards; and (3) to permit sophisticated parties to bargain around the default rule without significantly increasing transaction costs. *Id.* at 296-97. The Fifth Circuit, in *Action Industries*, cited the *Roadway Package* decision with approval, finding that the choice of law provision at issue was also insufficient to "express the parties' clear intent to depart from the FAA's vacatur standard." 358 F.3d 342-43.

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. 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. The *Kyocera* court found that the "unlawful expanded scope-of-review terms should be severed from the remainder of the arbitration clause," noting that there was no evidence that the "potential for expansive appellate review was critical to the entire agreement." 341 F.3d at 1001-02. That same 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., L.L.C. v. Mattel, Inc.* 113 Fed. Appx. 272, 273 (9th Cir. 2004). Parties might be dismayed to find that they are bound by the result of an arbitration that they never would have agreed to had they known the award would not be subject to meaningful judicial review. To have the best chance of avoiding this possibility, the parties should ensure that the arbitration provision is completely clear that an arbitral award will not be effective if the court refuses to implement the expanded judicial review.

Agreements to Narrow the Judicial Scope of Review

Some contracting parties would prefer to remove arbitral awards from any judicial scrutiny whatsoever, while still obtaining the benefits of confirmation.[4] The Second Circuit has resoundingly rejected this approach, holding that parties cannot relieve courts of their obligation to review arbitration awards under the FAA. *Hoeft v. MVL Group, Inc.*, 343 F.3d 57 (2d Cir. 2003). The arbitral agreement at issue in *Hoeft* provided that the arbitrator's decision was not "subject to any type of review or appeal whatsoever." *Id.* at 63. Nonetheless, the plaintiffs sought to confirm the award in court, but at the same time to preclude the court from reviewing the award. *Id.* In refusing to enforce this provision, 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

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misconduct." *Id.* The Second Circuit extended its holding to include the judicially created ground of 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. The court thus held that "private parties may not dictate to a federal court when to enter a judgment enforcing an arbitration award." *Id.*

Other courts however, have stated that parties to arbitration agreements can agree to eliminate at least some aspects of judicial review. In *Bowen v. Amoco Pipeline*, 254 F.3d 925, 931 (10th Cir. 2001), the court stated that "parties to an arbitration agreement may eliminate judicial review by contract, [but] their intention to do so must be clear and unambiguous." The court found that the parties' agreement that the district court's ruling would be "final" did not foreclose appellate review but "merely reinforced the appellate jurisdiction conferred by [28 U.S.C.] §1291," which "grants appellate courts jurisdiction from 'all final decisions of the district courts.'" *Id.* More recently, in *MACTEC, Inc. v. Gorelick*, 427 F.3d 821 (10th Cir. 2005), the Tenth Circuit Court of Appeals refined this position, ruling that a clause in an arbitration agreement that forecloses judicial review of an arbitration award beyond the district court level is enforceable. The arbitration agreement provided that the district court's judgment "on the award rendered by the arbitrator shall be final and nonappealable and may be entered in any court having jurisdiction thereof." *Id.* at 827. The court found that the clause preserved district court review of an arbitral award under the FAA while foreclosing only appellate review of the district court's judgment and was "in a sense, a compromise whereby the litigants trade the risk of protracted appellate review for a one-shot opportunity before the district court." *Id.* at 829.

The *MACTEC* court also addressed the apparent conflict between its "stated willingness to accept private *restrictions* on judicial review with [its] express holding that private *expansions* on judicial review are unenforceable." *Id.* at 829. The key inquiry is "'whether the alternate rule conflicts with the federal policies furthered by the FAA.'" *Id.* (quoting *Bowen*, 254 F.3d at 935). The "fundamental policy" upon which the court focused in *MACTEC* was the "reduc[tion of] litigation costs by providing a more efficient forum." *Id.* However, the court noted that it would not uphold "any and all private restrictions on judicial review over an arbitrator's award." *Id.* The court distinguished the *Heoft* case, noting that there the plaintiff had argued he was entitled to judicial confirmation of the award but that the court could not examine the substance of the arbitrator's decision. The plaintiff thus sought all of the benefits of confirmation without the risk of vacatur. *Id.* The contract at issue in *MACTEC*, however, did allow for district court review of the award. Thus, the court explained, "none of the policy concerns implicated by *Hoeft* are present in this case." *Id.*

Other courts have hinted that they might enforce provisions that eliminated all judicial review. *See, e.g., 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.") (citations omitted). 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 (stating that "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..."). Whether the courts would do so remains to be seen.

Conclusion

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

1 "Evident partiality" is a term of art under the FAA. In light of the use of three-person arbitration panels with arbitrators appointed by each of the parties, the courts have tended to reject a partiality standard based on the appearance of bias and have, instead, required that the "alleged partiality be direct, definite, and capable of demonstration." *Nationwide Mutual Ins. Co. v. Home Ins. Co.*, 429 F.3d 640, 645 (6th Cir. 2005) (citation omitted); *see also Sphere Drake Ins. Ltd. v. All. Am. Life Ins. Co.*, 307 F.3d 617, 620-21 (7th Cir. 2002).

2 In *Volt*, the Supreme Court let stand a California court's interpretation of a choice of law clause to incorporate California's arbitration rules into an arbitration agreement. The Court found that the California court's interpretation did not infringe upon federal rights as the only right conferred by the FAA is to have private arbitration agreements enforced according to their terms. 109 S. Ct at 1253-54.

3 In *Mastrobuono*, the Supreme Court addressed whether, by including a New York choice of law provision, the parties intended to incorporate into their agreement a New York rule that barred arbitrators from awarding punitive damages. The Court held that the general choice of law provision was insufficient to express an intent to incorporate state law restrictions on the arbitrators' authority to award punitive damages. 115 S. Ct. at 1217-19.

4 Section 9 of the FAA provides that "[if] the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to their arbitration... [then] any party to the arbitration may apply to the court so specified for an order confirming the award." 9 U.S.C. § 9. The Circuits Court of Appeal differ on the standard for finding that such an agreement exists. *Compare PVI, Inc. v. Ratiopharm GmbH*, 135 F.3d 1252, 1253-54 (8th Cir. 1998) (agreement that award would be "final, binding, and conclusive" was insufficient to show requisite agreement under section 9) with *Milwaukee Typographical Union No. 23 v. Newspapers, Inc.*, 639 F.2d 386, 389-90 (7th Cir. 1981) (finding that the agreement required by the FAA need not be explicit, and that language such as "final and binding" is sufficient). No similar agreement is necessary for a party to be able to apply to a court to vacate or modify the award. 9 U.S.C. §§ 10-11.