The Ability to Contract for Expanded Judicial Review of Arbitration Awards Is Limited in Several Jurisdictions

Introduction

Our clients frequently ask which is better for their contracts – resolving disputes in arbitration or court? Because appeal rights are limited in arbitration, the question arises whether we can arbitrate in the first instance, but preserve a later right of appeal. Some contracts now provide for an appellate panel of arbitrators, who review the decision of the arbitration hearing panel. Contracting for judicial review of arbitration awards is more problematic. The federal circuits are split on whether parties can contract to impose a legal standard of review by courts following their private arbitrations.

The Federal Arbitration Act (“FAA”) sets out very narrow grounds upon which an arbitration ruling may be vacated or modified by a court. See 9 U.S.C. §§ 10 – 11. Several of these grounds relate primarily to fraud or corruption on the part of the arbitrator(s). The broadest basis available to a reviewing court under the FAA (and most state statutes) for modifying or overturning an arbitration award is that a court may vacate an arbitration award “where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.” 9 U.S.C. § 10(a)(4). Most state arbitration statutes similarly limit the scope of judicial review of arbitration awards.

By contrast to the constraints imposed by the FAA and similar state law legislation, there is near universal agreement that arbitration is a creature of contract, and that a party is bound to arbitrate only to the extent that it has agreed to do so, and then only with regard to the specific issues that are contemplated by the party’s arbitration agreement. See eg. Volt Information Services, Inc. v. Board of Trustees of Leland Stanford Jr. Univ., 489 U.S. 468 (1989) (“Congress’s principal purpose [in enacting the FAA was to ensure] that private arbitration agreements are enforced according to their terms….Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit.”)

Thus, it appears that parties are entitled to establish by contract the scope of an arbitrator’s authority, and that a court should review an arbitration award in such a way as to ensure that such contractual authority, whatever its scope may be, has not been exceeded. In particular, parties to an arbitration clause could limit the arbitrator(s)’s powers in deciding any dispute in accordance with applicable law, and that an award that violates this mandatory restriction would be subject to challenge in the courts as an award which “exceeds the arbitrator(s)’s powers.” See 9 U.S.C. § 10(a)(4).

This view has been accepted in many jurisdictions, including the United States Court of Appeals for the Fourth Circuit. Other courts, however, have expressed hostility to attempts to limit the arbitrator’s “authority” in a way that would require a court to review the arbitrator’s legal conclusions under a de novo standard. These courts have resisted or even refused to review arbitration awards under anything other than a “fraud or corruption” standard. In fact, most courts considering the issue tend to view the question presented not as one involving a question of arbitrators “exceeding their authority;” rather, most courts frame the issue as whether parties by contract may expand the narrow standards of judicial review.
expressly established under the FAA. This memo provides a very brief overview of the federal jurisprudence\(^1\) addressing this issue.

**Circuit Split**

*Courts Embracing “Expanded” Review*

The Fourth Circuit addressed the issue of contractual expansion of judicial review of arbitrator decisions in *Syncor International Corporation v. David L. McLeland*, 120 F.3d 262 (4\(^{th}\) Cir. 1997), and has not revisited the issue since the decision. The *Syncor* court upheld an employment arbitration agreement, which called for expanded judicial review of an arbitration award. The arbitration agreement required that “the arbitrator shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected by judicial review for any such error.” The standard of review this clause imposes on the reviewing court exceeds the grounds for review expressly authorized under the FAA, which does not expressly authorize full *de novo* review.\(^2\) The *Syncor* court acknowledged the limited scope of review of arbitration awards under the FAA and applicable case law. The court determined, however, that the reasoning of the Fifth Circuit in a case (discussed below) addressing the same point of law was persuasive, and the Court effectively adopted that decision as its own. Quoting from the Fifth Circuit Opinion, the *Syncor* court stated:

In this case, however, the parties contractually agreed to permit expanded review of the arbitration award by the federal courts. Specifically, their contract details that “the arbitration decision shall be final and binding on both parties, except that errors of law shall be subject to appeal.” (citation omitted). Such a contractual modification is acceptable because, as the Supreme Court has emphasized, arbitration is a creature of contract. Because these parties contractually agreed to expand judicial review, their contractual provision supplements the FAA’s default standard of review and allows for *de novo* review of issues of law embodied in the arbitration award. (citation omitted).

Id. at *6 (quoting Gateway Technologies, Inc. v. MCI Telecommunications Corp., 64 F.3d 993, 996-997 (5\(^{th}\) Cir. 1995).

In *Gateway*, the parties also contracted for expanded judicial review of any arbitration award. The contract specifically stated that “the arbitration decision shall be final and binding on both parties, except that errors of law shall be subject to appeal.” The *Gateway* court upheld this provision and reasoned that the FAA merely provides the “default standard of review” and the parties are free to contractually expand

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\(^1\) The FAA applies to “[any] written provision in any…contract evidencing a transaction involving [interstate] commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction….” 9 U.S.C. § 2. This requirement has been broadly interpreted to correspond with Congress’s power under the Commerce Clause. *Allied Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 269-70. Construction projects of any significant size almost always involve interstate commerce.

\(^2\) In point of fact, it is probably a more accurate characterization to say that this provision limited the arbitrator’s authority in such a way that any meaningful review of whether the arbitrator had exceeded his authority necessarily required the District Court to engage in a *de novo* review of the arbitrator’s legal reasoning. As noted, courts addressing this issue tend to view it as an “expansion” of the standards set forth in the FAA, rather than a question of “exceeded authority” under 9 U.S.C. § 10(a)(4).
it. Id. ("[The parties have] "sacrificed the simplicity, informality, and expedition of arbitration on the altar of appellate review.")

In 2001, the Third Circuit joined the Fifth and the Fourth Circuits, holding that private parties may contract for greater judicial review than allowed under the FAA. In Roadway Package System, Inc. v. Kaiser, 257 F.3d 287 (3rd Cir. 2001), the Third Circuit held that parties could contractually agree to the application of otherwise inapplicable state law standards for review of arbitration awards that differ from the FAA standards, where the state rules are "expressly incorporated into [the parties'] agreement."3 Most recently, in a case very similar to Roadway, the First Circuit in Puerto Rico Telephone Co. v. U.S. Phone Manufacturing Corp., 427 F.3d 21 (1st Cir. 2005), also determined that parties may contract for judicial review standards that differ from §10 of the FAA.4

Courts Rejecting “Expanded” Review

The Tenth and Ninth Circuits take a contrary view,5 expressly holding that parties cannot contractually create judicial review greater than that provided in the FAA. Two circuits (the Seventh and Eighth) have

3 The arbitration clause at issue in Roadway simply contained a choice of law clause that called for the application of Pennsylvania’s standard for court review of arbitration awards was actually more narrow than the FAA. The Roadway court determined that, although the parties could “opt out” of the FAA standards for some other standard, here under Pennsylvania law, the agreement to opt out had to be clear. The court held that a mere choice of law clause, standing alone, was insufficient to establish a contractual intent to “opt out” of the FAA standards. Id.

4 While the Second Circuit Court of Appeals has not addressed the issue of expanded judicial review, the United States District Court for the Southern District of New York was, in fact, the first federal court in the country to enforce an arbitration agreement that contained a provision for an expanded form of judicial review. In Fils et al Cables d’Acier de Lens v. Midland Metals Corp., 584 F.Supp. 240 (SDNY 1984), the district court held that, “since resort to arbitration is by itself a product of contract, there appears no reason, absent a jurisdictional or public policy barrier, why the parties cannot agree to alter the standard roles.” At the outset, the court recognized that in a normal case, judicial review and arbitration award under the FAA is quite limited, being confined to determining whether one of the specific grounds enumerated in 9 USC § 10 or 11 (for vacating or modifying an award) is present. The court, however, reasoned that “[e]ven though federal courts are courts of limited jurisdiction, that the FAA does not itself preclude a grant of greater power to the reviewing court because the review provided by the Act is not independently jurisdictional in nature.” In effect, the court determined that, because the FAA does not create independent jurisdiction for parties to confirm or vacate an award in federal court, the Act cannot solely control the standard of review. According to the Fils court, “one can only be compelled to arbitrate that which he has agreed to arbitrate... [t]he parties did not agree to arbitrate the disputes in the customary sense; rather they agreed to a process by which a non-judicial body would make a determination, which would then be subject to substantial judicial review” (emphasis added). District Courts from other circuits have also concluded that the FAA provisions addressing judicial review represent merely a default standard which may be expanded or modified by contract. See eg. M&L Power Services, Inc. v. American Networks Int‘l, 44 F.Supp.2d 134, 141 (D.R.I. 1999); New England Util. v. Hydro-Quebec, 10 F.Supp.2d 53, 63 (D.Mass. 1998); Flexible Mfg. Sys. v. Super Prods. Corp., 874 F.Supp. 247, 248-49 (E.D. Wis. 1994); Flight Sys. v. Paul A. Laurence Co., 715 F.Supp. 1125, 1127-28 (D.D.C. 1989).

5 The Circuit split arises, in significant part, out of conflicting language in the Supreme Court’s opinions in Volt, 489 U.S. 468 (1989) and Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52 (1995), neither of which directly address the issue of judicial review. Particularly in the Volt decision, the Supreme Court expressed significant support for freedom of contract in the context of drafting arbitration clauses, while also appearing to concede that
expressed doubt as to whether parties may contract for greater judicial review, but have not expressly so held.\textsuperscript{6}

In \textit{Bowen v. Amoco Pipeline Co.}, 254 F.3d 925 (10\textsuperscript{th} Cir. 2001), the parties included in their agreement a clause purporting to expand judicial review and including a right to appeal "on grounds that the award is not supported by the evidence." When one of the parties opposed confirmation and sought judicial review, the District Court refused to apply the parties' expanded standards of review and upheld the award under the FAA standards. In discussing the judicial review of arbitration awards, the \textit{Bowen} court acknowledged that the Fifth and the Ninth Circuits\textsuperscript{7} allowed expanded judicial review. The Tenth Circuit determined, however, that contracting for expanded judicial review was contrary to the purposes of the FAA, namely the "legislative intent to further the federal policy favoring arbitration by preserving the independence of the arbitration process." As a practical matter, the Tenth Circuit was concerned that it would be required to judicially review arbitration awards under unfamiliar standards that would vary with each agreement. Additionally, because "parties may force reviewing courts to apply unfamiliar rules and procedures," contracting for a standard of review other than that provided in the FAA would "threaten the independence of arbitration or weaken the distinction between arbitration and adjudication."

Originally, the Ninth Circuit held that parties could contract for expanded judicial review.\textsuperscript{8} However, the Ninth Circuit revisited this issue en banc and reversed its prior ruling, in \textit{Kyocera}, 341 F.3d 987, 1000 (9\textsuperscript{th} Cir. 2003) (en banc) ("[W]e therefore overrule \textit{LaPine} I, affirm the District Court's 1995 conclusion, and hold that a federal court may only review an arbitrable decision on the grounds set forth in the [FAA]. Private parties have no power to alter or expand those grounds; any contractual provision purporting to do so is, accordingly, legally unenforceable."). The court determined that "once a case reaches the federal courts...the private arbitration process is complete, and because Congress has specified the standards for confirming an arbitration award, federal courts must act pursuant to those standards and no others." Additionally, the Ninth Circuit did not believe Congress, in enacting the FAA, was giving private parties the "power to dictate how the federal courts conduct the business of resolving disputes." As with the \textit{Bowen} decision, the Ninth Circuit's decision in \textit{Kyocera} expressed concerns about judicial sovereignty and independence.

In an earlier 1991 decision, Judge Posner, writing for the United States Court of Appeals for the Seventh Circuit, stated that parties "cannot contract for judicial review of [an arbitration award]; federal jurisdiction cannot be created by contract." \textit{Chicago Typographical Union v. Chicago Sun Times, Inc.}, 935 F.2d 1501 (7\textsuperscript{th} Cir. 1991). Even though the issue before the court was not whether private parties may expand judicial review of arbitration awards, and thus this language is \textit{dicta}, the Seventh Circuit clearly expressed significant concern about the possibility of expanding the scope of judicial review provided for in the FAA.

Congress’s statutory arbitration scheme was mandatory. As a result, courts and commentators on both sides of this issue have cited these Supreme Court cases in support of their position.

\textsuperscript{6} The Eleventh, Sixth, and (as noted) Second Circuits have not addressed this issue at the appellate level.

\textsuperscript{7} The Ninth Circuit subsequently reversed this position.

\textsuperscript{8} See \textit{LaPine Tech. Corp. v. Kyocera Corp.}, 130 F.3d 884 (9\textsuperscript{th} Cir. 1997) (noting the Ninth Circuit court “fully agreed [the] with the Fifth Circuit.”) The arbitration provision in the Kyocera case provided, in pertinent part, as follows: “The decisions and awards of the Tribunal...may be vacated, modified, or corrected by the Court (a) based upon any grounds referred to in the Act, or (b) where the Tribunal’s findings of fact are not supported by substantial evidence, or (c) where the Tribunal’s conclusions of law are erroneous.” \textit{Kyocera}, 341 F.3d 987, 990.
In 1998 and 2003, the United States Court of Appeals for the Eighth Circuit also had the opportunity to
decide the issue of whether private parties may contract for an expanded judicial review of an arbitration
award. In both instances, the Eighth Circuit did not rule on the issue before it. The court strongly
indicated, however, that it would not allow contractual expansion of judicial review. See, UHC
Management Co. v. Computer Sciences Corp., 148 F.3d 992 (8th Cir. 1998) (“[i]t is not clear, however,
that parties have any say in how a federal court will review an arbitration award when Congress has
ordained a specific, self limiting procedure for how such a review is to occur. . . Section 9 of the FAA
provides that federal courts ‘must grant’ an order confirming an arbitration award ‘unless the award is
vacated, modified, or corrected as prescribed in Sections 10 and 11 of this Title.’” Moreover, “Congress
did not authorize de novo review of such an award on its merits; and commanded that when the
exceptions do not apply, a federal court has no choice but to confirm.”); see, also, Schoch v. Info USA,
Inc., 341 F.3d 785 (8th Cir. 2003) (the court summarized UHC Management, and then noted that such
provisions “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. . .
arbitration does not provide a system of ‘junior varsity trial courts’ offering the losing party complete and
rigorous de novo review. It is a private system of justice offering benefits of reduced delay and expense.
A restrictive standard of review is necessary to preserve these benefits and to prevent arbitration from
becoming a preliminary step to get to judicial resolution.”).

Conclusion

A contract provision which calls for expanded judicial review of arbitration awards may not be enforced in
every court or jurisdiction. One of the most important considerations when attempting to draft such a
provision will involve the choice of forum and law clauses that will ultimately apply to the issue. The
circuit split discussed above may eventually be taken up by the Supreme Court; however, in the event
that a state arbitration act, and not the FAA, applies to the issue, consideration must be given to how
relevant state courts have treated and enforced these provisions.

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