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Expansion of Judicial Review of Arbitration Awards

By Rory D. Cosgrove and Jason W. Anderson – March 13, 2017

Arbitration provides a way to resolve complex disputes expeditiously, giving parties the freedom to structure their dispute resolution on mutually acceptable terms that are precisely tailored to their relationship. Unlike in traditional litigation, parties can choose their decision maker (often an individual with specialized expertise), define the arbitrable issues, and select the procedures to be used in the arbitration. These attributes often encourage parties to forgo the traditional judicial process in favor of this faster, more predictable private process.

However, the benefits of arbitration come at a significant price to the nonprevailing party. The Federal Arbitration Act (FAA) and state arbitration laws limit the availability of judicial review to vacate an arbitration award largely to procedural irregularities.

Grounds for Vacating an Award under the FAA
The FAA allows a court to vacate an award only in the following instances:

> (1) where the award was procured by corruption, fraud, or undue means;
> (2) where there was evident partiality or corruption in the arbitrators;
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
> (4) 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).

These grounds address the overall fairness and impartiality of the arbitration process but normally not the underlying substantive merits of the award itself. As one court has neatly summarized, review of an arbitrator's decision under the FAA is "one of the narrowest standards of judicial review in all of American Jurisprudence." *Uhl v. Komatsu Forklift Co.*, 512 F.3d 294, 305 (6th Cir. 2008).

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Despite the general freedom of parties to set the terms of arbitration by agreement, parties may not by contract alter or eliminate the four statutory grounds in section 10(a) for vacating an arbitration award. *Hall St. Assocs., LLC v. Mattel, Inc.*, 552 U.S. 576, 581–84 (2008). Because the statutory grounds to vacate an arbitration award are principally aimed at procedural irregularities, judicial review of any substantive grounds have been narrowly circumscribed. Although courts have reviewed awards for "manifest disregard of the law" by the arbitrator, usually on the basis that this would exceed the arbitrator's powers under section 10(a)(4), whether this remains a basis to vacate an arbitration award after *Hall Street* is an "open question." *Samaan v. Gen. Dynamics Land Sys., Inc.*, 835 F.3d 593, 600 (6th Cir. 2016).

Legality of Expanded Judical Review Provisions

But what if an arbitrator issues an award well outside of the parties' reasonable expectations? What if substantial evidence does not support the award? What if the arbitrator applied the wrong law or incorrectly applied the right law?

Given the FAA's limited grounds for review, parties have tried by contract to circumvent the FAA by drafting expanded judicial review provisions. But the big question is whether parties may establish their own standard of judicial review for an arbitration award. Before the U.S. Supreme Court's 2008 decision in *Hall Street*, the federal circuit courts had split over whether parties by contract could alter judicial review under the FAA.

The FAA set narrow grounds for reviewing arbitration awards under section 10(a), which has been interpreted to preclude review of awards for legal errors or substantial evidence. *Kyocera Corp. v. Prudential–Bache Trade Servs. Inc.*, 341 F.3d 987, 994 (9th Cir. 2003) (en banc). Absent an arbitrator's violation of one of the four statutory grounds, the FAA required a court to confirm the arbitration award.

However, dicta in a 1989 decision by the U.S. Supreme Court evidently caused confusion over parties' ability to alter judicial review of an arbitration award under the FAA: "[P]arties are *generally free to structure their arbitration agreements as they see fit*. Just as they may limit the issues which they will arbitrate . . . so too may they specify by contract the rules under which the arbitration will be conducted." *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989) (emphasis added). Unmoored to the text of the FAA, four federal circuit courts have allowed expanded judicial review of an arbitration award. *See, e.g.*, *P.R. Tel. Co., Inc. v. U.S. Phone Mfg. Corp.*, 427 F.3d 21, 31 (1st Cir. 2005); *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 293 (3d Cir. 2001); *Syncor Int'l Corp. v. McLeland*, 1997 WL 452245, at *6 (4th Cir. 1997); *Gateway Techs., Inc. v.*

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MCI Telecomms. Corp., 64 F.3d 993, 997 (5th Cir. 1995). Others have concluded that, irrespective of the parties' contract, the FAA provided the only grounds for judicial review. *Kyocera Corp.*, 341 F.3d at 1000; *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 936 (10th Cir. 2001).

Hall Street resolved the circuit split and held that the FAA's grounds for vacating or modifying an arbitration award are "exclusive" and may not be altered by contract. The Supreme Court concluded that an arbitration award's finality should prevail over parties' freedom to contract to expand the scope of judicial review.

However, the Court explicitly limited its holding to arbitration agreements proceeding under the FAA. *Hall Street* did not decide whether the FAA precluded "more searching review" based on other statutory authority, so it left open the question of whether parties could increase the level and scope of judicial review under state law. Thus, *Hall Street* did not foreclose parties' agreements to heightened judicial review of arbitration awards in all circumstances when operating under state law.

Judicial Review Provisions and Uniform Arbitration Acts

Most states have their own arbitration statutes modeled after the Uniform Arbitration Act or the Revised Uniform Arbitration Act. Like the FAA, these uniform acts preclude parties by contract from altering the grounds for judicial review. Revised Uniform Arbitration Act § 23 cmt. B (2000).

For instance, Washington adopted the Uniform Arbitration Act. In Washington, judicial review of an arbitration award is limited to the eight grounds provided for by statute. *Malted Mousse, Inc. v. Steinmetz*, 79 P.3d 1154, 1158 (Wash. Ct. App. 2003). Parties cannot "create their own boundaries of review." *Barnett v. Hicks*, 829 P.2d 1087, 1093 (Wash. 1992); *cf. Schneider v. Setzer*, 872 P.2d 1158, 1160–62 (Wash. Ct. App. 1994) (concluding that parties cannot waive a trial de novo under the mandatory arbitration statute in order to seek immediate review of an arbitration award in the court of appeals).

Nevertheless, Washington courts have held that an arbitrator exceeds his powers by committing a legal error that is apparent "on the face of the award," meaning that the reviewability of an award may depend on whether it includes detailed reasoning. *See Cummings v. Budget Tank Removal & Envtl. Servs., LLC*, 260 P.3d 220, 226–27 (Wash. Ct. App. 2011). Thus, at least in Washington, parties may affect the reviewability of an arbitration award by agreeing whether it should include detailed reasoning.

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State Interpretations of Judicial Review Provisions

Most states, consistent with *Hall Street*'s interpretation of the FAA, interpret their arbitration statutes to preclude expanded judicial review of an arbitration award. *Brookfield Country Club, Inc. v. St. James-Brookfield, LLC*, 696 S.E.2d 663, 666 (Ga. 2010) (citing states). These courts stress that the benefits of arbitration would be lost if parties could require review of arbitration awards on the merits.

However, a small minority of states—California, Connecticut, New Jersey, and Rhode Island—permit parties to expand the scope of judicial review. *See, e.g.*, *Cable Connection, Inc. v. DIRECTV, Inc.*, 190 P.3d 586, 600 (Cal. 2008); *Garrity v. McCaskey*, 612 A.2d 742, 745 (Conn. 1992); N.J. Stat. Ann. § 2A:23B-4(c) (2013); *Bradford Dyeing Ass'n, Inc. v. J. Stog Tech GmbH*, 765 A.2d 1226, 1233 (R.I. 2001) (assuming without deciding that parties may expand the scope of judicial review of an arbitration award by contract). These courts maintain that because the FAA is designed to enforce the terms of the parties' arbitration agreement and because public policy favors arbitration, expanded judicial review would not frustrate this goal.

Thus, after *Hall Street*, parties in some states—when proceeding under state law—may alter the scope of judicial review of an arbitration award. Parties need not avail themselves of the FAA and restricted judicial review in their arbitration agreements.The U.S. Supreme Court decision in *Volt* supports the proposition that parties may intend to conduct their arbitration under state-law standards of review conflicting with the FAA. To do so, the parties' arbitration agreement must clearly invoke state law to govern the agreement and the standards of judicial review because there is a strong presumption that the FAA, and not state law, rules apply both to the arbitration and on appeal. *Johnson v. Gruma Corp.*, 614 F.3d 1062, 1066–67 (9th Cir. 2010).

Conclusion

Parties that decide to use arbitration to resolve their disputes should consult appellate counsel when drafting their arbitration agreement. Appellate counsel can advise on the extent to which an arbitrator's decision may be reviewed; how to craft the arbitration agreement to set up favorable judicial review; and the risks that an unfavorable decision poses for appellate review of the substantive merits, such as legal or factual errors.

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