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Limiting And Expanding By Contract U.S. Court Review Of Arbitral Awards

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Commentary

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I. Overview

A recent decision by the Tenth Circuit Court of Appeals confirms the need for careful and informed drafting in commercial arbitration clauses of the standard for court review of arbitral awards and underscores the limitations on the parties' freedom to contract in this area. In *MACTEC, Inc. v. Gorelick*, 427 F.3rd 821 (10th Cir. 2005), the court of appeals held that an arbitration provision in a stock purchase agreement which stated that "[j]udgment upon the award . . . shall be final and nonappealable . . ." permitted federal district court review of an award but precluded court of appeals' review of the district court's decision. The district court's review, of course, is limited to the four narrow grounds allowed by the Federal Arbitration Act, 9 U.S.C. §10(a) ("FAA") and the ground of "manifest disregard of law" which was added by the Supreme Court in *Wilko v. Swan*.[1]

Although different courts and circuits might take different approaches, the lessons of *MACTEC* and other recent cases for drafters of arbitration clauses in commercial contracts are as follows.

Parties' Power To Limit Court Review Of Awards

- The language "[j]udgment upon the award . . . shall be final and nonappealable" will still permit federal district court review of an award on the grounds set forth in the FAA,[2] but will preclude an appeal of the district court's ruling to the court of appeals in the Tenth Circuit and likely to other circuit courts as well.

- Language to the effect that the district court's ruling or judgment on the award "shall be final" will likely not preclude a court of appeal's review of the district court's judgment because such language does not evince the parties' clear and unequivocal intent to waive all appellate review.

- Language that an award is "not subject to any type of review or appeal whatsoever" has been held by the Second Circuit not to deprive the federal courts of the ability to review an award under the FAA or "manifest disregard of law" standards.

- As a matter of drafting strategy, it is seldom, if ever, advisable for parties even to attempt to contract away court review of arbitral awards on the four FAA grounds or, in international arbitrations, on the

somewhat similar limited grounds on which courts may refuse to recognize and enforce a foreign arbitral award set forth in Article V of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958.

Parties' Power To Expand Scope Of Court Review Of Awards

- The Circuits are split over whether parties may by contract expand the standards by which the federal courts may review an arbitration award beyond those set forth in the FAA and the judicially-created "manifest disregard of law" standard. The Ninth and Tenth Circuits have held the parties may not do so and the Seventh and Eighth Circuits have strongly suggested they would follow suit. In contrast, the Third, Fifth (and in an unpublished opinion apparently the Fourth) Circuits have allowed parties to contact for expanded judicial review of awards and the First Circuit has indicated in *dicta* it would do the same.

II. Discussion

A. Restrictions On Judicial Power

MACTEC was a contract dispute over payment of royalties for a patented invention in which the arbitrator awarded the respondent, Gorelick, $4.5 million in damages. Thereafter, MATEC moved, in district court, to set aside the award, but the district court instead confirmed the award and MACTEC appealed. The Tenth Circuit dismissed the appeal for lack of jurisdiction. It held that the words "final and nonappealable" in the parties' arbitration agreement did not waive district court review of an arbitration award under the FAA's standards but was a "clear and unequivocal" indication of the parties' intent to waive all appellate review of the district court's decision. 427 F.3d at 830. Citing *Bowen v. Amoco Pipeline Co.*, 254 F. 3d 925 (10th Cir. 2001), the *MACTEC* court explained that the Tenth Circuit had previously held that an arbitration agreement that states that an award is "final" does not preclude an action to set aside an arbitral award under the limited grounds provided for in the FAA.

The Tenth Circuit distinguished its earlier holding in *Bowen* that "parties may not contract for expanded judicial review of arbitration awards." 254 F. 3d at 937. The MACTEC court explained its willingness to accept private *restrictions* on judicial review of arbitral awards as contrasted with its previous unwillingness to accept *expansion* of judicial review, as follows. Since "the fundamental policy behind the FAA is to reduce litigation costs by providing a more efficient forum, it makes sense to uphold contractual provisions that support that aim while striking down provisions that subvert it." 427 F.3d at 829. In *dicta*, however, the court seemed to indicate that it would not uphold "any and all private restrictions on judicial review over an arbitrator's award." Id. Citing *Hoeft v. MVL Group, Inc.*, 343 F.3d 57, 63 (2nd Cir. 2003),[3] the Tenth Circuit expressed skepticism about whether a non-appealability provision, no matter how worded, could prevent a federal district court from reviewing and possibly vacating an arbitral award under the standards set forth in the FAA. 427 F.3d at 829. The *Hoeft* court had expressed concern about allowing the prevailing party in an arbitration to use the courts to confirm an arbitral award without allowing them the minimal oversight provided for in the FAA, stating:

> Congress impressed limited, but critical, safeguards into [the arbitration] process, ones that 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. . . . Since federal courts are not rubber stamps, parties may not, by private agreement, relieve them of their obligation to review arbitration awards for compliance with Section 10(a) [of the FAA].

343 F. 3d at 64.

B. Expansion Of Judicial Review

In addition to the controversy over the validity of restrictions on court review of arbitration awards, there is a sharp split among the Circuits about whether parties can expand the scope of court review of arbitral awards. In addition to the Tenth Circuit, the Ninth Circuit has held that parties may not con-

tractually expand court review of arbitration awards beyond that set forth in the FAA. *Kyocera Corp. v. Prudential-Bache Trade Services, Inc.*, 341 F.3d 987, 1000, (9th Cir. 2003), and the Seventh and Eight Circuits have strongly suggested they would follow suit. *See Chicago Typographical Union No. 16 v. Chicago-Sun Times, Inc.*, 935 F. 2d 1501, 1504-5 (7th Cir. 1991) (looking to the FAA for guidance in construing Section 301 of the Taft-Hartley Act, "Federal courts do not review the soundness of arbitration awards. . . . If the parties want, they can contract for an appellate arbitration panel to review the arbitrator's award. But they cannot contract for *judicial* review of that award; federal jurisdiction cannot be created by contract.") (emphasis in original); *Schoch v. Infousa, Inc.*, 341 F.3d 785, 789 fn. 3 (8th Cir. 2003) ("While we do not expressly adopt the Tenth Circuit's persuasive reasoning in *Bowen*, we again express skepticism as to whether parties can contract for heightened judicial review of arbitration awards. . .").

In contrast, the Third and Fifth Circuits have allowed parties to contract for expanded judicial review of arbitration awards. *See Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 293 (3rd Cir. 2001) ("parties may opt out of the FAA's off-the-rack vacatur standards and fashion their own. . . ."); *Gateway Techs., Inc. v. MCI*, 64 F. 3rd 993, 997 (5th Cir 1995) ("When, as here, the parties agree contractually to subject an arbitration award to expanded judicial review, federal arbitration policy demands that the court conduct its review according to the terms of the arbitration contract.") In an unpublished opinion, the Fourth Circuit also appears to have adopted this standard. *Sycor International Corp. v. McLeland*, 120 F.3d 262 1997 WL 452245 at *6 (4th Cir. 1997), *cert denied*, 522 U.S. 1110 (1998) ("Because the parties contractually agreed to expand judicial review, the 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.") And the First Circuit, in *dicta*, has stated that it would allow the parties to contract for an expanded standard of review. *Puerto Rico Telephone Company, Inc. v. U.S. Phone Manufacturing Corp.*, 427 F. 3d 21, 31 (1st Cir. 2005) ("We agree with the other circuits that have concluded that the parties can by contract displace the FAA standard of review . . .").

As with other provisions of their arbitration agreements, parties should carefully consider the impact of what they may view as boilerplate language in an arbitration clause on the scope of review of arbitration awards by U.S. courts and, in international transactions, by foreign courts as well.

Endnotes

1. *Wilko v. Swan*, 346 U.S. 427 (1953) overruled on other grounds, *Rodriguez de Quijas v. Shearson/American Exp., Inc.*, 109 S.Ct. 1917 (1989).

2. The FAA's limited grounds on which a district court may vacate an arbitral award are where:

   (a) the award was procured by corruption, fraud, or undue means.

   (b) there was evident partiality or corruption in the arbitrators, or either of them.

   (c) 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.

   (d) 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.

3. In *Hoeft*, the Second Circuit held that a federal district court could review an award under the FAA's standards even though the parties' arbitration agreement stated that the arbitral award would not be "subject to any type of review or appeal whatsoever." 343 F. 3d at 63. ■

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