Alternatives

TO THE HIGH COST OF LITIGATION

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Court Decisions

'The Other Shoe': Are Agreements *Narrowing* Judicial Review Enforceable?

BY MICHAEL S. OBERMAN

Any list of the attributes of arbitration surely would spotlight the scope of judicial review—although that scope often provokes two disparate reactions.

Some companies are concerned about having a significant matter resolved in arbitration, where there is no review by a court on the merits (e.g., for errors of law). In contrast, some companies seeking finality expeditiously and inexpensively are discouraged by the sometimes drawn-out process of subjecting an award to the limited review permitted by the Federal Arbitration Act or state arbitration statute at the trial and appellate court levels.

In roughly the decade leading to the U.S. Supreme Court's decision in *Hall Street Assocs. LLC v. Mattel Inc.*, 552 U.S. 576 (2008), some parties attempted to expand by contract the scope of judicial review, providing in particular that the award would be reviewed for errors of law. These expanded judicial review clauses soon faced judicial challenge, and the lower courts split on their enforceability.

Some courts reasoned that arbitration is a creature of contract, and courts should honor the scope of review the parties agreed upon. Other courts found that parties could not by contract alter a statutory scheme for judicial review, and that the statutory grounds were the exclusive bases for judicial review. See, generally, Petition for a Writ of Certiorari, *MACTAC Inc. v. Gorelick*, 2006 WL 189805 (Jan. 23, 2006) (collecting cases and law review articles).

Hall Street definitely resolved the issue for cases under the Federal Arbitration Act, holding that the FAA grounds for vacatur or modification are exclusive and cannot be expanded by the parties' agreement.

The Court, however, held open the possibility that broader review might be available under state law. After *Hall Street,* the highest courts of California, Alabama and Texas held that their state laws permit expanded review and are not preempted by the FAA.

In contrast, the Maine, Georgia and Tennessee top courts held that their state statutes do not permit expanded review. See Michael S. Oberman, "The *Hall Street* Parade: State Courts Step Out and Consider Expanded Review of Arbitration Awards," 4:3 *N. Y. Dispute Resolution Lawyer* 23 (Fall 2011).

So the enforceability of arbitration clauses expanding judicial review has been substantially resolved, especially for the many cases controlled by the FAA.

But what about the flip side? Can parties by contract reduce the scope of judicial review, by providing that the award will be subject to limited or even no judicial review?

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This question is percolating in lower federal courts and in state courts, and at the moment there is a conflict of authority. Once again, some courts see arbitration as a creature of contract and are inclined to enforce a clearly expressed waiver of judicial review agreed to by the parties.

In contrast, some courts find that the narrowing of judicial review violates public policy, on the theory that the already limited scope of review set out in statute protects the integrity of the arbitral process.

This article takes a brisk walk through the case law to date, which currently shows a trend against narrow review—especially where parties attempt to waive judicial review entirely.

FIRST IN NINTH

1. The Ninth U.S. Circuit Court of Appeals appears to be the first federal court of appeals to discuss the issue, although its statements supporting narrow review have been dicta. In *Aerojet-General Corp. v. Am. Arbitration Assn.*, 478 F.2d 248, 251 (9th Cir. 1973), the court stated that "[w]hile it has been held that the parties to an arbitration can agree to eliminate all court review of the proceedings [citing *Gramling v. Food Machinery & Chemical Corp.*, 151 F. Supp. 853 (D.S.C. 1957)], the intention to do so must clearly appear." The court held that an AAA rule making the association's determination as to locale for an arbitration "final and binding" did not preclude review "in accordance with a minimum standard of fair dealing."

The Ninth Circuit was clear that the issue remains unresolved in that circuit in *Kyocera Corp. v. Prudential-Bache Trade Services, Inc.*, 341 F.3d 987, 999 n.16 (9th Cir. 2003) (en banc). This case is likely best remembered for its holding that parties could not expand the scope of judicial review, but the court also observed 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 for a *broader* standard of review than that authorized by Congress, although we need not resolve that question here." (Emphasis in the opinion.) *Kyocera* is the latest expression from the Ninth Circuit. See *Swenson v. Bushman Investment Properties, Ltd.*, 870 F. Supp. 2d 1049, 1055-56 (D. Idaho 2012)(available at http://bit.ly/YgKv3g)(tracing case law and holding in the case before it that the parties' agreement did not clearly waive judicial review).

2. In *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 931 (10th Cir. 2001), the Tenth Circuit noted in dicta that "parties to an arbitration agreement may eliminate judicial review by contract," while holding that parties could not expand judicial review.

Court Clash

The subject: Another visit to *Hall Street*.

Isn't judicial review settled law? It depends. The Supreme Court ended attempts at expanded federal court review. But there is ….

. . . An issue for contract writers: Can parties limit the courts' inquiry into their arbitration awards?

3. The Second Circuit squarely held in *Hoeft v. MVL Grp. Inc.*, 343 F. 3d 57, 63 (2d Cir. 2003), overruled on other grounds, *Hall Street Assocs. LLC v. Mattel, Inc.*, 552 U.S. 576 (2008)(available at http://bit.ly/Wl-N3AU), that an arbitration clause providing that the award "shall be binding and conclusive upon each of the parties hereto and shall not be subject to any type of review or appeal whatsoever" was unenforceable (citation and internal question marks omitted).

The case reached the circuit from a judgment vacating an award for manifest disregard of the law and denying a petition to confirm the award. The district court had assumed that parties could agree to eliminate judicial review but found that the clause in the case did not clearly do so.

The circuit stated: "Arbitration awards are not self-enforcing, a fact that the Hoefts, who petitioned the District Court to confirm the award, cannot deny. Thus, while we have spoken in broad terms of deference to private agreements to arbitrate, we have always done so with an awareness of the confirmation-and-vacatur-safety net that hangs below." Id. The court added:

> An agreement that contemplates confirmation but bars all judicial review presents serious concerns. Arbitration agreements are private contracts, but at the end of the process the successful party may obtain a judgment affording resort to the potent public legal remedies available to judgment creditors. In enacting [FAA] § 10(a), Congress impressed limited, but critical, safeguards onto this process. … This balance would be eviscerated, and the integrity of the arbitration process could be compromised, if parties could require that awards, flawed for any of these reasons [in § 10(a)], must nevertheless be blessed by federal courts. 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 § 10(a).

Id. at 64. The court cited the dicta of the Ninth and Tenth Circuits (discussed above) in noting that "[d]ecisions enforcing agreements to decrease the otherwise applicable level of judicial review" are "scarce." *Id.* The Second Circuit recently treated *Hoeft* as its controlling precedent on the issue of waiving judicial review in a post-*Hall Street* summary order in *Agility Public Warehousing Co. K.S.C. v. Supreme Foodservice GMBH*, 2012 WL 3854880 (2d Cir. Sept. 6, 2012)(available at http://bit.ly/ZNYJKp).

4. In *MACTEC Inc. v. Gorelick*, 427 F.3d 821 (10th Cir. 2005), the Tenth Circuit—five years after *Bowen*—returned to the question of narrowed review and granted a motion to dismiss an appeal from a district court judgment confirming an award, where the arbitration agreement provided: "Judgment upon 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 noted that, in *Bowen*, it had ruled against expanded judicial review, but it was now permitting restricted review. The

court explained that *Bowen* rested on the FAA's underlying policies. Because, in the present case, the award had been reviewed by the district court under § 10(a), elimination of appellate review would not conflict with the policies of the FAA.

The court held "that contractual provisions limiting the right to appeal from a district court's judgment confirming or vacating an arbitration award are permissible, so long as the intent to do so is clear and unequivocal." Id. at 830. The court found that the word "nonappealable" "serves this purpose." Id. The Tenth Circuit cited *Hoeft* in drawing a distinction between a clause that applied to a district court's review of an award as opposed to a clause that applied only to appellate review of a district court's judgment on an award.

5. *Van Duren v. Rzasa-Ormes*, 926 A.2d 372, 374 (N.J. Super. Ct. App. Div. 2007), held that an arbitration agreement "that clearly precludes judicial review beyond the trial court level is enforceable," aff'd, 948 A.2d 1285 (N.J. 2008). The court dismissed the appeal because the "defendant obtained meaningful review of her claims in the Chancery Division and waived any further review by way of appeal here." Id. Before the lower court, the plaintiff had moved to confirm the award, and the defendant had moved to vacate it.

The court relied on New Jersey precedent enforcing a waiver of appeal (not specific to arbitration cases). The court observed, however, that arbitration parties already have effectively waived a right to appeal the merits of an arbitration award, limited to the grounds of review contained in the arbitration statute. The court added that "complete elimination of judicial review at the initial trial level" would violate public policy, citing *Hoeft*. Id. at 380.

LIMITED 'APPEALABILITY'

6. In *Uhl v. Komatsu Forklift Co.*, 512 F.3d 294, 300-01 (6th Cir. 2008), the Sixth Circuit construed a provision that "[t]he award shall be exclusive, final, and binding to all issues and claims" and held that this formulation did not waive appealability of a judgment confirming an award (citation and quotation marks omitted).

7. In *Southco Inc. v. Reell Precision Manufacturing Corp.*, 331 F. App'x 925, 927 (3d Cir. 2009), the Third Circuit touched the issue but resolved it, in an unreported order, by contract construction. The court held that an agreement stating that the arbitration is "non-appealable" "signifies that that the parties to the contract may not appeal the merits of the *arbitration*; not that the parties agree to waive a right to appeal the district court's judgment confirming or vacating the arbitration decision" under the limited grounds of § 10(a). Id.

The court cited its earlier decision in *Tabas v. Tabas*, 47 F.3d 1280, 1288 (3d Cir. 1995) (en banc), as "observing that, where a contract provided for 'final, binding and non-appealable' arbitration, the Court must adhere to the arbitration decision on the merits."

The Third Circuit also cited *Rollins Inc. v. Black*, 167 F. App'x 798, 799 n.1 (11th Cir. 2006) as holding that a binding, final and non-appealable award "simply means the parties have agreed to relinquish their right to appeal the merits of their dispute; it does not mean the parties relinquish their right to appeal an award resulting from an arbitrator's abuse of authority. …" *Southco*, 331 F. App'x at 927. *Southco* is in obvious tension with *MACTEC*, which found that the word "non-appealable" does suffice to waive an appeal from the trial court.

8. *Strom v. First Am. Prof. Real Estate Servs. Inc.*, 2009 WL 2244211 (W.D. Okla. July 24, 2009)(available at http://bit.ly/ZNZ-P8Y), decided a motion to compel arbitration, where the arbitration clause contained a provision that "[t]here shall be no right to appeal the decision of the arbitrator." *Id.* at *1. Finding a severability provision in the underlying agreement, the court ruled that—to the extent that the language of the waiver clause actually provided a total waiver of review—the waiver clause would be unenforceable; the court then struck that clause, enforcing the balance of the arbitration agreement.

9. *Heartland Surgical Specialty Hosp. LLC. v. Reed*, 287 P.3d 933 (Kan. Ct. App. 2012), is the most recent "first-impression" appellate decision on the enforceability of a provision narrowing judicial review. The arbitration agreement stated that the "parties waive their right to appeal the ultimate decision of the arbitrator." Id. at 937.

The court began by construing the clause as a waiver of appeal of "the substantive findings of fact and conclusions of law" in the arbitration. Id. The court then surveyed the case law—not including *Hall Street*—and found two approaches: one permitting a waiver of judicial review if the waiver is clear (citing *Bowen* and *MACTAC*), and the other declining enforcement of such a waiver as contrary to public policy (citing *Silicon Power v. General Elec. Zenith Controls*, 661 F. Supp. 2d 524 (E.D. Pa. 2009); *Barsness v. Scott*, 126 S.W. 3d 232, 238 (Tex. Ct. App. 2003), and *Circle Zebra Fabricators Ltd. ex rel. Circle Zebra Management L.L.C. v. Americas Welding Corp.*, 2011 WL 1844443, at *6 (Tex. Ct. App. Mar. 17, 2011), rehearing denied (May 5, 2011).

The court recognized that these latter courts permitted waiver of the review of arbitration awards' merits, but not of judicial review under statutory grounds. "The rationale here generally is that allowing judicial review under these limited circumstances protects the integrity of arbitrations." *Heartland*, 287 P. 3d. at 937-38.

The court agreed with the second approach, and held "that public policy prohibits parties from contractually eliminating judicial review of all aspects of the arbitrator's decision. Arbitration loses its value if there is no protection for the integrity of the process." Id. at 938.

The court observed that no parties in their "right mind" would agree to accept an arbitration award even if later discovered that the award tripped the limited review grounds of the arbitration statute. Id. at 938-39. The court added: "The right of parties to contract does not trump this basic principle of fairness." Id. at 939.

In the alternative, the court held that the waiver of the "ultimate decision of the arbitrator" did not "clearly and unequivocally

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'[A] failure to timely file a challenge is the equivalent of a waiver. Clauses that provide in advance for a waiver by whichever side loses—in some respects—merely advance the moment of waiver.'

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express an intention to waive the right of appeal on the basis of bias, corruption, fraud, or other factors set forth" in the Kansas arbitration statute. *Id.*

* * *

Hall Street might suggest that courts should in all instances apply the FAA where applicable, and not permit parties to force departures from statutory mandates.

That was certainly the thrust of the *Hall Street* opinion, when courts were being asked by parties to do *more* review than provided by statute.

But the opposite situation—a waiver of review—arguably can be distinguished. A losing party need not challenge an award, and a failure to timely file a challenge is the equivalent of a waiver. Clauses that provide in advance for a waiver by whichever side loses—in some respects—merely advance the moment of waiver.

Yet the statutory limited grounds for review are intended to accord relief when there is a denial of a fundamentally fair process, and a party that waives this limited review in advance could be surprised by circumstances surrounding an award that might warrant vacatur even under the limited statutory grounds.

These considerations are likely to keep the issue percolating until the Supreme Court (which denied certiorari on the issue as recently as 2006 in the *MACTAC* case, 126 S. Ct. 1622) finally gives us a companion case to *Hall Street* and lets the other shoe drop.

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