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ARBITRATION

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Standards for Judicial Review of Arbitration Awards

On May 29, 2007, the U.S. Supreme Court granted a petition for a writ of certiorari in *Hall Street Assoc., L.L.C. v. Mattel, Inc.*[1] to decide the issue of whether a federal court can enforce a clause in an arbitration agreement that provides for a more expansive review of an arbitration award than is otherwise provided in §§10 and 11 of the Federal Arbitration Act (FAA).[2]

The issue is one that has caused a split in the federal courts of appeals, with seemingly compelling arguments on both sides. Some circuits have held that the FAA provides the exclusive standard by which a federal court can review arbitration awards, and as such, parties cannot, by private agreement, modify in this case, enlarge—the scope of judicial review. Other circuits have held that the FAA review provisions provide a default rule only, which the parties can modify by agreement, and the FAA's overriding purposes is to require enforcement of parties' arbitration agreement, even where it includes some modification of the default standard of review.

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Facts

The underlying dispute in *Hall Street* arose out of a property lease between Hall Street Associates (Hall), the landlord, and Mattel Inc. (Mattel), the tenant, for commercial property in Oregon which Mattel used for a toy manufacturing facility.[3] When Mattel learned that the well water on the property was contaminated, it gave Hall notice of termination of the lease. The lease did not contain an arbitration agreement, so Hall filed suit in Oregon state court, claiming that Mattel was required to indemnify Hall from all actions by any party relating to the condition of the property, including the water contamination.

Mattel removed the case to the Oregon federal district court, which possessed diversity jurisdiction. The case proceeded to trial on the issue of whether Mattel's notice of termination was valid; the district court held it was.[4] After an unsuccessful attempt to settle the case through mediation, the parties sought the district court's approval of an agreement to arbitrate the remaining issue of indemnification.[5] This arbitration agreement provided that the district court could vacate, modify or correct an award under the agreement where the arbitrator's conclusions of law are erroneous.[6] The district court approved the arbitration agreement, relying on the U.S. Court of Appeals for the Ninth Circuit's then-binding panel opinion in *LaPine Tech. Corp. v. Kyocera Corp.*,[7] which upheld agreements expanding judicial review of arbitration awards.[8]

The arbitrator, appointed under the judicially approved agreement, concluded that Hall was not entitled to indemnification from Mattel because Mattel had not violated any "applicable" environmental laws within the meaning of the lease. Even though Mattel had violated the Oregon Drinking Water Quality Act (ODWQA),[9] the arbitrator ruled that the ODWQA was not an "applicable" environmental law designed to protect landowners from environmental contamination, but rather was simply a measure to protect human health.[10] Hall sought de novo review of the arbitrator's legal conclusion regarding the ODWQA, as presumably allowed under the parties' arbitration agreement. The district court held that the arbitrator erred in concluding that the ODWQA was not an "applicable" environmental law, and granted Hall's motion to vacate and remanded the matter to the arbitrator. On remand, the arbitrator rendered a decision in Hall's favor, awarding Hall declaratory relief and damages.[11]

Both sides sought review of the arbitrator's

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new award. After the district court sustained the award, Mattel appealed to the Ninth Circuit, challenging the provision in the parties' arbitration agreement allowing for de novo review of the arbitrator's legal conclusions.[12] Mattel's appeal was based on the intervening en banc decision in *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*,[13] which reversed *LaPine* and held that the FAA provides the sole standards by which a federal court can review an arbitration award and that parties cannot contract for different standards.

Under *Kyocera*, the Ninth Circuit was "compel[ed]…to vacate the district court's judgment based on the arbitration agreement" and remanded the case to the district court with instructions to "confirm the original arbitration award…unless the district court determines that the award should be vacated…or modified or corrected under the grounds allowable under [the FAA.]"[14] "On remand, the district court again failed to enforce the arbitration award, this time because it was 'implausible.'"[15] Mattel again appealed to the court of appeals, which held that "[i]mplausibility is not a valid ground for avoiding an arbitration award under [the FAA,]" and again remanded to the district court with instructions to enforce the original arbitration award and declare Mattel the prevailing party.[16] Hall unsuccessfully sought en banc review from the Ninth Circuit,[17] and the district court entered judgment for Mattel.[18] Hall then successfully petitioned for U.S. Supreme Court review.[19]

FAA Statutory Framework

Congress enacted the FAA "to reverse the longstanding judicial hostility to arbitration agreements…and to place arbitration agreements upon the same footing as other contracts,"[20] providing that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[21] To ensure effective enforcement of arbitration agreements, courts may stay litigation on issues that are within the scope of the arbitration agreement, compel parties to submit to arbitration, appoint neutral arbitrators, and compel the appearances of witnesses.[22] In addition, the FAA provides that if one of the parties seeks a judicial order confirming the arbitration award "the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in section 10 and 11…."[23] Section 10 of the FAA provides that a party to the arbitration agreement may seek an order from a federal court vacating the arbitration award where:

> (1) The award was procured by corruption, fraud, or undue means;
>
> (2) There was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) 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) 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.[24]

Section 11 provides that, upon the application of a party to the arbitration, a federal district court may enter an order modifying or correcting the arbitration award where:

> (a) There was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award;
>
> (b) The arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted; or
>
> (c) The award is imperfect in matter of form not affecting the merits of the controversy.[25]

Although the FAA states in §9 that a federal district court must grant an order confirming an arbitration award unless the award is to be "vacated, modified, or corrected *as prescribed* in §§10 and 11[,]"[26] the statute is otherwise silent on the issue of whether §§10 and 11 are the exclusive grounds upon which an order to vacate, modify or correct may be granted. Moreover, the FAA makes no mention of whether parties are free to provide a different standard of review in their arbitration agreements. This (equivocal) statutory silence has led to the split in the federal courts of appeals.

Expanded Judicial Review

Several of the circuit courts, including the U.S. Courts of Appeals for the First, Third, Fourth, Fifth, and Sixth circuits, have stated, either as part of the ruling in the case or in dicta, that parties have the power to provide for expanded judicial review of awards in their arbitration agreements.[27] The basis for such decisions lies in what these courts have viewed as the underlying purpose of the FAA—to ensure judicial enforcement of the parties' arbitration agreement.[28] These decisions rely on prior Supreme Court precedent, such as *Mastrobuono v. Shearson Lehman Hutton, Inc.*,[29] and *Volt Info. Sci., Inc. v. Bd. of Trustees of Leland Stanford Jr. Univ.*,[30] which, in other circumstances, emphasized the importance of enforcing the terms the parties agreed to include in their arbitration agreements:

> [T]he FAA's pro-arbitration policy does not operate without regard to the wishes of the contracting parties…. '[I]t does not follow that the FAA prevents the enforcement of agreements to arbitrate under different rules than those set forth in the Act itself. *Indeed, such a result would be quite inimical to the FAA's purpose of ensuring that private agreements to arbitrate 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. Just as they may limit by contract the issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted.'[31]

While this language is supportive of enforcing arbitration agreements providing for expanded review of awards, courts on the other side of the debate maintain that the decisions

in which this language appears do not sanction party modification of the role of the reviewing court. For example, the Ninth Circuit in *Kyocera* explained that while *Volt* did hold that parties could contract for the rules under which an arbitration would be conducted, it is quite a different matter to contract for the rules under which a federal court will conduct its review:

> Pursuant to *Volt*, parties have complete freedom to contractually modify the arbitration process by designing whatever procedures and systems they think will best meet their needs…. Once a case reaches the federal courts, however, the private arbitration process is complete, and because Congress has specified standards for confirming an arbitration award, federal courts must act pursuant to those standards and no others…. Even when Congress is silent on the matter, private parties lack the power to dictate how the federal courts conduct the business of resolving disputes.[32]

Similarly, the Tenth Circuit in *Bowen v. Amoco Pipeline Co.* explained that "[a]lthough the [Supreme] Court has emphasized that parties may 'specify by contract the rules under which [] arbitration will be conducted'…it has never said that parties are free to interfere with the judicial process."[33] That court also noted that *Volt* held that parties may agree to procedural rules governing an arbitration because "[e]nforcing the parties' contract '[gave] effect to the contractual rights and expectations of the parties without doing violence to the policies behind… the FAA.'"[34]

By contrast, an agreement to expand the scope of judicial review would "threaten to undermine the independence of the arbitration process and dilute the finality of arbitration awards[,]" key policies underlying the FAA.[35] Although the Ninth and Tenth circuits are the only federal appellate courts to have denied enforcement of arbitration agreements altering the standard for judicial review of awards, the Second, Eighth, and Seventh circuits have indicated in dicta that they too would hold such provisions unenforceable under the FAA if such an agreement were before them.[36]

Key Questions

The case before the Supreme Court will implicate a number of important policy considerations. Is expanded judicial review a good thing because it will lead arbitrators to do a better job adhering to the applicable law? Or is it a bad thing in compelling the parties to treat the arbitration as a reviewable trial, hence undermining the efficiency advantages of arbitration? Will it also open the proverbial "flood gates" once parties to arbitration agreements can contract for easier access to the courts? Another unanswered question is how far parties can go in private agreements dictating the scope of judicial review. Judge Alex Kozinski, in his concurring opinion in *LaPine*, concluded that the arbitration agreement should be enforced because the agreement provided that a reviewing court should vacate, modify, or correct any award (a) based on the grounds referred to in the FAA, (b) where the arbitrator's findings of fact are not supported by substantial evidence, or (c) where the arbitrator's conclusions of law are erroneous—standards already used by the courts.[37] He would, however, "call the case differently if the agreement provided that the district judge would review the award by flipping a coin or studying the entrails wof a dead fowl."[38]

Conclusion

While an agreement requiring a federal court to examine turkey gizzards in its review of an arbitration award is surely at the far end of the spectrum, it currently remains an open question whether there is a limit to the standard of review parties can impose upon the courts. Assuming the Supreme Court does not have second thoughts about its grant of review in this case—given the possibility that the arbitration agreement in this case could be viewed as a judicially sanctioned process similar to a hearing before a special master—the Court's ultimate ruling in *Hall Street* will, hopefully, shed light on whether private parties have the power to prescribe the scope of judicial review of arbitration awards, and if so, whether there are any limits to contractual authority in this area.

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1. __SCt__, 2007 WL 142533, 75 U.S.L.W. 3398 (May 29, 2007) (No. 06-989).
2. 9 USC §1 et seq. (2000).
3. Petition for a Writ of Certiorari at 3-4, *Hall St. Assoc., L.L.C. v. Mattel, Inc.*, (No. 06-989), 2007 WL 128611 (Jan. 12, 2007).
4. *Hall St. Assoc., L.L.C. v. Mattel, Inc.*, 145 F.Supp. 2d 1211, 1215 (D.Or. 2001), aff'd 113 Fed. Appx. 272 (9th Cir. 2004).
5. Petition for a Writ of Certiorari at 4.
6. Petition for a Writ of Certiorari at 2.
7. 130 F3d 884 (9th Cir. 1997) (subsequently overruled by *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F3d 987 (9th Cir. 2003) (en banc)).
8. Petition for a Writ of Certiorari at 5.
9. ORS 448.114, et seq.
10. Petition for a Writ of Certiorari at 6.
11. Petition for a Writ of Certiorari at 7-8.
12. Petition for a Writ of Certiorari at 8.
13. 341 F3d 987 (9th Cir. 2003) (en banc).
14. *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 113 Fed. Appx. 272, 273 (9th Cir. 2004) (unpublished).
15. *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 196 Fed. Appx. 476, 477 (9th Cir. 2006) (unpublished).
16. Id. at 477-78.
17. Petition for a Writ of Certiorari at 11.
18. *Hall St. Assocs., L.L.C., v. Mattel Inc.*, 2007 WL 656445 (D. Or. Feb. 26, 2007).
19. *Hall St. Assocs., L.L.C., v. Mattel, Inc.*, __SCt__, 2007 WL 142533, 75 U.S.L.W. 3398 (May 29, 2007) (No. 06-989).
20. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 US 20, 24, 111 S.Ct. 1647 (1991).
21. 9 USC §2.
22. 9 USC §§2-5, 7.
23. 9 USC §9.
24. 9 USC §10.
25. 9 USC §11.
26. 9 USC §9 (emphasis added).
27. See, e.g., *Puerto Rico Tel. Co., Inc. v. U.S. Phone Mfg. Corp.*, 427 F.3d 21 (1st Cir. Oct. 14, 2005); *Jacada (Europa) Ltd. v. Int'l Mktg. Strategies, Inc.*, 401 F3d 701 (6th Cir. March 18, 2005); *Roadway Package Sys., Inc. v. Kayser*, 257 F3d 287 (3rd Cir. 2001); *Syncor Int'l Corp. v. McLeland*, 120 F.3d 262 (4th Cir. 1997) (unpublished); *Gateway Tech., Inc. v. MCI Telecomm. Corp.*, 64 F.3d 993 (5th Cir. 1995).
28. See, e.g., *Puerto Rico Tel.*, 427 F.3d at 31; *Gateway Tech.*, 64 F.3d at 996.
29. 514 US 52, 115 S.Ct. 1212 (1995).
30. 489 US 468, 109 S.Ct. 1248 (1989).
31. *Gateway Tech.*, 64 F.3d at 996 (quoting *Mastrobuono*, 514 U.S. 51, 115 S.Ct. at 1216) (emphasis in original).
32. 341 F3d at 999-1001 (citing cases).
33. 254 F3d 925, 934 (10th Cir. 2001) (quoting *Volt*, 489 U.S. at 479).
34. 254 F3d at 934-35 (quoting *Volt*, 489 U.S. at 479).
35. 254 F3d at 935.
36. *Hoeft v. MVL Group, Inc.*, 343 F3d 57 (2d Cir. Sept. 3, 2003) (holding that parties could not agree to preclude any judicial review of an arbitration award, but taking no position on agreements to expand the scope of judicial review); *Schoch v. InfoUSA, Inc.*, 341 F3d 785 (8th Cir. Sept. 3, 2003) (holding that the language in the parties' arbitration agreement did not clearly and unmistakably indicate they intended to expand the scope of judicial review, but noting that it doubted such an agreement would have been enforceable anyway); *Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc.*, 935 F2d 1501, 1505 (7th Cir. 1991) (holding that parties cannot contract for judicial review of an arbitration award under §301 of the Taft-Hartley Act because "federal jurisdiction cannot be created by contract[;]" the court looked to the FAA in arriving at its decision).
37. 130 F3d at 891.
38. Id.