

# The Expanding Scope of Judicial Review of Arbitration Awards:

## Where Does the Buck Stop?

BY KATHERINE A. HELM

**Although arbitration awards are meant to be final, some judicial review remains a vital part of the arbitration process. Yet the question still facing courts today is this: What is the proper scope of judicial review of arbitration awards? This article examines the unresolved tension between, on the one hand, the limited grounds for review in the Federal Arbitration Act, and on the other, common law grounds for review and expanded judicial review provisions negotiated by the parties themselves. The author concludes that it is undesirable to make arbitration more complicated and expensive by altering the statutory grounds of review.**

**A**rbitration is a contractual form of dispute resolution. It involves submitting the parties' dispute to one or more impartial decision makers for a final decision that is binding on the parties. Most often the parties agree to put an arbitration clause in their transaction documents (known as a future disputes clause); less often they agree to arbitrate a

dispute after the dispute arises by entering into a submission agreement. The parties typically provide in their arbitration or submission agreement the range of issues to be decided by the arbitrator, the scope of relief the arbitrator can award, and many of the procedural aspects of the process itself. The role of the judiciary in the arbitration process is limited. Yet it

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cannot be said that there is a body of reliable, uniform precedents to guide parties when an appeal is appropriate on statutory or common law grounds.

This article examines the statutory and common law bases for judicial review of arbitration awards and how courts have interpreted them. Part I provides an overview of the legal grounds for judicial review under the Federal Arbitration Act (FAA). Part II discusses the common law “manifest disregard of the law” doctrine. Part III addresses the issue of parties establishing their own standard of judicial review. Part IV discusses various policy considerations that support the finality of arbitration awards.

In the early 20th century, arbitration agreements were made specifically enforceable by federal legislation. The first modern arbitration statute in the United States was New York’s Arbitration Act of 1920.<sup>1</sup> Soon thereafter, Congress enacted the United States Arbitration Act of 1925, often referred to by U.S. practitioners as the Federal Arbitration Act (FAA).<sup>2</sup> The FAA represents strong public policy in favor of arbitration and the freedom to contract. Accordingly, as the use of arbitration in business disputes has increased over the years, so has the FAA’s reach.

The Supreme Court has made the FAA the nationwide standard governing virtually all forms of commercial arbitration. Its jurisprudence makes plain that federal law preempts state law that is inconsistent with or “undermine[s] the goals and policies of the FAA.”<sup>3</sup>

### I. Judicial Review under the FAA

It has been said that “arbitral awards are nearly impervious to judicial oversight.”<sup>4</sup> This is a bit of an overstatement. Awards are subject to judicial

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review under § 10 of the FAA. The scope of this review is narrow. This is what gives rise to the greater efficiency of arbitration. If courts were free to intervene more liberally in the arbitration process, the advantage of a speedy and less costly resolution of disputes by private arbitration mechanisms would certainly disappear.

Section 10(a) of the FAA vests courts with jurisdiction to review an arbitration award only where the process has been “tainted in certain specific ways.”<sup>5</sup> This provision is the source of authority for most judicial review of arbitration awards. It provides, in relevant part, that a reviewing court may vacate an award only:

- (1) Where the award was procured by corruption, fraud, or undue means.
- (2) Where there was evident partiality or corruption in the arbitrators, or either of them.
- (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.
- (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.

Each ground for judicial review has engendered much litigation. Courts generally consider FAA §10(a)(1) through (3) to raise concerns about the overall fairness and impartiality of the arbitral process itself, not the correctness of the award.<sup>6</sup> The correctness of the award tends to be litigated under §10(a)(4).<sup>7</sup> As a whole, courts have consistently applied an “exceedingly deferential”

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standard when construing these bases for vacating an award.<sup>8</sup> This article will examine each ground in turn.

### **Section 10(a)(1)—Fraud**

As a result of the phrase “procured by fraud,” FAA Section 10(a)(1) typically focuses the court on events that led up to the award, i.e., events taking place prior to and/or during the hearing process.

For example, in one case a corporation tried to vacate an award on grounds of fraud citing newly discovered evidence showing the former employee had lied on his employment questionnaire. The court held that the corporation had to show that it could not have discovered the evidence prior to the arbitration.<sup>9</sup>

In a case alleging that a witness who testified at the hearing had procured an award through perjury, the court ruled that a challenging three-part test had to be satisfied prior to relieving the prevailing party in the arbitration from a final judgment due to fraud: (1) the fraud must be established by clear and convincing evidence; (2) the fraud must not have been discoverable upon the exercise of due diligence prior to or during the arbitration hearing; and (3) the fraud must materially relate to an issue in the arbitration.<sup>10</sup> Using this test, the court upheld the award, stating that the alleged perjury did not materially relate to an issue in the arbitration.

In *Forsythe International, S.A. v. Gibbs Oil Co.*,<sup>11</sup> the court went even further. It held that § 10(a)(1) does not require vacatur in the event of fraudulent conduct unless there is a nexus between the fraud and the basis for the arbitrator’s decision. In this case, the arbitration panel declined to hear testimony concerning allegations that Gibbs Oil fraudulently breached an oral contract. The basis for this decision was that the panel interpreted the contract in a manner that rendered the testimony irrelevant. The court held that where an arbitration panel hears an allegation of fraud and then rests its decision on a ground that is clearly independent of the issues connected to the fraud, fraud as a ground for vacatur is absent.

### **Section 10(a)(2)—Evident Partiality**

The Supreme Court has addressed evident partiality only once—in *Commonwealth Coatings Corp. v. Continental Casualty Co.*<sup>12</sup> The case involved a dispute between a contractor and a subcontractor. The complaint was that the third arbitrator on the panel had failed to disclose that the contractor had been his regular business customer and had paid him for services on the very projects involved in the arbitration.

The Court sternly ruled that arbitrators have an obligation to disclose anything that is potentially relevant to the arbitration and that a failure to disclose creates an inference of possible bias that authorizes the court to vacate an award. Justice Byron White, joined by Justice Thurgood Marshall in a concurring opinion, emphasized that parties must be cognizant of all non-trivial relationships in order to exercise full and fair judgment. Therefore, it would be prudent for potential arbitrators to disclose at the outset any relationships they have to the dispute and the parties, while the parties are still able to reject or accept them as arbitrators.

Since *Commonwealth Coatings*, courts have had to deal with allegations of evident partiality in many different circumstances, usually with less egregious facts. In *Continental Insurance Co. v. Williams*,<sup>13</sup> an arbitrator failed to disclose that, concurrent with the arbitration, he was representing a party in an unrelated litigation against Continental Insurance. The court found that there was evident partiality and vacated the award. But it struggled with this assessment, stating that “evident partiality, like obscenity, is an elusive concept: one knows it when one sees it, but it is awfully difficult to define in exact terms. No jurist has yet coined an exacting legal standard for ‘evident partiality,’ although many have tried.”<sup>14</sup>

More recently, the 11th Circuit fashioned a new, but less than “bright line” test for vacating an award due to evident partiality. This test requires either an actual conflict of interest or nondisclosure of information known by the arbitrator that would lead a reasonable person to believe that a potential conflict exists.<sup>15</sup> The 11th Circuit’s test was predicated on the Supreme Court’s statement in *Commonwealth Coatings* that courts “should be even more scrupulous to safeguard the impartiality of arbitrators than judges, since the former have completely free rein to decide the law as well as the facts.”<sup>16</sup>

The lesson from many court cases is that arbitrators should always err on the side of full disclosure before appointment and provide ongoing disclosure thereafter.<sup>17</sup>

The 9th Circuit has placed an equal burden on the parties to: (1) obtain prehearing disclosure statements from party-appointed arbitrators who agree to act in a neutral manner, and (2) promptly decide based on those statements whether to challenge the arbitrator’s appointment. The failure to challenge an arbitrator based on these statements could lead to a waiver of the right to later challenge the award for evident partiality, as happened in *Fidelity Federal Bank, FSB v. Durga Ma Corp.*<sup>18</sup>

In this case the court held that Fidelity waived

its right to seek to vacate the award based on evident partiality of Durga Ma's arbitrator because Fidelity had constructive notice of the arbitrator's relationship with one of Durga Ma's attorneys (he was his former brother-in-law), and Fidelity had not objected to the arbitrator's appointment or his failure to make disclosures until after an interim award was entered. The court reasoned that the waiver doctrine and placing the burden on the parties to request and act on disclosure statements from an arbitrator before or during the arbitration proceedings was consistent with the federal policy favoring the finality of arbitration awards as a cost-effective method of resolving disputes.

However, the 5th Circuit defanged the waiver doctrine slightly by holding that a party must have actual knowledge of the perceived conflict of interest in order to waive its objection.<sup>19</sup> Thus, constructive knowledge is not sufficient. This places the onus of making disclosure on the arbitrator; the party has no duty to investigate. The court held that "[a] simple disclosure requirement minimizes the role of the courts in weighing arbitrators' potential conflicts, and at the same time, minimizes the discretion of the arbitrators in determining what to reveal."

#### **Section 10(a)(3)—Arbitrator Misconduct**

Section 10(a)(3) of the FAA lists three types of arbitrator misconduct as grounds for vacatur. The first type of misconduct is an arbitrator refusal to postpone the hearing without sufficient cause; the second is an arbitrator refusal to hear evidence pertinent and material to the controversy. The third type of misconduct is a "catch all": "any other misbehavior by which the rights of any party have been prejudiced."

Because an arbitrator enjoys wide latitude in conducting an arbitration, courts have construed this vague language very narrowly and time and again have excluded errors of law from their purview.<sup>20</sup> Consequently, most successful claims for vacatur under § 10(a)(3) are based on a clear violation of one of the first two grounds. But successful cases are not that common.

One of the few cases to vacate an award based on an arbitrator's failure to hear evidence perti-

nent and material to the dispute is *Hoteles Condado Beach, La Concha & Convention Center v. Union De Tronquistas Local 901*.<sup>21</sup> In this case, an employee was dismissed for allegedly violating the hotel's disciplinary rules by exposing himself to a hotel guest. The employee's union filed a grievance alleging that the dismissal was without cause. The arbitrator found in the employee's favor, giving no weight to a criminal trial transcript offered into evidence by the hotel containing the testimony of the hotel guest who made the complaint. The hotel successfully sought to vacate the award. The 1st Circuit affirmed the district court's decision vacating the award under § 10(a)(3), ruling that the arbitrator's refusal to consider relevant evidence (the transcript) deprived the hotel of a full and fair hearing. In reaching this decision, the court relied on a body of jurisprudence that holds that while an arbitrator is not bound to hear all of the evidence tendered by the parties, the arbitrator is required to grant each of the parties an equally adequate opportunity to present its evidence and arguments.<sup>22</sup>

Arbitrators are not bound by rules of judicial procedure or evidence, and courts generally do not assess whether there has been a fair hearing in arbitration based on the ethical standards that are required of Article III judges.<sup>23</sup> Rather, in determining arbitrator misconduct under § 10(a)(3), courts look to the parties' agreement. Next they assess the parties' contractual understanding of what constituted a fair hearing when they entered into their agreement in order to determine whether a deprivation of a right to present particular evidence or be heard orally rendered the arbitration proceeding unfair.<sup>24</sup> Therefore, a party will have great difficulty showing that its rights were prejudiced by an arbitrator's failure to compel document production or adherence to other civil discovery procedures where the parties' agreement granted the arbitrator broad authority to conduct the arbitral proceedings.<sup>25</sup>

#### **Section 10(a)(4)—Misuse of Power**

Misuse of power is the most frequently cited reason for vacating an arbitration award.<sup>26</sup> In

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assessing an alleged “misuse of power,” courts apply the somewhat nebulous standard of whether an arbitrator exceeded the powers delegated to her by the parties in the arbitration agreement.<sup>27</sup> Unlike the three grounds for vacatur that look to conduct, the “misuse of power” inquiry allows the court to focus on the correctness of the award in the context of the question presented, along with the arbitral reasoning that produced the award.<sup>28</sup> The 5th Circuit, for example, in *Brotherhood of Railroad Trainmen v. Central of Georgia Railway Co.*, explained that an award “without foundation in reason or fact” is an award that misuses or exceeds the authority or jurisdiction of the arbitrator.<sup>29</sup> In this court’s view, arbitrators are bound to derive a basis for their award that is “rationally inferable, if not obviously drawn” from the letter or purpose of the agreement placed in issue by the parties. In this case, the employer relocated its operations and refused to pay displaced employees a National Railroad Adjustment Board (NRAB) award, as stipulated by the arbitrator. The district court vacated the award. The 5th Circuit reversed. It held that an arbitrator’s role is to carry out the aims of the agreement at issue, and unless his position cannot be considered *in any way rational*, he has acted within his power. Here the court found that the award was rationally inferable from the parties’ agreement, or at least there was no evidence that it was not.

Other courts have said that the award must have a “foundation in reason or fact,” meaning it must, in some logical way, be derived from the wording or purpose of the parties’ agreement.<sup>30</sup> The Supreme Court has “wordsmithed” this standard as follows: an arbitrator’s award must “draw its essence from the contract and cannot simply reflect the arbitrator’s own notions of industrial justice.”<sup>31</sup>

Applying this test, the 2nd Circuit said that an arbitrator’s award must be based on issues explicitly presented by the parties.<sup>32</sup> In that circuit, an inquiry under § 10(a)(4), therefore, focuses on whether the arbitrators had the power, based on the parties’ submissions or the arbitration agreement, to reach a certain issue, not whether the arbitrators correctly decided that issue. An award can only be vacated for a misuse of power if the arbitrator acted outside the scope of the agreement, and thus outside the scope of her authority, imposing her own brand of justice.<sup>33</sup>

The 6th Circuit has created a much less deferential test, holding that an award does not “draw its essence” from a collective bargaining agreement when any of the following is true: (1) the award conflicts with express terms of the agreement; (2) it imposes additional requirements not expressly pro-

vided for in the agreement; (3) it is not rationally supported by or derived from the agreement; or (4) it is based on general considerations of fairness and equity instead of the exact terms of the agreement.<sup>34</sup>

This added gloss to the Supreme Court’s “essence of the contract” test has resulted in orders vacating 29% of labor arbitration awards reviewed by the 6th Circuit on merit-based grounds.<sup>35</sup>

## II. “Manifest Disregard of the Law” Doctrine

In addition to FAA-based grounds for vacatur of an arbitration award, the Supreme Court has said in dictum that awards can be vacated if they are in “manifest disregard of the law.” This statement came from *Wilko v. Swan*,<sup>36</sup> which was later overturned on other grounds. Nevertheless, parties frequently assert the manifest disregard doctrine as a ground to vacate an award. All the federal circuits recognize it as a ground for vacatur but not all state courts do.

What is manifest disregard of the law? In *Wilko*, the Supreme Court distinguished between an arbitrator’s erroneous interpretation of law, which is not subject to judicial review, and an arbitrator’s manifest disregard of the law, which is subject to review. On its face, manifest disregard implies some impropriety by the arbitrator, specifically, the failure to apply the law. However, the Supreme Court did not define the bounds of the manifest disregard doctrine in *Wilko*. Consequently the federal circuit courts have come up with different formulations of their own.

One construction of manifest disregard references assumptions underlying Congress’s endorsement of arbitration. Thus, courts have interpreted the *Wilko* dictum to mean that “an arbitration award will not be set aside for mistaken application of law; only where there is ‘disregard’ of law will courts interfere.”<sup>37</sup> Other decisions have branded the manifest disregard doctrine as one of “last resort,” the application of which is limited to the rare occurrences of apparent egregious impropriety on the part of the arbitrator, “where none of the provisions of the FAA apply.”<sup>38</sup>

The precise boundaries of the manifest disregard standard were left undefined by the Supreme Court in *First Options v. Kaplan*.<sup>39</sup> The Court acknowledged the differing standards that various circuit courts had employed in reviewing awards under the manifest disregard standard, but apparently felt no need to clarify the standard.

Bereft of Supreme Court guidance, the federal circuit courts have continued to fend for themselves when it comes to challenges to arbitration awards based on manifest disregard of the law. This has led one court to sardonically remark that

attempts at construing the vague Supreme Court non-statutory rule is tantamount to playing “the children’s game of ‘telephone,’ [where] the current message differs from the original message—and indeed may well convey the opposite message.”<sup>40</sup>

Despite this stumbling block, most circuits agreed that a manifest disregard of law requires more than an error of law and more than a failure by the arbitrator to understand or apply the law. The District Court for the Central District of Illinois, for example, has required that the party challenging the award demonstrate that the majority of arbitrators deliberately disregarded what they knew to be the law in order to reach the result they did.<sup>41</sup>

In a similar fashion, the 2nd Circuit has held that a court must find that the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and that this legal principle was well defined, explicit, and clearly applicable to the case.<sup>42</sup>

The 6th Circuit and the D.C. Circuit have adopted a similarly constrained standard of judicial review.<sup>43</sup>

Given the narrow construction of “manifest disregard of the law,” most courts vacate on this ground only in rare instances. The 8th Circuit recently refused to vacate an award favoring an employee based on an arbitrator’s incorrect interpretation of the Family and Medical Leave Act (FMLA), which had been incorporated into the collective bargaining agreement. The court deemed the error in judgment by the arbitrator insufficient to reverse the award.<sup>44</sup>

Similarly, the 7th Circuit has held that vacatur for manifest disregard of the law is limited to two distinct instances: if the arbitrator completely disregarded the parties’ contract or if the arbitrator directed either party to violate the law.<sup>45</sup>

Following this trend toward narrowing the manifest disregard doctrine, the 5th Circuit has ruled that even if it were manifest that the arbitrators acted contrary to the applicable law, the award must be upheld unless it would result in a “significant injustice.”<sup>46</sup>

These extraordinarily narrow standards of review reflect the strong inclination to extract the teeth from the troublesome and undefined doctrine of manifest disregard. As a matter of policy, courts have generally enunciated a strong desire to leave contract interpretation to the arbitrator and to affirm an arbitrator’s award, even if the

reviewing court might have interpreted the contract differently.<sup>47</sup>

### III. Defining the Scope of Review by Contract

This section addresses the phenomenon of putting the standard of judicial review in the parties’ contract. This phenomenon is predicated on the fact that arbitration is a creature of contract and that the parties control the process (party autonomy). In the now infamous words of Judge Richard Posner, “Indeed, short of authorizing trial by battle or ordeal or, more doubtfully, by a panel of three monkeys, parties can stipulate to whatever procedures they want to govern the arbitration of their disputes.”<sup>48</sup>

#### *Expanding Review by Contract*

Courts on one end of the spectrum have upheld efforts by the parties to contractually expand the standard of judicial review. They point to the notion that the FAA reflects a federal policy to ensure the enforceability of private agreements to arbitrate according to their specific terms.<sup>49</sup>

The Supreme Court’s statement in *Volt v. Information Sciences v. Board of Trustees of Leland Stanford Jr. University* is often cited as support for this view. The Court stated:

Arbitration under the [FAA] 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.<sup>50</sup>

One commentator has argued that “freedom to contract” is so ingrained in our society that parties must, as a matter of equity, be free to place contractual restrictions on arbitral power by raising the level of judicial oversight.<sup>51</sup> The argument goes that parties need this kind of protection particularly where the stakes are high and they would not otherwise consider arbitration.

The 5th Circuit was the first federal circuit court to address whether the parties can contractually expand the judicial standard of review. It held in *Gateway Technology v. MCI Telecommunications Corp.* that parties can do this.<sup>52</sup> The parties’ arbitration clause stated that “errors of law shall be subject to appeal” and also provided for *de novo* review. The 5th Circuit said parties can contractually agree to permit expanded review of the award

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through *de novo* review of issues of law. The court, relying largely on *Volt*, stated that the FAA merely provides a default standard of review and that the parties are free to expand judicial review by agreement. It said expanded review for errors of law was required in this case because it was the express and unambiguous intent of the parties as stipulated by their contract. To find otherwise would render the language of the contract meaningless and frustrate the intent of the parties.

The 4th Circuit, for much the same reasons, supported expanded judicial review for errors of law or legal reasoning where that was provided in the parties' agreement.<sup>53</sup> The court stated in no uncertain terms that "the scope of the arbitration agreement is a question to be determined by the court, not the arbitrator, and is subject to *de novo* review."

Likewise, the 3rd Circuit agreed that the parties could expand judicial review by providing in their agreement for judicial review based on "substantial evidence and legal validity."<sup>54</sup>

Recently, the 5th Circuit applied the *Gateway* holding to an agreement between an individual and an employer.<sup>55</sup> In another case, *Hughes Training Inc. v. Cook*, the court rejected the argument that the employment contract was a contract of adhesion.<sup>56</sup> It concluded that since the expanded review clause was equally available to both parties, it was not so one-sided as to be unconscionable.

Not unexpectedly, there has been some backlash in response to these decisions. Most notable is the 10th Circuit's holding in *Bowen v. Amoco Pipeline Co.*<sup>57</sup> The court pointedly disagreed with other circuit court decisions permitting contractual expansion of the scope of judicial review, stating "no authority clearly allows private parties to determine how federal courts review arbitration awards." The 10th Circuit noted that while the Supreme Court has permitted parties to determine by contract what issues to arbitrate and the procedures used in arbitration, it has never stated that the parties were free to control the judicial process itself. The court went on to explain that the proper relationship between arbitration and the judicial process is a severed one. With contractually expanded judicial review, the Court reasoned, "[a]rbitration would become 'just another step' in the litigation dance." It concluded with the cleverly judicious view that parties can contract for broader appellate arbitral review of an award but not for expanded judicial review, for the simple reason that federal jurisdiction cannot be created by contract.<sup>58</sup>

Following the *Bowen* lead, the 9th Circuit flip-flopped on the position it took in 1997 upholding

contractually expanded judicial review.<sup>59</sup> In *Kyocera Corp. v. Prudential-Bache Trade Service*,<sup>60</sup> a highly litigated, high profile, complex case, the 9th Circuit, in an *en banc* decision, overruled its earlier decision allowing the parties to expand judicial review.<sup>61</sup> It held that private parties have no power to alter or to expand the grounds set forth in the FAA and "any contractual provision purporting to do so is, accordingly, legally unenforceable." The court said it agreed with *Bowen* subscribed to the notion that the grounds for setting aside arbitration awards are exhaustively stated in the statute. Finally, the *en banc* 9th Circuit also acknowledged that expanded judicial review of arbitration decisions, even when agreed to by the parties, could jeopardize the benefits of arbitration by rendering it "merely a prelude to a more cumbersome and time-consuming judicial review process."

This invigorated support for the FAA may lead other courts to follow the 9th and 5th Circuits in ruling that parties have no authority to expand the grounds for the judicial review of an arbitration award.

#### *Limiting Review by Contract*

The flip side of expanding judicial review is limiting its scope. Do the policies behind the FAA preclude this? The 2nd Circuit addressed an aspect of this question in *Hoelt v. MVL Group*.<sup>62</sup> The arbitration clause at issue sought to preclude all judicial review of an arbitration award. The court held the clause unenforceable, reasoning that "since federal courts are not rubber stamps, parties may not, by private agreement, relieve them of their obligation to review arbitration awards."

*Hoelt* dovetails nicely with the 9th and 10th Circuit decisions on expanded judicial review. These courts ruled that the freedom to contract has its limits and once arbitration cases reach the federal court, the FAA alone establishes the standard of review. The 10th Circuit pointed out in *Hoelt* that Congress imposed "limited, but critical, safeguards" onto the process by which arbitration awards serve as mechanisms to resolve private disputes.<sup>63</sup> Arbitration clauses eliminating judicial review are, therefore, unenforceable for the same reason that clauses expanding judicial review are unenforceable: Arbitral awards need to have a confirmation-and-vacatur safety net because they are not self-enforcing.<sup>64</sup> At the end of the day, parties are powerless to contractually expand or limit the prescribed standards of the FAA by which federal courts review arbitration awards.

#### IV. Policy Considerations

Public policy supports limited judicial participation in arbitration proceedings.<sup>65</sup> Court decisions authorizing expanded judicial review by contractual agreement have been harshly criticized on the ground that this contravenes public policy.

The origin of public policy as a ground for deferring to a statute lies in the common law of contracts, which provides that a court can refuse to enforce a contract if doing so would violate a clear and well-defined public policy or interest.<sup>66</sup> Under this line of reasoning, a court's review of an arbitration award should be highly deferential

most certain to outweigh the occasional benefits of overturning erroneous conclusions of law.

One legal scholar has expressed disdain for parties who want to "have it all" (i.e. a less expensive arbitration process with heightened judicial review). He argues that when parties agree to arbitrate, they accept whatever reasonable uncertainties might arise from the process and thereby trade the federal procedures and expanded judicial review for the perceived simplicity, informality and expedition of arbitration.<sup>71</sup> Another commentator says that the FAA was never intended to make arbitration the equivalent of litigation; accordingly, parties should not be able to alter

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and based on strict statutory or judicially created standards so as not to undermine the fundamental goals of arbitration.

Once parties have contracted to have an arbitrator resolve their disputes, "it is the arbitrator's view of the facts and of the meaning of the contract that they have agreed to accept."<sup>67</sup> As long as the arbitrator is "even arguably construing or applying the contract and acting within the scope of his authority, the fact that a court is convinced the arbitrator committed serious error does not suffice to overturn [the award]."<sup>68</sup> This deference to the award must be respected in order to advance both the federal policy favoring arbitration and the parties' stated interest in arbitration, since it is the arbitrator's construction and not the federal courts' construction for which the parties bargained.<sup>69</sup>

Increasing the scrutiny that courts apply to arbitration decisions by contracting for broadened judicial review of arbitration awards is an ineffective way to deal with concerns about a "maverick" arbitrator failing to apply the law. Expanded review only complicates the arbitration process. Providing for judicial review of errors of fact and law would require arbitrators to issue lengthy findings of fact and law and would almost certainly result in a plethora of appeals. This would sacrifice the relative simplicity and time-saving features of arbitration. It would also burden an already overworked judiciary.<sup>70</sup> Indeed, the inevitable costs of enhanced review are al-

most certain to outweigh the occasional benefits of overturning erroneous conclusions of law. By agreeing to arbitrate, parties should understand that they gain the benefits of arbitration, but sacrifice some of the benefits of litigation, including a full appellate process.<sup>72</sup>

The judiciary itself has become frustrated with the parties' sense of entitlement when it comes to judicial review of arbitral awards. The 7th Circuit has made clear that we need look no further than the FAA, which does not contemplate *de novo* judicial review as the standard of review for arbitration awards.<sup>73</sup> It said that arbitration is not a system of "junior varsity trial courts" offering the losing party complete and rigorous *de novo* review.<sup>74</sup> Mere dissatisfaction with an award is not a good enough reason for the losing party to obtain expanded judicial review.<sup>75</sup>

While that is generally the view courts take, the 6th Circuit may be encouraging parties to appeal labor arbitration awards. Sixth Circuit Judge Jeffrey Sutton has pointed with dismay to the large number of decisions by his Circuit vacating labor arbitration awards on merit-based grounds. He wrote, "Who among the practicing bar would not appeal an award that has a one-in-four chance of winning?" He continued, "Only an exceedingly unimaginative attorney would shy away from that argument."<sup>76</sup>

The 11th Circuit, in an attempt to quell a manifest disregard appeal of an arbitration award in *B.L. Harbert International v. Hercules Steel Co.*, warned counsel that they will be sanctioned for



frivolous challenges to arbitration awards.<sup>77</sup> It stated:

[T]his Court is exasperated by those who attempt to salvage arbitration losses through litigation that has no sound basis in the law applicable to arbitration awards. The warning this opinion provides is that in order to further the purposes of the FAA and to protect arbitration as a remedy we are ready, willing, and able to consider imposing sanctions in appropriate cases.

The court went on to deny the losing party's motion to vacate, holding that the facts of the case "did not come within shouting distance" of a manifest disregard of the law. The court bitingly declared that "[t]he only manifest disregard of the law evident in this case is Harbert's refusal to accept the law of this circuit which narrowly circumscribes judicial review of arbitration awards." It made it as plain as possible that the promise of arbitration is broken when a losing party adopts a "never-say-die" attitude and makes a disingenuous claim that drags the dispute further through the court system.

Sanctions in the form of attorney fees were recently awarded for a frivolous appeal of an arbitration award that the California Court of Appeal said had "indisputably no merit." In *Evans v. Centerstone Development Co.*<sup>78</sup> the court sanctioned the plaintiffs and their lawyers, jointly and

severally, holding that "[p]laintiffs' crude attempt to characterize their claims so they would fall within acceptable bases for an appeal is an artifice we condemn."

In the same vein, the 7th Circuit affirmed Rule 11 sanctions against a party that had challenged an arbitration award with the "baseless" argument that the arbitrator had exceeded his authority.<sup>79</sup> The court held that it was continuing a long line of 7th Circuit cases that have discouraged parties from challenging arbitration awards and upheld sanctions in cases where a challenge to the award was substantially without merit.

## Conclusion

In sum, it is clear that judicial standards of review, like judicial precedents, are not the property of private litigants.<sup>80</sup> That said, federal appellate courts must continue to develop predictable precedents involving statutory grounds for judicial review. They also should take a more uniform approach to the manifest disregard doctrine. When they do, parties and their counsel may be able to recognize the appeal resistance of most arbitration awards.

Arbitration's goals are unquestionably best served by ensuring the finality of arbitration awards. This is consistent with the bargain the parties have made. The remedy for any flaws in the system is having the parties choose better arbitrators, not to appeal arbitration awards. ■

## ENDNOTES

<sup>1</sup> N.Y. Civ. Prac. L. & R. § 7501 *et seq.*

<sup>2</sup> 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1-13). The FAA governs arbitration of all contractual disputes involving interstate commerce. The FAA presumably governs most arbitration contracts because nearly all transactions can in some way "affect" interstate commerce.

The primary purpose of the FAA was "to place arbitration agreements 'upon the same footing as other contracts'" and to eliminate the traditional reluctance of courts to enforce arbitration agreements. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974) (quoting H.R. Rep. No. 96, 68th Cong., 1st Sess. 1, 2 (1924)). Accordingly, the FAA provides that an arbitration agreement shall be "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2.

<sup>3</sup> *Volt Info. Sci. v. Board of Trustees of Leland Stan. Jr. Univ.*, 489 U.S. 468, 478 (U.S. 1989). See also, *Southland Corp. v. Keating*, 465 U.S. 1, 11 (1984) (Congress intended the FAA to apply in state courts and preempt state anti-arbitration

laws to the contrary); *Doctor's Assocs. v. Casarotto*, 517 U.S. 681, 688 (1996) (enforceability of arbitration clauses is determined by federal, not state, law); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995) (a federal common law of arbitrability preempts state law disfavoring arbitration).

<sup>4</sup> *Teamsters Local Union No. 42 v. Supervalu*, 212 F.3d 59, 61 (1st Cir. 2000).

<sup>5</sup> *Advest, Inc. v. McCarthy*, 914 F.2d 6, 8 (1st Cir. 1990).

<sup>6</sup> See *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145, 147 (1968) ("[Sections 10(a)(1), (2), and (3)] show a desire of Congress to provide not merely for any arbitration but for an impartial one.").

<sup>7</sup> See Stephen L. Hayford, "Law in Disarray: Judicial Standards for Vacatur of Commercial Arbitration Awards," 30 *Ga. L. Rev.* 731, 747-48 (1996).

<sup>8</sup> See, e.g., *Bull HN Info. Sys. v. Hutson*, 229 F.3d 321, 324 (1st Cir. 2000).

<sup>9</sup> *Shearson Hayden Stone, Inc. v. Liang*, 493 F. Supp. 104, 109 (D. Ill. 1980).

<sup>10</sup> *Bonar v. Dean Witter Reynolds*, 835 F.2d 1378, 1383 (11th Cir. 1988).

<sup>11</sup> 915 F.2d 1017, 1022 (5th Cir. 1990).

<sup>12</sup> *Supra* n. 6.

<sup>13</sup> No. 84-2646-Civ, 1986 WL 20915 (S.D. Fla. 1986).

<sup>14</sup> *Id.* at \*3-4.

<sup>15</sup> *Lifecare Int'l v. CD Med.*, 68 F.3d 429, 433 (11th Cir. 1995).

<sup>16</sup> *University Commons-Urbana, Ltd. v. Universal Constructors*, 304 F.3d 1331, 1338 (11th Cir. 2002) (quoting *Commonwealth Coatings*, *supra* n. 6, 393 U.S. at 149).

<sup>17</sup> See generally, Platt W. Davis III, "Nondisclosure of Arbitrator Conflicts and the 'Evident Partiality' Standard," *CPA J.*, 54 (2004).

<sup>18</sup> *Fidelity Fed. Bank, FSB v. Durga Ma Corp.*, 386 F.3d 1306, 1308 (9th Cir. 2004).

<sup>19</sup> See *Positive Software Solutions v. New Century Mortg. Corp.*, 436 F.3d 495 (5th Cir. 2006).

<sup>20</sup> See *United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 29, 36 (1987). See also generally, Murray S. Levin, "The Role of Substantive Law in Business Arbitration and the Importance of Volition," 35 *Am. Bus. L.J.* 105, 110 (1997).

<sup>21</sup> 763 F.2d 34 (1st Cir. 1985).

<sup>22</sup> *Id.* at 39, citing *National P.O.*,

*Mailhandlers, Watchmen, Messengers & Group Leaders Div., Laborers Int'l Union of N. Am. v. U.S. Postal Serv.*, 751 F.2d 834, 841 (6th Cir. 1985); *Totem Marine Tug & Barge v. North Am. Towing*, 607 F.2d 649, 651 (5th Cir. 1979); *Bell Aerospace Co. Div. of Textron v. Local 516, Int'l Union, United Auto. Workers of Am.*, 500 F.2d 921, 923 (2d Cir. 1974).

<sup>23</sup> *Peoples Sec. Life Ins. Co. v. Monumental Life Ins. Co.*, 991 F.2d 141, 146 (4th Cir. 1993).

<sup>24</sup> *National Casualty Co. v. First State Ins. Group*, 430 F.3d 492, 497 (1st Cir. 2005).

<sup>25</sup> *Id.* at 498.

<sup>26</sup> Hayford, *supra* n. 7, at 747-48.

<sup>27</sup> In the rather nondeferential words of one legal scholar, "the statutory phrase [exceeded their powers] is an empty vessel, which the courts have to fill by defining just what are the powers of the arbitrators. Until this is done it is, of course, impossible to ascertain whether the arbitrators have exceeded their powers." Ian R. Macneil *et al.*, *Federal Arbitration Law*, § 40.5.1.3, at 40.37 (1995).

<sup>28</sup> Hayford, *supra* n. 7, at 748.

<sup>29</sup> *Brotherhood of RR Trainmen v. Central of Ga. Ry. Co.*, 415 F.2d 403, 411-12 (5th Cir. 1969).

<sup>30</sup> See, e.g., *Standard Tankers (Bahamas) Co. v. Motor Tank Vessel, Akti*, 438 F. Supp. 153 (D.N.C. 1977).

<sup>31</sup> *Misco*, *supra* n. 20, at 38.

<sup>32</sup> *Westerbeke Corp. v. Daihatsu Motor Co.*, 304 F.3d 200 (2d Cir. 2002).

<sup>33</sup> *Banco de Seguros del Estado v. Mutual Marine Office*, 344 F.3d 255, 262 (2d Cir. 2003).

<sup>34</sup> *Cement Divs., Nat'l Gypsum Co. v. United Steelworkers, Local 135*, 793 F.2d 759, 766 (6th Cir. 1986).

<sup>35</sup> *Michigan Family Restaurant v. SEIU, Local 517M*, 438 F.3d 653 (6th Cir. 2006), rehearing *en banc* pending, 2006 U.S. App. LEXIS 11479.

<sup>36</sup> 346 U.S. 427 (1953) (overruled on other grounds in *Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477 (1989)).

<sup>37</sup> *Local 771, I.A.T.S.E. v. RKO General, Inc., WOR Div.*, 546 F.2d 1107, 1113 (2d Cir. 1977). See also, *Denver & Rio Grande W. R.R. v. Union Pac. R.R.*, 119 F.3d 847 (10th Cir. 1997) (holding that errors in arbitrator's factual findings or interpretations of law, unless showing manifest disregard of law, do not justify review).

<sup>38</sup> *Duferco Int'l Steel Trading v. T. Klaveness Shipping A/S*, 333 F.3d 383, 389 (2d Cir. 2003) (reporting that since 1960, the 2nd Circuit has vacated arbitral awards for manifest disregard in only four out of 48 cases).

<sup>39</sup> *First Options, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995).

<sup>40</sup> *Michigan Family Restaurant*, *supra* n. 35 (Sutton, J., concurring).

<sup>41</sup> *Shearson Hayden Stone*, *supra* n. 9. This rationale has been used to equate

an award rendered in "manifest disregard of the law" with one that is "fundamentally irrational." The "fundamentally" or "completely irrational" standard persists today as a spin-off of the manifest disregard standard. See, e.g., *Health Serv. Mgmt. Corp. v. Hughes*, 975 F.2d 1253 (7th Cir. 1992).

<sup>42</sup> *DiRussa v. Dean Witter Reynolds*, 121 F.3d 818, 821 (2d Cir. 1997). Prior to *DiRussa*, the 2nd Circuit had announced a broader scope of review, stating that the absence of an arbitrator's reasoned opinion may reinforce a reviewing court's confidence that an arbitrator engaged in manifest disregard of the law or facts. *Halligan v. Piper Jaffray*, 148 F.3d 197, 204 (2d Cir. 1998). More recent decisions, however, follow the narrower *DiRussa* construction and hold that (1) the rejected or ignored governing law must be explicit and clearly applicable to the facts of the case, and (2) a manifest disregard of the facts alone is not sufficient grounds for vacatur. See, e.g., *Wien & Malkin LLP v. Helmsley-Spear*, 6 N.Y.3d 471 (N.Y. 2006); *Wallace v. Buttari*, 378 F.3d 182 (2d Cir. 2004); *Banco de Seguros del Estado v. Mutual Marine Office*, 344 F.3d 255 (2d Cir. 2003).

<sup>43</sup> See, e.g., *Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 330 F.3d 843 (6th Cir. 2003); *LaPrade v. Kidder Peabody & Co.*, 246 F.3d 702 (D.C. Cir. 2001).

<sup>44</sup> *Electrolux Home Prods. v. United Auto. Aero. & Agric. Implement Workers of Am.*, 416 F.3d 848 (8th Cir. 2005).

<sup>45</sup> *George Watts & Son v. Tiffany & Co.*, 248 F.3d 577 (7th Cir. 2001).

<sup>46</sup> *Sapic v. Government of Turkmenistan*, 345 F.3d 347, 363 (5th Cir. 2003).

<sup>47</sup> *Inter-City Gas Corp. v. Boise Cascade Corp.*, 845 F.2d 184 (8th Cir. 1988).

<sup>48</sup> *Baravati v. Josephthal, Lyon & Ross*, 28 F.3d 704, 709 (7th Cir. 1994).

<sup>49</sup> *Volt*, *supra* n. 3, 489 U.S. at 476.

<sup>50</sup> *Id.* at 479.

<sup>51</sup> See generally, Lee Goldman, "Contractually Expanded Review of Arbitration Awards," 8 *Harv. Negotiation L. Rev.* 171, 173-74 (2003).

<sup>52</sup> See *Gateway Technology v. MCI Telecomm. Corp.*, 64 F.3d 993 (5th Cir. 1995).

<sup>53</sup> *Syncor International Corp. v. McLeland*, 120 F.3d 262 (4th Cir. 1997) (unpublished *per curiam* opinion, 1997 U.S. App. LEXIS 21248).

<sup>54</sup> *Roadway Package Sys. v. Kayser*, 257 F.3d 287, 293 (3rd Cir. 2000) ("We now join with the great weight of authority and hold that parties may opt out of the FAA's off-the-rack vacatur standards and fashion their own.").

<sup>55</sup> See, e.g., *Harris v. Parker College of Chiropractic*, 286 F.3d 790 (5th Cir. 2002).

<sup>56</sup> *Hughes Training Inc. v. Cook*, 254 F.3d 588, 594 (5th Cir. 2001).

<sup>57</sup> 254 F.3d 925 (10th Cir. 2001).

<sup>58</sup> *Id.* at 936-37. The court credited the 7th Circuit with the idea of con-

tracting for review by an appellate arbitration panel. See, *Chicago Typographical Union No. 16 v. Chicago Sun-Times*, 935 F.2d 1501 (7th Cir. 1991).

<sup>59</sup> *Lapine Tech. Corp. v. Kyocera Corp.*, 130 F.3d 884 (9th Cir. 1997).

<sup>60</sup> 341 F.3d 987 (9th Cir. 2003).

<sup>61</sup> *Id.* ("We now affirm the district court's confirmation of the arbitral panel's award. In so doing, we correct the law of the circuit regarding the proper standard for review of arbitral decisions under the [FAA].")

<sup>62</sup> 343 F.3d 57 (2d Cir. 2003).

<sup>63</sup> *Id.* at 64.

<sup>64</sup> *Id.* at 63-65. See also John Fellas, "The Scope of Judicial Review of Arbitration Awards," *N.Y.L.J.*, Nov. 7, 2003 (contrasting *Kyocera* and *Hoelt*).

<sup>65</sup> See *Evans v. Centerstone Dev. Co.*, 134 Cal. App. 4th 151, 157 (Cal. Ct. App. 2005).

<sup>66</sup> See *Seymour v. Blue Cross/Blue Shield*, 988 F.2d 1020, 1023 (10th Cir. 1993) (discussing common law roots of the public policy basis for finality of arbitral decisions).

<sup>67</sup> *Misco*, *supra* n. 20, at 37-38.

<sup>68</sup> *Id.* at 38.

<sup>69</sup> *United Steelworkers of Am. v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 599 (1960). See also the American Arbitration Association (AAA) *Guide For Commercial Arbitrators*, stating that "the parties breathe life into the arbitrator." Available at [www.adr.org/sp.asp?id=22016](http://www.adr.org/sp.asp?id=22016).

<sup>70</sup> *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, n.34 (10th Cir. 2001) (describing how upholding an "opt-in" enhanced review clause would turn arbitration into another step on the litigation ladder).

<sup>71</sup> See Hayford, *supra* n. 7, at 740-41.

<sup>72</sup> See Brad A. Galbraith, "Vacatur of Commercial Arbitration Awards in Federal Court: Contemplating the Use and Utility of the Manifest Disregard of the Law Standard," 27 *Ind. L. Rev.* 241, 263 (1993).

<sup>73</sup> *Eljer Mfg. v. Kowin Dev. Corp.*, 14 F.3d 1250, 1254 (7th Cir. 1994).

<sup>74</sup> *National Wrecking Co. v. International Bhd. of Teamsters, Local 731*, 990 F.2d 957, 960 (7th Cir. 1993).

<sup>75</sup> Judge Posner summarized the situation as follows: "By including an arbitration clause in their contract the parties agree to submit disputes arising out of the contract to a nonjudicial forum, and we do not allow the disappointed party to bring his dispute into court by the back door, arguing that he is entitled to appellate review of the arbitrators' decision." *Baravati*, *supra* n. 48, 28 F.3d at 706.

<sup>76</sup> *Michigan Family Restaurant*, *supra* n. 35 (Sutton, J., concurring).

<sup>77</sup> 441 F.3d 905 (11th Cir. 2006).

<sup>78</sup> *Supra* n. 65.

<sup>79</sup> *Cuna Mut. Ins. Soc'y v. Office & Prof'l Employees Int'l Union*, 443 F.3d 556 (7th Cir. 2006).

<sup>80</sup> *Hoelt*, *supra* n. 62, 343 F.3d at 65.