Uncertain Appeal

By Ronald M. Greenberg

Both opponents and advocates of expanded judicial review of arbitration decisions invoke the intent of the Federal Arbitration Act

Two disparate systems exist for the determination of civil disputes. One is the judicial system; the other, arbitration. Each system has its own unique benefits and drawbacks. Generally, the judicial system affords greater discovery and the right to a jury trial. Arbitration is perceived as more efficient and less expensive.

There are also significant differences between the two systems at the appellate level. The losing party in a trial has a wide range of appellate rights and can challenge, for example, the sufficiency of evidence or the application of law. On the other hand, the losing party in an arbitration has limited rights to judicial review. The losing party cannot raise challenges based on evidence, including its insufficiency, or legal errors. For the most part, judicial review is limited to issues involving due process, such as not receiving notice of hearings, not having a neutral arbitrator, or the refusal of the arbitrator to hear relevant and material evidence. Basically the procedure itself is reviewed on appeal as opposed to the merits of the dispute.

Thus the willingness to give up appellate rights is a factor when considering arbitration. Nevertheless, because of an evolving trend in matters governed by the Federal Arbitration Act,[1] parties who opt for arbitration governed by the FAA may be able to secure the best of both worlds—the efficiencies of arbitration and the more extensive bases for appeal. This trend is due to the fact that some courts have upheld agreements for expanded judicial review of arbitration awards, but it depends upon the circuit in which the judicial review occurs. The Ninth Circuit is one of the circuits that allows parties to agreements governed by the FAA to agree to expanded judicial review. Although California state courts also are called upon to review arbitration awards that are governed by the FAA, no state court has yet addressed the issue of expanded judicial review of FAA-governed agreements.

The trend of allowing parties to contract for expanded judicial review, however, does not extend to the California Arbitration Act. As a result of the decision earlier this year in *Crowell* v. *Downey Community Hospital Foundation*[2] and the recent decision in *Oakland-Alameda County Coliseum Authority* v. *CC Partners*,[3] if a matter is governed by the CAA,[4] any provision for expanded judicial review is void. However, because of a conflict between these two decisions, it is unsettled whether the inclusion of a clause providing for expanded judicial review will void the entire arbitration agreement.

What this means is that practitioners

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called upon to draft arbitration agreements for clients who reside in California must now fully understand the present state of the law in both the federal and state judicial systems in California. If expanded judicial review of arbitration awards in California is desired, the practitioner must find a way for the arbitration agreement to be governed by the FAA and have a basis (such as diversity) for federal jurisdiction or, alternatively, hope that California state courts will adopt a position of expanded judicial review for arbitration awards governed by the FAA. If practitioners cannot find a way to place an arbitration agreement under the FAA, they must hope that another California Court of Appeal will render an opinion opposite to *Crowell* and *Oakland-Alameda County Coliseum Authority*, thereby establishing a conflict for resolution by the California Supreme Court.

Appellate Review in Federal Court

The purpose of the FAA, which was enacted in 1925, was to abolish longstanding antiarbitration laws and to make agreements to arbitrate that fall within its purview specifically enforceable.[5] Section 10(a) of the FAA[6] allows the court to vacate an award on specified grounds regarding the conduct of the arbitrators. In commenting upon this provision, the court in *Barbier* v. *Shearson Lehman Hutton Inc.*, stated, "It is well-settled that judicial review of an arbitration award is narrowly limited. The award may be vacated only if at least one of the grounds specified in 9 U.S.C. Section 10 is found to exist."[7] These grounds include:

- The procurement of an award "by corruption, fraud, or undue means."[8]
- The "evident partiality or corruption" of the arbitrator.[9]
- The arbitrator refused to "postpone the hearing, upon sufficient cause," or refused "to hear evidence pertinent and material to the controversy," or engaged in "any other misbehavior by which the rights of any party may have been prejudiced."[10]
- The arbitrator "exceeded [his or her] powers, or so imperfectly executed them that mutual, final, and definite award upon the subject matter submitted was not made."[11]

Some federal courts have augmented these grounds by articulating that an award may also be vacated when it is in "manifest disregard of the law."[12] However, this concept is not uniformly accepted in the federal system. As the court stated in *Baravati* v. *Josephthal, Lyons & Ross Inc.*:

> A number of courts, including our own, have said that they can set aside arbitral awards if the arbitrators exhibited a "manifest disregard of the law." Two courts, however, have declined to adopt this formula, though without rejecting it. Two have criticized it....We can understand neither the need for the formula nor the role that it plays in judicial review of arbitration (we suspect none that it is just words). If it is meant to smuggle review for clear error in by the back door, it is inconsistent with the entire modern law of arbitration. If it is intended to be synonymous with the statutory formula that it most nearly resembles—whether the arbitrators "exceeded their powers"—it is superfluous and confusing. There is enough confusion in the law. The grounds for setting aside arbitration awards are exhaustively stated in the statute....[13]

Despite the seemingly well-established precedents for limited judicial review of arbitration awards in the federal judicial system, some federal courts also have recognized that parties may agree to a broader scope of judicial review of an award. Specifically, to avoid the FAA's limitations on the scope of judicial review, parties to an agreement to arbitrate have provided in their agreements that an award may be vacated if it is not supported by substantial evidence or if it is based upon errors of law. This evolution, however, has not been uniformly accepted.

Best exemplifying the divergence of views on this issue is the case of *Lapine Technology Corporation* v. *Kyocera Corporation*,[14] in which three judges expressed three different views on this subject. The underlying facts involved parties to an international joint venture who agreed to arbitration in San Francisco pursuant to the Rules of the International Chamber of Commerce. The arbitrators were to "issue a written award which shall state the bases of the award and include detailed findings of fact and conclusions of law."[15] The arbitration agreement further provided that the U.S. District Court for the Northern District of California could confirm, vacate, modify, or correct the award. The parties also agreed to the following in their arbitration agreement: "The decisions and awards of the Tribunal may be enforced by the judgment of the Court or may be vacated, modified or corrected by the Court (a) based upon any grounds referred to in the Act, or (b) where the Tribunal's findings of fact are not supported by substantial evidence, or (c) where the Tribunal's conclusions of law are erroneous."[16]

The district court, when asked to conduct the expansive review to which the parties had agreed, declined. The court held that the parties could not contract for a more expanded judicial review than what was allowed under Section 10 of the FAA.[17]

In reversing that decision, the Ninth Circuit held that parties to an arbitration agreement could contract for a more expansive judicial review than that allowed by the FAA. According to Judge Ferdinand F. Fernandez, who authored the court's opinion:

> This appeal boils down to one major issue: Is federal court review of an arbitration agreement necessarily limited to the grounds set forth in the FAA or can the court apply greater scrutiny, if the parties have so agreed?...
>
> We hold that we must honor that agreement. We must not disregard it by limiting our review to the FAA grounds....[18]

In a concurring opinion, Judge Alex Kozinski stated:

> While I join Judge Fernandez's opinion, I find the question presented closer than most. The Supreme Court cases on which the opinion relies are helpful...but they don't get us all the way there. As Judge Mayer points out, they say that parties may set the time, place and manner of arbitration; none says that private parties may tell the federal courts how to conduct their business....
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> Nevertheless, I conclude that we must enforce the arbitration agreement according to its terms. The review to which the parties have agreed is no different from that performed by the district courts in appeals from administrative agencies and bankruptcy courts, or on habeas corpus. I would call the case differently if the agreement provided that the district judge would review the award by flipping a coin or studying the entrails of a dead fowl. Given the strong policy of party empowerment embodied in the Arbitration Act, I see no reason why the Congress would object to enforcement of this agreement. This is not quite an express congressional authorization but, given the Arbitration Act's policy, it's probably enough.[19]

Disagreeing with this result, Judge H. Robert Mayer in his dissent wrote:

> Whether to arbitrate, what to arbitrate, how to arbitrate, and when to arbitrate are matters that parties may specify contractually. However, Kyocera cites no authority explicitly empowering litigants to dictate how an Article III court must review an arbitration decision. Absent this, they may not. Should parties desire more scrutiny than the Federal Arbitration Act authorizes courts to apply, "they can contract for an appellate arbitration panel to review

the arbitrator's award[;] they cannot contract for judicial review of that award."[20]

The Fourth and Fifth Circuits have also considered the issue of whether parties to an arbitration agreement can contract for a more expansive scope of judicial review of an arbitration award and have upheld the right of the parties to do so.[21] The Third Circuit, in a different context in which the issue was whether parties could agree to a more limited judicial review procedure under state law than that allowed by the FAA, cited the Fourth, Fifth, and Ninth Circuits in support of its decision: "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 (including by referencing state law standards)."[22]

The Tenth Circuit, however, has expressly rejected expanded judicial review.[23] It refused to give effect to a provision in an arbitration agreement that allowed for appeal of an arbitration award if it is "not supported by the evidence."[24] The court's basis for reaching this conclusion was its view of the FAA's provision for limited judicial review, as well as its focus on the distinction between the litigation process and arbitration.[25]

Lining up with the Tenth Circuit are the Seventh and Eighth Circuits. For example, in *Chicago Typographical Union No. 16* v. *Chicago Sun-Times, Inc.*, the Seventh Circuit held, "An agreement to submit a dispute over the interpretation of a labor or other contract to arbitration is a contractual commitment to abide by the arbitrator's interpretation. 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."[26]

Likewise, in *UHC Management Company* v. *Computer Sciences Corporation* the Eighth Circuit stated, "Notwithstanding these cases, we do not believe it is yet a foregone conclusion that parties may effectively agree to compel a federal court to cast aside sections 9, 10 and 11 of the FAA."[27]

A review of these opinions shows that while the results are all based upon an interpretation of the FAA, the focus, however, dictates the result. For the Third, Fourth, Fifth, and Ninth Circuits, the focus is upon the FAA's strong policy of enforcing the right of the parties to define their agreements to arbitrate. For the Seventh, Eighth, and Tenth Circuits, the focus is upon the congressional intent of the FAA, which is to limit the scope of appellate review.

Given the split among the circuits, unless and until the U.S. Supreme Court takes up the issue, the circuit in which a party attempts to enforce an agreement for expanded judicial review will dictate whether the agreement will be enforced. Thus, practitioners representing clients whose arbitration agreements provide for expanded judicial review of arbitration awards and who have an option of where to petition to confirm or vacate an arbitration award should not file the petition before considering the available locations for filing. Indeed, if a basis for federal jurisdiction exists, the FAA allows a party to petition to confirm or vacate an award in any location considered a proper venue—even if the arbitration was conducted elsewhere.[28]

Appellate Review in State Court

Until the California Court of Appeal's decision in *Crowell*, it was unsettled whether California courts would adopt the concept of the right of the parties to contractually agree to expanded judicial review of arbitration awards governed by the FAA or CAA. State courts are called upon to enforce the FAA because the FAA does not create a basis for federal jurisdiction.[29]

Under applicable law, decisions of federal courts of appeals on federal questions are not binding on state courts; they are merely persuasive.[30] Moreover, if the federal appellate courts are divided, "state courts must make an independent determination of federal law."[31] This is true in California even when a Ninth Circuit opinion exists on the very matter at issue.[32]

The Second Appellate District in *Crowell*, and the First Appellate District in *Oakland-Alameda County Coliseum Authority*, interpreted the CAA—and their decisions leave open the question of what California courts will do when asked to enforce an expanded judicial review component of an arbitration agreement governed by the FAA. The uncertainty is compounded by the fact that *Crowell* was a majority decision.

In rejecting expanded judicial review under the CAA, the court in *Crowell* stated: "Because the Legislature clearly set forth the trial court's jurisdiction to review arbitration awards when it specified grounds for vacating or correcting awards in sections 1286.2 and 1286.6, we hold that the parties cannot expand that jurisdiction by contract to include a review on the merits."[33] The *Oakland-Alameda County Coliseum Authority* court expressly adopted this holding.[34]

That conclusion mirrors the Tenth Circuit's decision regarding the FAA. Both rely upon legislative intent to limit the scope of judicial review of arbitration awards. Thus, there is reason to believe that at least the First and Second Appellate Districts would apply that same reasoning for cases governed by the FAA. What other California appellate courts might do is an open question, because the decisions of one district of the court of appeal are not binding on other districts of the court of appeal.[35]

The dissent in *Crowell* mirrored the focus of the Third, Fourth, Fifth, and Ninth Circuits upon the broad policy of enforcing arbitration agreements. Justice Michael G. Nott wrote, "I conclude that the parties entered into an arms-length arbitration agreement to have the trial court act in excess of its statutory authority by reviewing the award for errors of law and sufficiency of the evidence. I perceive no substantial argument that would make it inappropriate for the trial court to act in accord with the wishes of the parties."[36]

Were the issue not confusing enough, the recent decision in *Sanders* v. *Kinko's Inc.*[37] makes it even more so. The *Sanders* court addressed whether the FAA precludes a state court from determining if class certification issues should be resolved before an arbitration agreement covered by the FAA is enforced. In upholding the right of the state court to stay the arbitration pending determination of the class certification issues, the court held that state procedural law applied even though the right to arbitration was governed by the FAA's substantive law.

Moreover, in *Mount Diablo Medical Center Authority* v. *Health Net of California*,[38] the First Appellate District addressed a generic choice-of-law provision that specified California law as governing the validity, construction, interpretation, and enforcement of an agreement containing an arbitration clause that would otherwise be governed by the FAA. The court construed the provision to mean that California procedural law governed the enforcement of the arbitration. Under the CAA the court had the authority to stay the arbitration, whereas no comparable authority exists under the FAA.

If *Sanders* and *Mount Diablo* apply to the right to contract for expanded judicial review under the FAA, enforcement of that right may turn upon whether the party seeking to enforce it in California is confined to the state court, where enforcement is unlikely, or can find an independent basis for federal court jurisdiction, where enforcement is assured.

Sanders and *Mount Diablo* also create the same type of uncertainty if a federal court is asked to enforce an agreement for expanded judicial review of an arbitration award governed by the CAA. That situation could arise when federal jurisdiction is based upon diversity. Since decisions of the Ninth Circuit are binding upon federal district courts in California, even if contrary authority exists in other circuits,[39] a CAA-governed agreement that provides a right for expanded judicial

review deemed to be procedural would be enforceable in federal district court in California—although a California state court would not enforce the agreement.

Apart from the uncertainty as to what California courts will do when called upon to enforce an agreement for expanded judicial review of arbitration awards, *Crowell* also raises the issue of whether agreements to arbitrate that contain provisions for expanded judicial review are even enforceable. Recognizing that for some people and entities a willingness to agree to arbitrate is dependent upon being able to contract for expanded judicial review, the court in *Crowell* refused to sever the expanded judicial review portion of the arbitration agreement and, instead, invalidated the entire arbitration agreement.[40]

The *Oakland-Alameda County Coliseum Authority* court refused to follow the portion of *Crowell*'s holding that voided the entire arbitration agreement. Two primary distinguishing factors referenced by the court were the existence of a severance clause and the fact that the argument to void the arbitration agreement was first made after the arbitration award. In *Crowell*, the agreement at issue contained no severance clause, and the argument to void the arbitration agreement was first raised prior to the arbitration.

As a result of these differences, it may be that arbitration agreements that contain provisions for expanded judicial review of arbitration awards may be valid in the First Appellate District and void in the Second Appellate District. In the remaining appellate districts the issue is still open.

The implications of *Crowell* and *Oakland-Alameda County Coliseum Authority* are significant. For those who now have agreements for arbitration that contain an enhanced judicial review provision, should they still want arbitration even if the enhanced judicial review portion is unenforceable, they should so specify in an amendment to their arbitration agreements before a dispute arises and one side changes its mind about arbitration. It would also be prudent for lawyers aware of a provision for expanded judicial review in an arbitration agreement to advise their clients of the present state of the law on this subject.

In today's commercial world, a system that allows for expanded judicial review of arbitration awards in some parts of the country, including federal courts in California, and prohibits it in other parts of the country, including state courts in California, cannot remain. Apart from being a trap for the unwary and promoting forum shopping, the dichotomy makes no sense. Only the U.S. Supreme Court can now resolve the conflict over whether the FAA allows for agreed-upon provisions for expanded judicial review of arbitration awards. State courts are obligated to follow U.S. Supreme Court opinions interpreting federal law.[41]

As for California law, given the conflicts among the federal circuits and the fact that two California appellate courts have rejected the Ninth Circuit's position—though the dissent in one of the decisions adopted the Ninth Circuit's position—the California Supreme Court should decide whether the CAA allows for expanded judicial review. This decision will be of great importance for California practitioners and persons and entities doing business in the state.

In the final analysis, certainty from both the U.S. Supreme Court and the California Supreme Court is needed so that those with existing arbitration agreements that contain provisions for expanded judicial review can know if their arbitration agreements are even enforceable, let alone if expanded judicial review will be allowed. Also, those who contemplate entering into arbitration agreements should know whether they can contract for expanded judicial review. ■

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[1] Federal Arbitration Act, 9 U.S.C. §§1 *et seq.*

[2] Crowell v. Downey Cmty. Hosp. Found., 95 Cal. App. 4th 730 (2002).

[3] Oakland-Alameda County Coliseum Auth. v. CC Partners, California Court of Appeal No. A094859 (Aug. 27, 2002).

[4] California Arbitration Act, CODE CIV. PROC. §§1280 *et seq.*

[5] Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 219-20, 105 S. Ct. 1238, 1241-42, 84 L. Ed. 2d 158 (1985).

[6] 9 U.S.C. §10(a).

[7] Barbier v. Shearson Lehman Hutton Inc., 948 F. 2d 117, 120 (2d Cir. 1991).

[8] 9 U.S.C. §10(a)(1).

[9] 9 U.S.C. §10(a)(2).

[10] 9 U.S.C. §10(a)(3).

[11] 9 U.S.C. §10(a)(4).

[12] Health Servs. Mgmt. Corp. v. Hughes, 975 F. 2d 1253 (7th Cir. 1992). Though the award in this case, which involved an architect prevailing on a claim for services performed, was not vacated, the court did opine that the concept of "manifest disregard of the law" meant "something beyond and different from mere error in law or failure on the part of the arbitrators to understand or apply the law; it must be demonstrated that the majority of arbitrators deliberately disregarded what they knew to be the law in order to reach the result they did." *Id.* at 1267.

[13] Baravati v. Josephthal, Lyons & Ross Inc., 28 F. 3d 704, 706 (9th Cir. 1994) (citations omitted).

[14] Lapine Tech. Corp. v. Kyocera Corp.,130 F. 3d 884 (9th Cir. 1997), *affirming in part, reversing and remanding in part*, 909 F. Supp. 697 (N.D. Cal. 1995).

[15] *Id.*, 130 F. 3d at 887.

[16] *Id.*

[17] Lapine Tech. Corp. v. Kyocera Corp., 909 F. Supp. 697 (N.D. Cal. 1995).

[18] Lapine, 130 F. 3d at 887-88.

[19] *Id.* at 891.

[20] *Id.* (quoting Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc., 935 F. 2d 1501, 1505 (7th Cir. 1991)).

[21] Syncor Int'l Corp. v. McLeland, 120 F. 3d 262 (4th Cir. 1997), 1997 WL 4532245 (unpublished); Gateway Techs., Inc. v. MCI Telecomms. Corp., 64 F. 3d 995 (5th Cir. 1995).

[22] Roadway Package Sys., Inc. v. Kayser, 257 F. 3d 287, 293 (3d Cir. 2001).

[23] Bowen v. Amoco Pipeline Co., 254 F. 3d 925, 933-37 (10th Cir. 2001).

[24] *Id.* at 933.

[25] *Id.* at 932.

[26] Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc., 935 F. 2d 1501, 1505 (7th Cir. 1991) (emphasis in original).

[27] UHC Mgmt. Co. v. Computer Scis. Corp., 148 F. 3d 992, 997 (8th Cir. 1998).

[28] Cortez Byrd Chips Inc. v. Bill Hebert Constr. Co., 529 U.S. 193, 120 S. Ct. 1331, 146 L. Ed. 2d 171 (2000).

[29] Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 25, n.32, 103 S. Ct. 927, 74 L. Ed. 2d 765 (1983).

[30] Rohr Aircraft Corp. v. County of San Diego, 51 Cal. 2d 759, 764 (1959).

[31] *Id.*

[32] Forsyth v. Jones, 57 Cal. App. 4th 776, 783 (1997) ("Where the federal circuits are in conflict, the decisions of the Ninth Circuit are entitled to no greater weight then those of other circuits.").

[33] Crowell v. Downey Cmty. Hosp. Found., 95 Cal. App. 4th 730, 739 (2002).

[34] Oakland-Alameda County Coliseum Auth. v. CC Partners, California Court of Appeal No. A094859, at 10-12 (Aug. 27, 2002).

[35] Estate of Cleveland, 17 Cal. App. 4th 1700, 1709 (1993); McAdory v. Rogers, 215 Cal. App. 3d 1273, 1277 (1989).

[36] Crowell, 95 Cal. App. 4th at 750.

[37] Sanders v. Kinko's Inc., 99 Cal. App. 4th 1106 (2002).

[38] Mount Diablo Med. Ctr. v. Health Net of Cal., Inc., California Court of Appeal No. A096018 (Aug. 28, 2002).

[39] Zuniga v. United Can Co., 812 F. 2d 443, 450 (9th Cir. 1987).

[40] Crowell, 95 Cal. App. 4th at 739-40.

[41] Forsyth v. Jones, 57 Cal. App. 4th 776, 782 (1997).