Arbitration - USA

Parties may not contractually waive judicial review of arbitral awards

Contributed by **K&L Gates**

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Authors

JP Duffy

Priya Chadha

Introduction

In a recent award enforcement decision,(1) the US Court of Appeals for the Ninth Circuit ruled that parties cannot contractually eliminate judicial review of arbitral awards under the US Federal Arbitration Act. The enforcement decision is significant for international arbitration practitioners because it demonstrates an ongoing judicial trend to apply and interpret the act strictly. It also highlights the need to draft arbitration clauses carefully and to consider legal developments in likely enforcement jurisdictions when doing so.

Facts

The underlying dispute in the enforcement decision concerned lawyers' fees granted in connection with the settlement of a class action lawsuit. The lawyers had previously entered into an agreement which provided that any disputes about the allocation of fees among them would be arbitrated. The arbitration clause stated that:

> *"Class Counsel agree on behalf of themselves, their clients, and all Class Counsel to submit any disputes concerning fees (including, but not limited to, disputes concerning the fee allocation to any Class Counsel as recommended by Co-Lead Counsel, and disputes between Co-Lead Counsel regarding the determination of appropriate fee allocations) to binding, non-appealable arbitration."*(2)

Class counsel could not agree on how to divide the legal fees and submitted the dispute to arbitration. Following the issuance of an award that allocated the fees between the various class counsel members, the class counsel member that received the bulk of the money petitioned a federal district court to confirm the award pursuant to Chapter 1 of the Federal Arbitration Act. In response, the class counsel members who received the second highest amount moved to vacate the award. After considering both applications, the federal district court granted the petition to confirm and denied the motion to vacate.

Decision

The class counsel members who had sought to vacate the award subsequently appealed the trial court decision to confirm the award to the Ninth Circuit. On appeal, the party that had successfully confirmed the award argued that the Ninth Circuit lacked jurisdiction to hear the appeal, because the underlying arbitration clause provided that the arbitration would be both "binding" and "non-appealable". In short, the party that prevailed on the award and at the trial court level argued that the wording "binding, non-appealable arbitration" permitted review of the award at the trial court/confirmation level, but prohibited any appellate review of the trial court's confirmation decision.

The Ninth Circuit rejected that argument in its entirety and ruled that "an arbitration agreement that eliminates all federal court review of arbitration awards, including review under § 10" of the Federal Arbitration Act, is not enforceable. The Ninth Circuit then denied the appeal and upheld the decision to confirm the award.

Ninth Circuit's rationale

The Ninth Circuit first considered the meaning of the phrase "binding, non-appealable arbitration" and recognised that while it could be "understood to preclude only federal

court review of the *merits* of the Arbitrator's decision" at the enforcement stage, it could also be interpreted to divest courts of any right to review awards.(3) The Ninth Circuit therefore concluded that the phrase was ambiguous.(4)

The Ninth Circuit next considered the role that the Federal Arbitration Act plays in confirmation proceedings and the manner in which the Supreme Court construed the act in the landmark *Hall Street Associates* decision, which held that parties may not contractually alter or expand the grounds set forth in Section 10 of the act for reviewing arbitral awards.(5)The Ninth Circuit extrapolated from *Hall Street Associates* that parties may not waive those grounds either.

Lastly, the Ninth Circuit noted that permitting parties to contractually opt out of judicial review of arbitral awards would "frustrate" legislative measures designed to ensure "a minimum level of due process for parties to an arbitration"(6) Consequently, the Ninth Circuit found that the bases set forth in Section 10 of the act for refusing to confirm an award provide a due process floor that parties may not eliminate by agreement.

Comment

The enforcement decision is further evidence of a US judicial trend to enforce the act strictly. It is particularly noteworthy because the Ninth Circuit continues to recognise the 'manifest disregard of the law' doctrine – which is not expressly set forth in the Federal Arbitration Act – as a basis for challenging the confirmation of arbitral awards.(7)

The enforcement decision also demonstrates the need to draft arbitration clauses carefully and to stay abreast of legal developments in likely enforcement jurisdictions, because language that might seem innocuous or even necessary can often have surprising results if not carefully considered. Accordingly, the enforcement decision re-emphasises the importance of approaching experts when drafting arbitration clauses.

For further information on this topic please contact JP Duffy or Priya Chadha at K&L Gates by telephone (+1 212 536 3900), fax (+1 212 536 3901) or email (JP.Duffy@klgates.com or Priya.Chadha@klgates.com). The K&L Gates website can be accessed at www.klgates.com.

Endnotes

(1) *In re Wal-Mart Wage and Hour Employment Practices Litigation*, 11-177718, 2013 US App LEXIS 24948 (9th Cir December 17 2013).

(2) *Id*, at *5.

(3) *Id*, at *8-9. Notably, US courts recognise that Chapter 1 of the Federal Arbitration Act does not permit judicial review of the underlying merits of an arbitral award at the enforcement stage. *See Biller v Toyota Motor Corp*, 668 F3d 655, 666 (9th Cir 2012) (recognising that "the FAA [Federal Arbitration Act] does not authorize a judicial merits review of arbitration awards"); *Rich v Spartis*, 516 F3d 75, 81 (2d Cir 2008) (explaining that "an arbitration award should be enforced, despite a court's disagreement with it on the merits, if there is a barely colorable justification for the outcome reached"); *White Springs Agric Chems, Inc v Glawson Invs Corp*, 660 F3d 1277, 1283 (11th Cir 2011) ("Even though White Springs presents its argument in terms of the FAA [Federal Arbitration Act], it asks us to do what we may not—look to the legal merits of the underlying award"); *Six Flags Over Texas v IBEW, Local 116*, 143 F3d 213, 214 (5th Cir 1998) ("The courts have no authority to reconsider the merits of an award even though the parties may allege that the award rests on errors of fact or on misinterpretation of the contract").

(4) In concluding that the phrase was ambiguous, the Ninth Circuit relied on a decision from the Second Circuit Court of Appeals in New York which found that an arbitration clause which provided that any award "shall not be subject to any type of review or appeal whatsoever" could not prohibit judicial review of an arbitral award. See *Hoeft v MVL Group, Inc,* 343 F3d 57, 63 (2d Cir 2003), overruled on other grounds by *Hall Street Assocs, LLC v Mattel, Inc*, 552 US 576 (2008).

(5) For further information on *Hall Street Associates*, *see* JP Duffy, "*Hall Street: The End of Manifest Disregard Challenges to International Arbitral Awards in the US?*" TDM 1 (2009), www.transnational-dispute-management.com.

(6) *Employment & Labor*, 2013 US App LEXIS 24948, at *13.

(7) For further details on the manifest disregard of the law doctrine, please see "AAA issues optional appellate arbitration rules".

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