

CONTRACTUAL EXPANSION OF THE SCOPE OF  
JUDICIAL REVIEW AFTER *HALL STREET*:  
TIME TO AMEND THE FAA

I. INTRODUCTION

Should parties be allowed to contractually expand the scope of judicial review of arbitral awards? The courts have struggled with this question for years. The Federal Arbitration Act (FAA) provides limited grounds on which a court can vacate an arbitral award.<sup>1</sup> Section Nine of the FAA states that a federal court must confirm certain arbitration awards unless an award is vacated, modified, or corrected as prescribed in Sections Ten and Eleven.<sup>2</sup> Section Ten provides the grounds for vacatur,<sup>3</sup> and Section 11 lists grounds for modifying or correcting an award.<sup>4</sup>

These limited grounds seem clear at first glance. However, for years the U.S. Courts of Appeals could not agree on whether these limited grounds are exclusive, or whether these are

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<sup>1</sup> 9 U.S.C. §§ 9-11 (2008).

<sup>2</sup> *Id.* § 9.

<sup>3</sup> Section 10 provides in relevant part: (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

- (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; or
- (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.

<sup>4</sup> Section 11 provides: In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration—

- (a) Where 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) Where 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.
  - (c) Where the award is imperfect in matter of form not affecting the merits of the controversy.
- The order may modify and correct the award, so as to effect the intent thereof and promote justice between the parties.

merely default provisions that could be displaced by agreement of the parties. Finally, the U.S. Supreme Court stepped in and resolved the split within the circuits. The question is no longer whether parties *can* expand the scope of judicial review by contract, but whether they *should be allowed to*. The forum for the debate is no longer in the courts, but the halls of Congress.

This paper will first provide a summary of the important cases from each circuit interpreting the FAA regarding this issue. This paper will then summarize the Supreme Court's decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.*<sup>5</sup> Tracing the history of these cases will give the reader a sense of the policy considerations at stake in the debate. Finally, this paper will propose an amendment to the FAA which will return the FAA to its original policy of respecting the agreement of the parties and encourage the use of arbitration as a method of dispute resolution.

## II. INTERPRETING THE FAA

### A. *Split Circuits Prior to Hall Street Associates, L.L.C. v. Mattel, Inc.*

Prior to the U.S. Supreme Court's decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, a number of U.S. Circuit Courts of Appeals had addressed the issue of whether the FAA allowed parties to contractually expand the scope of judicial review. Some circuits allowed these contractual provisions and others rejected them.

This section will provide a summary of the important decisions from each circuit in order to provide the backdrop to the U.S. Supreme Court's decision in *Hall Street* and to review the policy arguments surrounding the issue.

#### 1. *Circuits That Allowed Contractual Expansion of the Scope of Judicial Review*

Prior to *Hall Street*, the First, Third, Fourth, Fifth, and Sixth Circuits utilizing different paths determined that parties could contractually expand the scope of judicial review. These

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<sup>5</sup> *Hall Street Associates, L.L.C. v. Mattel, Inc.*, No. 06-989 (U.S. Mar. 25, 2008).

courts typically relied on the contractual nature of arbitration and the national policy favoring enforcement of the parties' agreement. This subsection will summarize each of the major cases as chronologically decided.

a. *Fifth Circuit*

The Fifth Circuit was the first to allow parties to contractually expand the scope of judicial review of an arbitration award. In *Gateway Technologies, Inc. v. MCI Telecommunications Corp.*, MCI won a contract to create a phone system to be used in the Virginia Department of Corrections.<sup>6</sup> MCI subcontracted with Gateway, and they entered into an agreement which provided for binding arbitration as a means of dispute resolution.<sup>7</sup> The arbitration agreement provided that, “the arbitration decision shall be final and binding on both parties, except that errors of law shall be subject to appeal.”<sup>8</sup> A dispute arose between the parties, and an arbitrator ultimately concluded that MCI breached the contract and awarded actual and punitive damages to Gateway.<sup>9</sup>

MCI sought to vacate the award pursuant to the expanded judicial review provision, while at the same time seeking to confirm the arbitrator’s award.<sup>10</sup> The district court refused to apply the de novo standard of review, as the contract implied, and instead reviewed the award under a “harmless error” standard.<sup>11</sup> The district court confirmed the award and MCI appealed

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<sup>6</sup> 64 F.3d 993, 995 (5th Cir. 1995).

<sup>7</sup> *Id.*

<sup>8</sup> *Id.* at 996.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* With regard to the contract impliedly calling for a de novo standard of review, the court stated, “[T]he contract expressly and unambiguously provides for review of “errors of law”; to interpret this phrase short of de novo review would render the language meaningless and would frustrate the mutual intent of the parties.” *Id.* at 997.

to the Fifth Circuit.<sup>12</sup> The Fifth Circuit concluded that the district court erred in failing to review the award for errors of law, and vacated the punitive damages portion of the award.<sup>13</sup>

The Fifth Circuit's decision hinged on the foundational concept that arbitration is a "creature of contract," and cited a number of U.S. Supreme Court cases in support of that proposition.<sup>14</sup> Further, the court concluded that the FAA's limited grounds for vacating an arbitration award were merely "default" rather than "mandatory" provisions, which the parties could contractually supplement.<sup>15</sup> The court also noted that no provision in the FAA specifically prohibited an expanded scope of review.<sup>16</sup> Ultimately the court held, "When, as here, the parties agree contractually to subject an arbitration award to expanded judicial review, federal arbitration policy demands that the court conduct its review according to the terms of the arbitration contract."<sup>17</sup>

Later, in *Hughes Training, Inc. v. Cook*, the Fifth Circuit "expanded its holding in *Gateway* to allow a court to review an arbitrator's factual findings, if the parties so specify."<sup>18</sup>

#### b. *Fourth Circuit*

In *Syncor Int'l Corp. v. McLeland*, the parties entered into an arbitration agreement, as well as a number of employment and secrecy agreements.<sup>19</sup> When McLeland, after his

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<sup>12</sup> *Id.* at 996.

<sup>13</sup> *Id.* at 995, 997.

<sup>14</sup> *Id.* at 996 (citing *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995) (quoting *Volt Information Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989)) (indicating the FAA's purpose is to ensure that private agreements to arbitrate are enforced according to their terms); *Vimar Seguros y Reaseguros, S.A., v. M/V Sky Reefer*, 515 U.S. 528 (1995); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987).

<sup>15</sup> *Id.* at 997 ("Because these parties contractually agreed to expand judicial review, their contractual provision supplements the FAA's default standard of review and allows for de novo review of issues of law embodied in the arbitration award.").

<sup>16</sup> *Id.* at note 3.

<sup>17</sup> *Id.* at 997.

<sup>18</sup> Mark R. Trachtenberg and Christina F. Crozier, *Risky Business: Altering the Scope of Judicial Review of Arbitration Awards by Contract*, 69 TEX. B. J. 868, 868 (2006) (citing *Hughes Training, Inc. v. Cook*, 254 F.3d 588, 590 (5th Cir. 2001).

<sup>19</sup> 1997 WL 452245 at \*1-2 (4th Cir. 1997).

employment with Syncor was terminated, allegedly violated the employment and secrecy agreements, Syncor demanded arbitration.<sup>20</sup> In an *ex parte* arbitration proceeding, the arbitrator found McLeland had violated the employment and secrecy agreements, and the district court enforced the award.<sup>21</sup>

On appeal, McLeland claimed among other things, that the district court erred in failing to apply the heightened review mandated by the parties' agreement, which stated that "[t]he arbitrator shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected by judicial review for any such error."<sup>22</sup> The Fourth Circuit pointed to the Fifth Circuit's reasoning in *Gateway* and concluded that the district court erred in failing to apply a de novo standard of review to the arbitrator's legal conclusions, pursuant to the contractual agreement of the parties.<sup>23</sup> The court applied its own de novo review of the arbitrator's award and concluded that it was correct.<sup>24</sup>

*c. Third Circuit*

In *Roadway Package System, Inc. v. Kayser*, the parties entered into an agreement whereby Kayser served as an "independent linehaul contractor" in furtherance of the business operations of Roadway Package System (RPS).<sup>25</sup> Their agreement included a clause granting Kayser the right to demand arbitration if he was terminated by the company.<sup>26</sup> After his termination, he sought arbitration and received a damage award.<sup>27</sup> RPS sought to vacate the

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<sup>20</sup> *Id.* at \*2.

<sup>21</sup> *Id.* at \*3.

<sup>22</sup> *Id.* at \*6.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at \*7.

<sup>25</sup> 257 F.3d 287, 288 (3d Cir. 2001).

<sup>26</sup> *Id.* at 289.

<sup>27</sup> *Id.* at 290.

award and the district court obliged, applying the standards provided in the FAA to conclude that the arbitrator exceeded the scope of his authority.<sup>28</sup>

Unlike the cases described above, the arbitration agreement at issue in *Kayser* did not include a specific provision expanding the scope of judicial review.<sup>29</sup> Instead, the agreement contained a choice-of-law provision indicating that the agreement would be governed by Pennsylvania law.<sup>30</sup> *Kayser* argued that this provision meant that the vacatur standards that should have been applied were not those laid out in the FAA, but instead those found in the Pennsylvania Uniform Arbitration Act.<sup>31</sup> The court then examined whether the parties could agree to “opt out” of the “default” standards for vacatur provided in the FAA.<sup>32</sup> Like other courts in the cases described above, the Third Circuit pointed to the contractual nature of arbitration<sup>33</sup> to “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).”<sup>34</sup> Although the court held that the parties could legally provide for different standards of review, the court decided that the parties had not clearly done so in this case.<sup>35</sup> Therefore, the Third Circuit affirmed the district court’s application of the FAA standards and ultimate vacation of the arbitrator’s award.<sup>36</sup>

#### d. *Sixth Circuit*

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<sup>28</sup> *Id.* at 288.

<sup>29</sup> See *Gateway Tech. Inc. v. MCI Telecommunications Corp.*, 64 F.3d 993, 996 (5th Cir. 1995); *Syncor*, 1997 WL 452245 at \*6.

<sup>30</sup> *Kayser*, 257 F.3d at 290.

<sup>31</sup> *Id.* at 291.

<sup>32</sup> *Id.* at 288, 291-93.

<sup>33</sup> *Id.* at 292 (citing *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 220 (1985) (stating that the FAA “was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered”); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995) (stating that the FAA embraces a “proarbitration policy” but “does not operate without regard to the wishes of the contracting parties.”)).

<sup>34</sup> *Id.* at 293.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.* at 300.

The Sixth Circuit faced a question similar to that in *Kayser* when it decided *Jacada (Europe), Ltd. v. International Marketing Strategies, Inc.*<sup>37</sup> In that case, the parties entered into an agreement to distribute software overseas.<sup>38</sup> The agreement included an arbitration clause, as well as a choice-of-law provision which provided that the agreement was to be governed by the laws of Michigan.<sup>39</sup> Once again, this agreement did not contain a provision explicitly providing for expanded judicial review of the arbitrator’s award. When a dispute arose, arbitration commenced, and the arbitrators ultimately awarded damages to International Marketing Strategies (IMS).<sup>40</sup> *Jacada* sought to vacate the award, which the district court, applying the FAA standards, refused to do.<sup>41</sup> In deciding “whether the parties intended to opt out of the FAA’s standard for vacatur in favor of Michigan’s more thorough standard of review,” the court cited *Mastrobuono v. Shearson Lehman Hutton, Inc.*, in assuming the parties could in fact do so.<sup>42</sup> Ultimately, the court concluded the parties did not intend to opt out of the FAA standards and upheld the district court’s decision.<sup>43</sup>

e. *First Circuit*

In *Puerto Rico Telephone Co., Inc. v. U.S. Phone Mfg. Corp.*, the parties entered into a contract which contained an arbitration agreement.<sup>44</sup> The contract also contained a choice-of-law provision which stated that the laws of Puerto Rico would govern the contract.<sup>45</sup>

Additionally, the arbitration clause contained a provision which stated: “The [arbitration] panel

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<sup>37</sup> 401 F.3d 701 (6th Cir. 2005).

<sup>38</sup> *Id.* at 703.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* at 703-04.

<sup>41</sup> *Id.* at 704.

<sup>42</sup> *Id.* at 709-10 (*citing* *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53 (1995) (stating “the central purpose of the FAA is to ensure that private agreements to arbitrate are enforced according to their terms)).

<sup>43</sup> *Id.* at 712.

<sup>44</sup> 427 F.3d 21, 23 (1st Cir. 2005).

<sup>45</sup> *Id.*

shall meet in Puerto Rico and apply the law of the Commonwealth of Puerto Rico.”<sup>46</sup> Numerous disputes arose between the parties, and ten years after the initial request for arbitration, a panel of arbitrators awarded significant damages to U.S. Phone.<sup>47</sup> Puerto Rico Telephone Company (PRTC) filed an action to vacate the award, arguing that the contract provided for expanded judicial review of the award.<sup>48</sup> The district court held that the FAA provided the exclusive standards for vacating an arbitration award.<sup>49</sup> The court applied the FAA's standards of review and upheld the arbitrators' award.<sup>50</sup>

On appeal, the First Circuit pointed to the contractual nature of arbitration and the purposes behind the FAA to conclude that parties could expand the scope of judicial review if they clearly expressed that intention.<sup>51</sup> Like the courts in *Kayser* and *Jacada*, the First Circuit concluded that a choice-of-law provision alone was not enough to indicate a clear intent to displace the FAA's standards of review.<sup>52</sup> The court also rejected PRTC's arguments that other provisions of the contract clearly evidenced an intent to subject the arbitrators' decision to more exacting review under Puerto Rican law.<sup>53</sup> In sum, the court concluded that although parties could contract to expand the scope of judicial review, the parties had not clearly done so in this case.<sup>54</sup>

## 2. Circuits That Rejected Contractual Expansion of the Scope of Judicial Review

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<sup>46</sup> *Id.*

<sup>47</sup> *Id.* at 24.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

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

<sup>51</sup> *Id.* at 31.

<sup>52</sup> *Id.* at 29. *See Jacada (Europe), Ltd. v. Int'l Marketing Strategies, Inc.*, 401 F.3d 701, 712 (6th Cir. 2005); *Roadway Package System, Inc. v. Kayser*, 257 F.3d 287, 293 (3d Cir. 2001).

<sup>53</sup> *Id.* at 30-31. PRTC asserted that “Under Puerto Rican law, if the parties’ arbitration agreement specifies that the award should be ‘conformable to law,’ then the award will be reviewed for legal error.” *Id.* at 30 (*citing Union de la Industria Licorera de Ponce v. Destileria Serralles Inc.*, 116 P.R. Offic. Trans. 426, 432 (P.R. 1985)). The court rejected PRTC’s argument that their contractual provision, which stated that the contract would be governed “in accordance with the laws of the Commonwealth of Puerto Rico,” was enough to establish an intent to displace the FAA’s standards of review – even if such language meant what they claimed it did. *Id.* at 31.

<sup>54</sup> *Id.* at 31.

Prior to the *Hall Street* decision, the Seventh, Eighth, Ninth, and Tenth Circuits held that parties could not contractually expand the scope of judicial review. These courts typically relied on the nature of arbitration as an efficient method of dispute resolution supported by the general pro-arbitration policy of the FAA. These courts were also reluctant to allow parties to contractually create federal jurisdiction. This subsection will summarize each of the major cases in the order in which they were decided.

a. *Seventh Circuit*

Although contractual expansion of judicial review was not directly at issue in the case, the Seventh Circuit in *Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc.* indicated that such expansion would not be allowed.<sup>55</sup> The case involved a dispute between composing room employees and a newspaper publisher.<sup>56</sup> In his decision, Judge Richard Posner indicated the Seventh Circuit's hostility to contractual expansion of the scope of judicial review:

Federal courts do not review the soundness of arbitration awards...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. Unless the award was procured by fraud, or the arbitrator had a serious conflict of interest – circumstances that invalidate the contractual commitment to abide by the arbitrator's result – his interpretation of the contract binds the court asked to enforce the award or set it aside. The court is forbidden to substitute its own interpretation even if convinced that the arbitrator's interpretation was not only wrong, but plainly wrong.<sup>57</sup>

Although often described as mere dicta,<sup>58</sup> Judge Posner's words nonetheless clearly set forth the Seventh Circuit's position on the issue. In several decisions after this case, the Seventh Circuit continued to espouse this position.<sup>59</sup>

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<sup>55</sup> 935 F.2d 1501, 1505 (7th Cir. 1991).

<sup>56</sup> *Id.* at 1503.

<sup>57</sup> *Id.* at 1505.

<sup>58</sup> See, e.g., Thomas S. Meriwether, Comment, *Limiting Judicial Review of Arbitral Awards under the Federal Arbitration Act: Striking the Right Balance*, 44 HOUS. L. REV. 739, 754 (2007); Steven J. Ware, "Opt-In" for

### b. Eighth Circuit

In *UHC Management Co. v. Computer Sciences Corp.*, the Eighth Circuit did not decide whether it would allow contractual expansion of the scope of judicial review, but indicated its reluctance to do so.<sup>60</sup> In that case, UHC Management Company (UHC) entered into a subcontract with Computer Sciences, and their agreement included an arbitration provision.<sup>61</sup> After an arbitration, UHC sought to vacate the award, arguing that the parties contracted for a heightened form of judicial scrutiny which required a de novo review of the award.<sup>62</sup> The court, though refusing to decide the issue, indicated it was hostile to contractual expansion of the scope of review.<sup>63</sup> The court examined the language of Sections Nine, Ten, and Eleven of the FAA and concluded that “Congress did not authorize de novo review of such an award on its merits; it commanded that when the exceptions do not apply, a federal court has no choice but to confirm.”<sup>64</sup> In confirming the arbitral award,<sup>65</sup> the Eighth Circuit assumed contractual expansion was allowable if the parties clearly expressed such an intent, and concluded that the parties had not clearly intended to supplant the FAA’s limited scope of review.<sup>66</sup> The court affirmed the arbitral award.<sup>67</sup>

### c. Tenth Circuit

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*Judicial Review of Errors of Law under the Revised Uniform Arbitration Act*, 8 AM. REV. INT’L ARB. 263, 265-66 (1997).

<sup>59</sup> See, e.g., *Prostyakov v. Masco Corp.*, 513 F.3d 716, 723 (7th Cir. 2008) (“We repeatedly have stated that we do – and will not – review arbitral awards for legal or factual error.”) (*citing* *Wise v. Wachovia Sec., L.L.C.*, 450 F.3d 265, 269 (7th Cir. 2006); *George Watts & Sons, Inc., v. Tiffany & Co.*, 248 F.3d 577, 579 (7th Cir. 2001)); *but see* *Edstrom Industries, Inc. v. Companion Life Insurance Company*, 516 F.3d 546, 549-50 (7th Cir. 2008) (holding that the parties could opt-out of the FAA through a choice of law provision, which Judge Posner described as a different question than opting-out by altering the standard of review).

<sup>60</sup> 148 F.3d 992, 998 (8th Cir. 1998).

<sup>61</sup> *Id.* at 994.

<sup>62</sup> *Id.* at 997.

<sup>63</sup> *Id.* at 998.

<sup>64</sup> *Id.* at 997.

<sup>65</sup> *Id.* at 999.

<sup>66</sup> *Id.* at 998.

<sup>67</sup> *Id.* at 999.

Ernest Bowen noticed an oily sheen on a creek that ran through his property, which ultimately led him and his wife to sue Amoco in federal court.<sup>68</sup> However, the predecessors in interest of both parties in 1918 had signed an agreement which contained an arbitration clause, so the dispute was forced into arbitration.<sup>69</sup> Before arbitrating the dispute, the parties agreed upon the rules that would govern, and also “agreed to modify these rules to expand the scope of judicial review. Specifically, the parties agreed that both would have the right to appeal any arbitration award to the district court within thirty days ‘on the grounds that the award is not supported by the evidence.’”<sup>70</sup> After the arbitration panel awarded damages to the Bowens, Amoco sought review of the award under the heightened standard provided in the agreement.<sup>71</sup> The district court, in confirming the award, applied only the standards of review provided in the FAA.<sup>72</sup>

The Tenth Circuit upheld the district court’s confirmation of the award, holding that parties cannot “alter the judicial process by private contract.”<sup>73</sup> Though the court acknowledged the contractual nature of arbitration, it concluded that the standard of review provided in the FAA was exclusive: “Through the FAA, Congress has provided explicit guidance regarding judicial standards of review of arbitration awards...[T]he FAA is more than a collection of default rules, which parties may alter with complete discretion.”<sup>74</sup> Further, the court stated that allowing contractual expansion would undermine the policies behind the FAA, such as the independence and finality of the arbitration process.<sup>75</sup> The court explained, “Moreover, expanded judicial review places federal courts in the awkward position of reviewing proceedings

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<sup>68</sup> Bowen v. Amoco Pipeline Co., 254 F.3d 925, 927-28 (10th Cir. 2001).

<sup>69</sup> *Id.* at 928.

<sup>70</sup> *Id.* at 930.

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Id.* at 933.

<sup>74</sup> *Id.* at 934-35.

<sup>75</sup> *Id.* at 935.

conducted under potentially unfamiliar rules and procedures.”<sup>76</sup> Ultimately, the court explicitly held “that parties may not contract for expanded judicial review of arbitration awards.”<sup>77</sup>

d. *Ninth Circuit*

Perhaps the circuit that struggled the most over the issue of contractual expansion was the Ninth Circuit, which managed to find itself on both sides of the issue in the same case!<sup>78</sup> An agreement among Kyocera Corporation, Prudential-Bache Trade Corporation, and LaPine Technology Corporation went bad, and the dispute went to arbitration.<sup>79</sup> The arbitration agreement contained a clause providing for expanded judicial review.<sup>80</sup> The arbitrators awarded over \$243 million in damages to LaPine and Prudential, which prompted Kyocera to seek judicial review of the award.<sup>81</sup> The district court refused to apply the heightened review, and confirmed the award after reviewing the award under the standards contained in Sections Ten and Eleven of the FAA.<sup>82</sup> A Ninth Circuit panel reversed the district court’s conclusion, holding that parties could contractually expand the scope of judicial review.<sup>83</sup> The panel remanded the case to the district court to apply the heightened standard of review.<sup>84</sup>

On remand, the district court vacated one of the findings of fact because it was not supported by substantial evidence, and remanded the case to the arbitrators to consider the effect of vacating that finding on its ultimate damage award.<sup>85</sup> The arbitrators concluded the fact had no effect on the damages award, and the district court ultimately confirmed the arbitrators’ award

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<sup>76</sup> *Id.*

<sup>77</sup> *Id.* at 937.

<sup>78</sup> *See generally* Kyocera Corp. v. Prudential-Bache Trade Services, Inc., 341 F.3d 987 (9th Cir. 2003).

<sup>79</sup> *Id.* at 989-90.

<sup>80</sup> *Id.* at 990-91. The agreement for expanded review stated: “The Court shall vacate, modify or correct any award: (i) based upon any of the grounds referred to in the Federal Arbitration Act, (ii) where the arbitrators’ findings of fact are not supported by substantial evidence, or (iii) where the arbitrators’ conclusions of law are erroneous.”

<sup>81</sup> *Id.* at 990.

<sup>82</sup> *Id.* at 991.

<sup>83</sup> *Id.*

<sup>84</sup> *Id.* at 992.

<sup>85</sup> *Id.* at 993.

after applying the heightened standard of review.<sup>86</sup> The district court’s confirmation of the award was affirmed by a three-judge panel of the Ninth Circuit.<sup>87</sup>

The case was reheard by the Ninth Circuit sitting *en banc*, and the court ultimately held that “private parties may not contractually impose their own standard on the courts.”<sup>88</sup> The court concluded that the limited grounds for vacatur provided in the FAA were exclusive “[b]ecause the Constitution reserves to Congress the power to determine the standards by which federal courts render decisions, and because Congress has specified the exclusive standard by which federal courts may review an arbitrator’s decision.”<sup>89</sup> While the court recognized arbitration’s contractual nature, it stated: “Once a case reaches the federal courts...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.”<sup>90</sup> The court also expressed concern that contractual expansion would undermine the policies behind the FAA by “compromis[ing] the simplicity that purportedly makes arbitration attractive.”<sup>91</sup> Ultimately, the Ninth Circuit upheld the original decision of the district court, which decided that the FAA’s grounds for vacatur provided the exclusive standard of review.<sup>92</sup>

#### B. *The Reasoning of Hall Street Associates, L.L.C. v. Mattel, Inc.*

It is clear that the circuits were hopelessly split on the issue of whether judicial review of arbitral awards could be contractually expanded. The various decisions were irreconcilable. Did the FAA merely provide a default standard of review, which could be supplanted by contract (thereby promoting the FAA’s perceived underlying policy of honoring the agreement of the

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<sup>86</sup> *Id.*

<sup>87</sup> *Id.* (citing *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 229 F.3d 769 (9th Cir. 2002)).

<sup>88</sup> *Id.* at 994.

<sup>89</sup> *Id.*

<sup>90</sup> *Id.* at 1000.

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

parties)? Or did the FAA provide an exclusive standard of review, meaning parties could not “create federal jurisdiction by contract” (thereby promoting the FAA’s perceived underlying policy of promoting arbitration as a simple and efficient mode of dispute resolution)? The Supreme Court provided its answer in *Hall Street*.

The case arose out of a lease dispute between Hall Street Associates and Mattel.<sup>93</sup> After attempting to mediate the dispute, without success, the parties proposed to go to arbitration.<sup>94</sup> The arbitration agreement contained a clause expanding the scope of judicial review, which stated: “The Court shall vacate, modify, or correct any award: (i) where the arbitrator’s findings of facts are not supported by substantial evidence, or (ii) where the arbitrator’s conclusions of law are erroneous.”<sup>95</sup> After the arbitrator decided for Mattel, Hall Street sought to have the award vacated on the basis of legal error.<sup>96</sup> The district court relied on the original Ninth Circuit panel’s ruling that judicial review could be contractually expanded, and vacated the award based on legal error.<sup>97</sup>

The case was remanded to the arbitrator, who entered judgment in favor of Hall Street.<sup>98</sup> On review, the district court again applied the heightened standard of review and this time upheld the award.<sup>99</sup> By the time this decision was appealed to the Ninth Circuit, the circuit had issued its *en banc* ruling against contractual expansion of judicial review.<sup>100</sup> Applying that rule, the Ninth Circuit remanded the case to the district court to review the original award under only

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<sup>93</sup> Hall Street Associates, L.L.C. v. Mattel, Inc., No. 06-989, slip op. at 1 (U.S. Mar. 25, 2008).

<sup>94</sup> *Id.* at 2.

<sup>95</sup> *Id.*

<sup>96</sup> *Id.* at 2-3.

<sup>97</sup> *Id.* at 3 (citing *LaPine Technology Corp. v. Kyocera Corp.*, 130 F.3d 884, 889 (9th Cir. 1997)).

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

the standard provided in the FAA.<sup>101</sup> Applying the FAA, the district court again vacated the award, and the Ninth Circuit again reversed.<sup>102</sup>

The Supreme Court’s decision turned largely on the words of the FAA: “Under the terms of §9, a court ‘must’ confirm an arbitration award ‘unless’ it is vacated, modified, or corrected ‘as prescribed’ in §§10 and 11. Section 10 lists grounds for vacating an award, while §11 names those for modifying or correcting one.”<sup>103</sup> This language led the Court to conclude that the standard of review provided in the FAA is exclusive, and cannot be contractually modified.<sup>104</sup> The Court also concluded that the language used by Congress was incompatible with labeling the FAA’s provisions as “default.”<sup>105</sup>

Additionally, the Court recognized that arbitration is a “creature of contract” and conceded that the FAA allows parties to “tailor some, even many features of arbitration by contract.”<sup>106</sup> The Court, however, refused to allow the general policy favoring the enforcement of the parties’ agreement to override the specific language of the FAA.<sup>107</sup> The Court found that the language chosen by Congress evidenced a “national policy favoring arbitration with just the limited review needed to maintain arbitration’s essential virtue of resolving disputes straightaway.”<sup>108</sup> The case was ultimately remanded for further proceedings.<sup>109</sup>

### III. TIME TO AMEND THE FAA

The Supreme Court resolved the circuit split on contractual expansion of judicial review – and it is difficult to argue with the court’s reasoning. Whatever competing policy interests the

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<sup>101</sup> *Id.* at 3-4.

<sup>102</sup> *Id.* at 4.

<sup>103</sup> *Id.* at 5.

<sup>104</sup> *Id.* at 7.

<sup>105</sup> *Id.* at 10-11.

<sup>106</sup> *Id.* at 8-9.

<sup>107</sup> *Id.* at 9-10.

<sup>108</sup> *Id.* at 11.

<sup>109</sup> *Id.* at 15.

FAA embodies, the language Congress chose to use in Section Nine clearly limits judicial review of arbitration awards. Now that the Supreme Court has determined the meaning of the words used in the FAA, it is time to revisit the policies behind the FAA and consider whether those words should be changed. This section will propose an amendment to the FAA that would allow the parties to contractually expand judicial review of arbitration awards. Such an amendment would promote the most important policy behind the FAA – respecting the agreement of the parties – and would encourage the use of arbitration as a method of dispute resolution.

#### *A. The Proposed Amendment*

After *Hall Street*, federal jurisdiction cannot be “created by contract” – but it can be created by Congress. In light of the Supreme Court’s decision, in order to allow parties to prescribe the amount of review appropriate in their particular circumstance, Section Nine of the FAA must be amended. After amendment, Section Nine should read:<sup>110</sup>

#### **§ 9. Award of arbitrators; confirmation; jurisdiction; procedure**

If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title, or as prescribed by the agreement of the parties if the parties have agreed to more expansive review than is provided in sections 10 and 11 of this title. If no court is specified in the agreement of the parties, then such application may be made to the United States court in and for the district within which such award was made. Notice of the application shall be served upon the adverse party, and thereupon the court shall have jurisdiction of such party as though he had appeared generally in the proceeding. If the adverse party is a resident of the district within which the award was made, such service shall be made upon the adverse party or his attorney as prescribed by law for service of notice of motion in an action in the same court. If the adverse party shall be a nonresident, then the notice of the application shall be served by the marshal of any district within which the adverse party may be found in like manner as other process of the court.

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<sup>110</sup> Language added by the amendment is underlined.

Though rather simple, this amendment would represent a return to the original purposes of the FAA and promote the use of arbitration.

### *B. Why Congress Should Pass This Amendment*

Congress should pass the amendment proposed in this paper because it would represent a return to the original purposes behind the FAA – respecting the parties’ bargain. Further, this amendment would encourage arbitration and provide protection to the parties involved.

#### *1. A Return to the Original Policies of the FAA*

Perhaps the most important policy motivation behind the FAA was a Congressional desire to respect the agreement of the parties. This policy is embodied in Section Two of the FAA, which states that certain agreements to arbitrate “shall be valid, irrevocable, and enforceable.”<sup>111</sup> The United States Supreme Court, in a number of instances, recognized that respecting the bargain agreed to by the parties motivated the passage of the FAA.<sup>112</sup> The Court stated in *Dean Witter Reynolds, Inc. v. Byrd* that the legislative history of the act “makes clear that its purpose was to place an arbitration agreement upon the same footing as other contracts, where it belongs, and to overrule the judiciary’s longstanding refusal to enforce agreements to arbitrate.”<sup>113</sup> The Court further stated that “the FAA’s purpose [is] ensuring that private agreements to arbitrate are enforced according to their terms.”<sup>114</sup> Further, in *First Options of Chicago v. Kaplan*, the Court observed that “the basic objective in this area is not to resolve

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<sup>111</sup> 9 U.S.C. § 2 (2008).

<sup>112</sup> Cynthia A. Murray, Note, *Contractual Expansion of the Scope of Judicial Review of Arbitration Awards under the Federal Arbitration Act*, 76 ST. JOHN’S L. REV. 633, 655 (2002) (citing, e.g., *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 270-71 (1995) (stating that Congress sought to address the judiciary’s refusal to enforce parties’ agreements to arbitrate)).

<sup>113</sup> 470 U.S. 213, 219-20 (1985).

<sup>114</sup> *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995) (quoting *Volt Information Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989)).

disputes in the quickest manner possible, no matter what the parties' wishes, but to ensure that commercial arbitration agreements, like other contracts are enforced according to their terms."<sup>115</sup>

In recognizing a desire to enforce the parties' agreements, the Court has repeatedly stated that "arbitration is a creature of contract."<sup>116</sup> As such, we allow parties to decide for themselves how a number of features of arbitration will operate in the parties' specific situation.<sup>117</sup> For example, parties may decide: what issues to arbitrate and who decides arbitrability,<sup>118</sup> the types of damages that will be available,<sup>119</sup> the rules which will govern the arbitration,<sup>120</sup> whether the arbitrator must provide a reasoned opinion,<sup>121</sup> "the way arbitrator's are chosen, what their qualifications should be,...and [the] choice of substantive law."<sup>122</sup>

As described above, it is clear that Congress was motivated by a desire to enforce parties' bargains, and Congress expressed this desire by allowing parties to determine a number of issues related to their arbitration. As the *Hall Street* decision revealed, Congress imperfectly implemented the purposes behind the FAA through the language it chose to use in Section Nine. This imperfection can be corrected. Adopting the amendment proposed in this paper would return us to the policies that were originally behind the FAA. As explained more fully below, allowing parties to contractually expand the scope of judicial review would encourage arbitration as a method of dispute resolution.

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<sup>115</sup> *First Options of Chicago v. Kaplan*, 514 U.S. 938, 947 (1995).

<sup>116</sup> Meriwether, Comment, *supra* note 59, at 740 (*quoting* *United Steelworkers of Am. V. Am. Mfg. Co.*, 363 U.S. 564, 570 (1964) (Brennan, J., concurring)); *see also* *Hall Street Associates, L.L.C. v. Mattel, Inc.*, No. 06-989, slip op. at 8 (U.S. Mar. 25, 2008).

<sup>117</sup> Murray, *supra* note 111, at 646-47.

<sup>118</sup> *See First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 945 (1995) ("[A] party can be forced to arbitrate only those issues it specifically has agreed to submit to arbitration"); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985) (certain claims may be excluded from the scope of an arbitration agreement).

<sup>119</sup> *See Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 58 (1995).

<sup>120</sup> *See Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior University*, 489 U.S. 468, 478-79 (1989).

<sup>121</sup> Murray, *supra* note 111, at 647.

<sup>122</sup> *Hall Street Associates, L.L.C. v. Mattel, Inc.*, No. 06-989, slip op. at 9 (U.S. Mar. 25, 2008).

## 2. Adopting This Amendment Will Encourage the Use of Arbitration

Arbitration would become much more attractive to parties if they had the ability to tailor it in such a manner so as to create a “perfect forum.”<sup>123</sup> Parties may be more willing to submit disputes to arbitration if, at the outset, they were able to balance the risks of arbitration (such as an erroneous decision) against the benefits (such as efficiency of dispute resolution) in a manner that fit their particular circumstances. While such a policy may result in more appellate review of arbitral awards, it may nonetheless result in less overall litigation, and less costly litigation.<sup>124</sup>

Just because expanded review is available does not mean that all parties will take advantage of it. For example, if the contract is “run-of-the-mill,” the parties may determine that the benefits of speed and finality are more important than the risk of an erroneous decision and thus decline to expand the scope of judicial review.<sup>125</sup> On the other hand, if the dispute or potential dispute is complex with large dollar amounts at stake, parties may conclude that speed and finality are less important than reaching the correct conclusion, and can thereby “justify the added procedure.”<sup>126</sup> The point is that arbitration is a much more attractive option to parties if they are given the opportunity to conduct this calculus.

Allowing parties to decide whether to allow for expanded review will not necessarily lead to a significant sacrifice in efficiency<sup>127</sup> or “clog the courts” with endless appeals.<sup>128</sup> First, as discussed above, many parties may decide to stick with the limited review provided in the FAA based on their own calculus in their own circumstances. Second, parties who otherwise may

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<sup>123</sup> See Di Jiang-Schuerger, Note, *Perfect Arbitration = Arbitration Litigation?* 4 HARV. NEGOTIATION L. REV. 231, 246 (1999).

<sup>124</sup> *Id.* at 247, 251.

<sup>125</sup> See Ware, *supra* note 58, at 272.

<sup>126</sup> *Id.*

<sup>127</sup> By “efficiency,” the author refers to the perceived benefits of arbitration, such as speed, lower costs, and finality of the decision.

<sup>128</sup> See Stephen P. Younger, *Agreements to Expand the Scope of Judicial Review of Arbitration Awards*, 63 ALB. L. REV. 241, 261 (1999).

avoid arbitration may choose it if they had the ability to tailor it to their specific situation by providing for expanded review.<sup>129</sup> Third, even if arbitration with expanded judicial review is in many ways less efficient than “regular” arbitration, it is quite probable that it is far more efficient than litigation would be.<sup>130</sup> In sum, allowing the parties to make their own decision about expanding judicial review does not mean all parties will so expand, and will encourage some parties to arbitrate who otherwise would not. Any efficiency in the system that is lost by allowing expanded review could be offset by the efficiency gained by the parties who choose arbitration over litigation.

### 3. *Protection of the Parties*

Allowing contractual *expansion* of judicial review begs the question: why not allow contractual *limitation* of judicial review?<sup>131</sup> The logic is the same in terms of allowing the parties to agree to what is best in their own circumstances. However, allowing for contractual limitation of judicial review would be a potentially dangerous step for consumers. Arbitration is used not only by sophisticated businesses, but has also expanded into many other areas<sup>132</sup> – such as credit card and cellular phone agreements. The fact is that most of these contracts contain arbitration agreements which are adhesive in nature. It does not take much imagination to foresee a circumstance where a company includes an arbitration agreement in its adhesive contract that completely forecloses *any* judicial review of an arbitral award – putting the consumer at greater risk of abuse. Because of the risks posed to consumers in such situations, the amendment proposed in this paper provides only for contractual *expansion* of the scope of judicial review.

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<sup>129</sup> See Jiang-Schuerger, *supra* note 122, at 251.

<sup>130</sup> See *id.* at 247.

<sup>131</sup> See generally Meriwether, *supra* note 58.

<sup>132</sup> Younger, *supra* note 127, at 241.

#### IV. CONCLUSION

In conclusion, Congress should adopt the amendment to the FAA that is proposed in this paper. Adopting such an amendment will return the FAA to its original policy of respecting the agreement of the parties. Further, allowing contractual expansion of the scope of judicial review would encourage the use of arbitration in dispute resolution, and would not necessarily result in a more inefficient judicial system.