



Risky Business: Altering the Scope of Judicial Review of Arbitration Awards by Contract

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Your client is frustrated that her company, hit with several adverse arbitration decisions contradicting well-settled law, has no meaningful opportunity to challenge the decisions in court. Another client, with a favorable arbitration award in hand, is upset because the savings his company hoped to achieve through arbitration vanished when the other side challenged the award in court.

These frustrations highlight arbitration's apparent "fall from grace."¹ This article addresses the extent to which parties can deal with these countervailing concerns by either expanding or restricting the scope of judicial review of arbitration awards by contract.

Default Scope of Judicial Review

Judicial review of an arbitration award is "extremely narrow" and focuses on the integrity of the arbitration process, rather than the propriety of the result.² Every reasonable presumption must be indulged in favor of the arbitrators' decision, and none is indulged against it.³ However, this onerous standard has not discouraged many losing parties from challenging arbitration awards in courts. Indeed, the Eleventh Circuit recently warned that "[i]f we permit parties who lose in arbitration to freely relitigate their cases in court, arbitration will do nothing to reduce congestion in the judicial system; dispute resolution will be slower instead of faster; and reaching a final decision will cost more instead of less."⁴ The onerous standard of review on one hand, and the litigiousness of losing parties on the other, have prompted many parties to consider modifying the scope of judicial review by contract. However, this option is not without risk.

Expanding the Scope of Judicial Review

Both the Fifth Circuit and one Texas court of appeals have held that parties to an arbitration agreement can contract for an expanded scope of appellate review, as long as the parties clearly and unmistakably express their intent in the contract.⁵

In the pivotal case of *Gateway Technologies, Inc. v. MCI Telecommunications Corp.*, the Fifth Circuit enforced an arbi-

tration clause providing that the "arbitration decision shall be final and binding on both parties, except that errors of law shall be subject to appeal."⁶ The court concluded that the provision permitted "de novo review of issues of law embodied in the arbitration award" and, under this lenient standard of review, vacated the arbitrator's award of punitive damages against MCI.⁷

In a subsequent case, the Fifth Circuit construed a similar provision — permitting appeals of "errors of law" — to apply only to pure legal questions.⁸ It refused to apply this provision to mixed questions of law and fact, like the evidentiary sufficiency challenges urged by the appellants.⁹ The court reasoned that, absent a definition of the phrase "errors of law" in the arbitration agreement, the phrase should be read narrowly, because a broader reading would have encompassed all of the arbitrator's findings.¹⁰

The Fifth Circuit later expanded its holding in *Gateway* to allow a court to review an arbitrator's factual findings, if the parties so specify. In *Hughes Training, Inc. v. Cook*, the court enforced an arbitration clause that permitted review of an arbitrator's findings of fact and conclusions of law under the same standard that an appellate court would apply to a trial court's findings and conclusions following a bench trial.¹¹

There is a significant split of opinion on this issue among the federal circuits. The *Gateway* holding permitting an expanded scope of review has been adopted by the First, Third, and Fourth Circuits, which, like the Fifth Circuit, reason that arbitration is a creature of contract and that parties should be free to tailor the scope of review to fit their particular needs and circumstances.¹² However, *Gateway* has been rejected by the Seventh, Ninth, and Tenth Circuits on the grounds that the Federal Arbitration Act's grounds for vacatur are mandatory, not default rules, and that parties do not have the power to determine the scope of judicial review.¹³ This split ultimately will require resolution by the U.S. Supreme Court. Thus, there is some degree of risk in relying on Fifth Circuit authority in evaluating whether to enter into an arbitration agreement authorizing an expanded scope of review. A Supreme Court



decision rejecting *Gateway* could deny parties to an existing arbitration agreement the judicial safety net for which they have contracted.¹⁴

Restricting the Scope of Judicial Review

Courts are much less inclined to permit parties to contractually limit or eliminate appellate review. The San Antonio Court of Appeals recently considered a provision in an arbitration agreement, which stated that “[a]n award or determination of the arbitration tribunal shall be final and conclusive upon the parties ... and no appeal thereof shall be made by the parties.”¹⁵ It held that, notwithstanding this provision, it would consider a challenge that the award was tainted by fraud, misconduct, or gross mistake — a ground for vacatur available under the common law.¹⁶ It also held that the statutory grounds for vacating or modifying an award, set forth in Sections 171.088 and 171.091 of the Texas Civil Practice and Remedies Code, could not be waived.¹⁷

Two federal circuit courts also have weighed in on this question. The Second Circuit refused to enforce an arbitration clause providing that the arbitrator’s award “shall be binding and conclusive upon each of the parties hereto and shall not be subject to any type of review or appeal whatsoever.”¹⁸ Instead, it held that the vacatur grounds set forth in the Federal Arbitration Act (9 U.S.C. §10) and in the common law “represent a floor for judicial review of arbitration awards below which parties cannot require courts to go, no matter how clear the parties’ intentions.”¹⁹ The court reasoned that “there is a fundamental difference between an agreement to increase the scrutiny that courts apply when considering whether to confirm or vacate an arbitration award and an agreement to prevent courts from reviewing the substance of an arbitration award at all.”²⁰ While arbitration agreements are private contracts, federal law permits the successful party to turn the award into a judgment and obtain “the potent public legal remedies available to judgment creditors.”²¹ The court reasoned that Congress’ will would be thwarted if federal courts were forced to rubber-stamp these awards when safeguards that Congress had enacted to protect against awards “tainted by partiality, a lack of elementary procedural fairness, corruption, or similar misconduct” had been circumvented by the parties.²²

In contrast, the Tenth Circuit recently gave some hope to those parties seeking to contractually limit post-arbitration judicial review. It held that a clear and unequivocal agreement foreclosing judicial review of an arbitration award *beyond the district court level* is enforceable.²³ The Tenth Circuit held that private contractual restrictions on appellate review — in contrast to provisions that expand appellate review — fulfill the FAA’s fundamental purpose of reducing “litigation costs by

providing a more efficient forum.”²⁴ However, noting the concerns raised by the Second Circuit, the court indicated that a clause precluding judicial review of any kind probably would be unenforceable.²⁵

Other Options to Consider

Parties seeking to incorporate some measure of “appellate” review of an arbitral decision should consider contracting for a private appellate arbitration panel as a substitute for judicial review, especially given the expense of post-award litigation and the fact that the *Gateway* decision might one day be reversed. Both courts and commentators have endorsed this option, describing the advantages of such an approach in terms of efficiency, flexibility, and confidentiality.²⁶ For example, parties that adopt this approach can exercise more control over the manner and standards by which such an “appeal” would be handled, in essence tailoring the traditional appellate rules to their liking. They could also set a schedule for more expedited review than would be available in the courts.²⁷

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Conclusion

Courts are more likely to enforce arbitration agreements that expand the scope of judicial review than those that would restrict it. However, the ability to contractually expand the scope of review may be in jeopardy if the U.S. Supreme Court decides to resolve the existing circuit split. Parties seeking to expand “appellate” review of an arbitration award should consider contracting for a private arbitration panel as an alternative.

Notes

1. These frustrations are widely shared by general counsel across the country, according to a recent commentator. Lou Whiteman, *Arbitration's Fall From Grace*, In-House Counsel (July 13, 2006), available at <http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1152695125655#>.
2. *Universal Computer Sys., Inc. v. Dealer Solutions*, 183 S.W.3d 741, 752 (Tex. App.—[1st Dist.] 2005, pet. denied); *Tuco, Inc. v. Burlington N. R. Co.*, 912 S.W.2d 311, 315 (Tex. App.—Amarillo 1995), modified on other grounds, 960 S.W.2d 629 (Tex. 1997).
3. *Universal Computer Sys., Inc. v. Dealer Solutions*, 183 S.W.3d 741, 752 (Tex. App.—[1st Dist.] 2005, pet. denied) (citing *CVN Group, Inc. v. Delgado*, 95 S.W.3d 234, 238 (Tex. 2002)).

4. *B.L. Harbert, Int'l, LLC v. Hercules Steel Co.*, 441 F.3d 905, 906 (11th Cir. 2006).
5. *Gateway Technologies, Inc. v. MCI Telecomm. Corp.*, 64 F.3d 993 (5th Cir. 1995); *Prescott v. Northlake Christian Sch.*, 369 F.3d 491, 497 (5th Cir. 2004) (remanding case for determination of parties' intent in including handwritten provision that “[n]o party waives appeal rights, if any, by signing this [arbitration] agreement.”) (alteration in original); *Tanox, Inc. v. Akin Gump Strauss Hauer & Feld, L.L.P.* 105 S.W.3d 244, 252 (Tex. App.—Houston [14th Dist.] 2003, pet. denied) (holding that parties could contractually expand scope of judicial review but had not done so in this case).
6. 64 F.3d at 996.
7. *Id.* at 997, 1001.
8. *Harris v. Parker Coll. of Chiropractic*, 286 F.3d 790, 794 (5th Cir. 2002).
9. *Id.*
10. *Id.*
11. 254 F.3d 588, 590 (5th Cir. 2001).
12. *Puerto Rico Tele. Co. v. U.S. Phone Mfg. Corp.*, 427 F.3d 21, 31 (1st Cir. 2005); *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 293 (3d Cir. 2001); *Syncor Int'l Corp. v. McLeland*, 120 F.3d 262, 262 (4th Cir. Aug 11, 1997) (mem. opinion)
13. *Chicago Typographical Union v. Chicago Sun-Times, Inc.*, 935 F.2d 1501, 1505 (7th Cir.1991); *Hyocera Corp. v. Prudential-Bache Trade Serv., Inc.*, 341 F.3d 987, 994 (9th Cir. 2003) (en banc); *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 933 (10th Cir. 2001).
14. See Christopher D. Kratovil, *Judicial Review of Arbitration Awards*, UT State and Federal Appeals Conference (June 2006); Margaret Moses, *Can Parties Tell Courts What To Do? Expanded Judicial Review Of Arbitral Awards*, 52 U. KAN. L. REV. 429, 465 (2004).
15. *Barnes v. Scott*, 126 S.W.3d 232, 238 (Tex. App.—San Antonio 2003, pet. denied).
16. *Id.*
17. *Id.*
18. *Hoefl v. MVL Group, Inc.*, 343 F.3d 57, 60 (2d Cir. 2003).
19. *Id.* at 64.
20. *Id.*
21. *Id.*
22. *Id.*
23. *MACTEC, Inc. v. Gorelick*, 427 F.3d 821, 826 (10th Cir. 2005), cert. denied, 126 S. Ct. 1622 (Mar. 27, 2006).
24. *Id.*
25. *Id.*
26. See, e.g., *Chicago v. Typographical Union No. 16 v Chicago Sun-Times, Inc.*, 935 F.2d 1501 (7th Cir. 1991); Christopher D. Kratovil, *Judicial Review of Arbitration Awards*, at 13-14, University of Texas, 16th Annual Conference on State and Federal Appeals (June 1-2, 2006).
27. Kratovil, *supra*, at 14.

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