Journal of Dispute Resolution

Volume 2004 | Issue 2 Article 5

2004

Arbitration Clauses Should Be Enforced According to Their Terms - Except When They Shouldn't Be: The Ninth Circuit Limits Parties' Ability to Contract for Standards of Review of Arbitration Awards - Kyocera Corporation v. Prudential-Bache Trade Services

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NOTES

Arbitration Clauses Should Be Enforced According to Their Terms—Except When They Shouldn't Be: The Ninth Circuit Limits Parties' Ability to Contract for Standards of Review of Arbitration Awards

Kyocera Corporation. v. Prudential-Bache Trade Services.[1]

I. INTRODUCTION

Arbitration is the process whereby parties submit disputes to a third, neutral party who will issue a decision that is both final and binding upon the parties.[2] The Supreme Court has recognized arbitration as a valuable form of dispute resolution, with its primary advantages being speed, affordability, and the lower degree of hostility created by a less adversarial environment.[3] In contrast to litigation, the standards of review for arbitral awards are defined in the Federal Arbitration Act (FAA) and are extremely narrow. In somewhat of a collision-course with the terms of the FAA is the fact that some courts have interpreted the holding of *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*,[4] wherein the Supreme Court held that parties agreements should be enforced according to their terms, as supportive of the conclusion that parties should be free to contract for non-statutory standards of review. With more and more parties submitting disputes to arbitration, the issue of whether parties can contractually expand the standard of review has become extremely unclear, with complex divisions even among individual circuits.[5] This Note addresses the effects of allowing parties to contract for standards of review beyond those established in the FAA, and the Ninth Circuit's self-reversing decision in *Kyocera* prohibiting such agreements.

1. 341 F.3d 987 (9th Cir. 2003).
2. BLACK'S LAW DICTIONARY 100 (7th ed. 1999).
3. *See, e.g.*, Moses H. Cone Mem'l Hosp. v. Mercury Const. Corp., 460 U.S. 1 (1983); *Kyocera*, 341 F.3d at 998.
4. 489 U.S. 468, 479 (1989).
5. *See* Stephen L. Hayford, *Law in Disarray: Judicial Standards for Vacatur of Commercial Arbitration Awards*, 30 GA. L. REV. 731, 833 (1996) (for a comprehensive, nationwide, analysis of the issue of contractual expansion of standards of review as of 1996).

II. FACTS AND HOLDING

In 1984, Kyocera Corporation (Kyocera), LaPine Technology Corporation (LaPine), and Prudential-Bache Trade Corporation (Prudential) formed a partnership to manufacture and market computer disk drives.[6] LaPine owned the design to the disk drives which it licensed to Kyocera, who manufactured the drives.[7] Prudential would purchase the drives manufactured by Kyocera, sell them to LaPine on credit, and in turn LaPine would market the drives to its own customers.[8] The partnership venture existed for only a short time before LaPine fell "into serious managerial and financial difficulties."[9] Soon thereafter, Kyocera gave notice to LaPine and Prudential that it considered them in default for "failure to pay for delivered drives."[10]

In light of the circumstances prompted by LaPine's financial downturn, the parties entered into negotiations seeking to restructure the partnership.[11] The negotiations resulted in a general "Definitive Agreement" (DA) and a more detailed "Amended Trading Agreement" (ATA).[12] The terms of the ATA eliminated Prudential as a middle-man in the partnership and instead provided that Kyocera would sell the drives directly to LaPine.[13] Kyocera objected to the terms of the ATA, refused to execute the agreement, and was subsequently informed by LaPine that it was considered in breach of contract.[14]

LaPine sued Kyocera for breach of contract in federal district court "seeking damages and an injunction compelling Kyocera to continue supplying drives."[15] Kyocera then filed a motion to compel arbitration which was granted by the district court pursuant to the terms of the DA.[16] Arbitration proceeded in two phases, with a three arbitrator panel determining in "Phase I" that Kyocera had accepted LaPine and Prudential's version of the ATA, therefore entering into a valid contract requiring Kyocera to sell drives directly to LaPine.[17] In "Phase II" the arbitrators determined that Kyocera had breached the contract in question, and unanimously awarded LaPine and Prudential $243,133,881 in damages and interest.[18]

Relying on the arbitration clause found in the parties' DA, Kyocera filed a motion in the district court to "Vacate, Modify, and Correct the Arbitral Award."[19] The terms of the DA provided for a broader scope of judicial review than the Federal Arbitration Act (FAA).[20] Specifically, the terms of the DA permitted vacatur

6. *Kyocera*, 341 F.3d at 989.
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.* at 989-90.
12. *Id.* at 990.
13. *Id.*
14. *Id.*
15. *Id.*
16. Lapine Tech. Corp. v. Kyocera Corp., 130 F.3d 884, 886-87 (9th Cir. 1997) [hereinafter *LaPine I*]; *Kyocera*, 341 F.3d at 990. Section 8.10 of the DA provided the terms governing resolution of disputes among the parties. *Id.*
17. *Kyocera*, 341 F.3d at 990.
18. *Id.*
19. *Id.*
20. *Id.* The Definitive Agreement provided that:

based upon any grounds found in the FAA, in addition to "where the arbitrators' findings of fact are not supported by substantial evidence, or . . . where the arbitrators' conclusions of law are erroneous."[21] Accordingly, Kyocera argued for vacatur not only under the standards of the FAA, but also under the broader terms of the DA, claiming that "the arbitration panel's factual findings were unsupported by substantial evidence," and that "the panel made various errors of law."[22] The district court held that the FAA enumerated the grounds for judicial review of arbitral decisions, and parties could not, as they did in this case, contract to enlarge the statutory standard of review.[23] The court then evaluated Kyocera's claims under the standards set forth in the FAA and denied Kyocera's motion.[24] Kyocera appealed.[25]

On appeal, Kyocera argued that the court erred in applying the FAA standard of review rather than the broader contractual standards of review.[26] The Ninth Circuit, in a divided decision, reversed the district court and held that federal courts were not limited to the standards of review set forth in the FAA, but could also apply standards agreed to by the parties.[27] On remand, the district court reviewed the arbitral decision under the broader standards provided in the DA and confirmed the arbitral panel's award.[28] Kyocera appealed the district court's con-

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The arbitrators shall issue a written award which shall state the bases of the award and include detailed findings of fact and conclusions of law. The United States District Court for the Northern District of California may enter judgment upon any award, either by confirming the award or by vacating, modifying or correcting the award. 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.*

Id. at 990-91 (emphasis added).

In comparison, the Federal Arbitration Act provides as follows with regard to the scope of judicial review of arbitral awards:

Vacatur is permissible: (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.

9 U.S.C. § 10(a) (2000). A Court may *modify* or correct an award:

(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; or (c) where the award is imperfect in matter of form not affecting the merits of the controversy.

9 U.S.C. § 11 (2000).

21. Kyocera Corp.. v. Prudential-Bache Trade Servs, 341 F.3d 987, 990-91 (9th Cir. 2003).

22. *Id.* at 991.

23. LaPine Tech. Corp. v. Kyocera Corp., 909 F. Supp. 697 (N.D. Cal. 1995); *Kyocera*, 341 F.3d at 991.

24. *Kyocera*, 341 F.3d at 991.

25. *Id.*

26. *Id.*

27. *LaPine I*, 130 F.3d 884, 890; *Kyocera*, 341 F.3d at 991.

28. LaPine Tech. Corp. v. Kyocera Corp., 2000 WL 765556 (N.D. Cal. 2000) (unpublished order); *Kyocera*, 341 F.3d at 993.

firmation.[29] Thereafter a three judge panel of the Ninth Circuit unanimously affirmed the district court's confirmation of the arbitral panel's decision.[30] Kyocera then filed a request for rehearing en banc.[31]

The Ninth Circuit granted Kyocera's request for rehearing en banc and considered the district court's order confirming the arbitration award.[32] Rather than affirm its prior decision on the issue, the Ninth Circuit reversed itself, holding that Congress had provided the standard of review for arbitral awards in the FAA, and that contractual provisions providing for judicial review on any other grounds than those set forth in the FAA were invalid.[33]

III. LEGAL BACKGROUND

The Federal Arbitration Act (FAA) permits vacatur of arbitral awards in four limited situations:

> (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.[34]

Similarly, section 11 of the FAA permits modification of arbitral awards in only three narrow situations.[35] Under the terms of the FAA, if a party properly petitions a court to confirm an arbitral award, and none of the specific grounds enumerated in the FAA for either vacatur or modification are present, then the court must confirm the award.[36]

While it is clear that the FAA delineates standards for review of arbitral awards, it is unclear if these are the only permissible standards. The question of whether parties may agree to expand the standard of review beyond those ex-

29. Kyocera Corp. v. Prudential-Bache Trade Servs., 299 F.3d 769 (9th Cir. 2002) [hereinafter *LaPine II*].

30. *See id.* at 780-93.

31. Kyocera Corp.. v. Prudential-Bache Trade Servs, 341 F.3d 987, 994 (9th Cir. 2003).

32. *Id.* at n.11.

33. *Id.* at 1003. The Ninth Circuit denied Kyocera relief, vacated *LaPine I*, and *LaPine II*, and reinstated the decision of the United States District Court for the Northern District of California. *Id.*

34. 9 U.S.C. § 10 (2000).

35. *Id.* § 11. A Court may *modify* or correct an award:

> (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; or (c) where the award is imperfect in matter of form not affecting the merits of the controversy.

Id.

36. *Id.* § 9. *See also* Fils et Cables D'Acier de Lens v. Midland Metals Corp., 584 F. Supp. 240, 243 (S.D.N.Y. 1984).

pressed in the FAA has divided the federal courts. Unfortunately, the Supreme Court has yet to decide whether contractual expansion beyond the FAA standards is permissible.[37] The disagreement among lower courts, combined with the growing popularity of arbitration agreements—and in turn controversies involving arbitration agreements—underscores the need for finality in this area of the law. The inability of courts to establish a consistent body of law in this area is rooted in countervailing arguments concerning the intent of Congress in enacting the FAA, as well as public policy arguments regarding the judiciousness of contractual expansion of the FAA standards.[38]

A. Courts Allowing Contractual Expansion

In 1984, a New York federal district court heard *Fils et Cables D'Acier de Lens v. Midland Metals Corp.*,[39] and became the first federal court to decide that parties may contract to expand the standard of review for arbitral awards.[40] The dispute in *Fils* was based on two contracts wherein Midland agreed to purchase galvanized wire from Fils, a foreign producer of wire.[41] The arbitration clause entered into by the parties presented a novel issue, in that it contained a provision setting forth a standard for review of the arbitral award which differed from the standards of the FAA.[42] After the arbitrator awarded damages to Fils, Midland sought to have the award vacated in part while Fils sought confirmation of the award.[43] The *Fils* court began its analysis of the issue by recognizing that the standards for review set forth in the FAA were "quite limited."[44] Next, the court emphasized that arbitration is a "creature of contract," citing several cases emphasizing the contractual nature of arbitration and the efficiencies that make arbitration a preferable alternative to litigation.[45]

Focusing on the contractual nature of arbitration, the court concluded that the parties should be allowed to alter the standards of review if there are no jurisdic-

37. The Court declined a petition for certiorari in January 2004. Kyocera Corp. v. Prudential-Bache Trade Servs., 341 F.3d 987 (9th Cir. 2003), *cert. denied*, 124 S. Ct. 980 (2004).

38. *See* Leanne Montgomery, Note, *Expanded Judicial Review of Commercial Arbitration Awards—Bargaining for the Best of Both Worlds: Lapine Technology Corp. v. Kyocera Corp.*, 68 U. CIN. L. REV. 529, 531 (2000).

39. 584 F. Supp. 240 (S.D.N.Y. 1984).

40. *Id.* at 244. *See, e.g.*, Anthony J. Longo, Comment, *Agreeing to Disagree: A Balanced Solution to Whether Parties May Contract for Expanded Judicial Review Beyond the FAA*, 36 J. MARSHALL L. REV. 1005, 1005 (2003); Montgomery, *supra* note 38, at 539.

41. *Fils*, 584 F. Supp. at 242.

42. *Id.* at 243. Paragraph 13 of both *Fils* contracts provided:

> The arbitrator shall make findings of fact and shall render an award based thereon and a transcript of the evidence adduced thereat shall, upon request, be made available to either party. Upon an application to the court for an order confirming said award, the court shall have the power to review (1) whether the findings of fact rendered by the arbitrator are, on the entire record of said arbitration proceedings, supported by substantial evidence, and (2) whether as a matter of law based on said findings of fact the award should be affirmed, modified or vacated. Upon such determination, judgment shall be entered in favor of either party consistent therewith.

Id. at 242.

43. *Id.* at 243.

44. *Id.*

45. *Id.* at 243-44. *See also* United Steelworkers of Am. v. Enter. Wheel & Car Corp., 363 U.S. 593, 599 (1960) (holding that the parties bargained for the judgment of the arbitrators, not the court).

tional or public policy barriers.[46] The court quickly dismissed the proposition that there may be jurisdictional barriers to contractual modification of the standards of review by pointing out that the FAA is not independently jurisdictional in nature, and that jurisdiction in this case was satisfied by virtue of diversity pursuant to 28 U.S.C. section 1332.[47] In its analysis of the potential public policy barriers, the court effortlessly discarded the fact that expanding the scope of review beyond the standards of the FAA would counteract the inherent efficiency associated with arbitration, and instead concluded that such agreements still reduce the burden that would be exacted of lower courts in the absence of arbitration (i.e., had the dispute gone to trial).[48] Having rejected the possible barriers to contractual expansion of the standard for review of the arbitral award, the court proceeded to review the award according to the standards agreed to in the parties' contract.[49]

In 1995, the Fifth Circuit became the first federal circuit to hold that parties could expand, by contract, the standard of review for arbitral awards.[50] The case, *Gateway Technologies Inc. v. MCI Telecommunications Corp.*,[51] involved a contract wherein MCI, who had been hired by the Virginia Department of Corrections, subcontracted a job to Gateway, who agreed to implement a telephone system for use by prisoners.[52] In addition, the contract provided that the parties would submit "errors of law" in the arbitration award to *de novo* judicial review.[53] After the district court failed to apply the "de novo review clause" and affirmed the arbitrators' award of damages to Gateway,[54] MCI sought to have the award vacated, claiming that the arbitrator had made several errors of law.[55]

In analyzing the issue, the Fifth Circuit followed reasoning very similar to the court in *Fils*, and highlighted the "extraordinarily narrow" standards of review in the FAA.[56] Furthermore, the court's reasoning paralleled the *Fils* case in that the court emphasized the contractual nature of arbitration and concluded that parties may decide not only *what* issues to arbitrate, but also the rules under which they will arbitrate.[57] The court cited several landmark arbitration cases to bolster its conclusion that contracts should be enforced according to the terms agreed to by the parties, and that since the parties in this case agreed to a standard for review of the arbitral award, the district court erred in not applying that standard.[58] The

46. *Fils*, 584 F. Supp. at 244.
47. *Id.*; 28 U.S.C. § 1332(b) (2000).
48. *Fils*, 584 F. Supp. at 244.
49. *Id.* at 240.
50. Gateway Techs., Inc. v. MCI Telecomms. Corp., 64 F.3d 993 (5th Cir. 1995).
51. *Id.*
52. *Id.* at 995.
53. *Id.* at 997. The contract stated specifically that "[t]he arbitration decision shall be final and binding on both parties, except that *errors of law shall be subject to appeal.* *Id.* at 995.
54. In confirming the arbitrator's award in its entirety, the district court chose to apply the "harmless error" standard rather than the *de novo* standard the parties had agreed upon. *Id.* at 997.
55. *Id.* at 995. MCI claimed that the arbitrator had improperly assessed both attorneys' fees and punitive damages, in addition to excluding critical evidence. *Id.*
56. *Id.* at 996.
57. *Id.*
58. *Id.* at 996-97. For cases the Fifth Circuit relied on in *Gateway*, see Allied-Bruce Terminix Cos. v. Dobson, 115 S. Ct. 834 (1995) (the FAA intended courts to enforce arbitration agreements so as to place the agreements upon the same footing as other contracts); First Options of Chicago v. Kaplan, 514 U.S. 938 (1995) (observing that the basic objective in this area is to ensure that commercial arbitration agreements are enforced according to their terms); Volt Info. Scis., Inc. v. Bd. of Trs. of Leland

court went on to apply the *de novo* standard, holding that "federal arbitration policy demands that the court conduct its review according to the terms in the [parties'] contract."[59] The Third, Fourth, Fifth, and Ninth Circuit all permitted contract expansion before the Ninth Circuit broke rank and reversed itself in *Kyocera* in 2003.[60]

B. Courts Prohibiting Contractual Expansion

In direct conflict with the *Fils* and *Gateway* decisions are the courts which have refused to allow parties to contractually expand the standard of review for arbitral awards. While the reasoning of the courts allowing contractual expansion focuses mostly on the contractual nature of arbitration, the courts that have prohibited contractual expansion have focused on the importance of recognizing applicable statutes—namely sections 10 and 11 of the FAA—and the fear of offending public policy by undermining the goals of the FAA and arbitration in general.[61]

The Seventh Circuit, in *Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc.*,[62] became one of the first federal circuits to prohibit contractual expansion of the standard for review of arbitral awards beyond the terms of the FAA, although the prohibition was in dicta.[63] *Chicago* involved arbitration arising from a labor dispute between the *Chicago Sun-Times* and its employees.[64] At arbitration, the arbitrator ruled in favor of the *Chicago Sun-Times*; the employees subsequently sought to vacate the award, and the *Chicago Sun-Times* successfully sought confirmation of the award.[65] On appeal, Judge Posner, writing for the majority—and taking a notably more conservative view on the issue than *Fils* or *Gateway*—upheld the arbitrator's award.[66] Unlike *Fils* and *Gateway*, the parties to the *Chicago* contract had not agreed to expand the standard of review for the arbitral award. Rather, on appeal, the employees sought to have the award vacated because the arbitrator had erred in interpreting the contract.[67] Judge Posner pointed out that agreements to arbitrate a labor or other contract are a contractual commitment to abide by an arbitrator's interpretation.[68] Further, he stated that

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Stanford Junior Univ., 489 U.S. 468, 479 (1989) (holding that parties may limit by contract the issues which they will arbitrate, as well as the rules under which arbitration will be conducted). *Id.*

59. *Gateway*, 64 F.3d at 997. The court, in a footnote, noted that had the contract been silent with regard to the issue in dispute, then the terms of the FAA would govern. *Id.* at n.3. Further, the court stated that the FAA did not prohibit parties who had agreed to arbitration from contracting for more expansive judicial review of arbitral awards. *Id.*

60. Roadway Package Sys., Inc. v. Kayser, 257 F.3d 287 (3d Cir. 2001); Hughes Training, Inc. v. Cook, 254 F.3d 588 (5th Cir. 2001);); LaPine Tech. Corp. v. Kyocera Corp., 130 F.3d 884 (9th Cir. 1997), *rev'd en banc*, 341 F.3d 987 (9th Cir. 2003). In an unpublished decision, the Fourth Circuit followed the reasoning set forth in *Gateway* and held that parties could agree to expand review of arbitral awards. Syncor Int'l Corp. v. McLeland, 120 F.3d 262 (4th Cir. 1997) (unpublished order).

61. *See* Montgomery, *supra* note 38, at 542.

62. 935 F.2d 1501 (7th Cir. 1991).

63. *Id.*

64. *Id.* at 1503.

65. *Id.* at 1503-04.

66. *Id.* at 1511.

67. *Id.* at 1505.

68. *Id.*

parties could contract for an appellate arbitration panel to review the arbitrator's award, but that contracting for *judicial* review of that award was impossible.[69] Unwilling to allow the court to "substitute its own interpretation even if convinced that the arbitrator's interpretation was not only wrong, but plainly wrong," Judge Posner declined to review the award under anything other than the terms of the FAA.[70]

Almost exactly one decade after *Chicago*, the Tenth Circuit, in *Bowen v. Amoco Pipeline Co.*,[71] became the first federal circuit to issue an unqualified prohibition of contractual expansion beyond the terms of review in the FAA.[72] *Bowen* involved a claim by a citizen who sought damages in federal court for a creek Amoco had polluted in Oklahoma.[73] Thereafter, Amoco successfully sought an order compelling arbitration, pursuant to a provision in an easement agreement.[74] The parties submitted the dispute to arbitration and expanded the scope of review by agreeing that "both [parties] 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.'"[75] The arbitration panel awarded damages in favor of the plaintiffs, at which point the plaintiffs sought confirmation of the award.[76] In turn, Amoco sought to vacate the award and filed a notice of appeal pursuant to the expanded standards of review in the contract.[77] The district court refused to apply the expanded standards of review, choosing instead to apply the terms of the FAA.[78] On appeal, the Tenth Circuit affirmed the district court, holding that parties may not contract for expansion of review of arbitral awards.[79]

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69. *Id.* Significantly, Judge Posner emphasized that parties could not create federal jurisdiction by contract. *Id.*

70. *Id.* In 1998, the Eighth Circuit issued an opinion prohibiting contractual expansion of the standard for review of arbitral awards. *See, e.g.*, UHC Mgmt. Co. v. Computer Sci. Corp., 148 F.3d 992 (8th Cir. 1998). Interestingly, the Eighth Circuit's analysis of the issue resembled, nearly identically, Judge Mayer's dissenting opinion for the Ninth Circuit in *LaPine I*. *LaPine I*, 130 F.3d 884, 891. However, the Eighth Circuit's prohibition, as in *Chicago*, was limited to dicta. *UHC Mgmt. Co.*, 148 F.3d at 998. The Eighth Circuit stated as follows:

> We may not set an award aside simply because we might have interpreted the agreement differently or because the arbitrators erred in interpreting the law or in determining the facts. Although this result may seem draconian, the rules of law limiting judicial review and the judicial process in the arbitration context are well established and the parties here, both sophisticated in the realms of business and law, *can be presumed to have been well versed in the consequences of their decision to resolve their dispute in this manner.*

Id. at 998 (quoting Stroh Container Co. v. Delphi Indus., Inc., 783 F.2d 743, 751 (8th Cir. 1986) (emphasis added)).

71. 254 F.3d 925 (10th Cir. 2001).

72. *Id.* at 936. The court stated:

> Although we are the first circuit to hold that parties may not contract for an expanded standard of review, two circuits have indicated they too would reject contractually expanded standards. In dicta, both the Seventh and Eighth Circuits have expressed disapproval of contractually expanded standards of review, acknowledging the independence of the arbitration process and noting parties may contract for an appellate arbitration panel should they desire more review.

Id.

73. *Id.* at 927-929.

74. *Id.* at 928.

75. *Id.* at 930.

76. *Id.*

77. *Id.*

78. *Id.*

79. *Id.* at 937.

In reaching its decision, the Tenth Circuit quickly attacked the reasoning employed in *Gateway* and *LaPine I*, which had held that parties could contractually expand the standards beyond the terms of the FAA.[80] In so doing, the court stated that while it is true that the Supreme Court has held that courts are bound to interpret contracts with the expressed intentions of the parties,[81] it does not follow that "the FAA's primary purpose compels enforcement of contractual expansion of judicial review."[82] To the contrary, the court pointed to the terms of the FAA as explicit guidance regarding standards for review of arbitral awards, and cited *Chicago* for the proposition that the parties could contract for appellate *arbitration* if they had desired.[83] The court went even further to discredit the reasoning of those courts supporting contractual expansion by concluding that *Volt*—a case often cited in support of contractual expansion—does not support contractual expansion of review.[84] *Volt*, the court argued, suggests that the FAA is a body of law that preempts state laws that contravene its terms, and is therefore more than a "collection of default rules."[85]

In rejecting the position that the contractual nature of arbitration should allow parties to contract for expanded review, the court reasoned that such expansion threatens to undermine the policies behind the FAA.[86] The court then presented a laundry list of reasons that contractual expansion of standards for review of arbitral awards would undermine the arbitral process entirely.[87] Most important among the reasons the court included were: (1) the fact that the FAA's limited review ensures judicial respect for the arbitral process and prevents courts from enforcing parties' agreements to arbitrate only to refuse to respect the results of arbitration; and (2) expanded review threatens the independence of arbitration and weakens the distinction between arbitration and adjudication.[88] Among the fed-

80. *Id.* at 933.

81. *Id.* (quoting Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 479 (1989)).

82. *Id.* at 934.

83. *Id.*

84. *Id.*

85. *Id.* at 934-35.

86. *Id.* at 935.

87. *Id.*

88. *Id.* at 935-36. The court stated:

> Unlike the contract clause at issue in *Volt*, the contract clause in this case threatens to undermine the policies behind the FAA. We would reach an illogical result if we concluded that the FAA's policy of ensuring judicial enforcement of arbitration agreements is well served by allowing for expansive judicial review after the matter is arbitrated. The FAA's limited review ensures judicial respect for the arbitration process and prevents courts from enforcing parties' agreements to arbitrate only to refuse to respect the results of the arbitration. These limited standards manifest a legislative intent to further the federal policy favoring arbitration by preserving the independence of the arbitration process. Unlike § 4 of the FAA, which allows parties to petition a federal court for an order compelling arbitration "in the manner provided for in [the] agreement," the provisions governing judicial review of awards, 9 U.S.C. §§ 10-11, contain no language requiring district courts to follow parties' agreements. . . . Contractually expanded standards, particularly those that allow for factual review, clearly threaten to undermine the independence of the arbitration process and dilute the finality of arbitration awards because, in order for arbitration awards to be effective, courts must not only enforce the agreements to arbitrate but also enforce the resulting arbitration awards. . . . Moreover, expanded judicial review places federal courts in the awkward position of reviewing proceedings conducted under potentially unfamiliar rules and procedures. . . . Because parties may not force reviewing courts to apply unfamiliar rules and

eral circuits that have prohibited contractual expansion beyond the terms of the FAA are the Seventh, Eighth (in dicta), Tenth, and recently the Ninth in *Kyocera*.[89]

IV. INSTANT DECISION

In *Kyocera Corp. v. Prudential-Bache Trade Servs.*,[90] the Ninth Circuit, rehearing the case en banc, was faced with the decision of whether their previous decision in *LaPine I*—allowing parties to contractually expand the standard for review of arbitral awards beyond the terms of the FAA—was erroneous.[91] In contrast to the approach whereby the Circuit began its analysis in *LaPine I*—wherein the court focused on the contractual nature of arbitration and the need to "honor th[e] agreement"[92]—the court in the instant decision began by considering sections 10 and 11 of the FAA.[93] As several courts before it, the Ninth Circuit opined that the standards for review under the FAA were very narrow, and acknowledged their design to preserve due process while prohibiting unnecessary intrusion into the arbitration process.[94] The court followed by reviewing the circuit split, and sided with the Seventh, Eighth, and Tenth Circuits in prohibiting parties from contractually expanding the standards for review of arbitral awards.[95]

In reaching its decision, the court reasoned that parties have no power to determine the rules by which federal courts operate, especially when considering that the FAA has delineated specific standards for review.[96] The court then brought attention to the parties' ability, under *Volt*, to contractually modify the arbitration process to meet their needs, but concluded that once a case reaches the federal courts the arbitration process has been completed and federal courts must abide by the standard for confirmation of awards that was set forth in the FAA.[97] Determining that the standard of review is solely for the court to decide, the court adamantly rejected the proposition that parties could control how the federal courts conduct the business of resolving disputes, even if Congress had not provided guidance through the FAA.[98]

> procedures . . . expanded judicial review would threaten the independence of arbitration and weaken the distinction between arbitration and adjudication. Arbitrators are chosen for their specialized experience and knowledge, which enable them to fashion creative remedies and solutions that courts may be less likely to endorse. Expanded judicial review therefore places a court in the position of reviewing that which it would not do and reduces arbitrators' willingness to create particularized solutions for fear the decision will be vacated by a reviewing court.

Id. at 935-36 (emphasis added) (internal citations omitted).

89. Chicago Typographical Union v. Chicago Sun-Times, Inc., 935 F.2d 1501 (7th Cir. 1991); UHC Mgmt. Co. v. Computer Sci. Corp., 148 F.3d 992 (8th Cir. 1998); Bowen v. Amoco Pipeline Co., 254 F.3d 925 (10th Cir. 2001); Kyocera Corp. v. Prudential-Bache Trade Servs., 341 F.3d 987 (9th Cir. 2003).

90. 341 F.3d 987 (9th Cir. 2003).

91. *Id.* at 997.

92. *LaPine I*, 130 F.3d at 888.

93. *Kyocera*, 341 F.3d at 997. *See* 9 U.S.C. §§ 10, 11 (2000).

94. *Kyocera*, 341 F.3d at 998.

95. *Id.* at 1000.

96. *Id.*

97. *Id.*

98. *Id.*

Having held that federal courts may only review an arbitral award under the terms of the FAA, the court then considered whether the invalid standard of review provision invalidated the entire contract.[99] The court decided that even though the standard of review provision was invalid, it did not permeate any other portion of the arbitration clause, and could be severed from the agreement.[100] Proceeding to review the arbitral award under the terms of the FAA, with the standard of review provision having been severed, the court held that Kyocera had shown no cause for relief under the terms of the FAA, and in turn vacated both *LaPine I* and *LaPine II*.[101]

V. COMMENT

By holding that parties cannot contractually expand the scope of judicial review of arbitral awards, the Ninth Circuit sent a clear signal that the expansionist direction some courts have taken with regard to this issue should be curbed. Serving to increase the clarity of this signal, the Ninth Circuit decision required the court to vacate its previous decisions in *LaPine I* and *LaPine II*. However, the court did not merely reverse itself, but also provided lengthy reasoning for its decision to re-hear the decision en banc and subsequently reverse its previous holdings.[102]

The court rejected the notion that it did not have the authority to re-hear the case en banc, and cited Federal Rule of Appellate Procedure 35.[103] The court also stated that "whether private parties may impose on a federal court a standard of review beyond that approved by Congress remains a question of 'exceptional importance.'"[104] The court then likened itself to the Supreme Court in *Lawrence v. Texas*,[105] and concluded that the necessity of eliminating erroneous precedent—*Bowers v. Hardwick*[106] in the case of the Supreme Court in *Lawrence*—required that the court decide the issue in order to correct a legal error.[107] The length to which the Ninth Circuit went in justifying its self-reversal stresses the importance of the issue to future contracting parties and litigants in all jurisdictions.

The disagreement between courts on the issue of contractual expansion can be distilled to the two conflicting ideologies represented in the current debate.[108] Those who oppose contractual expansion argue that in addition to contravening the terms of the FAA and violating the limits of federal court jurisdiction, such

99. *Id.*
100. *Id.*
101. *Id.* at 1003.
102. *Id.* at 995-97.
103. *Id.* at 996. *See* FED. R. APP. P. 35.
104. *Id.* The court noted that whether parties could contractually expand the standard of review of arbitral awards "may well affect large numbers of parties with critical contractual and statutory rights and billions of dollars at stake." *Id.* at 996.
105. 539 U.S. 558 (2003).
106. 478 U.S. 186 (1986).
107. Kyocera Corp.. v. Prudential-Bache Trade Servs, 341 F.3d 987, 997 (9th Cir. 2003).
108. *See* Lee Goldman, *Contractually Expanded Review of Arbitration Awards*, 8 HARV. NEGOT. L. REV. 171 (2003); Karon A. Sasser, Comment, *Freedom to Contract for Expanded Judicial Review in Arbitration Agreements*, 31 CUMB. L. REV. 337 (2001); Longo, *supra* note 40; Eric van Ginkel, *Reframing the Dilemma of Contractually Expanded Judicial Review: Arbitral Appeal vs. Vacatur*, 3 PEPP. DISP. RESOL. L.J. 157 (2003).

agreements will eliminate the traditional benefits associated with arbitration.[109] On the other hand, supporters of contractual expansion argue that the purpose of the FAA is to place arbitration contracts on the same footing as other contracts, and that parties' agreements should be enforced according to their terms.[110]

The Ninth Circuit's holding is notable in that the court cited several decisions from other circuits prohibiting contractual expansion which had been decided since its decision in *LaPine I*.[111] The most significant of the cases cited by the Ninth Circuit was *Bowen v. Amoco Pipeline Co.*, wherein the Tenth Circuit became the first federal circuit to prohibit contractual expansion.[112] *Bowen*, which was decided nearly four years after the Ninth Circuit allowed contractual expansion of judicial review in *LaPine I*, has become what many consider the most significant and persuasive case rejecting contractually expanded judicial review.[113] The Ninth Circuit decision to reverse itself and follow the reasoning of the Tenth Circuit in *Bowen* may well be seen by many as an indicator of the direction that other courts may take in the future. This should not be surprising considering the Tenth Circuit, in contrast to the courts supporting contractual expansion, provided extensive reasoning to support its conclusion that contractual expansion would essentially conflict with federal policies furthered by the FAA and thereby weaken arbitration generally.[114] The Ninth Circuit, while agreeing with the Tenth Cir-

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109. In *Kyocera*, the Ninth Circuit aligned itself with this view when it concluded that the strengths of the arbitration process—namely its privacy, flexibility, quickness, and economically advantageous structure—will be jeopardized by broad judicial review of arbitral awards. 341 F.3d at 998. For other cases adopting this view see Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc., 935 F.2d 1501 (7th Cir. 1991); UHC Mgmt. Co. v. Computer Sci. Corp., 148 F.3d 992 (8th Cir. 1998); Bowen v. Amoco Pipeline Co., 254 F.3d 925 (10th Cir. 2001). *See also* Hayford, *supra* note 5, at 833; Kevin A. Sullivan, Comment, *The Problems of Permitting Expanded Judicial Review of Arbitration Awards Under the Federal Arbitration Act*, 46 ST. LOUIS U. L.J. 509, 560 (2002).

110. Roadway Package Sys., Inc. v. Kayser, 257 F.3d 287 (3d Cir. 2001); Fils et Cables D'Acier de Lens v. Midland Metals Corp., 584 F. Supp. 240 (S.D.N.Y. 1984); Gateway Techs., Inc. v. MCI Telecomms. Corp., 64 F.3d 993 (5th Cir. 1995); Syncor Int'l Corp. v. McLeland, 120 F.3d 262 (4th Cir. 1997) (unpublished order); Hughes Training, Inc. v. Cook, 254 F.3d 588 (5th Cir. 2001); LaPine Tech. Corp. v. Kyocera Corp., 130 F.3d 884 (9th Cir. 1997), *rev'd en banc*, 341 F.3d 987 (9th Cir. 2003). *See also* Olivier Antione, *Judicial Review of Arbitral Awards*, 54 DISP. RESOL. J. 23, 30 (1999); Montgomery, *supra* note 38, at 531; 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, 655-656 (2002).

111. In support of the conclusion that parties should be prohibited from contracting for a standard of review more expansive than the FAA, the Ninth Circuit cited cases from the Tenth, Eighth, and Seventh Circuits. Bowen v. Amoco Pipeline Co., 254 F.3d 925 (10th Cir. 2001); UHC Mgmt. Co. v. Computer Sci. Corp., 148 F.3d 992 (8th Cir. 1998); Chicago Typographical Union v. Chicago Sun-Times, Inc., 935 F.2d 1501 (7th Cir. 1991).

112. Kyocera Corp.. v. Prudential-Bache Trade Servs, 341 F.3d 987, 999 (9th Cir. 2003). *See, e.g., Bowen*, 254 F.3d 925.

113. *See, e.g.*, Goldman, *supra* note 108, at 174; van Ginkel, *supra* note 108, at 162. In *Bowen*, the Tenth Circuit acknowledged the position the Ninth Circuit had taken in *LaPine I*, as well as that taken by the Fifth Circuit in *Gateway*, but disagreed with the two Courts and concluded that while it is true that the purpose of the FAA is to ensure that arbitration agreements are to be enforced according to their terms, it does not follow that parties are free to interfere with the judicial process. *Bowen*, 254 F.3d at 933.

114. *See Bowen*, 254 F.3d at 935-936. *See also* discussion *infra* Part III.B. For an example of the limited reasoning used by courts in support of contractual expansion see *Gateway*, 64 F.3d at 996-97 (resting its argument on the conclusion that *Volt*, wherein the Supreme Court held that parties agreements are to be enforced according to their terms, dictates that parties should be allowed to contractually expand the standard of review).

cuit's several policy arguments against contractual expansion, focused the reasoning for its holding on the language of the FAA. While the terms of the FAA present the strongest argument against contractually expanded judicial review, rather than limiting itself to this argument, the Ninth Circuit should have emulated the *Bowen* opinion and articulated the many policy reasons supporting its decision.

As stated above, parties need not look any further than the language of the FAA to find the strongest argument against contractually expanded judicial review.[115] Section 10 of the FAA provides the limited grounds under which a court "may" vacate an arbitral award.[116] Given the qualified nature of the word "may" within the statute, some courts have concluded that the list of grounds for vacatur in section 10 is non-exclusive.[117] However, section 9 provides that: "[A]ny 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."[118]

In light of the language of section 9, it would appear that a court must grant an order confirming an arbitral award, even if an arbitral award were vacated pursuant to a non-statutory standard agreed to by the parties, as any non-statutory standard would fall outside of the "sections 10 and 11" requirement of the statute.[119] Both courts and commentators have argued that contractually expanded judicial review would be unconstitutional.[120] However, as Professor Goldman concisely stated, this argument rests on the assumption that contractual expansion is in fact absolutely prohibited by the FAA.[121]

While the Ninth Circuit did not go as far as the Tenth Circuit in outlining the potential dangers of allowing contractual expansion, it should be noted that if a future court were to reject the proposition that the terms of the FAA alone prohibit contractual expansion, the policy reasons behind rejecting contractual expansion outweigh the arguments in favor of such expansion. As stated above, some of the obvious advantages of the arbitration process over litigation include the speed and affordability, the less adversarial environment, and the simpler procedural and evidentiary rules.[122] By allowing contractual expansion courts run the risk of adding cases to already crowded dockets, decreasing the trademark efficiency of

115. *See, e.g.*, Goldman, *supra* note 108, at 180.

116. 9 U.S.C. § 10 (2000).

117. *See* Goldman, *supra* note 108, at 180.

118. 9 U.S.C. § 9 (2000) (emphasis added).

119. *See* van Ginkel, *supra* note 108, at 211.

120. *See* First Options of Chicago v. Kaplan, 514 U.S. 938 (1995); Di Jiang-Schuerger, Note, *Perfect Arbitration = Arbitration Plus Litigation?*, 4 HARV. NEGOT. L. REV. 231, 237-239 (1999); Sullivan, *supra* note 109, at 555.

121. Goldman, *supra* note 108, at 187-188. Professor Goldman dissected the argument as follows:

> It is suggested that increased review is tantamount to creating federal jurisdiction by contract and the judicial exercise of that jurisdiction would violate the separation of powers doctrine. The FAA does not create federal jurisdiction, rather, the parties can only be in federal court if there is an independent basis of jurisdiction. Thus, the claim that expanded review would be an unconstitutional assumption of power necessarily rests upon the premise that Congress intended to limit judicial review to the circumstances enumerated in section 10. That position has been discussed and rejected [in a previous section of this article]. Quite simply, there is no independent constitutional argument against expanding judicial review.

Id.

122. Kyocera Corp.. v. Prudential-Bache Trade Servs, 341 F.3d 987, 998 (9th Cir. 2003).

arbitration,[123] and most importantly undermining the enforceability of arbitration awards by sending a signal that an arbitrator's award is not genuinely final.[124] Furthermore, contractual expansion presents the risk of opening a back door to parties seeking to have the legal merits of an arbitrator's decision reviewed by an appellate court.[125] The concepts of security and finality of judgment in arbitration would essentially be sacrificed for the ability to have a judge review the arbitral award under the agreed-upon standard. This prospect is even more daunting when considering the likelihood that a judge would be asked to review an arbitral award without a complete record or arbitrator opinion.[126]

In view of the statutory considerations standing in the way of agreements for contractual expansion, and the fact that several circuits have expressed concern that arbitration may be weakened by such agreements, it is likely that courts will begin to prohibit agreements expanding the standard of review beyond the terms of the FAA. However, it is also likely that some courts will continue to follow the reasoning of *Gateway*, and other courts who transplant into the instant debate the *Volt* mantra that "parties' agreements should be enforced according to their terms."

VI. CONCLUSION

Given the absence of a unified body of law regarding contractual expansion of the standard for review of arbitral awards, it is likely that the Supreme Court will at some point be forced to squarely decide the issue. However, until that time, parties will be left with a body of law that, as Professor Hayford stated, is in disarray.[127] While it is true that the goal of the FAA is to ensure that arbitration agreements are placed on the same footing as other agreements,[128] and that parties' agreements should be enforced according to their terms,[129] it does not follow that parties should be free to contract for standards of review that are clearly contradictory to the terms of the FAA and which present the potential of weakening the arbitration process. Furthermore, given the fact that, as Judge Posner concluded, parties desiring to have an arbitral award reviewed may agree to appellate arbitration, it should not be said that parties have no recourse if presented with an undesirable arbitral award. Until the Supreme Court is faced with the issue, par-

123. There is very strong argument that the very narrow grounds for review under sections 10 and 11 of the FAA function to preserve the brevity and finality of arbitration.

124. Bowen v. Amoco Pipeline Co., 254 F.3d 925, 935-37 (10th Cir. 2001); Montgomery, *supra* note 38, at 554; Sullivan, *supra* note 108, at 549-59; Sasser, *supra* note 107, at 365. *But see* Goldman, *supra* note 108, at 185-87.

125. *Bowen*, 254 F.3d at 935-37; Montgomery, *supra* note 38, at 554; Sullivan, *supra* note 109, at 549-559; Sasser, *supra* note 108 at 365. *But see* Goldman, *supra* note 108, at 185-87.

126. Sullivan, *supra* note 109, at 553; Sarah R. Cole, *The Overlooked Problem of Party Autonomy in Dispute Resolution*, 51 HASTINGS L.J. 1199, 1200 (2000). *But see* Goldman, *supra* note 108, at 185-87. Several commentators have suggested that a requirement that arbitral awards include findings of fact and conclusions of law would eliminate a great deal of the uncertainty associated with this risk. *See* van Ginkel, *supra* note 108, at 213-14. *See generally* Stephen L. Hayford, *A New Paradigm for Commercial Arbitration: Rethinking the Relationship Between Reasoned Awards and the Judicial Standards for Vacatur*, 66 GEO. WASH. L. REV. 443, 461-88 (1998).

127. Hayford, *supra* note 5, at 731.

128. Allied-Bruce Terminix, Inc. v. Dobson, 513 U.S. 265, 270 (1995).

129. Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 479 (1989).

ties should look to Congress to amend the FAA rather than continue to contravene the limited standards of review set forth therein.

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