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De Novo a “No No:” Contractually Expanded Judicial Review Clauses Do Not Preclude FAA Application in State Court Unless the Parties Make it Intentionally Clear The FAA Does Not Apply in Their Agreement

Raymond James Fin. Servs., Inc. v. Honea

I. INTRODUCTION

This Note addresses a recent Alabama Supreme Court decision concerning the issue of contracted appellate review in arbitration agreements.¹ After analyzing the history of enforcement of arbitration agreements between contracting parties in U.S. Supreme Court precedent, this Note will explore the most recent Supreme Court decision regarding when parties may seek judicial review of arbitration awards. The Federal Arbitration Act’s (FAA) preemptive effect over state court law will also be addressed, as the Supreme Court was not thoroughly explanatory on the issue. This Note will also evaluate and compare another state court ruling in Pennsylvania on the same judicial review provision and its reasoning for a contrary ruling to the Alabama case. Finally, the Note will argue that when parties do not expressly provide that the FAA does not apply to the dispute in controversy, expanded judicial review beyond the FAA’s limited scope should be unenforceable.

II. FACTS AND HOLDING

Raymond James Financial Services, Inc. (RJFS), and Bernard Michaud, a securities broker at RJFS, appealed the judgment of the Jefferson Circuit Court vacating an arbitration award entered in their favor and against Kathryn L. Honea (Honea), a former client.² Honea opened multiple investment accounts at a branch office of Raymond James in Birmingham in May 1997³ and signed a client agreement containing an arbitration clause.⁴

The agreement stated that the parties would first submit their dispute to mediation.⁵ If, after mediation, the dispute remained unresolved, then the parties agreed to resolve their claim through arbitration conducted before one of a number

1. *Raymond James Fin. Servs., Inc. v. Honea*, No. 1081688, 2010 WL 2471019, at *1 (Ala. June 18, 2010).

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

of selected groups well-versed in securities law.⁶ Furthermore, the parties agreed the arbitrators would resolve the dispute according to applicable law and would draft a written decision explaining their decision for each party.⁷ The agreement also contained provisions that noted when each party could appeal the decision rendered by the tribunal.⁸ According to the clause, either party could appeal the decision if the arbitrators did or did not award damages in excess of \$100,000 or if they awarded punitive damages.⁹ The court stated that because Honea's claim involved more than \$100,000, a court having jurisdiction would conduct a 'de novo' review of the transcript and exhibits of the arbitration hearing.¹⁰

As the basis of her claim, Honea alleged that, "between May 1997 and 2000, she deposited over \$1,200,000 into her accounts and that the accounts decreased in value by approximately \$1,050,000."¹¹ "On March 3, 2006, Honea sued RJFS in the Jefferson Circuit Court, alleging that her losses were the result of abusive brokerage practices . . ."¹² She alleged that these practices violated the Alabama Securities Act¹³ and asserted claims of "breach of contract, breach of fiduciary duty, negligence, wantonness, and fraud."¹⁴ "RJFS subsequently moved the trial court to compel arbitration pursuant to the arbitration provision in the client agreement Honea had signed . . ."¹⁵ RJFS argued that because the transactions resulting from the contract agreement involved interstate commerce, the provisions of the agreement between the parties should be subject to the FAA.¹⁶ "The trial court granted the [RJFS] motion, and Honea thereafter pursued her claims in arbitration."¹⁷

The three-member arbitration panel unanimously entered an award in favor of RJFS.¹⁸ The panel "dismiss[ed] Honea's breach-of-fiduciary-duty, negligence, wantonness, fraud, and Alabama Securities Act claims with prejudice, and den[ie]d her breach-of-contract claim based on the statute of limitations."¹⁹ Eleven days later, Honea filed a motion in the Jefferson Circuit Court seeking to vacate the arbitration award based upon her argument "that the arbitrators manifestly disregarded the law and that one of the arbitrators was biased in favor of RJFS . . ."²⁰ "On October 17, 2008, Honea filed an additional motion with the trial court

6. *Raymond James*, 2010 WL 2471019, at *1 (The parties agreed to arbitrate before "the New York Stock Exchange, Inc., the National Association of Securities Dealers, Inc., the American Stock Exchange, Inc., or other self-regulatory organizations (SRO) subject to jurisdiction of the Securities and Exchange Commission pursuant to the arbitration rules of the Exchange or SRO . . .").

7. *Id.*

8. *Id.*

9. *Id.* ("[B]oth parties will have a right to appeal the decision of the arbitrators if the arbitrators award damages that exceed \$100,000; the arbitrators do not award damages and the amount of my loss of principal exceeds \$100,000; or the arbitrators award punitive damages.").

10. *Id.* at *7.

11. *Id.* at *1.

12. *Raymond James*, 2010 WL 2471019, at *1.

13. ALA. CODE § 8-6-1 (1975); *Raymond James*, 2010 WL 2471019, at *1.

14. *Raymond James*, 2010 WL 2471019, at *1.

15. *Id.*

16. Federal Arbitration Act (FAA), 9 U.S.C. §§ 1-16 (1925) (current version at 9 U.S.C. §§ 1-16 (2006)); *Raymond James*, 2010 WL 2471019, at *1.

17. *Raymond James*, 2010 WL 2471019, at *1.

18. *Id.* at *2.

19. *Id.*

20. *Id.*

asking it to conduct a *de novo* review of the arbitration award pursuant to . . . [the provision of the agreement] which specifically authorized such a review by the trial court”²¹ The provision permitted *de novo* review if “the arbitrators do not award damages and the amount of [the client’s] loss of principal exceeds \$100,000.”²²

In response to Honea’s motion, RJFS argued that manifest disregard of the law is not grounds for vacatur of an arbitration award.²³ More specifically, RJFS contended that parties may not expand review of arbitration awards by contract because the FAA provides the exclusive grounds for seeking judicial review of this arbitration award.²⁴ As a strong basis for the argument, RJFS noted the arbitration provision itself stated that “any unsettled dispute or controversy will be resolved by arbitration . . . in accordance with the [FAA]”²⁵ RJFS furthered this argument by stating that “there [was] no evidence indicating that either it or Honea contemplated review under the common law . . . ,” and Alabama case law shows that where the parties do not contemplate the state arbitration act or contract common law to govern review, then the FAA should govern.²⁶

On July 20, 2009, the trial court issued an order concluding that Honea was entitled to a *de novo* review of the arbitration award and the trial court vacated the award that had been entered in favor of RJFS.²⁷ On August 27, 2009, RJFS filed an appeal of the trial court decision.²⁸ On appeal, the Supreme Court of Alabama disregarded RJFS’s FAA preemption argument and instead directed the trial court to conduct a *de novo* review of the transcript and exhibits of the arbitration hearing and to enter a judgment based on that review, in accordance with the parties’ contractual provisions.²⁹ The Supreme Court of Alabama found the arbitration agreement’s inclusion of a *de novo* review clause preempted FAA application pursuant to Alabama contract law and remanded for further judicial review.

21. *Id.*

22. *Id.* (internal quotations omitted).

23. *Raymond James*, 2010 WL 2471019, at *2; (citing *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008) (holding “the propositions (1) that manifest disregard of the law is not a valid ground for seeking the vacatur of an arbitration award; and (2) that the . . . [FAA], provides the exclusive grounds for seeking judicial review of arbitration awards in Alabama and parties may not expand those grounds by contract to provide for *de novo* judicial review of such awards.”) (citation omitted)).

24. *Raymond James*, 2010 WL 2471019, at *2.

25. *Id.* at *6 (internal quotations omitted).

26. *Id.*; (citing *Alafabco, Inc. v. Citizens Bank*, 872 So. 2d 798, 801 (Ala. 2002) (overruled on other grounds) (“stating that where there is no evidence indicating that the parties wished to proceed in arbitration pursuant to the Alabama Arbitration Act, § 6-6-1 et seq., Ala. Code 1975 (‘the AAA’), or the common law, ‘the parties did not contemplate arbitration’ under that authority and the FAA must govern”)).

27. *Raymond James*, 2010 WL 2471019, at *2.

28. *Id.*

29. *Id.* at *8.

III. LEGAL BACKGROUND

A. Supreme Court Precedent on Arbitration Enforcement from Contractual Agreements

The Supreme Court, in its recent decisions, expressly showed its deference to the position that arbitration for securities claims is required where the parties' contract so provides. In *Shearson/American Express v. McMahon*, customers of a brokerage firm brought suit against Shearson/American Express alleging violations of the antifraud provisions of section 10(b) of the Securities Exchange Act.³⁰ The Supreme Court approved arbitration as a means of resolving claims under the Exchange Act and the Racketeer Influenced Corrupt Organizations Act (RICO).³¹ However, the Court left open the question of whether arbitration of claims under the Securities Act of 1933 (Securities Act) could be compelled.³²

In its 1953 decision, *Wilko v. Swan*, the Supreme Court held that arbitration could not be compelled under the Securities Act because the agreement to arbitrate was a "stipulation," and . . . the right to select the judicial forum is the kind of 'provision' that cannot be waived under s[ection] 14 of the Securities Act."³³ The Court reasoned that the Securities Act was passed as a protection to securities buyers, and its protective provisions require the exercise of judicial discretion to ensure the contract's effectiveness.³⁴ In order to effectively protect these disadvantaged buyers in potential conflicts with issuers of securities, the Court held "Congress must have intended s[ection] 14 . . . to apply to waiver of judicial trial and review", thus allowing the waiver of an arbitration agreement.³⁵

The Supreme Court again addressed the question in 1989 of whether arbitration under the Securities Act could be compelled in *Rodriguez de Quijas v. Shearson/American Express, Inc.*³⁶ In *Rodriguez de Quijas*, the Court analyzed *Wilko*, and stated the reasoning in *Wilko* has "fallen far out of step with our current strong endorsement of the federal statutes favoring this method [arbitration] of resolving disputes."³⁷ The Supreme Court overruled *Wilko* and held that pre-dispute arbitration agreements are enforceable under the Securities Act.³⁸

The Supreme Court next addressed whether parties could agree to expand judicial review. The Court answered the question in the positive. In *Volt Information Sciences, Inc. v. Bd. of Trustees of the Leland Stanford Univ.*, the Court determined whether a state arbitration act, which authorizes a court to stay arbitration pending resolution of related litigation, is pre-empted by the FAA.³⁹ In *Volt Information Sciences*, a construction contract between two parties contained an agreement to arbitrate all disputes arising out of the contract and a choice of law

30. 482 U.S. 220, 222 (1987).

31. *Id.* at 242.

32. *Id.*

33. 346 U.S. 427, 434-35 (1953) *overruled by* *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989).

34. *Id.* at 437.

35. *Id.*

36. 490 U.S. 477, 479 (1989).

37. *Id.* at 481.

38. *Id.* at 483.

39. 489 U.S. 468, 470 (1989).

clause providing that the contract would be governed by the law where the construction project was located.⁴⁰ As the plaintiff, Stanford moved to stay arbitration pending resolution of related litigation between a party to the arbitration agreement and third parties not bound by it pursuant to a California statute.⁴¹

The Court acknowledged that the FAA governs contracts in interstate commerce and the FAA contains no provision allowing a court to stay arbitration pending resolution of related litigation involving third parties not bound by the arbitration agreement.⁴² In dicta, the Court noted that the FAA was designed to strictly enforce agreements to arbitrate and treat such agreements as equal to contracts.⁴³ However, the Court noted that Section 4 of the FAA only confers the right to obtain an order to direct arbitration as provided for in the parties' agreement and not a right to compel arbitration at any time.⁴⁴ In interpreting the choice of law provision to mean that parties intended to stay the arbitration proceeding, the Court reasoned that the federal policy is to ensure the enforceability of the agreement according to its terms.⁴⁵ Because arbitration is a matter of contract, the Court articulated that parties should be able to choose the terms to which they will arbitrate their various claims.⁴⁶ The Court held that application of the California civil procedure statute to stay arbitration under this contract in interstate commerce did not undermine the goals and policies of the FAA and gave effect to the contractual rights and expectations of the parties.⁴⁷

Finally in 2010, when the Supreme Court reviewed a dispute over an arbitration panel's decision, the Court noted that the burden on the party seeking to vacate the arbitration award is high.⁴⁸ In *Stolt-Nielsen*, a case more related to mandatory class action arbitration than bilateral contract enforcement, the Court granted certiorari to determine whether an arbitration panel exceeded its powers when it forced arbitration on behalf of a class when the agreement was silent on the issue.⁴⁹ The Court reasoned that when an arbitrator strays from interpretation of the contract and "effectively dispenses his own brand of industrial justice," then

40. *Id.* at 468.

41. *Id.* at 471; see CAL. CIV. PROC. CODE ANN. § 1281.2(c)(1-4) (West, Westlaw through 2010 Reg. Sess.):

[W]hen a party to the arbitration agreement is also a party to a pending court action or special proceeding with a third party, arising out of the same transaction or series of related transactions and there is a possibility of conflicting rulings on a common issue of law or fact . . . the court (1) may refuse to enforce the arbitration agreement and may order intervention or joinder of all parties in a single action or special proceeding; (2) may order intervention or joinder as to all or only certain issues; (3) may order arbitration among the parties who have agreed to arbitration and stay the pending court action or special proceeding pending the outcome of the arbitration proceeding; or (4) may stay arbitration pending the outcome of the court action or special proceeding.

42. *Volt*, 489 U.S. at 476.

43. *Id.* at 474.

44. *Id.* at 474-75.

45. *Id.* at 476.

46. *Id.* at 479 ("[J]ust as they [private parties] may limit by contract the issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted.") (citation omitted).

47. *Id.*

48. *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1767 (2010) ("It is not enough for petitioners to show that the panel committed an error—or even a serious error.")

49. *Id.* at 1764.

the arbitration panel has exceeded its powers under section 10(a)(4) the FAA.⁵⁰ The Court held the mandatory class arbitration simply imposed its own view of sound policy regarding arbitration and imposing class arbitration is unenforceable.⁵¹

B. Nonstatutory Grounds for Vacatur at the Federal Circuit Level Prior to Hall Street

Beyond the express grant of judicial review for only those reasons contained in Section 10(a) of the Federal Arbitration Act⁵², a number of federal circuit courts recognized the existence of “nonstatutory” grounds for vacatur in the past.⁵³ Although, as noted above, judicial review of arbitration awards was limited and overturning an arbitration award under the FAA was difficult, parties could agree by contract to expand the scope of judicial review.⁵⁴ In *Gateway Technology Inc. v. MCI Telecomm Corp.*, the Fifth Circuit found that parties can designate by contract the rules by which arbitration would be conducted.⁵⁵

Some circuit courts used to grant *de novo* review. For example, the Fourth Circuit concluded that, where the 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.⁵⁶ The Eighth Circuit stated a similar standard; however, it noted that the court “will not interpret an arbitration agreement as precluding the application of the FAA unless the parties’ intent that the agreement be so construed is abundantly clear.”⁵⁷ The Eighth Circuit thus gave deference to application of the FAA without express intent otherwise and strongly suggested that parties may not contract for expanded judicial review of an arbitration award.⁵⁸ When the parties specifically contracted for appellate review, the majority of other federal circuit

50. *Id.* at 1767.

51. *Id.* at 1767-68.

52. 9 U.S.C. § 10(a) (2006)

[I]n 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.

§ 10(a)(1-4).

53. Stephen L. Hayford, *Law in Disarray: Judicial Standards for Vacatur of Commercial Arbitration Awards*, 30 GA. L. REV. 731, 739 (1996).

54. See *Gateway Tech., Inc. v. MCI Telecomms. Corp.*, 64 F.3d 993, 995 (5th Cir. 1995) (parties agreed that arbitration award would be final and binding on both parties, “except that errors of law shall be subject to appeal.” The court found contract supplementing usual standard of review and allowed court to undertake *de novo* review of arbitrator’s findings).

55. *Id.* at 996.

56. *Synco Int’l Corp. v. McLeland*, No. 96-2261, 1997 U.S. App. LEXIS 21248, at *17 (4th Cir. Aug. 11, 1997).

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

58. *Id.*

courts reviewed *de novo* a district court's confirmation or denial of an arbitral award.⁵⁹

However, the circuits were split on this topic. The Tenth Circuit held that private parties may not contract for a standard of review more expansive than that stated in the FAA.⁶⁰ Additionally, in a Seventh Circuit case construing section 301 of the Taft-Harley Act using the FAA as guidance, the Seventh Circuit held that the parties can contract for an appellate arbitration panel to review the arbitrator's award but cannot contract for judicial review of that award.⁶¹

C. Hall Street: *The Supreme Court Severely Limits Appellate Review*

In response to the split in the federal circuit courts concerning contractual judicial review of arbitration awards, the U.S. Supreme Court recently limited the extent to which parties may agree to expand review of an arbitration award. In *Hall Street Associates, L.L.C. v. Mattel, Inc.*, the Supreme Court decided the question of whether statutory grounds for prompt vacatur and modification may be supplemented by contract.⁶² In *Hall Street*, the dispute involved a lease between the landlord, Hall Street Associates, L.L.C., and the tenant, Mattel, Inc.⁶³ Due to the residue of manufacturing discharges by Mattel's predecessors, Mattel gave Hall Street notice of its intent to terminate the lease in 2001, and Hall Street subsequently filed suit for indemnification of the environmental cleanup costs.⁶⁴

At a bench trial where the termination issue was resolved, the parties decided to enter arbitration to resolve the indemnification claim.⁶⁵ As the losing party in initial arbitration, Hall Street filed a District Court Motion for Order Vacating Modifying And/Or Correcting Arbitration Accord on the ground of legal error.⁶⁶ After the district court amended the decision in favor of Hall Street, Mattel contended that the Ninth Circuit's recent *en banc* action in *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*,⁶⁷ left the arbitration agreement's provision for judicial review of legal error unenforceable.⁶⁸ Pursuant to the recent *en banc* decision in *Kyocera*, the Ninth Circuit reversed in favor of Mattel stating that the terms of the arbitration agreement controlling the mode of judicial review were unenforceable and severable.⁶⁹

The Supreme Court granted certiorari to decide whether the grounds of vacatur and modification provided by sections 10 and 11 of the FAA are exclusive.

59. See, e.g., *Kaplan v. First Options of Chi.*, 19 F.3d 1503, 1509 (3d Cir. 1994), *aff'd*, 115 S. Ct. 1920 (1995); *Employers Ins. of Wassau v. National Union Fire Ins. Co.*, 933 F.2d 1481, 1485 (9th Cir. 1991); *Advest Inc. v. McCarthy*, 914 F.2d 6, 9 (1st Cir. 1990); *Moscley, Hallgarten, Estabrook & Woodcn v. Ellis*, 849 F.2d 264, 267 (7th Cir. 1988).

60. See *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 933 (10th Cir. 2001).

61. *Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc.*, 935 F.2d 1501, 1504-05 (7th Cir. 1991).

62. 552 U.S. 576, 578 (2008).

63. *Id.* at 579 ("[T]he lease provided the tenant would indemnify the landlord in the event the tenant failed to follow environmental laws using the premises.").

64. *Id.*

65. *Id.*

66. *Id.* at 580.

67. 341 F.3d 987, 1000 (9th Cir. 2003).

68. *Hall St.*, 552 U.S. at 580.

69. *Id.* at 581.

The Court reviewed sections 9 through 11 of the FAA and stated that it made more sense to view these provisions as “substantiating a national policy favoring arbitration with just the limited review needed to maintain arbitration’s essential virtue of resolving disputes straightaway.”⁷⁰ The Court felt that any other interpretation would allow numerous legal and evidentiary appeals that would cause arbitration to be merely a formal “prelude to a more cumbersome and time-consuming judicial review process”⁷¹

However, the Court did not give the FAA exclusive power to enumerate the instances in which judicial review is appropriate and decided nothing about other possible avenues for judicial review.⁷² The Court claimed that if a party wanted review of arbitration awards, he may contemplate enforcement under state statutory or common law, but this case involved only expeditious judicial review under sections 9, 10, and 11.⁷³ The Court felt both parties had the FAA in mind when agreeing to the arbitration clauses and when filing their briefs to the Supreme Court.⁷⁴ Finally, after noting its limited holding, the Court agreed with the Ninth Circuit in *Kyocera* and held the grounds stated in section 10 and 11 of the FAA either for vacating, or for modifying or correcting an arbitration award, constitute the exclusive grounds for expedited judicial review.⁷⁵

D. FAA Application Preemption over State Statutory or Common Law

The United States Supreme Court cases have their origination in the FAA, and the focal point of the FAA is section 2, which provides that a written provision evidencing dispute resolution by means of arbitration shall be “valid, irrevocable, and enforceable, save upon grounds as exist at law or in equity for the revocation of any contract.”⁷⁶ Section 10(a) of the FAA provides standards of review for arbitration awards.⁷⁷ The four provisions of section 10(a) explicitly define when a court can vacate an arbitration award.⁷⁸ These enumerated provisions do not allow for an appeal on the merits of the dispute.⁷⁹ Under a literal reading,

70. *Id.* at 588.

71. *Id.* (citing *Kyocera*, 341 F.3d at 998. *Cf.* *Ethyl Corp. v. United Steelworkers of Am.*, 768 F.2d 180, 184 (7th Cir. 1985)) (citations omitted).

72. *Id.* at 590.

73. *Hall St.*, 552 U.S. at 590 (noting that expeditious judicial review refers only to judicial review under sections 9, 10, and 11 of the FAA and judicial review refers to judicial review in different scope from those enumerated in sections 9, 10, and 11 of the FAA).

74. *Id.* at 591.

75. *Id.* at 592.

76. Federal Arbitration Act (FAA), 9 U.S.C. § 2 (2006).

77. 9 U.S.C. § 10(a)(1-4) (2006):

[I]n 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.

78. *Id.*

79. *Id.*

section 10(a) merely provides for judicial review in the event there is a gross procedural mistake or error on the part of the arbitration tribunal.⁸⁰

Legal scholars and courts struggle to determine if and when the FAA preempts state law in relation to expanding judicial review by contract. Congress's power to preempt state law is derived from the Supremacy Clause and courts determine whether federal law preempts state law.⁸¹ The purpose of Congress's intent is the ultimate answer for the courts.⁸² The Supreme Court has identified three categories of preemption that can occur: express preemption, field preemption, and conflict preemption.⁸³ The FAA does not have an express preemption provision.⁸⁴ Additionally, Congress has not preempted the entire field of arbitration law with the FAA.⁸⁵ Finally, federal law, in the form of conflict preemption, also preempts state law when the two "actually conflict" with each other.⁸⁶ Conflict preemption occurs when compliance with both the state law and federal law is a "physical impossibility."⁸⁷ Conflict also occurs when the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."⁸⁸ Referred to as obstacle preemption, this type of federal preemption is most applicable to the FAA.⁸⁹

In a recent case regarding FAA conflict preemption of state laws, the Supreme Court held when parties agree to arbitrate all questions arising under a contract, the FAA supersedes state laws lodging primary jurisdiction in another forum, whether judicial or administrative.⁹⁰ In *Preston v. Ferrer*, the case concerned a contract between respondent Alex E. Ferrer, a television judge, and petitioner Arnold M. Preston, a California attorney who renders services to persons in the entertainment industry.⁹¹ The Court reasoned that Preston's petition presented the sole issue of in which forum the dispute would be heard and the fact that the parties agreed by contract for resolution in arbitral forum was dispositive.⁹² The fact that the dispute will be decided in an arbitral forum does not mean any substantive rights are relinquished.⁹³

The U.S. Supreme Court has not definitively addressed the preemptive effect in state courts of FAA sections other than sections 1 and 2.⁹⁴ In terms of dealing

80. See Edward Brunt, *Arbitration and Constitutional Rights*, 71 N.C. L. REV. 81, 116 (1992) (arguing that even the original champion of the FAA, Julius Henry Cohen, allowed for a "remarkably active role for the courts in preserving procedural protections for the arbitral parties.").

81. See U.S. CONST. art. VI, cl. 2 ("This constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . ."); Calcb Nelson, *Preemption*, 86 VA. L. REV. 225, 225 (2000).

82. See Christopher R. Drahozal, *Federal Arbitration Act Preemption*, 79 IND. L.J. 393, 397 (2004).

83. *Barnett Bank v. Nelson*, 517 U.S. 25, 31 (1996) (recognizing three types of preemption).

84. *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 477 (1989).

85. *Id.* at 477.

86. *English v. Gen. Elec. Co.*, 496 U.S. 72, 79 (1990).

87. Nelson, *supra* note 81, at 227-28.

88. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941) (citing *Savage v. Jones*, 225 U.S. 501, 533 (1912)).

89. *Volt*, 489 U.S. at 477 (noting that the FAA can preempt state laws through obstacle preemption).

90. *Preston v. Ferrer*, 128 S. Ct. 978, 987 (2008).

91. *Id.* at 981-82.

92. *Id.* at 986.

93. *Id.*

94. See *Volt*, 489 U.S. at 477 n.6 ("[W]e have never held that §§ 3 and 4 . . . are nonetheless applicable in state court.") (citing *Southland Corp. v. Keating*, 465 U.S. 1, 16 n.10 (1984) ("[W]e do not hold that §§ 3 and 4 of the Arbitration Act apply to proceedings in state courts.")).

with the preemptive effect of the confirmation and vacatur of arbitration awards, the Supreme Court has not yet addressed whether sections 9 and 10 of the FAA apply in state courts.⁹⁵ Nor has the Court discussed the possible preemptive effect of the FAA on state vacatur standards.⁹⁶ Thus, since Part IV of the *Hall Street* opinion left open the possibility of parties to contemplate judicial review under state statutory or common law, state contract law may provide a basis for providing contracted judicial review as long as the parties expressly provide the FAA does not govern judicial review of arbitral awards.⁹⁷

E. State Court Analysis of Expanded Judicial Review and Vacatur

At a state court level, the Superior Court of Pennsylvania ruled on the same contract provision as *Raymond James*⁹⁸ in *Trombetta v. Raymond James Financial Services, Inc.*⁹⁹ In *Trombetta*, which was similar to the factual dispute in *Raymond James*, James Trombetta maintained brokerage accounts with RJFS.¹⁰⁰ In March of 2000, the stock market declined and Trombetta began sustaining substantial losses.¹⁰¹ Trombetta filed suit against RJFS and two employees for breach of fiduciary duty, fraud, misrepresentation, negligence, gross negligence, and failure to supervise investments.¹⁰² Trombetta's claims were denied by an arbitration panel and the losing party sought *de novo* review of the exact same contract provision as in *Raymond James*.¹⁰³

As opposed to *Raymond James*, the Superior Court of Pennsylvania resolved whether an arbitration clause providing for *de novo* review of an arbitration award by a trial court is enforceable as a matter of law.¹⁰⁴ The court viewed the *de novo* review clause as unambiguous and found the clause an exception to the "strictly limited" clause when the precise factual matter at hand arises.¹⁰⁵ Although the court found the *de novo* review clause unambiguous, the court returned to the question of whether, pursuant to Pennsylvania law, a contractual provision providing for *de novo* review over an arbitration award by a trial court is enforceable as a matter of law.¹⁰⁶ Trombetta argued that by enforcing the *de novo* review clause, arbitration would be encouraged because it would initially allow arbitration but

95. Christopher R. Drahozal, *Contracting Around Hall Street*, 14 LEWIS & CLARK L. REV. 905, 924 (2010).

96. *Id.*

97. See Richard C. Reuben, *Personal Autonomy and Vacatur after Hall Street*, 113 PENN ST. L. REV. 1103, 1151-54 (2009).

98. *Raymond James Fin. Servs., Inc. v. Honca*, No. 1081688, 2010 WL 2471019 (2010).

99. 907 A.2d 550 (Pa. Supr. 2006).

100. *Id.* at 554.

101. *Id.* at 555.

102. *Id.*

103. *Id.* at 576.

104. *Trombetta*, 907 A.2d at 557.

105. *Id.* at 562 (RJFS argued there was ambiguity within the arbitration contract by means of a separate provision that stated arbitration will be "strictly limited," thus undermining the interpretation of *de novo* review as unambiguous and showing *de novo* review was dispositive.). The court noted that the "strictly limited" clause that limited arbitration was not a standard of review and this factual matter presented the precise exception to the rule. *Id.*

106. *Id.* at 569.

then reserve judicial protection from erroneous arbitration decisions.¹⁰⁷ Furthermore, Trombetta argued this would add to the desirability of the arbitration process.¹⁰⁸

Despite Trombetta's arguments, the court ruled that enforcing *de novo* review clauses would actually provide a disincentive for entering into arbitration agreements.¹⁰⁹ The Superior Court of Pennsylvania rejected the logic of Trombetta's main argument by reasoning that parties would essentially be dissuaded from contracting for arbitration because it would be a "meaningless gesture" that could result in a future, more expensive *de novo* trial.¹¹⁰ In addition to Pennsylvania case law's disfavored view of a *de novo* review clause, the court noted the majority of state and federal jurisdictions either disfavor and/or expressly prohibit private parties from contracting for broad standards of review over arbitration awards.¹¹¹ The court then cited cases from other state courts and noted that a majority of them that have considered enforcing *de novo* review clauses contained in arbitration agreements under state law have voided them on violation of public policy.¹¹²

As a basis of reasoning on its ruling that a *de novo* review clause was unenforceable as a matter of law pursuant to federal and a majority of state law, the Superior Court of Pennsylvania reiterated the trial court's four main justifications.¹¹³ First, it proposed that enforcement of the *de novo* review clause would result in a bypassing of arbitration awards.¹¹⁴ Second, it noted enforcing the *de novo* review clause would undermine the judicial process.¹¹⁵ As an example of how the *de novo* review would undermine the judicial process, the trial court noted how the court would have to sit as a trier of fact without being able to hear witnesses or determine the scope of testimony.¹¹⁶ Third, the trial court expressed how *de novo* review would not necessarily lead to the conservation of judicial resources as the trial court is stripped of its ability to cut down on the admission of testimony, transcripts, and documents.¹¹⁷ The court's final justification for finding the *de novo* review clause unenforceable was that there are no established procedures for how a trial court would go about conducting *de novo* review over an arbitration award.¹¹⁸ Based on the trial court's clear and persuasive justifications and the lack of logic in Trombetta's argument after thorough analysis, the Supe-

107. *Id.* at 572.

108. *Id.*

109. *Trombetta*, 907 A.2d at 572.

110. *Id.*

111. *Id.* at 574.

112. *Id.* at 573; *see, e.g., Goulart v. Crum & Forster Pers. Ins. Co.*, 222 Cal.App. 3d 527 (1990); *John T. Jones Const. Co. v. City of Grand Forks*, 665 N.W.2d 698 (N.D. 2003); *Pepin v. Am. Universal Ins. Co.*, 540 A.2d 21 (R.I. 1998); *Schaefer v. Allstate Ins. Co.*, 590 N.E.2d 1242 (Ohio 1992); *Mendes v. Auto. Ins. Co.*, 563 A.2d 695 (Conn. 1989); *Schmidt v. Midwest Mut. Ins. Co.*, 426 N.W.2d 870 (Minn. 1988).

113. *Trombetta*, 907 A.2d at 574.

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. *Trombetta*, 907 A.2d at 574.

rior Court of Pennsylvania held *de novo* review clauses unenforceable as a matter of law in Pennsylvania.¹¹⁹

In addition to the states mentioned in *Trombetta*, a number of states have adopted *Hall Street's* approach when interpreting their own arbitration statutes.¹²⁰ These states have held that their own statutes, like the FAA, do not permit parties to expand the grounds for judicial review by contract.¹²¹ However, New Jersey, by statute, and California, through its supreme court precedent, allow parties to expand the grounds for judicial review by contract.¹²² In *Cable Connection, Inc. v. DIRECTV, Inc.*, the California Supreme Court addressed the preemption concerns raised by *Hall Street* and rejected them.¹²³ The court reasoned that because the parties did not specifically provide that the FAA's vacatur provisions would apply, and because the parties proceeded in state court as if state law applied, the California vacatur law should govern.¹²⁴

In another example of how states have interpreted arbitration agreements, Alabama has vacated an arbitration award when the parties did not choose the arbitrators in a manner consistent with the agreement.¹²⁵ In *Bowater Inc. v. Zager*, Bowater, Inc. appealed from a trial court order that refused to follow the method proscribed in the parties' agreement.¹²⁶ The Alabama Supreme Court frequently recognized the importance of following the contractually prescribed method of choosing arbitrators set forth in the arbitration agreement and has reversed trial court orders that have done otherwise.¹²⁷ The court reasoned the parties' arbitration agreement provided for the qualifications of the arbitrators and remanded the case for the trial court to enter a revised order compelling arbitration with the provisions of the arbitration agreement.¹²⁸

As this section indicates, a number of federal courts of appeals enforced judicial review of arbitration awards according to express contractual agreement in the past. However, the law relating to expanded review of arbitration awards has significantly changed since the U.S. Supreme Court's interpretation in *Hall Street*. *Hall Street* limited judicial review of arbitration awards to the standard of review possibilities under Sections 9 through 11 of the FAA. Since *Hall Street*, state court analysis of expanded arbitration review clauses has varied, but the majority

119. *Id.* at 574-77.

120. *See Brookfield Country Club, Inc. v. St. James-Brookfield, LLC*, 683 S.E.2d 40, 44-45 (Ga. Ct. App. 2009); *Pugh's Lawn Landscape Co. v. Jaycon Dev. Corp.*, No. W2008-01366-COA-R3-CV, 2009 Tenn. App. LEXIS 189, at *12-15 (Tenn. Ct. App. 2009); *Quinn v. Nafta Traders, Inc.*, 257 S.W.3d 795, 798-99 (Tex. App. 2008).

121. *See, e.g., Quinn*, 257 S.W.3d at 798-99.

122. N.J. STAT. ANN. § 2A:23B-4(c) (West 2007 & Supp. 2009 Current with laws effective through L.2010) ("[N]othing in this act shall preclude the parties from expanding the scope of judicial review of an award by expressly providing for such expansion in a record."); *Cable Connection, Inc. v. DIRECTV, Inc.*, 190 P.3d 586, 606 (Cal. 2008).

123. *Cable Connection*, 190 P.3d at 604-05.

124. *Id.* at 597 n.12.

125. *Bowater, Inc. v. Zager*, 901 So. 2d 658, 659 (Ala. 2004).

126. *Id.*

127. *Id.* at 668; *see, e.g., McDonald v. H&S Homes, LLC*, 853 So. 2d 920, 925 (Ala. 2003); *Ex parte Southern United Fire Ins. Co.*, 843 So. 2d 151, 157 (Ala. 2002); *Northcom, Ltd. v. James*, 848 So. 2d 242, 247-48 (Ala. 2002); *BankAmerica Housing Servs. v. Lee*, 833 So. 2d 609, 618-19 (Ala. 2002); *Ex Parte Cappaert Manufactured Homes*, 822 So. 2d 385, 387 (Ala. 2001).

128. *See Bowater*, 901 So. 2d 671.

of states have denied de novo review without an express statement by the parties within the arbitration clause that the FAA is inapplicable.

IV. INSTANT DECISION

At trial, RJFS argued that an Alabama court can vacate an arbitration award involving a dispute in interstate commerce and subject to the FAA only if one of the grounds for vacatur enumerated in section 10(a) of the FAA is clearly established.¹²⁹ Section 10(a) of the FAA allows vacatur of arbitration award when the award was procured by corruption or fraud or when there was evident partiality in the arbitrators.¹³⁰ Additionally, the statute allows vacatur when actions by the arbitrators are clearly erroneous or the arbitrators refuse to hear certain types of evidence.¹³¹ Honea's argument in response was that even though agreements providing for the expanded judicial review of arbitrations awards may not be enforceable under the FAA, they are nevertheless enforceable under Alabama common law because Alabama courts have consistently held that general contract law requires that arbitration agreements be enforced as written.¹³²

RJFS responded to Honea's proposition of contract enforcement by stating the arbitration provision itself stated that "any unsettled dispute or controversy will be resolved by arbitration . . . in accordance with the FAA."¹³³ RJFS furthered this argument by stating that there was no evidence that either it or Honea contemplated review under common law, and Alabama case law shows that where the parties do not contemplate the state arbitration act or contract common law to govern review, then the FAA should govern.¹³⁴

Instead of addressing this discrepancy between the two parties' arguments, the Alabama Supreme Court alluded to earlier precedent, citing *Bowater Inc. v. Zager*, where the court stressed that section 4 of the FAA shows deference to terms of the arbitration agreement.¹³⁵ Citing the U.S. Supreme Court, the Alabama Supreme Court further articulated the deference to the arbitration agreement when it cited *Volt Sciences*,¹³⁶ stating parties are generally free to structure their arbitration agreements as they see fit.¹³⁷ The Alabama Supreme Court also alluded to other Supreme Court precedent by claiming that when it permits the courts to "rigorously enforce" contractual agreements to their agreed to terms, it gives effect to the contractual expectations and rights of the parties, without undermining the FAA policies.¹³⁸

In deciding whether to apply section 10 of the FAA or Alabama common law, the Alabama Supreme Court stated that it was "at liberty to decide whether to

129. *Raymond James Fin. Servs., Inc. v. Honea*, No. 1081688, 2010 WL 2471019, at *3 (2010).

130. 9 U.S.C. §10(a)(1)(2).

131. §10(a)(3).

132. *Raymond James*, 2010 WL 2471019, at *5 ("[T]hey are nevertheless enforceable under Alabama common law because Alabama courts have consistently held that general contract law requires that arbitration agreements be enforced as written.").

133. *Id.* at *6.

134. *Id.*; see *Alafabco*, *supra* note 26 and accompanying text.

135. *Raymond James*, 2010 WL 2471019, at *7.

136. 489 U.S. 468 (1989).

137. *Id.* at 479.

138. *Bowater Inc. v. Zager*, 901 So.2d 658, 667-68 (Ala. 2004).

apply § 10 in state court proceedings on motions to vacate or to confirm an arbitration award.¹³⁹ The court further stated that Alabama common law compelled it to enforce contracts according to the terms in order to give effect to the contractual rights of the parties, which directly followed the precedent in *Bowater* and *Volt Sciences*.¹⁴⁰ The court then cited *Stolt-Nielsen*, quoting *Volt Sciences* within the *Hall Street* opinion, to further articulate its common law deference stance.¹⁴¹ Based on *Stolt-Nielsen's* quoting of *Volt Sciences*, the Alabama Supreme Court emphasized that the U.S. Supreme Court has reiterated the principle that courts and arbitrators must “give effect to the contractual rights and expectations of the parties.”¹⁴² Based on the Supreme Court precedent in *Volt Sciences* and the specific *de novo* review clause in the parties’ arbitration agreement, the Alabama Supreme Court gave effect to the provision in the arbitration agreement authorizing a court having jurisdiction to conduct a *de novo* review of the arbitration award.¹⁴³

The Alabama Supreme Court reversed the trial court’s judgment of *de novo* review of the entire dispute because the arbitration provision did not authorize that action; rather, it authorized the trial court to “conduct a ‘de novo’ review of the transcript and exhibits of the arbitration hearing” as the provision provided.¹⁴⁴ Faced with the fact that the arbitration hearing transcript was effectively unavailable and largely useless, the Alabama Supreme Court stated that the parties may follow the procedure outlined in the Alabama Rules of Court as a substitute.¹⁴⁵ Thus, the cause was remanded for the trial court to conduct a *de novo* review of the transcript and exhibits of the arbitration hearing and to enter a judgment based on that review conducted by section 10(d) of the Alabama Rules of Procedure.¹⁴⁶ Essentially, the Alabama Supreme Court limited *de novo* review to only the transcripts and exhibits of the arbitration hearing but felt it was at liberty to ignore section 10 of the FAA because it was a state court proceeding and not a federal issue relating to the FAA.

V. COMMENT

A. The “RUAA Theory” of Federal Preemption Should Apply Because the Parties Did Not Expressly Agree State Arbitration or Common Law Governs Judicial Review

According to Professor Ian Macneil in his treatise and Justice O’Connor in dissent in *Southland Corp. v. Keating*, an FAA section can be applicable in state court in two ways: it may either apply by its terms, or it may apply as an “emana-

139. *Raymond James*, 2010 WL 2471019, at *7.

140. *Id.*

141. *Id.* at *7.

142. *Id.* at n.5; see *Stolt-Nielsen*, 130 S. Ct. at 1774 (quoting *Volt*, 489 U.S. at 479 (1989)).

143. *Raymond James*, 2010 WL 2471019, at *7-*8.

144. *Id.* at *1-*2 (quotations omitted).

145. See ALA. R. APP. § 10(d) (2010) (“Statement of the evidence or proceedings when no report was made or when a transcript is unavailable.”); *Raymond James*, 2010 WL 2471019, at *7.

146. ALA. R. APP. § 10(d).

tion" from section 2 of the FAA.¹⁴⁷ This idea describes a situation where section 2's command that arbitration agreements be enforced cannot be fully honored without applying other FAA provisions.¹⁴⁸ Thus when an FAA provision "speaks to the most essential dimensions of the commercial arbitration process,"¹⁴⁹ meaning that the FAA must be applied in order to give effect to Section 2, then that FAA provision should apply in state court.¹⁵⁰

Furthermore, the drafters of the Revised Uniform Arbitration Act (RUAA) have tried to adopt a preemption theory that is applicable to issues such as those in *Trombetta* and *Raymond James*.¹⁵¹ Under the RUAA Theory, state laws that deal with "front-end" issues (the agreement to arbitrate and the arbitrability of a dispute) and "back-end" issues (modification, confirmation, and vacatur of awards) are most likely to be preempted.¹⁵² Section 2 of the FAA defines the allocation of authority between courts and arbitrators at the front end of the arbitration process and section 10 defines the allocation at the back end of the arbitration process.¹⁵³ Section 2 is considered substantive because it determines that when the parties have agreed to arbitrate, the arbitrators will have the authority to decide the dispute, thus tipping the allocation of authority away from the courts.¹⁵⁴ "Overall, then, the preemptive effect of the FAA as applied to confirmation and vacatur of arbitral awards is highly unsettled. State courts would seem more likely to enforce expanded-review provisions than federal courts"¹⁵⁵

Despite the fact there is a lack of settled law on the preemptive effect of the FAA concerning confirmation and vacatur of arbitral awards, interpreting section 10 of the FAA as a substantive rather than procedural provision demonstrates how the *Hall Street* ruling should apply in state courts.¹⁵⁶ A substantive provision of the FAA is one that "creates, defines and regulates rights."¹⁵⁷ One purpose of vacatur laws is to ensure that the arbitration process is brought to a conclusion.¹⁵⁸ In order to accomplish this goal, vacatur laws should be narrow enough to avoid

147. 1 IAN R. MACNEIL ET AL., *FEDERAL ARBITRATION LAW: AGREEMENTS, AWARDS, AND REMEDIES UNDER THE FEDERAL ARBITRATION ACT* § 10.8.3.2, at 10:99 (1995 & Supp. 1999); see also *Southland*, 465 U.S. at 24 (O'Connor, J., dissenting) (noting that by requiring state courts to enforce § 2, the majority opinion essentially forces state courts to also enforce §§ 3 and 4 because of their relationship to § 2).

148. See *Southland*, 465 U.S. at 24 (O'Connor, J., dissenting); Tom Cullinan, Note, *Contracting for an Expanded Scope of Judicial Review in Arbitration Agreements*, 51 VAND. L. REV. 395, 416 (1998) (noting that state vacatur laws should be preempted, and the FAA thus applicable, when the state laws permit an expanded role for the judiciary in reviewing awards because that expanded role "undermines . . . [§2's] command of enforcement").

149. Stephen L. Hayford, *Federal Preemption and Vacatur: The Bookend Issues Under the Revised Uniform Arbitration Act*, 2001 J. DISP. RESOL. 67, 75 (2001).

150. See *id.* at 75-76.

151. Drahozal, *supra* note 95, at 925.

152. Hayford, *supra* note 148, at 74-75.

153. Brian T. Burns, Note, *Freedom, Finality, and Federal Preemption: Seeking Expanded Judicial Review of Arbitration Awards Under State Law After Hall Street*, 78 FORDHAM L. REV. 1813, 1868 (2010).

154. *Id.*

155. Drahozal, *supra* note 95, at 926.

156. See *Preston*, 552 U.S. at 346 (2008) (noting that the FAA "calls for the application, in state as well as federal courts, of federal substantive law regarding arbitration").

157. *Edward D. Jones & Co. v. Schwartz*, 969 S.W.2d 788, 795 (Mo. App. W.D. 1998) (applying the FAA's vacatur provisions as substantive federal law).

158. Hayford, *supra* note 149, at 81.

providing parties with “a vehicle for easily escaping the arbitration bargain.”¹⁵⁹ Vacatur laws achieve this goal by defining the allocation of power between courts and arbitrators.¹⁶⁰ Under this approach, vacatur laws, like section 10 of the FAA, provide a “clear parallel” to laws relating to the enforcement of agreements to arbitrate, like section 2 of the FAA, because they both define the “role of the judiciary in holding parties to [arbitration] agreements.”¹⁶¹ Thus, laws, such as section 10 of the FAA, that prevent broad judicial review of awards are best characterized as substantive because they serve to ensure the “effectuation” of the arbitration process, both in its commencement and in its culmination.¹⁶² “Section 10 of the FAA plays precisely this role and, according to this line of reasoning, should apply in state court as a substantive piece of federal arbitration law.”¹⁶³

As witnessed in *Raymond James*, however, the Alabama Supreme Court felt it was at liberty to decide whether to apply section 10 of the FAA or state contract law.¹⁶⁴ By doing so, the court ignored the possibility that their interpretation is nonetheless still preempted because it undermines the policies of the FAA.¹⁶⁵ “Where the parties have provided for expanded review [subject to the FAA], application of a state law permitting such review would result in vacatur, whereas application of § 10 of the FAA would result in confirmation.”¹⁶⁶ “Thus, the state law would prevent a party from enforcing an award where the FAA” would otherwise enforce it.¹⁶⁷ This inconsistency would result in basic obstacle preemption as alluded to in *Volt Sciences*.¹⁶⁸ In a situation such as *Raymond James* where the parties did not expressly agree state arbitration or common law would rule over the FAA and the parties agreed that the FAA did apply, the state law should be preempted.

*B. De Novo Review Clauses Should be Unenforceable as a Matter of Law
When the Parties Do Not Expressly Agree State Contract Law Governs
over Section 10 of the FAA*

Although the Alabama Supreme Court limited the *de novo* review in its decision to the transcript and exhibits of the arbitration hearing, it deviated from the applicable U.S. Supreme Court precedent in *Hall Street* and the decisions of the majority of states on the enforceability of *de novo* review clauses in arbitration agreements. As alluded to in *Trombetta*, the majority of state and federal jurisdic-

159. *Id.*

160. *Schwartz*, 969 S.W.2d at 794-95; *Burns*, *supra* note 153, at 1855.

161. *Hayford*, *supra* note 149, at 75.

162. *Id.* (arguing that vacatur “concern[s] effectuation of the result of the arbitration process and thereby serve[s] to effectively culminate enforcement of contractual agreements to arbitrate”).

163. *Burns*, *supra* note 153, at 1855.

164. *Raymond James*, 2010 WL 2471019, at *7.

165. *See* 1 MACNEIL ET AL., *supra* note 147, § 10.8.2.4, at 10:93 (describing a three step analysis for determining whether, if a state court determines that a particular FAA provision does not apply in state court, that particular state law is nonetheless preempted where step three asks, “Do those rules limit or obstruct explicit FAA provisions . . . ? If they do, the laws are preempted.”).

166. *Burns*, *supra* note 152, at 1869.

167. *Id.*

168. *Volt Information Sciences, Inc. v. Leland*, 489 U.S. 468, 477 (1989) (noting that the FAA preempts state laws through obstacle preemption).

tions disfavor *de novo* review clauses, or have voided them when presented with the issue, because they undermine the speed and efficiency of the arbitration process and render the arbitration panel's decision somewhat meaningless.¹⁶⁹ Additionally, many potential issues arise when the courts enforce a *de novo* review clause without established procedures for the standard of review.¹⁷⁰

Without established standards of review for *de novo* review clauses in arbitration agreements, *de novo* review clause enforcement can lead to confusing issues for courts on how to proceed and rule on the appealed issue. For instance, the court hearing a *de novo* review from an arbitration panel's decision may not know whether it is supposed to enter a separate award or only a judgment on the decision.¹⁷¹ Additionally, if the parties do not mention specific provisions in the agreement, courts could become confused on whether they are supposed to make findings of fact and conclusions of law or only conclusions of law and not findings of fact.¹⁷² Also, if the party who does not prevail after *de novo* review wishes to appeal the decision by the court hearing the appeal on *de novo* review, then does that party proceed with another motion to vacate the award, a motion for post-trial relief, or a direct appeal to a higher appellate court?¹⁷³ These issues are unanswered by inclusion of a general *de novo* review clause in arbitration agreements without some type of established procedure.

In *Raymond James*, the Alabama Supreme Court stated that the parties should apply Rule 10(d) of the Alabama Rules of Appellate Procedure because a record of the transcript was effectively unavailable.¹⁷⁴ Applying this procedural rule further elaborates on some of the issues that may arise if a court allows expansive *de novo* review without established procedures. Rule 10(d) of the Alabama Rules of Appellate Procedure, titled "Statement of the evidence or proceedings when no report is made or when a transcript is unavailable", would require Honea to prepare a statement of the evidence or proceedings from the best available means and serve it to RJFS within 4 weeks of filing notice of an appeal.¹⁷⁵ This part of the rule extends the dispute's final decision further down the road than the parties anticipated and invokes a likely bias in Honea's statement preparation. Furthermore, after RJFS receives 2 weeks to present its objections to Honea's statement, the trial court then settles the dispute between the parties and issues an approved statement of the evidence of the prior arbitration proceedings.¹⁷⁶ This statement then becomes the record.¹⁷⁷ In essence, the trial court will prepare its own record of the arbitration proceeding based on the two parties' recollections without any required adherence to the prior arbitration panel's reasoning.

Unless the parties expressly agree by clear terms that the FAA's limited scope of judicial review in section 10 is not applicable to their dispute, *de novo* review

169. See *Trombetta*, 907 A.2d at 574.

170. See Reuben, *supra* note 97, at 1137 (noting that the "flexibility of decision making and the ability of the arbitrators to ground their rulings in norms other than law go to the heart of arbitration as a dispute resolution process and its distinction from public adjudication.").

171. See *Trombetta*, 907 A.2d at 574 n.19.

172. See *id.*

173. See *id.*

174. *Raymond James*, 2010 WL 2471019, at *8 (Ala. 2010).

175. See ALA. R.APP. P. §10(d) (2010).

176. *Id.*

177. *Id.*

clauses should be unenforceable in state courts because of the generalized, illogical and flawed procedures that would arise like in *Raymond James*. In an effort to preserve arbitration's purpose and effectiveness, *de novo* review clauses in arbitration agreements should be absolutely avoided in the future by contracting parties. The type of procedure adopted in *Raymond James* effectively discredits and eliminates the arbitration panel decision's enforceability and arguably provides a detriment to judicial efficiency.¹⁷⁸

When a court permits expanded judicial review of arbitral decisions or a party contracts for a *de novo* review clause, the policy behind arbitration is severely undermined because enforcing or contracting for *de novo* review clauses compromises the finality and efficiency upon which the arbitration process bases its attractiveness.¹⁷⁹ Alternative dispute resolution is an economical decision by the parties based on time, the cost of judicial resources and transaction costs.¹⁸⁰ When a court permits a *de novo* review of an arbitration decision, it defeats the purpose of arbitration and renders the decision somewhat meaningless. If Honea wanted to have expanded judicial review beyond the scope of section 10 of the FAA, then Honea should have expressly agreed that the FAA does not apply at all to the dispute.¹⁸¹ Because the essence of a *de novo* review clause directly contradicts the principles of an arbitration hearing and there was no express agreement that the FAA does not apply, this expanded review clause in *Raymond James* should have been held unenforceable as a matter of law because it allowed judicial review beyond the reasons enumerated in section 10 of the FAA.

In a matter invoking federal jurisdiction, the parties should not be able to expand judicial review because Congress has specified standards for confirming an arbitration award and the Supreme Court has ruled the exclusive grounds for review in *Hall Street*.¹⁸² *Raymond James*, however, involves an issue that does not invoke federal jurisdiction. The Supreme Court of Alabama felt this distinction gave the court the authority to ignore FAA application and enforce the contract as the parties wrote the agreement.¹⁸³ Even after RJFS argued that courts reviewing arbitration awards under Alabama common law or statute are limited to the three grounds listed in Section 6-6-14 of the Alabama Code,¹⁸⁴ and the application of this statute would reach the same end result as section 10 of the FAA, the court reverted to arguably misinterpreted and inapplicable principles in *Volt Information*

178. See Reuben, *supra* note 97, at 1127-28 ("Reliance on a broad freedom of contract invites rather than resolves such questions, and would lead to an inefficient use of the limited resources of the courts.").

179. See Reuben, *supra* note 97, at 1129-30 (noting that the potential efficiency advantages of speedy resolution and lower costs continue to be among the more compelling reasons parties have for choosing arbitration).

180. *Id.*

181. Burns, *supra* note 153, at 1871 ("Where the parties' agreement clearly provides that a body of state arbitration law should apply and a body of federal law—the FAA—should not, the parties' agreement should be honored, including provisions for expanded review, as long as the state law permits them.").

182. *Hall St.*, 552 U.S. at 583-84.

183. *Raymond James*, 2010 WL 2471019, at *7.

184. ALA. CODE § 6-6-14 (1975) ("An award . . . cannot be inquired into or impeached for want of form or for irregularity if the award determines the matter or controversy submitted, and such award is final, unless the arbitrators are guilty of fraud, partiality, or corruption in making it.") (current version 2006), available at <http://law.justia.com/codes/alabama/2006/3069/124958.html>.

Sciences and *Bowater*.¹⁸⁵ Thus, the court gave effect to the provision in the arbitration agreement authorizing a court having jurisdiction to conduct a *de novo* review of the award by virtue of *Bowater*, a case involving the enforceability of the arbitration procedure and not the appellate review of arbitration.¹⁸⁶ Additionally, the Supreme Court precedents of *Volt Information Sciences* and *Stolt-Nielsen* deal with the enforceability of the arbitration agreement itself, not the standard of review, which further articulates the inapplicability of their precedent to the current issue.¹⁸⁷

As an example of the proper analysis of *de novo* review clauses in arbitration agreements, the Superior Court of Pennsylvania addressed the exact same issue and thoroughly analyzed its common law for answers relating to *de novo* review clauses.¹⁸⁸ Instead of ruling that the court must enforce the contract as written because there is no federal jurisdiction, the Superior Court of Pennsylvania tackled the more glaring and pertinent issue: the enforceability of *de novo* review clauses in arbitration agreements.¹⁸⁹ The Superior Court in Pennsylvania reviewed numerous common law decisions and statutory provisions and found that neither gave support for contractually created heightened review.¹⁹⁰ In fact, the court argued that these provisions would be a disincentive to enter into an arbitration agreement.¹⁹¹ After stating there is no precedent in Pennsylvania that supports *de novo* review clauses, the court held *de novo* review clauses contained in arbitration agreements are unenforceable as a matter of law in Pennsylvania.¹⁹²

The Alabama Supreme Court did not address this issue in *Raymond James*. Instead of deciding on whether *de novo* review clauses are enforceable as a matter of law in Alabama, the court misinterpreted and generalized Supreme Court precedent in *Volt Sciences* and *Stolt-Nielsen* and applied inapplicable Alabama case law from *Bowater*. Furthermore, and most importantly, the Alabama Supreme Court ignored the fact that the parties did not expressly agree state statutory or common law applies over the FAA or that the FAA does not apply.¹⁹³ Without an express agreement clearly stated in the provision that section 10 of the FAA does not apply to judicial review or state contract law governs the dispute, state courts should not be at liberty to ignore the FAA's application.

VI. CONCLUSION

De novo review clauses are inherently expansive and contradict arbitration principles. As a pragmatic concern for courts and negotiating parties, a *de novo*

185. *Raymond James*, 2010 WL 2471019, at *7 n.5.

186. See *Bowater*, 901 So.2d at 667-68.

187. See *Volt*, 489 U.S. at 477-80; see also *Stolt-Nielsen*, 130 S. Ct. at 1764.

188. See *Trombetta*, 907 A.2d at 569-77.

189. *Id.*

190. *Id.*

191. *Id.* at 572 ("By permitting *de novo* review over arbitration awards, parties would be dissuaded from contracting for arbitration because it would be a meaningless gesture that could result in a time consuming and cost absorbing preliminary review that would then be followed by an even more expensive *de novo* trial.").

192. *Id.* at 576.

193. *Raymond James Fin. Servs., Inc., v. Honea*, 2010 WL 2471019, at *7.

review clause should not be enforced unless the parties expressly agree that state contract law will supersede FAA application.

The Alabama Supreme Court should have determined RJFS and Honea agreed to have state contract law rule over the FAA before assuming the *de novo* review clause was an enforceable provision. Without proper support from state law precedent, statutory provisions or express words in the parties' agreement, this *de novo* review clause should also be unenforceable as a matter of law because section 10 of the FAA arguably preempts state contract law as a substantive provision and the parties did not expressly agree state contract law would govern over the FAA concerning judicial review.

TOM SWOBODA