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January 3, 2009

## Expanded Judicial Review of Awards After *Hall Street* and in Comparative Perspective

John J. Barceló III\*

### Abstract

The essay addresses whether party preference for more intrusive court review of the facts and law of an arbitral award will (or should) be respected in national arbitration law. The recent U.S. Supreme Court decision in *Hall Street* rules that expanded review clauses are not enforceable under the Federal Arbitration Act. The essay argues, however, that expanded review of an international arbitral award should still be possible in the U.S. if the parties draft the arbitration clause carefully. For that purpose the parties should include an expanded review clause and should place the arbitral seat in a State that allows expanded review—for example, California. They should also expressly provide that the arbitration be governed by that State's arbitration law. A respondent seeking to subject an unfavorable award to expanded review could then file for set-aside in the State courts of the seat. Even if the award creditor were to remove to federal court, the essay argues that a federal court should apply the State arbitration law, which, in the case of California, allows expanded review when the parties expressly provide for it. The essay also discusses the options for obtaining expanded review of an award under Swiss, Italian, Swedish, and English law.

### I. Introduction

The New York Convention's lasting achievement has been to require courts worldwide<sup>1</sup> to enforce arbitration agreements and the awards resulting from them, subject, in the case of awards, to very limited grounds for rejection. The Convention makes arbitration agreements truly binding by protecting the resulting awards from excessive court interference at the enforcement stage. Without that protection, it would have been easy to undermine arbitration agreements. What a court gave with one hand (sending the parties to arbitration) it could have taken back with the other (rejecting the resulting award). Sometimes, however, parties would actually **prefer** a more thorough and intrusive court review of an award's merits. This essay addresses

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<sup>1</sup> There are now 144 parties to the U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards. See [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html)

the question whether such a preference—if clearly expressed contractually—will (or should) be respected in national arbitration law.

The issue does not arise under the New York Convention per se, but rather under the national arbitration law of the seat of arbitration, the *lex arbitri*. In international arbitration parties tend to choose a “neutral” jurisdiction as the seat of the arbitration, and look to the arbitration law (*lex arbitri*) of the seat to provide the curial law or framework procedural law to facilitate and supervise the arbitration. The courts of the seat, applying their national arbitration law, exercise a more important role in reviewing a resulting award than do the courts of other jurisdictions where the award may be brought for enforcement. The former are sometimes said to have primary jurisdiction, and the latter, secondary jurisdiction.<sup>2</sup> Under the New York Convention, if the award is annulled at the seat, other countries may refuse to enforce it.<sup>3</sup> The Convention does not accord the same consequence to court rejection of an award in other (secondary) jurisdictions. Thus, judicial review of an award at the seat is especially important. At the same time, review of the award at the seat is governed entirely by national arbitration law, unconstrained by the New York Convention. For that reason a party wanting serious judicial scrutiny of an award—including review of fact finding and application of law—would want that review to occur at the seat. Can that be accomplished by express language in the arbitration agreement calling for such an intrusive level of court review in the primary jurisdiction?

This question has been extensively litigated in the United States and partly—but not completely—put to rest by a recent U.S. Supreme Court decision, *Hall Street Associates v. Mattel*,<sup>4</sup> holding expanded review provisions unenforceable under the Federal Arbitration Act.<sup>5</sup> Before *Hall Street* was decided, Professor Várady wrote an important and insightful analysis<sup>6</sup> of the expanded judicial review issue when it first gained prominence in the United States through back and forth litigation in the 9<sup>th</sup> Circuit *Kyocera* case.<sup>7</sup> He returned to the issue in lectures he delivered in the Xiamen Summer School in China in 2007. In the published version of the Xiamen lectures Professor Varady included a discussion of *Hall Street*,<sup>8</sup> which was decided after he had delivered his original lectures. I have chosen the expanded review topic as a tribute to his work—taking it as the starting point for further inquiry. Section II below summarizes Professor

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<sup>2</sup> See *Karaha Bodas co., L.L.C. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara, et al*, 335 F. 3d 357, at 368 (2003).

<sup>3</sup> New York Convention Article V(1)(e).

<sup>4</sup> \_\_\_U.S. \_\_; 128 S.Ct. 1396 (2008).

<sup>5</sup> The American Review of International Arbitration has recently published a series of articles commenting on the *Hall Street* decision: Alan Scott Rau, *Fear of Freedom*, 17 Amer. Rev. Int’l Arb. 469 (2006); Hans Smit, *Hall Street Associates v. Mattel: A Critical Comment*, id. at 513; Mark Beckett, *Beyond Agnosticism: The Policy Justification for the Supreme Court’s Decision in Hall Street Associates*, id. at 525; David W. Rivkin & Erik P. Tuchmann, *Protecting Both the FAA and Party Autonomy: The Hall Street Decision*, id. at 537.

<sup>6</sup> Tibor Várady, *On the Option of a Contractual Extension of Judicial Review of Arbitral Awards—What Is Actually Pro-Arbitration?* (56 Zbornik Pravnog fakulteta u Zagrebu.2006, 455-478).

<sup>7</sup> The original 9<sup>th</sup> Circuit three-judge opinion was decided in 1997: *Lapine Technology Corp. v. Kyocera Corp.*, 130 F. 3d 884 (9<sup>th</sup> Cir. 1997) (enforcing an expanded judicial review clause under the FAA). The latest and final decision was rendered by the 9<sup>th</sup> Circuit sitting en banc: *Kyocera Corp. v. Prudential-Bache Trade Services, Inc.*, 341 F.3d 987 (9<sup>th</sup> Cir. 2003) (reversing the 1997 decision and refusing to enforce an expanded judicial review clause).

<sup>8</sup> Tibor Várady, *THE ELUSIVE PRO-ARBITRATION PRIORITY IN CONTEMPORARY COURT SCRUTINY OF ARBITRAL AWARDS* (to be published in the Hague by Nijhoff in 2009) (see Section II. The Impact of Party Autonomy on the Scope of Court Scrutiny of Arbitral Awards).

Várady's analysis and conclusions. Section III asks what motivates parties to opt for expanded judicial review. Section IV discusses the possibilities within the United States for expanded judicial review after the *Hall Street* decision—which did not completely close the door on expanded review. Section V explores briefly how other countries are likely to treat expanded review clauses. Throughout the discussion the underlying inquiry is the one originally formulated by Professor Varady: which result, for or against expanded review, is the more pro-arbitration.

## II. Professor Varady's "Pro-Arbitration" Inquiry<sup>9</sup>

The main thrust of Professor Varady's analysis is to stress the dilemmas that arise no matter which way a court chooses to react to expanded review clauses. Because there are difficulties and dilemmas associated with either enforcing or rejecting such clauses, Professor Varady notes the relative indeterminacy of the broader inquiry concerning which solution is the more favorable to arbitration. First, he notes that if the expanded review provision is struck down, the continued viability of the arbitration agreement itself is cast into doubt. Would the offending clause be severable, or, on the other hand, would it be so central to the basic agreement that without it the parties could not be said to have entered a binding agreement to arbitrate? That question has been answered in different ways by different courts.<sup>10</sup>

Of course if the parties are made aware of the problem at the drafting stage, they can easily provide a solution by expressly approving or rejecting severability. If they do not do so, however, the outcome is uncertain. The *Hall Street* Court did not address severability, because it was not an issue the Court had agreed to review. The Ninth Circuit in its final *Kyocera* opinion opted for severability, but its analysis was at least partly influenced by unique features of the case, namely, that it had endured for years, that the award against *Kyocera* had been repeatedly upheld—even applying expanded review—and that to reject the award at the end of the day based on rejection of the review clause would have given *Kyocera* an undeserved windfall benefit.<sup>11</sup> Even without these equitable considerations, it seems likely that U.S. courts, given their generally pro-arbitration stance, will opt for severability, unless something unique in the parties' agreement stresses the importance of a particular expanded review provision. But in any given case, if the parties fail to include an express provision on severability, the outcome will be hard to predict.

Professor Varady takes the analysis to a broader level, however, by focusing on consequences for the award within the New York Convention system. From this perspective more uncertainty is introduced. Even if a U.S. court opts for severability, that would not necessarily bind a foreign court asked to enforce the resulting award under the New York Convention. A foreign court could decide for itself under New York Convention Article V(1)(a) (concerning invalidity of the arbitration agreement as a ground for rejecting the award) whether

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<sup>9</sup> The discussion in this section summarizes Professor Varady's analysis in his forthcoming book. See *supra* fn 8.

<sup>10</sup> The final en banc decision of the 9<sup>th</sup> Circuit in *Kyocera* held the clause to be severable. *Kyocera Corp. v. Prudential-Bache Trade Services, Inc.*, 341 F.3d 987 (9<sup>th</sup> Cir. 2003). On the other hand the Court of Appeal of Paris has held the arbitration clause itself to be invalid when the parties have included a clause (found invalid) calling for court review of an award's merits in international arbitration. *De Diseno v. Mendes*, CA Paris (Oct. 27, 1994), 1995 Rev. Arb. 863, 2d decision, and P. Level's note.

<sup>11</sup> 341 F.3d 987, at 1002.

failure of the expanded review clause invalidates the entire arbitration agreement and thus defeats the award's enforceability.<sup>12</sup> Indeed, even Article V(1)(d) of the Convention (concerning failure to follow the parties' agreed arbitral procedure as a ground for rejecting the award) could block enforcement, unless—as Professor Varady notes—the procedure of judicial review is characterized as “post arbitral procedure” rather than an element of the party-agreed “arbitral procedure”.<sup>13</sup>

A second difficulty arises if the expanded review provision is honored and the reviewing court finds errors of fact or law. What follows next? Does the court issue a judgment correcting the award? If so, do we now have a court judgment for enforcement, but no longer a viable award? Or does the court remand the case to the arbitral tribunal for further consideration—in which case would any subsequent award introduce the famous two-awards problem, under which courts in some countries (notably France) might enforce the first award,<sup>14</sup> and courts in other countries, the second? The two-awards problem can arise, of course, whenever the home jurisdiction annuls an award—for whatever reason—and a second arbitration (or at least a second award) ensues. Unique difficulty related to expanded review arises primarily whenever the reviewing court simply renders a judgment correcting the award, rather than returning the case to the arbitrators for their further consideration. Thus, this source of risk could be reduced if the parties were to include a provision authorizing the arbitral tribunal's continued jurisdiction whenever a reviewing court sets aside an award, either partly or completely.

After surveying these difficulties and dilemmas Professor Varady comes down in the end on the side of the *Hall Street* majority. He concludes:

“And finally, the basic problem is with the contractual provision itself. Party agreements on expanded judicial review of arbitral awards are ill-advised. Pro-arbitration is the avoidance of this clause.”

Yet even if this conclusion is sound for the vast majority of arbitrations—and I am inclined to believe that it is—one may still be troubled by the rigidity of an arbitration regime that says to sophisticated commercial parties that if they want arbitration they may have it, but only according to one particular formula. Adding to one's sense of unease is the way this outcome clashes with the acknowledged rationale for pro-arbitration policy: allowing sophisticated commercial parties to agree by contract on how to resolve disputes.<sup>15</sup> The Supreme Court in

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<sup>12</sup> New York Convention Article V(1)(a) provides as a ground for non-enforcement that: “\* \* \* the [arbitration] agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made \* \* \*”. For arbitration within the United States good arguments could be advanced that U.S. law should control the validity of the arbitration agreement, but other solutions are also possible.

<sup>13</sup> New York Convention Article V(1)(d) provides as a ground for non-enforcement that: “\* \* \* the arbitral procedure was not in accordance with the agreement of the parties, \* \* \*.”

<sup>14</sup> See *Société PT Putrabali Adyamulia v. Rena Holding*, 2008 *Revue critique de droit international privé* 109-112 and Note by Sylvain Bollée (French Cour de cassation ordered enforcement in France of a first award that had been set aside in England for error of law, even after a second award had been rendered by the arbitral tribunal as a substitute for the first award).

<sup>15</sup> In *Volt Information Sciences, Inc. v. Board of Trustees of Stanford*, 489 U.S. 468 (1989), the Supreme Court itself explained: “There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate.” *Id.* at 476.

*Hall Street* left this tension unresolved by grounding its result in the text of the Federal Arbitration Act itself, without discussing how this result could be aligned with the act's purpose, which essentially was to ensure that courts enforced arbitration agreements according to the way the parties drafted them.<sup>16</sup>

### III. Why Do Parties Opt for Expanded Judicial Review? (Is Arbitration Flawed?)

To this sense of unease at the rigid legal paternalism underlying the *Hall Street* result, one might add another perspective. Traditional arbitration may have a certain ingrained tendency or institutional characteristic, which some parties might consider a flaw. In particular, some observers have suggested that arbitral awards—at least by comparison to the results in litigation—are driven less by strict application of legal rules to objectively determined facts and more by a tendency of arbitrators to search for compromise solutions. Empirical support for this view can be found in studies showing that parties with considerable arbitration experience find the results in arbitration highly unpredictable.<sup>17</sup>

Structural features of arbitration also seem to support the compromise-award thesis. Once arbitrators have plenary (unreviewable) power over the merits, they certainly have the **ability** to render compromise awards. Two features of the system suggest that they may have strong incentives to do so. First, important arbitrations involving large sums usually are heard by panels of three arbitrators, one appointed by each party and the third chosen by the other two. In international arbitration all three arbitrators must be independent,<sup>18</sup> but human nature is human nature. Even legal scholars who insist on arbitrator impartiality and independence also express a nuanced understanding of a human tendency of a party-appointed arbitrator to be at least somewhat disposed toward the party who appointed him or her.<sup>19</sup> The Chair of the tribunal, of course, will prefer unanimity. The path of least resistance for a Chair deliberating with co-arbitrators inclined in opposite directions could well be—at least in more instances than would occur in judicial decision making—to search for some form of compromise award.

A second structural feature of arbitration may be even more important. All arbitrators hope to be reappointed in future cases—not necessarily by the same parties or arbitrators, of

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<sup>16</sup> See Alan Scott Rau, *supra* note 5, for criticism of the *Hall Street* decision because of its inconsistency with party autonomy. The *Hall Street* dissent by Justices Stevens and Kennedy is based primarily on this point. See 128 S.Ct. 1396, at 1408.

<sup>17</sup> See Christian Bühring-Uhle, Lars Kirchhoff & Gabriele Scherer, *ARBITRATION AND MEDIATION IN INTERNATIONAL BUSINESS* at 106-108 (2d ed. 2006). See also Jens Dammann & Henry Hansmann, *Globalizing Commercial Litigation*, 94 Cornell L. Rev. 1, 32-39 for a critique of commercial arbitration based on their assessment that arbitrators tend to reach compromise awards and hence fail to apply legal rules and a contract's terms with analytical rigor. Dammann and Hansmann are skeptical that this "defect" of arbitration can be remedied and favor instead choice of court clauses where a court in a neutral, third country is chosen.

<sup>18</sup> See, for example, ICC Arbitration Rules Article 7(1): "Every arbitrator must be and remain independent of the parties involved in the arbitration."

<sup>19</sup> See Giorgio Bernini, *Report on Neutrality, Impartiality, and Independence* in *THE ARBITRATION PROCESS AND THE INDEPENDENCE OF ARBITRATORS* 31-37 (ICC ed., 1991) ("\* \* \* I readily concede, also in the light of existing practices, a margin of discretion in allowing departure from the basic canon of neutrality. As regards impartiality, however, the acceptance of possible deviations must be reduced to the barest minimum." *Id.* at 32-33).

course. But their chances of being reappointed are improved if they do not “ruffle feathers” by deciding too decisively for one party and humiliating the other. In this way they gain a reputation for judiciousness and fairness. Once parties and their attorneys get into the heat of legal battle, it is hard to imagine a litigator who does not believe that she or he deserves to win on at least some points. Arbitrators who decide completely in favor of one party are thus likely to be viewed by the losing party as inadequate or incompetent arbitrators—an opinion the losing party and counsel are not likely to keep to themselves. A savvy arbitrator thus may perceive a self-interest in rendering a compromise award so that no litigator goes away with a motive to run down the reputation of members of the tribunal.

Parties negotiating a complicated international transaction with elaborate terms and a specific choice of law clause will understandably want these contract terms and legal rules applied strictly to resolve any disputes. At the same time they may also prefer the traditional advantages of arbitration, namely avoidance of the other party’s judicial system and an award that can be enforced worldwide. In this circumstance parties might want to opt for arbitration, but subject to expanded judicial review at the seat as a partial safeguard against the structural features of arbitration that encourage compromise awards. Arbitrators who know the merits of their award will be scrutinized more closely by a reviewing court can be expected to take more seriously their adjudicatory responsibility to find facts objectively and interpret and apply law.<sup>20</sup> Of course this perceived benefit would come at a cost, in reduced finality of the award and increased delays, opportunities for obstruction, and litigation expense. But might it not be “pro-arbitration” to leave the trade-off decision to the parties, rather than narrowing their options to just two: either full-fledged litigation or traditional arbitration?

The *Hall Street* Court professed not to know whether its ruling would encourage or discourage arbitration,<sup>21</sup> and based its holding instead on what it asserted to be the constraints inherent in the statutory language of the Federal Arbitration Act.<sup>22</sup> At the same time, by including the following language the Court did not completely close the door to expanded review:

“In holding that §§ 10 and 11 provide exclusive regimes for the review provided by the statute [the FAA], we do not purport to say that they exclude more searching review based on authority outside the statute as well. The FAA is not the only way into court for parties wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable.”

Professor Varady concludes in his published Xiamen lectures that this language leaves the door to expanded review in the United States only slightly ajar and that it will not have much practical significance—especially in international arbitration—because such arbitration “normally takes place within the framework of the FAA.” But of course the extent to which this

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<sup>20</sup> See Mark Beckett, *supra* note 5, at 532-533 (arguing that expanded review would force arbitrators to write longer, more detailed awards to withstand judicial scrutiny).

<sup>21</sup> 128 S.Ct. at 1406. (“We do not know who, if anyone, is right, and so cannot say whether the exclusivity reading of the statute is more of a threat to the popularity of arbitrators or to that of courts.”)

<sup>22</sup> *Id.*

is true will depend on a least two factors: first, the degree to which there are consumers of international arbitral services who—at least in some settings—would prefer expanded judicial review (perhaps to counteract a perceived tendency toward compromise awards in arbitration) despite the added costs; and second, the degree to which there is a legal alternative to the FAA regime announced in *Hall Street*. Only future experience will tell us about the first factor. The next section takes up the second issue—what legal options for expanded review are still available in the United States after *Hall Street*.

#### **IV. Expanded Judicial Review in the United States After *Hall Street***

##### **A. State Law Authority for Expanded Judicial Review**

In the wake of *Hall Street*, parties searching for expanded judicial review when arbitrating in the U.S. will presumably turn to state arbitration law. For this purpose the New Jersey and California arbitration statutes should attract considerable attention. In the case of New Jersey the state arbitration law is quite explicit. It was one of the early state arbitration statutes and contains provisions almost identical to FAA Chapter 1 § 10.<sup>23</sup> However the New Jersey arbitration act also contains the following provision:

“c. \* \* \* [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”<sup>24</sup>

Thus, the plain language of the New Jersey statute authorizes expanded judicial review.

The California arbitration statute is not as explicit. Nevertheless, the California Supreme Court has recently construed the statute as allowing expanded review where the parties expressly opt for it. In *Cable Connection, Inc. v. DIRECTV, Inc.*,<sup>25</sup> the California Supreme Court refused to follow *Hall Street*, even though the state statute contained language almost identical to that of the FAA. The California Court held that parties could validly agree to expand judicial review of an award in California state courts where the California arbitration statute applied. The case involved a claim for withheld commissions and wrongful charges brought by a group of satellite TV retail dealers located in four different states of the U.S. against DIRECTV, a company that broadcasts TV programming throughout the country. Because the dealer agreements involved interstate commerce and called for arbitration (in Los Angeles), the FAA technically applied. But because the arbitration clause provided that “[t]he decision of the arbitrators may be entered and enforced as a final judgment in any court of competent jurisdiction \* \* \*”,<sup>26</sup> DIRECTV, the losing party in the arbitration, filed in a California state court to vacate the award.

The group of retail dealers, apparently without attempting to remove the dispute to federal court, litigated the case in state court on the theory that the California arbitration act was controlling. Holding in part that the group of retail dealers had thus waived any claim that they

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<sup>23</sup> 9 U.S.C. §10.

<sup>24</sup> New Jersey Statutes Annotated 2A:23B-4.

<sup>25</sup> 44 Cal. 4<sup>th</sup> 1334; 190 P. 3d 586 (2008).

<sup>26</sup> 44 Cal. 4<sup>th</sup> 1334, 1341 fn 3.

were proceeding under the FAA, the California Court decided that the case was governed by the California arbitration act.

The arbitration clause in *DIRECTV* provided that the arbitrators were to apply California substantive law and were to include factual findings and reasons in a written award. The clause allowed for expanded judicial review in the following language:

“The arbitrators shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected on appeal to a court of competent jurisdiction for any such error.”<sup>27</sup>

The Court held that this language was enforceable under the provision of the California arbitration act that allowed a court to vacate an award “(4) where the arbitrators exceeded their powers \* \* \*”.<sup>28</sup>

The *DIRECTV* court concluded that *Hall Street* specifically allowed state arbitration law to apply in a case like this. It held that although the FAA is superior federal law, the FAA does not pre-empt state arbitration law where, as here, the state law is fundamentally consistent with the FAA goal of ensuring the enforceability of agreements to arbitrate. The *DIRECTV* court vacated the award and returned the case to the arbitrators because it found that the arbitrators had misapplied both California state law and the applicable AAA arbitration rules by allowing the arbitration to go forward as a class action.

## **B. State Law and International Arbitration**

Although *DIRECTV* itself involved domestic, not international arbitration, nothing in California or New Jersey law would prevent parties to an international transaction from placing the seat in either state<sup>29</sup> and explicitly choosing that state’s arbitration act as the *lex arbitri*. If the parties also expressly opt for expanded judicial review and litigate the set-aside action in state court, presumably the expanded review clause would be honored. *DIRECTV* so holds. Though

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<sup>27</sup> 44 Cal. 4<sup>th</sup> at 1341.

<sup>28</sup> California Code of Civil Procedure, § 1286.2, subd (a)(4).

<sup>29</sup> For a U.S. court to exercise set-aside jurisdiction, the seat must be in the U.S. Whether it would also have to be in the state whose arbitration law the parties choose is not clear. The California statute, for example, provides for enforcement or vacation of an award, even if rendered in another state. See California Code of Civil Procedure, § 1286 (“If a petition or response under this chapter is duly served and filed, the court shall confirm the award as made, whether rendered in this state or another state, unless in accordance with this chapter it corrects the award and confirms it as corrected, or vacates the award or dismisses the proceedings.”) To avoid potential issues, of course, international parties would be well advised to place the seat in the state whose arbitration law they want to have applied.

The California arbitration law contains special provisions for international arbitration that apply only if the arbitration is in California. See California Code of Civil Procedure, Title 9.3 (“Arbitration and Conciliation of International Commercial Disputes) and § 1297.12 (“This title, except [certain cited provisions] applies only if the place of arbitration or conciliation is in the State of California.”) These special provisions, however, apply to such issues as enforcing an arbitration agreement, selecting arbitrators, and to the arbitral proceedings. They do not appear to affect the general provisions in Title 9, Chapter 4 on “Enforcement of the Award” (containing the set aside provisions interpreted in *DIRECTV*).

the *DIRECTV* parties were domestic, they were engaged in interstate commerce; thus, the FAA, by its terms, applied (as it would in an international case). Still, when litigating in state court, the parties were allowed to substitute the state arbitration act and its grounds for court review. The remaining question is whether the same result would follow were the case removed to federal court.

In analyzing this issue, it helps to consider two scenarios that would likely arise where international arbitration is involved: first one in which a U.S. party transacts with a non-U.S. party and second, one in which both transacting parties are non-American. Assume under either scenario that the parties agree to arbitrate in California and that they include an expanded judicial review clause identical to that in *DIRECTV*. Assume, further, that they expressly provide that the arbitration is to be governed by the California Arbitration Act and that the award may be enforced in California state courts. Will this form of arbitration agreement yield expanded judicial review in federal court despite the *Hall Street* ruling?

To answer this question we must consider how a set-aside petition might reach the federal court. After the award is rendered, the losing party will seek to have it set aside under the expanded judicial review provisions of the agreement. For that purpose the losing party, seeking to rely on *DIRECTV*, would presumably file for set aside in a California state court.<sup>30</sup> But in an effort to avoid *DIRECTV*, the respondent (the winning party in the arbitration) would presumably petition to remove the case to federal court and would argue that the limited review grounds of the Federal Arbitration Act Chapter 1 must be applied. Thus, the two crucial questions become: (i) can the case be removed and if so, (ii) would federal or state arbitration law apply to the removed case in federal court?

On the removal issue, the respondent will probably succeed. If one party is American and the other, non-American, the case could clearly be removed on the basis of diverse citizenship. Even if both parties are non-American (or diversity is incomplete), however, the case still seems removable. Precisely this pattern arose in *Banco De Santander Central Hispano, S.A. v. Consalvi Intern. Inc.*,<sup>31</sup> a recent federal district court case in the Southern District of New York. There two non-American parties arbitrated in New York, and the losing party brought a set-side claim in New York state court. The respondent nevertheless successfully removed the case to federal court. Under the generally applicable U.S. removal statute, the petition for removal would not have succeeded.<sup>32</sup> But the respondent also based its petition on § 205 of the FAA,

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<sup>30</sup> The winning party could of course race to the court house and file in federal court for recognition and enforcement of the award under FAA Chapter 2, because (as explained later in the text) the award falls under the New York Convention, and a Chapter 2 action (in contrast to a Chapter 1 proceeding) provides a federal substantive law basis for federal jurisdiction. But in that action the losing party could move to set aside the award, and the set aside action would go forward first—at least this is the law of 2d Circuit. See *Yusuf Ahmed Alghanim & Sons v. Toys “R” Us*, 126 F.3d 15 (2d Cir. 1997). Because the set aside action would arise under Chapter 1 and hence would not be based on federal substantive law, the question becomes whether the federal court must apply the state or the federal standard of review where federal substantive law does not apply to the merits. The same issue arises if the case reaches the federal court by removal from the state court, which is the pattern analyzed in the text.

<sup>31</sup> 425 F. Supp. 2d 421 (S.D.N.Y. 2006).

<sup>32</sup> The general removal statute is found at 28 U.S.C. § 1441(b). Under § 1441(b) removal is allowed only if the case, as filed by the plaintiff, could have been brought originally in federal court. In the *Banco De Santander* case, however, the losing party’s set aside action arose under Chapter 1 of the FAA, which does not provide an

which contains special provisions for removal of “an action \* \* \* [that] *relates* to an arbitration agreement or award **falling under the Convention** \* \* \*.”<sup>33</sup>

The *Banco de Santander* award fell under the Convention by the Convention’s own terms and specific provisions of U.S. law. Most commonly an award falls under the Convention because it was rendered outside the country where enforcement is sought. But the Convention also applies to an award rendered within the enforcing country—our case—if the enforcing country considers the award “non-domestic”.<sup>34</sup> Under U.S. law an award involving two non-Americans—even if rendered in the U.S.—would be considered non-domestic.<sup>35</sup> The *Banco de Santander* award thus fell under the Convention,<sup>36</sup> and the court found that the set aside action—though not itself arising under the New York Convention—nevertheless **related to an award falling under the Convention**. Thus, under this precedent any set aside action filed in a state court but involving two non-Americans would seem to be removable to federal court. The basic point can be stated even more broadly; if the arbitration takes place within the United States but involves an international transaction, then the award will fall under the Convention and a set-aside action originally filed in state court will be removable to federal court under the terms of FAA §205.

The second issue—concerning which arbitration law the federal court must apply to the removed action—involves complex analysis. A full discussion of what law federal courts must apply in an action not based on federal substantive law—as is the case for a set aside action, which (even when the FAA Chapter 1 applies) does not arise under federal substantive law—is beyond this essay’s scope. In general, however, the applicable *Erie* doctrine<sup>37</sup> provides that in such cases federal courts must apply federal procedural law and state substantive law. But is the standard (or ground) for court review of an award “procedural” or “substantive” under the *Erie* doctrine? Though the answer is not clear cut, existing case law supports the conclusion that the issue is substantive and, thus, that the federal court must apply the standards in the state arbitration statute for reviewing awards.

*Gasparini v. Center for Humanities, Inc.*,<sup>38</sup> a leading U.S. Supreme Court case on the *Erie* doctrine, is particularly instructive. In *Gasparini*, New York state enacted a statute designed to control excessive jury awards in tort actions by allowing trial judges expanded discretion in reviewing jury awards for excessiveness and appellate courts expanded discretion (for the same purpose) in reviewing lower court decisions. In a tort action brought in federal court because of diversity of citizenship, the Supreme Court held that the federal trial court must apply the expanded state standard—not the more restrictive federal standard—for review of jury damage

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independent basis for federal jurisdiction. And since the parties were two non-Americans (thus not satisfying diversity of citizenship), the claim could not have been brought originally in federal court.

<sup>33</sup> 9 U.S.C. § 205 (emphasis added).

<sup>34</sup> U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards Article I(1).

<sup>35</sup> See 9 U.S.C. § 202. (By implication from the § 202 provisions, an award falls under the Convention if it involves two non-American parties.)

<sup>36</sup> The parties did not even dispute this point. See 425 F.Supp.2d at 428.

<sup>37</sup> The doctrine—which derives from the U.S. Supreme Court decision in *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938)—concerns what law a federal court must apply when the substance of the dispute is not governed by federal law.

<sup>38</sup> 518 U.S. 415 (1996).

awards. The Court noted that the state’s purpose was substantive and also that requiring the state standard to apply would prevent forum shopping (as between state and federal court). The analogy to federal court review of arbitral awards seems straightforward. In our scenario California’s purpose is clearly substantive (to reject awards founded on errors of law), and requiring a federal district court to apply the state review standard would, as in *Gasparini*, avoid forum shopping.

In summary, even after *Hall Street*, parties to an international transaction should still be able to obtain expanded judicial review in the U.S. if they draft the arbitration clause with considerable care. They should begin by choosing a seat in California or New Jersey—or in any other state allowing expanded judicial review—and by expressly providing that the chosen state’s arbitration statute governs the arbitration. To avoid potential issues, they should probably also provide that the award can be enforced in the courts of the chosen state (or in any court having jurisdiction), that the arbitrators retain jurisdiction to adjust any award that has been vacated by a reviewing court, and that the arbitration agreement either is or is not intended to survive if the expanded review clause is not enforced.

## V. Expanded Judicial Review in Other Countries

Turning briefly to other countries, we can see that some definitely allow expanded judicial review in set aside actions, but again generally only if the parties draft the arbitration clause carefully. One common pattern—analogous to the U.S. pattern just discussed—allows parties, even in an international transaction, expressly to opt for the seat’s domestic arbitration regime (allowing expanded judicial review) in place of the normally applicable international regime (requiring limited review)

Switzerland is a country in point. The Swiss Private International Law Act [PILA] allows parties to an international arbitration agreement with seat in Switzerland to waive the provisions of the PILA and to opt instead for the Intercantonal Arbitration Convention (known as the Concordat).<sup>39</sup> Article 176(2) of the PILA provides:

“The provisions of this chapter [applying to international arbitration] shall not apply where the parties have agreed in writing that the provisions of this chapter are excluded and that the cantonal provisions on arbitration [normally applying to domestic arbitration] should apply exclusively.”<sup>40</sup>

In a recent decision the Swiss Federal Tribunal explained that to come under this provision parties must meet three requirements: (i) their agreement must be in writing; (ii) the parties must explicitly opt out of the provisions of the PILA; and (iii) they must explicitly agree to be bound

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<sup>39</sup> Redfern and Hunter assert that parties to international arbitration are unlikely to choose this option and that it is known locally in Switzerland as the “nostalgia” clause [presumably because the Concordat law applied in Switzerland prior to January 1, 1989, when the Private International Law Act of 1987 came into force]. See Alan Redfern & Martin Hunter, *LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION* at 437 fn 21 (Student Ed. 2003).

<sup>40</sup> International Council for Commercial Arbitration (J. Paulsson, ed.), *IV INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION*, Switzerland: Annex II—1 (March, 2008).

by the provisions of the Concordat.<sup>41</sup> Under Article 36 of the Concordat, an award can be annulled if:

“f. \* \* \* the award is arbitrary in that it was based on findings which were manifestly contrary to the facts appearing in the file, or in that it constitutes a clear violation of law or equity.”<sup>42</sup>

In some countries, where statutory provisions allow expanded review for domestic but not for international arbitration, court decisions have rejected the Swiss flexibility and have disallowed party attempts to choose domestic arbitration standards for international arbitration. France and Belgium follow this pattern.<sup>43</sup> In other countries with differential standards for domestic and international arbitration, such as Peru and Tunisia, the issue seems not yet to have arisen, or at least prominent commentators make no mention of it.<sup>44</sup>

In Italy, whether domestic or international arbitration is involved, parties may expressly provide for expanded judicial review.<sup>45</sup> The Italian Code of Civil Procedure, as amended through 2006, expressly provides for court review of an award, including an international award, for violation of the rules of law. Art. 829 para 2 provides: “The recourse [for nullity] for violation of the rules of law relating to the merits of the dispute shall be admitted if so expressly provided by the parties \* \* \*”. In Sweden, although the 1999 Swedish Arbitration Act contains

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<sup>41</sup> See Introduction to the Case Law Section, para. 9, 25 ASA Bull. (Issue #3) p. 519 (2007), citing a Swiss Federal Tribunal decision of 27 February 2007 (4P.304/2006); 25 ASA Bull. (Issue #3) p. 582.

<sup>42</sup> International Council for Commercial Arbitration (J. Paulsson, ed.), IV INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION, Switzerland: Annex I—7 (March, 2008).

<sup>43</sup> On French law, see Emmanuel Gaillard and John Savage, eds., Fouchard, Gaillard, Goldman, ON INTERNATIONAL COMMERCIAL ARBITRATION 917 (1999) (citing decisions of the Cour de cassation and the Court of Appeal of Paris). On Belgian law, see Guy Keutgen and Georges Albert Dal, “Belgium” in I International Council for Commercial Arbitration, (J. Paulsson, ed.), INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION at Belgium-37 (Supplm 49, April 2007) (“A contractual clause which provides for a right to appeal an arbitral award to the courts would be null and void.”).

<sup>44</sup> On Peruvian law, see Ulises Montoya Alberti, “Peru” in III International Council for Commercial Arbitration, (J. Paulsson, ed.) INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION at Peru 21-23 (Supplm. 27, December, 1998) (noting that appeal on the merits is available for domestic arbitration but not for international arbitration and omitting any discussion of whether parties to international arbitration are free to choose the domestic regime by express provision. On Tunisian law, see Habib Malouche, “Tunisia” in IV International Council for Commercial Arbitration, (J. Paulsson, ed.) INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION at Tunisia 12-13 (Supplm. 18, September, 1994) (noting that appeal on the merits is “regulated” in domestic arbitration but not available for international arbitration and omitting any discussion of whether parties to an international arbitration are free to choose the domestic regime). In Germany, whose arbitration law closely follows the UNCITRAL Model Law, no distinction is drawn between domestic and international arbitration, and the German statute is explicit in limiting court review of awards to the statutory grounds. Section 1059(1) of the ZPO (Code of Civil Procedure) provides: “Recourse to a court against an arbitral award may be made only by an application for setting aside in accordance with subsections 2 and 3 of this section.” These subsections do not allow review on the merits.

<sup>45</sup> See Piero Bernardini, “Italy” in III International Council for Commercial Arbitration, (J. Paulsson ed.), INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION at Italy-47 (Supplm 49, April, 2007). See also, Jean-François Poudret & Sebastien Besson, COMPARATIVE LAW OF INTERNATIONAL ARBITRATION at 772 (2d ed. 2007).

no express provisions on the point, at least one commentator believes that expanded judicial review would be available if the parties expressly provide for it.<sup>46</sup>

Finally, English law has long provided for judicial review of awards for errors of law. The English pattern may well have originated, or been allowed to continue, because of the importance of providing a developed case law in commercial fields to guide merchants relying on English law to govern their transactions. Court review assured consistency in commercial fields where the same issues arose repeatedly.<sup>47</sup> Also arbitrations in England in some trades were frequently conducted by non-lawyer arbitrators,<sup>48</sup> who could not always be expected to understand or apply fine points of commercial law correctly. In the current 1996 English Arbitration Act judicial review of awards for errors of law is no longer automatically available, but is nevertheless authorized if, among other sufficient conditions, the parties expressly provide for it in their agreement.<sup>49</sup> Review for fact finding errors is not authorized,<sup>50</sup> and review for errors of law applies only where English law is the governing law of the contract.<sup>51</sup>

## VI. Conclusion

Returning to Professor Varady's arresting inquiry concerning which approach—allowing of disallowing party choice of expanded judicial review—is more “pro-arbitration”, this essay seeks to build upon Professor Varady's original analysis. We have seen that even for international arbitration in the United States after *Hall Street*, expanded judicial review still seems available—but only if parties draft their agreement carefully. Certain other countries also allow expanded review, but again often only if the parties' will is expressed with definiteness and precision. Thus, one might say that in most countries—and certainly this is so for the United States—the default position disfavors expanded review in international arbitration. On the other hand for parties who have a serious interest in expanded review (possibly to counteract a perceived tendency of arbitrators to render compromise awards), it is available if they place the seat in one of the accommodating jurisdictions and draft the agreement expertly. Serious consequences attach to such provisions, including the sacrifice of some of arbitration's efficiency and the introduction of the potential for further wasteful litigation. Thus, conditioning the availability of expanded review on the presence in the arbitration agreement of express and rather uncommon provisions seems to function in the way the writing requirement once functioned for arbitration in general—as a gatekeeper to ensure that those who enter are informed and conscious of what lies on the other side of the gate. Whereas the writing

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<sup>46</sup> See Ulf Franke, “Sweden” in Vol. IV International Council for Commercial Arbitration, (eds. P. Sanders & A. van den Berg), INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION at Sweden-20 (Supplement 32, December, 2000) (commenting on Swedish Arbitration Act of 1999). Franke asserts: “The Act does not provide for any appeal on the merits to the courts. However, there [are] no restrictions for parties to make an arrangement to such effect, although this happens very rarely, if, indeed ever.” Id.

<sup>47</sup> Cf. Alan Redfern & Martin Hunter, LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION at 434 (Student Ed. 2003).

<sup>48</sup> See Redfern and Hunter, id. at 436 fn 13.

<sup>49</sup> See Jean-François Poudret & Sebastien Besson, COMPARATIVE LAW OF INTERNATIONAL ARBITRATION at 759 and cases cited at fn 332 (2d ed. 2007).

<sup>50</sup> Id.

<sup>51</sup> Id. The 1996 English Arbitration Act at Section 82(1) defines “question of law” as used in the act to refer to English law.

requirement was intended to guard against parties unwittingly giving up their rights to judicial justice, the drafting requirements incident to expanded review guard against parties unthinkingly re-introducing the potential burdens of judicial justice. Still, if this is the well-informed will of sophisticated commercial parties, would it not be pro-arbitration to endorse this form of party autonomy.