THE CANADIAN POSITION: CAN PARTIES TO AN ARBITRATION AGREEMENT VARY THE STATUTORY SCOPE OF JUDICIAL REVIEW OF THE AWARD?

Barry Leon and Laila Karimi, Torys LLP

I. INTRODUCTION ........................................... 451
II. OVERVIEW OF HALL STREET ........................................... 452
III. CANADIAN CASE LAW ON VARYING GROUNDS OF REVIEW ........... 455
   A. Food Services of America, Inc. v. Pan Pacific Specialties Ltd (British Columbia) ........... 455
   B. Noble China Inc. v. Lei (Ontario) .......... 457
   C. The Parties Cannot Confer Appellate Jurisdiction .......... 458
IV. CONCLUSION ........................................... 459

I. INTRODUCTION

The U.S. Supreme Court issued its decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.* on March 28, 2008. The case had triggered discussion in the United States and in other jurisdictions, including Canada, about the central issue: whether parties to an arbitration agreement can contractually vary the statutory grounds for judicial review of an arbitral award and, if so, to what extent.

In *Hall Street*, the agreement for a domestic arbitration provided broader grounds of judicial review than are specified in the Federal Arbitration Act (FAA). The agreement stated that the district court shall vacate, modify or correct the arbitration award where the arbitrator’s conclusions of law are incorrect.

The main question posed to the court was whether parties can contractually expand the grounds for judicial review of their arbitral award. In other words, is a U.S. court barred from enforcing an arbitration agreement that provides for more expansive grounds of judicial review than are specified in the FAA?

---

* Barry Leon, a partner in the Toronto office of Torys LLP, practices international and domestic litigation and arbitration. Laila Karimi is a student-at-law in the Toronto office of Torys LLP.

The Supreme Court held that if parties to an arbitration agreement want to make use of the expedited review of awards contemplated by the FAA, they cannot modify the grounds for judicial review by agreement.

The issue of varying statutory grounds of review has been the subject of limited Canadian judicial consideration and only in the context of whether parties can contract those grounds.

II. OVERVIEW OF HALL STREET

Hall Street involved a dispute between a landlord and tenant. The landlord, Hall Street, leased property to Mattel. The property had been used by Mattel and its predecessors as a toy manufacturing facility. It was undisputed that the well water on the property, used for drinking and bathing, was contaminated and that Mattel and its predecessors, in contravention of the Oregon Drinking Water Quality Act (ODWQA), did not test the well water for contaminants. Hall Street commenced an action claiming that Mattel was required to indemnify it from all actions by any parties in relation to the condition of the property. Under a settlement agreement, the parties decided to arbitrate, and the agreement specifically stated that the district court “shall vacate, modify or correct any award: (i) where the arbitrator’s findings of facts are not supported by substantial evidence, or (ii) where the arbitrator’s conclusions of law are erroneous.” The District Court approved and adopted the agreement as an order.

The arbitrator found that despite Mattel’s violation of the ODWQA, it had not violated any “applicable environmental laws.” Under the lease, a violation of applicable environmental laws would result in the landlord gaining broad indemnification rights. The arbitrator found that because the ODWQA was not designed to protect either human health, or landowners’ property from environmental contamination, it was not an applicable environmental law. Therefore, the arbitrator concluded that Mattel was exempt from the indemnification requirements of the lease.

The district court, in remanding the case back to the arbitrator, granted Hall Street’s motion to vacate the arbitration award on the ground that the arbitrator’s conclusion that the ODWQA was not an applicable environmental law was wrong. The arbitrator then reversed his decision in favor of Hall Street. On judicial review, the district court upheld the arbitrator’s amended decision. On appeal, the Ninth Circuit followed its en banc decision in Kyocera

Leon and Karimi Corp. v. Prudential-Bache Trade Services, Inc.\(^5\) and reversed the district court's initial vacation of the arbitrator's initial erroneous award holding that "the terms of an arbitration agreement controlling the [grounds] of judicial review [is] unenforceable and severable." On remand to the district court, the court held that an arbitrator exceeds his powers within the meaning of the FAA when the award is based on an implausible interpretation of a contract, as was the arbitrator's interpretation that the ODWQA was not an applicable environmental law. It again vacated the original arbitration award. Mattel appealed to the Ninth Circuit again and the court reversed the district court's decision by holding that "[i]mplausibility is not a valid ground for avoiding an arbitration award."\(^7\)

The district courts have been split on this issue. The Ninth and Tenth Circuit Courts have held that the FAA sets the exclusive standard by which an arbitrator's decision may be reviewed;\(^8\) other district courts, however, have held that parties may contractually expand the grounds for judicial review or may supplant the review set out in the FAA with clear contractual language.\(^9\)

The importance of the issue attracted a number of intervenors to the appeal. In support of the petitioner, the Wireless Association submitted that arbitration agreements as drafted by the parties should be enforced; otherwise, Congress's intention to encourage parties to arbitrate would be undermined. The New England Legal Foundation and the National Federation of Independent Business Legal Foundation intervened jointly, advancing the position that the FAA provides a default standard of judicial review upon which the parties may expand, that contractual freedom would reduce the burden on courts, and foster reliance on arbitration. In addition, the Pacific Legal Foundation advocated that the FAA was designed to encourage freedom of choice and that expanding the grounds of review by contract is simply a choice of procedure as opposed to an expansion of the courts' jurisdiction.

The American Arbitration Association and the United States Council for International Business supported the respondent, arguing that expanding judicial review would result in the loss of the element of finality of arbitration decisions. They also argued that such a finding would go against the plain meaning of the FAA and that it would open the floodgates and strain judicial

\(^{5}\) Hall Street Associates, L.L.C. v. Mattel Inc., 113 F.App'x 272, 273 & n.3 (9th Cir. 2004) (citing Kyocera Corp. v. Prudential-Bache Trade Services Inc., 341 F.3d 987, 994 (9th Cir. 2003)).

\(^{6}\) Hall Street, 113 F.App'x at 273.

\(^{7}\) Hall Street Associates, L.L.C. v. Mattel Inc., 196 F.App'x 476, 477 (9th Cir. 2006).

\(^{8}\) Hall Street, 113 F.App'x at 273; Bowen v. Amoco Pipeline Co., 254 F.3d 925, 930 (10th Cir. 2001).

\(^{9}\) Gateway Technologies Inc. v. MCI Telecommunications Corp., 64 F.3d 993, 996 (5th Cir. 1995); Syncor Int'l Corp. v. McLeland, 120 F.3d 262 (4th Cir. 1997).

\(^{10}\) Puerto Rico Tel. Co. v. U.S. Phone Mfg. Corp., 427 F.3d 21, 21 (1st Cir. 2005).
resources. They also offered the contention that since other leading jurisdictions limit the grounds for judicial review, the United States would become a less attractive forum for arbitration.

The U.S. Supreme Court's decision placed considerable emphasis on the literal text of the FAA. The Court held that the grounds for vacatur and modification set out in sections 10 and 11 of the FAA are the exclusive grounds for review by virtue of section 9, which states that "the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title" [emphasis added]. In focusing on the language of section 9, the Court determined that it provides for no flexibility; rather, section 9 of the FAA unequivocally tells courts to grant confirmation in all cases, except when one of the "prescribed" exceptions applies. This does not sound remotely like a provision meant to tell a court what to do just in case the parties say nothing else.

Instead of fighting the text, it makes more sense to see the three provisions, §§9-11, as substantiating a national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straightaway. Any other reading opens the door to the full-bore legal and evidentiary appeals that can "render informal arbitration merely a prelude to a more cumbersome and time-consuming judicial review process" and bring arbitration theory to grief in post-arbitration process.

The Supreme Court did not differentiate between contractually expanding or limiting rights of review in an arbitration agreement. Rather, the Court rejected any modification of the grounds of review set out in sections 10 and 11 of the FAA.

The intervenors on behalf of Hall Street argued that parties will flee arbitration if expanded review is not permitted, whereas one of the intervenors on behalf of Mattel argued that parties will flee the courts if expanded review is permitted. The Court gave little weight to these arguments, stating that "whatever the consequences . . . the statutory text gives us no business to expand the statutory grounds."

Despite the strict adherence to sections 10 and 11 of the FAA, the Court recognized that the FAA is not the only way in which parties can have arbitral

12. Hall Street Assocs., 170 L. Ed. 2d at 264.
13. Id. at 265.
14. Id. at 266.
awards reviewed. The Court pointed to state statutes and the common law as other means of having courts review arbitral awards. The Court outlined that the holding of this case applies only to parties taking advantage of the expedited judicial review under the FAA. In the end, the decision was remanded to the Ninth Circuit for consideration of other issues.

The dissenting opinion criticized the majority for ignoring the historical context in which the FAA was passed. Justice Stevens maintained that the core purpose of the FAA is to favor the enforceability of fairly negotiated arbitration agreements, stating that section 2 of the FAA makes written arbitration agreements "valid, irrevocable, and enforceable." He went on to state that reliance on the literal text of the FAA "is flatly inconsistent with the overriding interest in effectuating the clearly expressed intent of the contracting parties."

III. CANADIAN CASE LAW ON VARYING GROUNDS OF REVIEW

In Canada, very few court decisions have considered whether parties to an international arbitration agreement can contractually vary the statutory grounds for judicial review of an arbitral award.

In Canada's common law jurisdictions, the international arbitration statutes are Model Law\textsuperscript{16} statutes. There are separate domestic arbitration statutes that in some cases deal differently with rights of appeal and review. In Quebec, arbitration provisions are contained in the Civil Code, with a provision for the Model Law to be considered in international arbitration.

Those few Canadian court decisions on the subject of varying grounds of review in international arbitration have considered the question of limiting the grounds as opposed to expanding them.

A. Food Services of America, Inc. v. Pan Pacific Specialties Ltd (British Columbia)

In Food Services of America, Inc. v. Pan Pacific Specialties Ltd,\textsuperscript{17} a 1997 decision of the British Columbia Supreme Court, a trial-level court, the parties included a clause in their international arbitration agreement in which they "expressly waive any entitlement they have or may have to rely upon" the statutory grounds for refusing recognition or enforcement of an international arbitral award.\textsuperscript{18}

\begin{itemize}
  \item 15. *Hall Street Assocs.*, 170 L. Ed. 2d at 268 (Stevens, J., dissenting).
  \item 18. Id. ¶ 10.
\end{itemize}
Section 36 of the International Commercial Arbitration Act of British Columbia (BC ICAA), a Model Law statute, provides the grounds upon which a party may oppose recognition and enforcement of an international arbitration award in British Columbia, as follows:

Grounds for refusing recognition or enforcement

36 (1) Recognition or enforcement of an arbitral award, irrespective of the state in which it was made, may be refused only
(a) at the request of the party against whom it is invoked, if that party furnishes to the competent court where recognition or enforcement is sought proof that
(i) a party to the arbitration agreement was under some incapacity,
(ii) the arbitration agreement is not valid under the law to which the parties have subjected it or, failing any indication of that law, under the law of the state where the arbitral award was made,
(iii) the party against whom the arbitral award is invoked was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present the party’s case,
(iv) the arbitral award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the arbitral award which contains decisions on matters submitted to arbitration may be recognized and enforced,
(v) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties or, failing any agreement, was not in accordance with the law of the state where the arbitration took place, or
(vi) the arbitral award has not yet become binding on the parties or has been set aside or suspended by a court of the state in which, or under the law of which, that arbitral award was made, or
(b) if the court finds that
(i) the subject matter of the dispute is not capable of settlement by arbitration under the law of British Columbia, or
(ii) the recognition or enforcement of the arbitral award would be contrary to the public policy in British Columbia.

(2) If an application for setting aside or suspension of an arbitral award has been made to a court referred to in subsection (1) (a) (vi), the court where recognition or enforcement is sought may, if it considers it proper, adjourn its decision and may also, on the
application of the party claiming recognition or enforcement of the arbitral award, order the other party to provide appropriate security.\textsuperscript{19}

Section 36 of the BC ICAA is essentially the same as Article 34 of the Model Law (application for setting aside as exclusive recourse against arbitral award).\textsuperscript{20}

The respondent in \textit{Food Services} did not argue that a waiver was not permitted. Rather, it submitted that the waiver applied only where the arbitration was conducted strictly in accordance with the International Arbitration Rules of the American Arbitration Association, the rules under which the arbitration agreement required the arbitration to be conducted. The Supreme Court of British Columbia held that if that were the case, there would be no need to make use of Section 36, rendering the waiver useless.

The court did not discuss whether a waiver was possible. Implicitly it accepted that it was possible and discussed the respondent's submission, stating that "[i]t would not be appropriate for a court to go beyond the clear meaning of the words in an arbitration agreement and interpret them in such a way as to render the clause meaningless."\textsuperscript{21}

\textbf{B. Noble China Inc. v. Lei (Ontario)}

The 1998 decision of the Ontario Court (General Division) (now the Ontario Superior Court of Justice) in \textit{Noble China Inc. v. Lei}\textsuperscript{22} upheld a settlement agreement arbitration clause in which the parties contractually limited the grounds of judicial review of the arbitral award. The agreement provided: "No matter which is to be arbitrated is to be the subject matter of any court proceeding other than a proceeding to enforce the arbitration award."\textsuperscript{23}

The arbitration was governed by the Ontario International Commercial Arbitration Act (Ontario ICAA), a Model Law statute.\textsuperscript{24} The respondent Lei moved unsuccessfully to set aside the award under Article 34 of the Model Law (grounds for setting aside an arbitral award).\textsuperscript{25} In summary, the court concluded that:

(a) Article 19 of the Model Law (determination of rules of procedure), as incorporated into the Ontario ICAA, permits parties to

\textsuperscript{21} \textit{Food Services}, 32 B.C.L.R. (3d) ¶ 15.
\textsuperscript{23} \textit{Id.} at 73.
\textsuperscript{25} \textit{Noble China}, 42 O.R. (3d) at 96.
agree on the rules of procedure for their arbitration, except in the case of mandatory provisions of the Model Law (for example, Article 18, equal treatment of parties required) or where the procedure would be contrary to public policy;
(b) Contrary to the respondent’s submission, Article 34 is not a mandatory provision of the Model Law out of which parties cannot contract; and
(c) The agreement not to resort to the courts was part of the permitted procedural agreement of the parties.  

As a result, “[t]he rules to which they agreed exclude recourse to the courts except to enforce an award.” The court noted that the Ontario domestic arbitration statute expressly prohibits parties from contracting out of the comparable “setting aside an award” provision, which the Ontario ICAA does not do.

The court’s judgment analyzes how to determine which articles of the Model Law are mandatory and which are not. The court held that all articles that are not discussed in the Commentary with mandatory language (i.e., words such as “may” as opposed to “shall”) are not mandatory and can be derogated from. The court noted that the Commentary to Article 34 states that “[p]aragraph (2) lists the various grounds on which an award may be set aside.” The court held that Article 34 is not a mandatory provision.

C. The Parties Cannot Confer Appellate Jurisdiction

In Hall Street, one argument against permitting parties to expand the scope of court review of arbitral awards is grounded in the reasoning that parties should not have the ability to contractually agree that the courts will have greater jurisdiction than the FAA provides.

An indication of the way Canadian courts might react can be found in the 2004 decision of the Court of Appeal for Ontario in Brent v. Brent. The arbitration agreement did not purport to vary the scope of judicial review of the

26. Id. at 87, 90, 92, 93–94.
27. Id. at 88.
28. Id. at 88–89.
32. Noble China, 42 O.R. (3d) at 94.
33. Hall Street, 113 F.App’x at 273 (citing Kyocera, 341 F.3d at 994).
award. However, it did purport to allow an appeal (on questions of law) directly to the Court of Appeal, contrary to the scheme in the domestic arbitration statute for appeals from awards to go to the Superior Court (and only on specified grounds), with a limited further appeal right, with leave, to the Court of Appeal. The Court of Appeal held that it is a statutory court, with its jurisdiction defined by statute.\textsuperscript{35} It has no original jurisdiction to hear an appeal from an arbitration award and the parties cannot confer jurisdiction on it.\textsuperscript{36}

IV. CONCLUSION

The U.S. Supreme Court majority opinion in \textit{Hall Street} that parties cannot expand the scope of judicial review of arbitral awards was based squarely on the language in the relevant provisions of the FAA. The Court held that the grounds for vacatur and modification set out in sections 10 and 11 of the FAA are the exclusive grounds for review by virtue of section 9, which states that “the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title”.

The Ontario court’s reasoning in \textit{Noble China} was that the judicial review provision in Article 34 of the Model Law is not a mandatory provision out of which parties cannot contract. That reasoning is closer in spirit to Justice Stevens’ reasoning in his minority opinion in \textit{Hall Street} that the core purpose of the FAA is to favor the enforceability of fairly negotiated arbitration agreements.

It remains to be seen whether Canadian appellate courts will endorse the approach of the trial level courts in Ontario and British Columbia that permitted parties to contractually limit courts’ rights of review of arbitral awards. However, at least on the basis of on Canadian court decisions to date, it can be said that the FAA and the Model Law took opposite approaches to the ability of parties to expand the scope of judicial review of arbitral awards: the FAA precludes the parties from doing so while the Model Law appears to permit them to do so.

\textsuperscript{35} \textit{Id. at 740.}
\textsuperscript{36} \textit{Id.}