9th Circ. Decision Shows Limits Of Arbitrator Authority

By **Allen Lanstra and Raza Rasheed** (May 2, 2019, 3:15 PM EDT)

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To the dismay of losing parties, most arbitration awards are final and nonreviewable. The Federal Arbitration Act requires courts to confirm arbitration awards absent fraud, arbitrator misconduct, certain technical errors or a showing that the arbitrator was not even arguably interpreting the parties' agreement. Litigants are rarely able to persuade courts to vacate even the most wrongheaded awards, but a recent Ninth Circuit decision may provide a roadmap for litigants to challenge a broader spectrum of awards.

In Aspic Engineering and Construction Company v. ECC Centcom Constructors LLC,[1] the Army Corps of Engineers contracted with ECC and ECC International to build facilities in Afghanistan. Those companies entered into subcontracts with Aspic, a local Afghan company. The subcontracts incorporated by reference certain federal regulations requiring contractors to provide detailed accounting data before receiving payment if their projects are terminated before completion. The Army Corps of Engineers terminated its contracts with the ECC entities, which consequently terminated their subcontracts with Aspic.

Aspic did not comply with the federal regulations because it used handwritten receipts that were not written in English, and used dates from the Islamic, rather than Gregorian, calendar. Aspic's deficient record keeping practices prevented the ECC entities from recovering their full termination costs from the Army Corps of Engineers, so the ECC entities paid Aspic significantly less than it had originally demanded.

Aspic instituted arbitration proceedings and prevailed. The arbitrator awarded Aspic more than $1 million. Notwithstanding the subcontracts' incorporation of federal regulations, the arbitrator held that the parties could not have reasonably expected that Aspic could conform to the strict requirements expected of U.S. government contractors because it is a relatively unsophisticated local Afghan contractor.

The arbitrator further reasoned that it would be unfair to deprive Aspic of so much money merely because it kept records in a manner customary in Afghanistan. The arbitrator thus concluded that the parties never reached a true "meeting of the minds" with respect to the incorporation of the federal record keeping regulations, and ordered the ECC entities to pay Aspic in full.

The ECC entities challenged the result in the U.S. District Court for the Northern District of California, which vacated the arbitration award. In affirming, the U.S. Court of Appeals for the Ninth Circuit held that the arbitrator exceeded his authority in concluding that the parties could not have intended for Aspic to strictly adhere to the record keeping regulations.

The court reasoned that while the arbitrator's award might have been permissible if it had been based on the parties' past practices as a matter of contract interpretation, the award was "completely irrational" because it was based on the misapplication of contract law to avoid producing what the arbitrator considered an "unjust" result.

Aspic allows litigants to challenge arbitral decisions that invoke equitable concepts to sidestep a contract's written terms. Despite the frequency with which arbitration issues are litigated, federal law does not provide clear guideposts for determining when a court may set aside the award under Section 10 of the Federal Arbitration Act. Instead, decades of appellate decisions have created norms strongly favoring judicial deference to arbitration proceedings.

Thus, arbitrators are given wide latitude to utilize recognized contract doctrines in rendering a decision, even if they use those doctrines in a way that goes beyond what most courts would consider proper. This is what happened in Aspic: The arbitrator used ordinary contract principles (determining whether the parties reached a "meeting of the minds" to incorporate federal regulations into the subcontracts) in an inappropriate way (basing the determination on the overall "reasonableness" of the agreement, rather than objective indicia of the parties' intent) to achieve a desired result (ignoring the incorporated federal regulations entirely).

The fact that the Aspic court reined in the arbitrator's overreach may have significant implications in a variety of contexts. Litigants may argue that Aspic authorizes judicial intervention when the arbitrator misuses equitable concepts to circumvent the parties' written agreement. Although an underlying concern in Aspic was protecting the application of federal contracting regulations that are routinely incorporated into government contracts, the decision can be read more broadly as disapproving the use of an arbitrator's abstract sense of fairness to override the parties' agreement.

Courts, which have traditionally played little role in policing arbitral awards, may read Aspic as mitigating a broader spectrum of arbitral abuses. Even if courts decline to read Aspic broadly, arbitrators may view the decision as a warning to stay within the four corners of a contract.

The decision may be particularly helpful for business entities, because the relative sophistication of the parties is frequently at issue in commercial arbitration proceedings. Large domestic companies regularly arbitrate with ordinary consumers, small businesses and increasingly, as in Aspic, foreign entities in developing countries. Attorneys representing these smaller litigants often argue that the parties' differing sophistication levels should factor in to the arbitrator's interpretation of the agreement. Aspic may curb the effectiveness of such arguments.

Judicial decisions vacating arbitration awards will likely remain rare. The Aspic decision, however, is a reminder that arbitrators do not have unlimited equitable authority to mete out economic justice. If the parties agree to be governed by a written contract, arbitrators are expected to enforce it in accordance with the law of contracts. Aspic is heartening evidence that federal courts may act as a backstop — and potential source of leverage — to ensure that arbitrators do so.

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[1] Aspic Engineering and Construction Company v. ECC Centcom Constructors LLC, No. 17-16510 (9th Cir. Jan. 28, 2019)
