The Arbitration Newsletter

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The Arbitration Newsletter is published periodically by Whitaker Chalk Swindle & Schwartz PLLC, Fort Worth, Texas, to explore the rapidly developing law and practice of commercial arbitration both in the U.S. and other countries.[1]

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TOO "PRIMITIVE" TO PARTICIPATE?
Aspic Engineering & Construction Co. v. ECC Centcom Constructors LLC[2]

This case arose out of two subcontracts between ECC and Aspic. ECC, appellee, had prime contracts with the U.S. Army Corps of Engineers ("USACE") for various construction projects in Afghanistan. In connection with these contracts, ECC entered into two subcontracts with Appellant Aspic, a local Afghani subcontractor. These subcontracts incorporated by reference many U.S. Federal Acquisition Regulation ("FAR") clauses, including termination for convenience. The subcontracts additionally stated that Aspic owed "to ECC the same obligations that ECC owed to the United States government."[3]

USACE terminated ECC's prime contracts for convenience, leading to ECC terminating the subcontracts with Aspic. The dispute presented to the arbitrator was to determine the expenses owed to Aspic from ECC for performance under the subcontracts. The arbitrator awarded Aspic $1,072,520.90 and, though the argument was not before the arbitrator, the arbitrator concluded that Aspic need not comply with the FAR provisions in the subcontracts.[4] The arbitrator held:

> *Each subcontract included very detailed provisions relating to Federal regulations governing the work as well as pass through and 'Pay when/if Paid' clauses. . .* In light of the fact that the ASPIC was a local Afghanistan subcontractor that had some experience with government contracting but not nearly as extensive as that of ECC, and in view of the fact that the normal business practices and customs of subcontractors in Afghanistan were more 'primitive' than those of U.S[.] subcontractors experienced with U.S[.] Government work, it was not reasonable to expect that Afghanistan subcontractors would be able to conform to the strict and

[1] Nothing in The Arbitration Newsletter is presented as or should be relied on as legal advice to clients or prospective clients. The sole purpose of The Arbitration Newsletter is to inform generally. The application of the comments in The Arbitration Newsletter to specific questions and cases should be discussed with the reader's independent legal counsel. My thanks to Morgan Parker, a third-year law student at Texas A&M University School of Law, for her research and drafting assistance.

[2] No. 17-16510, 2019 U.S. App. LEXIS 2774, at *1 (9th Cir. 2019).

[3] *Id.* at *3.

[4] *Id.* at *5-6.

> detailed requirements of general contractors on U.S. Federal projects. Notwithstanding that expectation, ECC prepared its subcontract agreements to require the same level of precision and adherence to Federal procedures from ASPIC as ECC had toward the USACE through the pass through provisions of the agreements.
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> It was not reasonable that when the parties entered into the subcontract agreements, they both had the same expectations as to the performance of the agreements. ECC could not expect that ASPIC would be capable of modifying their local business practices to completely and strictly conform to the US governmental contracting practices that were normal to ECC. *There was not a true meeting of the minds when the subcontract agreements were entered. Hence, ASPIC was not held to the strict provisions of the subcontract agreements that ECC had to the USACE*. This arbitration demonstrated that ASPIC conducted its business practices in a manner normal to Afghanistan which was clearly not the same as a U[.]S[.] subcontractor working on a Federal project in the U.S.[5]

The award was confirmed in the Superior Court for San Mateo County, California.[6] Following the denial of its motion to vacate the arbitration award in county court, ECC removed the case to the Northern District of California. The district court granted ECC's motion to vacate the award on the grounds that the arbitrator exceeded his authority. The court held that "the Award conflicted with the contract because the arbitrator voided and reconstructed parts of the Subcontracts based on a belief that the Subcontracts did not reflect a 'true meetings [sic] of the minds'."[7] Aspic appealed to the Ninth Circuit.

The court had to determine "whether the Arbitrator exceeded his powers in finding that Aspic need not comply with the FAR provisions."[8] Ninth Circuit precedent holds that "Arbitrators exceed their powers when the award is 'completely irrational.'"[9] An award is completely irrational "only where the arbitration decision fails to draw its essence from the agreement."[10] ECC argued that the arbitrator was completely irrational by explicitly disregarding requirements that were evident by the plain meaning of the contract.[11] The court noted that though "[a]n arbitrator may interpret the contract 'in light of . . . indications of the parties' intentions and find that the parties' conduct modified the text of a contract," "What an arbitrator, however, may not do is disregard contract provisions to achieve a desired result."[12]

The court held that by concluding Aspic need not comply with the FAR requirements, the arbitrator did not acknowledge a modification of the subcontracts based on past practice of the parties, but instead improperly disregarded the plain text of the subcontracts to create what he

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[5] *Id.* at *9-10 (emphasis in original).
[6] *Id.* at *6.
[7] *Id.* (internal quotations omitted).
[8] *Id.* at *8-9.
[9] *Id.* at *8.
[10] *Id.* (internal quotations omitted).
[11] *Id.* at *11.
[12] *Id.*

deemed a "just" result.[13] The arbitrator based his award on facts that, in his mind, showed Aspics' "primitive" practices, such as using their native language and dates from the Islamic calendar.[14] "[T]he Arbitrator reasoned that the expectation of a seemingly less sophisticated contractor complying with these regulations was unreasonable" and therefore disregarded the clear provisions in the subcontracts.[15] To further its holding that the arbitrator exceeded his powers by being completely irrational, the court noted that neither party argued that the FAR provisions did not apply.[16] In fact, both parties argued certain FARs that required settlement and settlement procedures upon a contract termination for convenience.[17]

The court highlighted the seriousness of the arbitrator's mistake by stating: "To allow contractors and subcontractors, foreign or domestic, to evade the FAR provisions because a subcontractor was too unsophisticated or inexperienced to fully understand them would potentially cripple the government's ability to contract with private entities, and would violate controlling federal law."[18]

OBSERVATIONS

1. 9 U.S.C. §10(a)(4) remains the most successful vacatur ground used by complaining parties.

2. The arbitration agreement remains the foundation and limitation for all arbitrator power.

3. Arbitration is a creature of contract, as many courts observe, and is the customary source of the arbitrator's jurisdiction.

4. U.S. courts continue to recognize an arbitrator's lack of power to ignore the parties' contract and to enforce the arbitrator's own brand of industrial justice.[19]

5. The arbitrator cannot disregard "the plain text of a contract without legal justification" simply because of what the arbitrator believes is just.[20]

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[13] *Id.* at *13-14.

[14] "[T]he Arbitrator evaded the pass-through provisions by determining that there was not a true "meeting of the minds" when the parties formed the Subcontracts because "the normal business practices and customs of subcontractors in Afghanistan were more 'primitive' than those of U.S. subcontractors," and ECC could not expect Aspic to "strictly conform" to United States governmental contracting regulations." *Id.* at *13.

[15] *Id.* at *13.

[16] *Id.* at *14.

[17] *Id*.

[18] *Id.* at *15.

[19] *Southwest Regional Council of Carpenters v. Drywall Dynamics, Inc.*, 823 F.3d 521, 530 (9th Cir. 2016)("A court may intervene only when an arbitrator's award fails to 'draw its essence from the collective bargaining agreement,' such that the arbitrator is merely 'dispens[ing] his own brand of industrial justice'.").

[20] R-47(a), AAA Commercial Arbitration Rules (2013) ("The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable **and** within the scope of the agreement of the parties, including, but not limited to, specific performance of a contract."). (Emphasis added.).