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Court will resolve a clash of fundamental values

'Hall Street' tests the right to a review of arbitrators' decisions.

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IN A CASE BEFORE it this term, the U.S. Supreme Court will face the important task of reconciling the two fundamental policies underlying the nation's arbitration system and determining which one should take precedence: freedom of contract, or efficient dispute resolution.

The question arises in a relatively little-noticed case, *Hall Street Assocs. LLC v. Mattel Inc.*, 127 S. Ct. 2875 (No. 06-989 2007), in which the court will address a split of authority on the enforceability of contractual provisions expanding the standard of review that federal courts may apply to arbitration awards. The U.S. circuit courts of appeals are divided on the issue, and amicus briefs have been submitted both in favor of and against the contractual expansion of judicial review. See Marcia Coyle, "Justices take a critical look at arbitration," NLJ, Oct. 29 at 1.

The Federal Arbitration Act (FAA) creates a body of substantive federal law governing the enforcement and review of arbitration agreements and awards. *Allied-Bruce Terminix Co. Inc. v. Dobson*, 513 U.S. 265, 270-72 (1995). It has long been established that reviewing courts give an arbitrator's factual and legal findings great deference. Under the FAA, an arbitral award must be confirmed unless one of the stat-

utory exemptions listed in 9 U.S.C. 10 applies; the arbitrators acted in manifest disregard of the law; or the arbitral award is incomplete, ambiguous or contradictory. See 9 U.S.C. 9-10; *Matter of Arbitration between Carina Int'l Shipping Corp. and Adam Maritime Corp.*, 961 F. Supp. 559, 563 (S.D.N.Y. 1997). The statutory exemptions permit an arbitration award to be vacated only if the award was procured by corruption, fraud or

Freedom to contract is up against efficient dispute resolution.

undue means; the arbitrators exhibited "evident partiality" or "corruption"; the arbitrators were guilty of misconduct; or the arbitrators exceeded their power.

Given this deference to arbitration awards, a party seeking to vacate an arbitral award in federal court bears the heavy burden of showing that the award falls within the very narrow set of circumstances established by the FAA and common law.

In recent years, seven federal courts of appeals have addressed whether the limited standard of review prescribed by the FAA, in addition to the judicially created "manifest disregard of the law" standard, are the only grounds upon which federal courts may review arbitration awards. The question often arises when the parties have agreed by contract to expand the grounds for judicial review of an arbitration award. A split in the circuits has developed. Five circuits believe that freedom of contract supports enforcing clearly articulated contractual provisions granting additional grounds for judicial review. Two other circuits have expressly disagreed, holding that the FAA's underlying policies of efficient and cost-effective

dispute resolution bar enforcement of provisions allowing for expanded review of arbitration awards. The Supreme Court granted certiorari in *Hall Street Assocs.* to address the permissibility of contractual expansion of judicial review of arbitration awards.

Property dispute

The underlying dispute concerns a property lease between Mattel and Hall Street that did not contain an arbitration agreement. See Petition for Writ of Certiorari, *Hall Street Assocs.*, 2007 WL 12861, at *3 (Jan. 12, 2007). The case was filed in Oregon state court, and removed to the U.S. District Court for the District of Oregon.

After proceeding to trial on one of the claims, the parties agreed to arbitrate the remaining issues. The district court approved the parties' arbitration agreement, including a provision allowing the district court to review the arbitrator's factual findings for substantial evidence and to review the arbitrator's legal findings for legal error.

An arbitration hearing was conducted before a single arbitrator and resulted in an award in favor of Mattel. Hall Street sought to vacate the award in the federal district court. Citing the expanded judicial review provision of the parties' arbitration agreement, the district court vacated the award on a finding of legal error. After remand and subsequent review by the district court, both sides appealed to the 9th U.S. Circuit Court of Appeals.

The 9th Circuit eventually held that the arbitration agreement's expanded judicial review provision could not be enforced, and remanded the case with direction that the motion to vacate be considered under the FAA's narrow standard of review. *Hall Street Assocs. LLC v. Mattel Inc.*, 113 Fed. Appx. 272 (9th Cir. 2004). Once again, the district court vacated the award, and a second appeal and reversal followed. *Hall Street Assocs. LLC v. Mattel Inc.*,

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196 Fed. Appx. 476 (9th Cir. 2006). Ultimately, Hall Street petitioned the Supreme Court for a writ of certiorari, requesting that the court resolve the split among the circuits concerning the enforceability of contractual provisions expanding the standard of review that the federal courts may apply to arbitration awards. On May 29, the Supreme Court granted certiorari. The justices heard oral arguments on Nov. 7, and a decision is expected in the spring.

The circuit split is founded on the competing policies underlying the FAA—that is, the freedom of contract versus efficient and cost-effective dispute resolution. The 1st, 3d, 4th, 5th and 6th circuits have found that enforcing provisions expanding the scope of judicial review is in line with the right to freedom of contract implicit in the arbitration process. See *Gateway Techs. Inc. v. MCI Telecomm. Corp.*, 64 F.3d 993, 996 (5th Cir. 1995) (holding that refusal to enforce provisions allowing for expanded review of arbitration awards “would be quite inimical to the FAA’s purpose of ensuring that private agreements to arbitrate are enforced according to their terms”). See also *Syncor International Corp. v. McLeland*, No. 96-2261, 1997 U.S. App. Lexis 21248 (4th Cir. 1997); *Roadway Package Sys. Inc. v. Kayser*, 257 F.3d 287 (3d Cir. 2001); *Jacada Ltd. v. International Mktg. Strategies Inc.*, 401 F.3d 701 (6th Cir. 2005); *Puerto Rico Tel. Co. Inc. v. U.S. Phone Mfg. Corp.*, 427 F.3d 21 (1st Cir. 2005).

These circuits find support for this proposition in *Mastrobuono v. Shearson Lehman Hutton Inc.*, 514 U.S. 52 (1995), which construed a contractual choice-of-law provision to allow for punitive damages in arbitration; and *Volt Information Sciences Inc. v. Board of Trustees*, 489 U.S. 468 (1989), which held that the FAA did not pre-empt the parties’ agreement to abide by state rules of arbitration. In both cases, the Supreme Court said that Congress enacted the FAA for the “central purpose” of ensuring that private agreements to arbitrate are enforced according to their terms. *Mastrobuono*, 514 U.S. at 53-54; see also *Volt*, 489 U.S. at 478-79.

The 9th and 10th circuits have explicitly ruled to the contrary, finding that private parties have no power to alter or expand the FAA’s grounds for review of arbitration awards and that any contractual provisions purporting to do so are legally unenforceable. These circuits have found that enforcing provisions allowing expanded judicial review would undermine the public policy of efficient and cost-effective dispute resolution upon which the FAA, and the arbitration system, is founded.

Undermining the FAA

In *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 934-35 (10th Cir. 2001), for example, the court held that the enforcement of contractual provisions expanding judicial review would undermine the policies underlying the FAA, and would therefore be pre-empted. The court concluded: “Contractually expanded standards...clearly threaten to undermine the independence of the arbitration process and dilute the finality of arbitration awards because, in

The federal circuit courts have split over the matter.

order for arbitration awards to be effective, courts must not only enforce the agreements to arbitrate but also enforce the resulting arbitration awards.” Id. at 935. See also *Kyocera Corp. v. Prudential-Bache Trade Servs. Inc.*, 341 F.3d 987, 998 (9th Cir. 2003) (“[b]road judicial review of arbitration decisions could well jeopardize the very benefits of arbitration, rendering informal arbitration merely a prelude to a more cumbersome and time-consuming judicial review process”).

The 2d, 7th and 8th circuits have not explicitly ruled on this issue, although opinions from these courts suggest that they might follow the 9th and 10th circuits. See *Hoeft v. MVL Group Inc.*, 343 F.3d 57, 65 (2d Cir. 2003) (rejecting as unenforceable an arbitration clause that purported to preclude judicial review of an arbitration award, holding that judicial standards of review “are not the property of private litigants”); *Chicago Typographical Union v. Chicago Sun-Times Inc.*, 935 F.2d 1501, 1505 (7th Cir. 1991) (“[b]ut [the parties] cannot contract for judicial review of that award; federal jurisdiction cannot be created by contract”); *UHC Mgmt. Co. Inc. v. Computer Sci. Corp.*, 148 F.3d 992, 997-98 (8th Cir. 1998) (the ability to contract for a heightened standard of review is not “yet a foregone conclusion”).

Five amicus briefs have been filed in *Hall Street*. The American Arbitration Association and the U.S. Council for International Business argue strongly against giving contracting parties the ability to expand the scope of judicial review of arbitration awards. See Brief of Amicus Curiae American Arbitration Assoc. in Support of Affirmance, 2007 WL 2707884 (Sept. 14, 2007); and Brief for U.S. Council for Int’l Business as Amicus Curiae in Support of

Respondent, 2007 WL 2707883 (Sept. 14, 2007). These organizations argue that doing so would not only erode the efficient, practical and private form of dispute resolution offered by arbitration, but would also undermine the congressional goal of finality of arbitration awards. In addition, they point out that no other country allows parties to create their own standards of judicial review, and also that the international arbitration community favors limited judicial interference with arbitration awards.

Contracts control

Pacific Legal Foundation, CTIA—The Wireless Association, New England Legal Foundation and the National Federation of Independent Business Legal Foundation (filing a brief jointly with the New England Legal Foundation) submitted briefs in favor of allowing parties to expand the scope of judicial review. See Brief Amicus Curiae of Pacific Legal Foundation in Support of Petitioner, 2007 WL 2208838 (July 27, 2007); Brief of CTIA as Amicus Curiae in Support of Petitioner, 2007 WL 2197512 (July 27, 2007); and Brief of Amici Curiae New England Legal Foundation in Support of Petitioner, 2007 WL 2344617 (July 27, 2007). Each argues that the primary goal of the FAA is to enforce parties’ contractual rights, and each further suggests that the standard of review established by the FAA is merely a default rule that can be altered by agreement. In addition, they contend that when the policies of freedom of contract and efficient dispute resolution are in conflict, the Supreme Court has found that freedom of contract controls. *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221 (1985). Each of these briefs also suggests that many parties may be unwilling to arbitrate their disputes absent the ability to expand the scope of judicial review.

In conclusion, the split in the federal courts of appeals has created conflicting outcomes regarding the scope of judicial review of arbitral awards. By granting certiorari in *Hall Street*, the Supreme Court has an opportunity to bring predictability and uniformity back to the federal law of arbitration. The court also may clarify whether freedom of contract or the maintenance of an efficient and cost-effective alternative system of dispute resolution is the primary public policy underlying the FAA. ■

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