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ARBITRATION

BY SAMUEL ESTREICHER AND STEVEN C. BENNETT

Parties Can't Modify FAA Standards for Judicial Review

In a prior column, we wrote about the U.S. Supreme Court's grant of a petition for a writ of certiorari in *Hall Street Assoc. LLC v. Mattel Inc.*[1] to decide whether a federal court can enforce a clause in an arbitration agreement that provides for more expansive review of an arbitration award than is otherwise provided in §§10 and 11 of the Federal Arbitration Act (FAA).[2]

The Holding of 'Hall Street Assoc.'

On March 25, 2008, the Court issued its opinion in *Hall Street Associates*, holding that §§10 and 11 of the FAA "provide exclusive regimes for the review provided by the [FAA.]" Despite this holding, the decision leaves open "other possible avenues for judicial enforcement of arbitration awards," and remands the case for consideration of possible alternate grounds for the expanded review agreed upon by the parties.

The dispute in *Hall Street Associates* arose out of a lease between Hall Street Associates (Hall), the landlord, and Mattel Inc. (Mattel), the tenant, for commercial property in Oregon. Mattel gave notice of termination when it discovered that well water on the property was contaminated. Hall filed suit in Oregon state court for indemnity, claiming that, pursuant to the lease, Mattel was required to indemnify Hall for actions relating to the condition of the property, including water contamination. Mattel removed the case to federal district court, which possessed diversity jurisdiction. After a bench trial, the district court held that Mattel's notice of termination was valid. The parties then sought to mediate their differences, but were unsuccessful, and requested the court's approval to arbitrate the remaining issue of indemnification. The court approved an arbitration agreement that provided in relevant part:

> The United States District Court for the District of Oregon may enter judgment upon any award, either by confirming or by vacating, modifying or correcting the award. The Court shall vacate, modify or correct any award: (i) where the arbitrator's findings of fact are not supported by substantial evidence, or (ii) where the arbitrator's conclusions of law are erroneous.[3]

After a hearing, the arbitrator ruled that Hall was not entitled to indemnification from Mattel. Specifically, he held that the Oregon Drinking Water Quality Act (ODWQA)[4] was not an applicable federal, state, or local environmental law under the lease, but rather a measure to protect human health. As such, even though Mattel had violated the ODWQA, it had not violated an "applicable" environmental law under the lease, and Hall was therefore not entitled to indemnification. Hall filed a motion to vacate the award on the ground that it was legal error for the arbitrator to conclude that the ODWQA was not an applicable environmental law. The district court agreed, and granted Hall's motion to vacate and remand the matter to the arbitrator. On remand, the arbitrator rendered a decision in Hall's favor, awarding Hall declaratory relief and damages. Both sides sought review of the arbitrator's second award. The district court corrected the arbitrator's calculation of interest but otherwise sustained the award.

On appeal, the U.S. Court of Appeals for the Ninth Circuit vacated the district court decision and remanded with instructions to confirm the original award unless the district court determined that the award should be vacated or modified or corrected under the limited grounds provided in the FAA. The district court again held for Hall and the Ninth Circuit again reversed. Hall then successfully petitioned for U.S. Supreme Court review.[5]

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Majority Opinion

In the majority opinion authored by Justice David Souter, the Court held that §§10 and 11 of the FAA provide the exclusive grounds for review under the FAA. Interpreting the 1953 decision in *Wilko v. Swan*[6] as recognizing "manifest disregard of the law" as grounds for review beyond those provided in §10 of the FAA, Hall argued that "expandable judicial review authority has been accepted as the law since *Wilko*." The Court in *Hall Street Associates* disagreed, noting that the language referenced from *Wilko* "expressly rejects just what Hall Street asks for here, general review for an arbitrator's legal errors." The Court went on to observe the "vagueness of *Wilko's* phrasing": Was "manifest disregard" meant to be a new ground for review, or simply a collective reference to the grounds in §10 of the FAA, or shorthand for specific grounds found in §10? The Court left these questions largely unanswered, other than to reject the argument that *Wilko* supported enhanced review of arbitration awards by agreement.

The Court then turned to Hall's second argument, that "the FAA is 'motivated, first and foremost, by a congressional desire to enforce agreements into which parties have entered[,]'" and that the courts should enforce arbitration agreement as written, even with respect to judicial review.[7]

The Court explained that although there is a "general policy of treating arbitration agreements as enforceable…the FAA has textual features at odds with enforcing a contract to expand judicial review following the arbitration."

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Textual Bases

The Court noted three main textual bases for its view on the limits of court review of arbitration awards under the FAA.

- ***First,*** the Court invoked "the old rule of ejusdem generis [that] when a statute sets out a series of specific items ending with a general term, that general term is confined to covering subjects comparable to the specifics it follows." As such, "[s]ince a general term included in the text is normally so limited, then surely a statute," such as the FAA, "with no textual hook for expansion cannot authorize contracting parties to supplement review for specific instances of outrageous conduct with review for just any legal error."
- ***Second,*** the Court read the language of FAA §9, which states that "the court *must* grant such an order [to confirm an arbitration award] *unless* the award is vacated, modified, or corrected *as prescribed* in §10 and 11," to carry "no hint of flexibility."[8] As the majority observed, "[t]here is nothing malleable about 'must grant,' which unequivocally tells courts to grant confirmation in all cases, except when one of the 'prescribed' exceptions applies."
- ***Third,*** the Court pointed to language in §5 of the FAA,[9] which provides "an example of what Congress thought a default provision would look like."

After rejecting Hall's contention that §§10 and 11 of the FAA are not the exclusive grounds for judicial review of an arbitration award, the Court then stated that it was "deciding nothing about other possible avenues for judicial enforcement of arbitration awards."

As we pointed out in our previous column, the arbitration agreement at issue—which had been approved by the district court—could be viewed as a judicially sanctioned process similar to a hearing before a special master. In light of this procedural history, the Court asked at oral argument: "[S]hould the agreement be treated as an exercise of the District Court's authority to manage its cases under Federal Rules of Civil Procedure 16?"[10] The Court had requested supplemental briefing on the issue, but at the end of the day declined to address it, leaving the issue "open for Hall Street to press on remand."

Even more importantly, the Court made clear that it did "not purport to say that [§§10 and 11 of the FAA] exclude more searching review based on authority outside the [FAA] as well. The FAA is not the only way into court for parties wanting review of arbitration awards: [parties] may contemplate enforcement under state statutory or common law, for example, where judicial review of a different scope is arguable."[11]

In the instant case, however, neither the parties nor the courts below ever suggested that anything other than the FAA would apply to the arbitration award. Thus, while the Court's decision closed the door on altering the standard of review under the FAA, it opened doors to a whole host of avenues that parties might pursue to get around the FAA's limitations, raising more questions than answers as to the course that this area of law may take.

Justice John Paul Stevens, joined by Justice Anthony Kennedy, wrote a dissenting opinion, explaining that the majority's ruling "conflicts with the primary purpose of the FAA and ignores the historical context in which the Act was passed…."[12] According to Justice Stevens, the "settled understanding of the core purpose of the FAA" is to "ensure that private arbitration agreements are enforced according to their terms."[13] Justice Stephen Breyer also penned a dissenting opinion emphasizing that the majority opinion does not *preclude* enforcement of the parties' agreement.[14] Because there was no evidence that the parties' agreement violated any statute, rule, or policy, Justice Breyer would have simply remanded the case with instructions to enforce the arbitrator's final award.

Open Issues

The case thus leaves open several interesting questions:

- ***The first*** is how do parties signal that they are not proceeding under the FAA? In *Hall Street Associates*, although the agreement incorporated §7 of the FAA, regarding the power of the arbitrator to compel the attendance of witnesses, it did not otherwise "expressly invoke [the] FAA."[15]
- ***Second,*** since the FAA does not itself provide for federal subject matter jurisdiction, the independent contract action suggested by the *Hall Street Associates* Court would require an independent basis for proceeding in federal court.
- ***A third question*** left unresolved is whether an agreement expressly providing for application of state law to the enforcement of their arbitration agreement could override or displace the FAA? The Court has previously noted, in *Volt Information Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior University*,[16] that "[t]here is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure enforceability, according to their terms, of private agreements to arbitrate" and, further, "[t]he FAA contains no express preemptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration."[17]

In *Hall Street Associates*, however, the Court called it "arguable" that parties could rely upon state law as a basis for expanded judicial review. What's more, the application of state law to the review of arbitration awards could lead to a patchwork of arbitral review mechanisms. An overly exhaustive review by a court pursuant to state law could undermine the relevance of arbitration awards and thereby undermine the federal policy favoring arbitration.

- ***Finally,*** it is unclear whether, if state contract law applies, the application of state law also requires application of state arbitration law, which may contain the same narrow grounds of judicial review as the FAA.

Conclusion

In the guise of answering decisively the issue of statutory construction in front of it, whether the parties can provide for enhanced judicial review of arbitration awards, the Supreme Court has opened up an array of new issues for arbitration lawyers. In the meantime, it is in the hands of the Ninth Circuit to determine whether the district court's blessing on the parties' agreed scope of review is sufficient to let the most recent award stand.

1. Samuel Estreicher and Steven C. Bennett, "Standards for Judicial Review of Arbitration Awards," NYLJ Jan. 4, 2007.
2. 9 U.S.C. §1 et seq. (2000).
3. *Hall St. Assoc. LLC v. Mattel Inc.*, __S.Ct.__, 2008 WL 762537, at *3 (March 25, 2008) (quoting Pet. For Cert. 16a).
4. ORS 448.114 et seq.
5. *Hall St. Assocs. LLC v. Mattel Inc.*, 127 S.Ct. 2875, 75 U.S.L.W. 3398 (May 29, 2007) (No. 06-989).
6. 346 U.S. 427 (1953).
7. 2008 WL 762537, at *6 (quoting *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 220 (1985).
8. Id. (quoting 9 U.S.C. §9) (emphasis added).
9. Section 5 of the FAA states:

> If in the agreement provision be made for a method of naming or appointing an arbitrator or arbitrators or an umpire, such method shall be followed; but if no method be provided therein, or if a method be provided and any party thereto shall fail to avail himself of such method, or if for any other reason there shall be a lapse in the naming of an arbitrator or arbitrators or umpire, or in filling a vacancy, then upon the application of either party to the controversy the court shall designate and appoint an arbitrator or arbitrators or umpire, as the case may require, who shall act under the said agreement with the same force and effect as if he or they had been specifically named therein; and unless otherwise provided in the agreement the arbitration shall be by a single arbitrator.

9 U.S.C. §5.

10. 2008 WL 762537, at *8. Although the Court ultimately declined to address this issue, it requested supplemental briefing from the parties on this point.
11. Id.
12. Id. at *9 (Stevens, J., dissenting).
13. Id. (quoting *Volt Info. Sciences Inc. v. Bd. of Trustees of Leland Stanford Jr. Univ.*, 489 U.S. 468, 478 (1989)).
14. Id. at *11.
15. Id. at 8.
16. 489 U.S. 468 (1989).
17. Id. at 476-77.