No. 06 - 989

In the
Supreme Court of the United States
October Term, 2006

HALL STREET ASSOCIATES, L.L.C.,
Petitioner,
v.
MATTEL, INC.,
Respondent.

On Writ of *Certiorari* to the United States
Court of Appeals for the Ninth Circuit

BRIEF OF AMICI CURIAE NEW ENGLAND LEGAL FOUNDATION AND NATIONAL FEDERATION OF INDEPENDENT BUSINESS LEGAL FOUNDATION IN SUPPORT OF PETITIONER ON THE MERITS

INTEREST OF AMICI CURIAE

Amici curiae New England Legal Foundation ("NELF") and National Federation of Independent Business Legal Foundation ("NFIBLF") seek to bring to the Court's attention their views, and the views of their supporters, concerning the right of parties to an arbitration agreement to supplement the narrow statutory bases for judicial review under the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16.[1]

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1 Pursuant to Supreme Court Rule 37.6, counsel for amici state that neither counsel for Petitioner nor counsel for Respondent authored this Brief in whole or in part and no person or entity other than amici made a monetary contribution to the preparation or submission of the brief. Pursuant to

Amicus curiae NELF is a nonprofit, public interest law firm, incorporated in Massachusetts in 1977 and headquartered in Boston. Its membership consists of corporations, law firms, individuals, and others who believe in NELF's mission of promoting balanced economic growth in New England, protecting the free enterprise system, and defending economic rights. NELF's more than 130 members and supporters include a cross-section of large and small businesses, law firms and other organizations from New England and elsewhere throughout the United States.

Amicus curiae NFIBLF is a nonprofit, public interest law firm established to be the national voice and a legal resource for small business. NFIBLF is the legal arm of the National Federation of Independent Business (NFIB). NFIB is the nation's leading small-business advocacy association, with offices in Washington, D.C. and all 50 state capitals. Founded in 1943 as a nonprofit, nonpartisan organization, NFIB has as its mission to promote and protect the right of its members to own, operate and grow their businesses.

NELF, NFIBLF, and their respective members are committed to ensuring a reasonable interpretation of statutes, such as the FAA, that influence the business community and to upholding parties' freedom of contract. Amici are concerned in this case with securing a ruling that the FAA's narrow standard of judicial review is a default standard that allows parties to agree to more expansive judicial review. The FAA's limited standard of review exposes NELF and NFIBLF's member businesses, and businesses generally, to the risk of

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Supreme Court Rule 37.3 (a), amici have filed herewith written consent for the filing of this brief from counsel for each party.

legally erroneous arbitral decisions that are unreviewable on the merits. Since business disputes frequently involve high financial stakes, a decision confirming parties' freedom to contract for more heightened judicial review may well be a prerequisite to businesses' willingness to arbitrate their disputes. By contrast, affirmance of the Ninth Circuit's decision may deter the business community from choosing to arbitrate, thereby increasing the judiciary's caseload.

NELF and NFIBLF have each appeared regularly before this Court in cases raising issues of general significance to the New England and national business communities. *See, e.g., Ledbetter v. Goodyear Tire & Rubber Co.*, 127 S.Ct. 2162 (2007); *Rapanos v. United States*, 126 S. Ct. 2208 (2006); *S.D. Warren Co. v. Maine Bd. of Envtl. Prot.*, 126 S. Ct. 1843 (2006); *Arbaugh v. Y & H Corp.*, 546 U.S. 500 (2006); *Kelo v. City of New London,* 545 U.S. 469 (2005); *San Remo Hotel, L.P. v. City of San Francisco,* 545 U.S. 323 (2005); *Exxon Mobil Corp. v. Saudi Basic Indus. Corp.*, 544 U.S. 280 (2005); *Ballard v. Comm'r*, 544 U.S. 40 (2005); *Comm'r v. Banks,* 543 U.S. 426 (2005); *Green Tree Fin. Corp. v. Bazzle,* 539 U.S. 444 (2003); *EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002); *Palazzolo v. Rhode Island,* 533 U.S. 606 (2001); and *Crosby v. Nat'l Foreign Trade Council,* 530 U.S. 363 (2000). As they did in these prior cases, amici seek to provide an additional perspective which could aid the Court in deciding the issue presented in this case.

STATEMENT OF THE CASE

Amici adopt the Statement of the Case contained in the Brief of the Petitioner.

SUMMARY OF ARGUMENT

The FAA's narrow standard of judicial review is not exclusive but is instead a default standard that parties may supplement in their arbitration agreements. While the language of the FAA is silent on the issue, both the legislative history and decisions of this Court interpreting the FAA establish that the FAA was intended primarily to enforce the terms of parties' arbitration agreements, even when those terms depart from the FAA's provisions or affect the simplicity or finality of the arbitral process. There are also compelling policy reasons for permitting parties to contract for expanded judicial review, most notably the importance to many businesses considering arbitration of securing expanded judicial review of potentially large arbitral awards. The FAA's limited standard of judicial review exposes businesses to the risk of irrational or excessive arbitral awards that are unreviewable on the merits. The ability to contract for expanded review may therefore be the *sine qua non* for many businesses considering arbitration. Recent studies indicate that businesses are indeed avoiding arbitration and that the absence of judicial review on the merits is a strong motivating factor. A decision confirming the right of parties to contract for expanded judicial review can be expected to draw businesses back to arbitration as a viable alternative to litigation, thereby serving the interests of judicial economy.

ARGUMENT

I. The FAA's narrow standard of judicial review is a default standard that parties may expand by agreement.

This case involves the interpretation of § 10(a) of the FAA, which provides narrow bases on which a federal court may vacate an arbitration award.[2] Section 10(a) addresses flaws in the arbitral process but does not allow courts to review the merits of the arbitral award. At issue is whether § 10(a) establishes the exclusive standard of judicial review or is merely a minimum default standard that parties are free to supplement in their arbitration agreements. The FAA is silent

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2 9 U.S.C. § 10(a) provides:

> In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration--
> (1) where the award was procured by corruption, fraud, or undue means;
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

on this issue.

The parties in this case executed an arbitration agreement while litigation was pending that required the arbitrator "to decide the matters submitted based upon the evidence presented and the applicable law," and to issue a written decision with findings of fact and conclusions of law. (Petitioner's Appendix ("App.") 16a, ¶ 27). The agreement required the reviewing court, in turn, to vacate, modify, or correct the decision if the arbitrator's findings of fact were not supported by substantial evidence or if the arbitrator's legal conclusions were erroneous. *Id*. This provision for expanded judicial review was central to the parties' agreement to arbitrate their dispute. (2003 SER 153). The parties proceeded to arbitration, and the federal District Court for the District of Oregon subsequently vacated the arbitrator's decision due to errors of law. The Ninth Circuit reversed the District Court and invalidated the contractual term expanding judicial review because the Ninth Circuit concluded that § 10(a) provides the exclusive grounds for vacating an arbitral award. (App. 115A).

The Ninth Circuit has erred because its decision contradicts this Court's precedents interpreting the FAA. Since the FAA is silent on whether § 10(a) is an exclusive or default standard of review, this issue should be resolved in light of the statute's primary purpose. *See Robinson v. Shell Oil Co.*, 519 U.S. 337, 346 (1997). This Court has held that the FAA's primary purpose is to enforce the terms of the parties' arbitration agreement, and that the FAA allows parties to fashion their own rules of arbitration that may differ from the FAA's provisions:

> The FAA [does not prevent] the enforcement of agreements to arbitrate under different rules than those set forth in the Act itself. Indeed, such a result would be quite inimical to the FAA's primary purpose of ensuring that private agreements to arbitrate are enforced according to their terms.

Volt Info. Serv., Inc. v. Bd. of Trustees, 489 U.S. 468, 478-479 (1989) (enforcing arbitration agreement permitting stay of arbitration pending litigation between one party to arbitration and third party, where FAA requires stay of litigation between parties to arbitration agreement but does not address third-party litigation).

The Court recognized in *Volt* that the parties' freedom of contract is of paramount concern under the FAA, even when the exercise of that freedom may generate contract terms that depart from the FAA's provisions. "There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate." *Volt Info. Sciences*, 489 U.S. at 469. Applying this principle from *Volt* to § 10(a) establishes that it is not a mandatory and exclusive standard of review restricting parties' ability to bargain for the scope of judicial review appropriate to their circumstances. Instead, § 10(a) is a threshold standard ensuring basic procedural fairness in the arbitral process but allowing parties to supplement the statutory bases for judicial review if they so choose. Interpreting §10(a) as a default standard "preserve[s] the concept of freedom of contract by allowing parties to opt out of [it] in favor of a regime they prefer." Sarah Rudolph Cole, *Managerial Litigants? The Overlooked Problem of Party*

Autonomy in Dispute Resolution, 51 Hastings L.J. 1199, 1251 (2000).

The FAA's legislative history confirms this interpretation of § 10(a) because it shows that the intent of Congress was not to limit the scope of parties' arbitration agreements but rather to overcome widespread judicial hostility toward these agreements. "To overcome judicial resistance to arbitration, Congress enacted the [FAA] . . . ." *Buckeye Check Cashing, Inc. v. Cardegna*, 126 S.Ct. 1204, 1207 (2006).[3] In light of this historic judicial hostility, Congress most likely assumed that parties to arbitration agreements would not want courts to interfere with arbitrators' awards by reviewing their merits. "It is quite probable that the drafters [of the FAA] simply did not contemplate that parties would ever be interested in expanding judicial review of arbitration awards." Cole, *Managerial Litigants?*, 51 Hastings L.J. at 1255 (discussing FAA's legislative history).

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3 As the Court has explained in greater detail,

> The House Report accompanying the [FAA] makes clear that its purpose was to place an arbitration agreement 'upon the same footing as other contracts, where it belongs,' . . . and to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate."

Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 220 (1985) (quoting H.R.Rep. No. 96, 68th Cong., 1st Sess., at 1 (1924)). *Accord E.E.O.C. v. Waffle House, Inc.*, 534 U.S. 279, 289 (2002) ("[the FAA's] purpose was to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, and to place arbitration agreements upon the same footing as other contracts'") (quoting *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991)).

This conclusion finds support in the historical origins of commercial arbitration in this country. At that time, commercial arbitration generally involved the resolution of disputes by business people well-versed in trade practices and customs, rather than by lawyers applying legal principles:

> Prior to the passage of the FAA, commercial arbitration was considered an appealing alternative to litigation in which parties could decide disputes informally, through self-governance and reference to industry norms, rather than through formal, lengthy, and costly litigation. . . . Arbitrators were chosen according to the expertise within their industry, and were thus perhaps more apt [than lawyers or courts] at determining how such disputes should be decided . . . . There was generally no expectation that arbitrators would apply legal principles, but rather . . . that arbitrators would [rely upon] their experience in particular areas of business industries.

Caroline Kornelis, *Closing the Door, but Opening a Window: The Supreme Court's Reaffirmation of Applying the Federal Arbitration Act to the States*, 2006 J. Disp. Resol. 657, 659 (2006). *Accord* Stephen A. Hochman, *Judicial Review to Correct Arbitral Error--An Option to Consider*, 13 Ohio St. J. on Disp. Resol. 103, 103 (1997) ("[c]ommercial arbitration in the United States had its inception in certain industries . . . where the parties wanted industry people rather than lawyers to decide their disputes, primarily on the basis of customary practices in their industry

rather than legal principles").

Given this historical background of dispute resolution based on industry practice and judicial hostility toward arbitration, § 10(a) is properly understood as limiting the courts' traditional reviewing powers but not limiting the parties' contractual powers. "Congress presumed parties wanted the speed and simplicity of arbitration" rather than traditional appellate review. Lee Goldman, *Contractually Expanded Review of Arbitration Awards*, 8 Harv. Negot. L. Rev. 171, 184 (2003). However, the overarching purpose of the FAA is to enforce parties' arbitration agreements and to grant them the autonomy to define their own arbitral rules. *See Volt*, 489 U.S. at 469. Therefore, when the express terms of an agreement seek to expand judicial review, these terms should trump historic assumptions about parties' preference for minimal judicial involvement in the arbitral process. After all, "[a]rbitration under the Act is a matter of *consent, not coercion*, and parties are generally free to structure their arbitration agreements as they see fit." *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995) (quoting *Volt*, 489 U.S. at 479) (emphasis added). Simply put, the arbitral process under the FAA is a creature of contract, from the initiation of a claim through judicial review.

While expanded judicial review might lengthen the dispute resolution process, and while the FAA does embody a policy that arbitration should be speedy and efficient,[4] this Court has held that any conflict between expediency and the parties' intent "must be resolved in favor of the latter in order to realize the intent of the drafters." *Dean Witter Reynolds, Inc.*

4 *See Dean Witter Reynolds v. Byrd*, 470 U.S. at 220.

v. Byrd, 470 U.S. 213, 221 (1985) (enforcing agreement to arbitrate state securities law claims even though result was inefficient bifurcation, in separate arbitral and judicial fora, of state and federal securities laws claims). Therefore, the primacy of the parties' intent defeats any objection to expanded judicial review on the basis that it complicates or prolongs the arbitral process:

> We therefore reject the suggestion that the overriding goal of the Arbitration Act was to promote the expeditious resolution of claims . . . . [P]assage of the Act was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered, and we must not . . . allow the fortuitous impact of the Act on efficient dispute resolution to overshadow the underlying motivation.

Dean Witter Reynolds, 470 U.S. at 219, 220. *Accord First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 947 (1995) ("the basic objective [under the FAA] is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, . . . but to ensure that commercial arbitration agreements, like other contracts, 'are enforced according to their terms . . . .'") (citations omitted). The FAA codifies a national mandate of party autonomy in the arbitral process, and any competing concerns that inhere in the FAA must yield to this overriding goal.

II. Confirming parties' freedom to contract for expanded judicial review would foster reliance on arbitration and reduce the judiciary's caseload.

In addition to the support derived from the FAA's legislative history and purpose, there are compelling policy reasons to recognize parties' right to supplement the statutory bases for judicial review of arbitral decisions. Most importantly, the FAA's limited bases for judicial review expose parties to the risk of irrational or excessive arbitral awards that are unreviewable, barring a procedural irregularity. Without an enforceable agreement to expand judicial review, "a party might so fear the work of a maverick arbitrator that arbitration would not be an option." Goldman, *Contractually Expanded Review*, 8 Harv. Negot. L. Rev. at 184. Moreover, businesses may face claims involving high financial stakes and could suffer a substantial monetary impact from a legally unsupportable arbitral award. *See* Younger, *Agreements to Expand the Scope of Judicial Review*, 63 Alb. L. Rev. at 251-2. When businesses cannot resolve their disputes through settlement negotiations or mediation, expanded judicial review for arbitral errors of law may be the *sine qua non* for them to agree to arbitrate their disputes, as the facts of this case indicate.

Commentators have noted the existence of certain "maverick," or legally unsupportable if not irrational, arbitral decisions which reviewing courts must nevertheless affirm under the FAA's limited standard of review. *See* Younger, *Agreements to Expand the Scope of Judicial Review*, 63 Alb. L. Rev. at 248 (discussing, as prime examples of aberrant arbitral decisions affirmed by judiciary, *Koch Oil, S.A. v. Transocean Gulf Oil Co*, 751 F.2d 551 (2d Cir. 1985), and *Advanced Micro Devices,*

Inc. v. Intel Corp., 885 P.2d 994 (Cal. 1994)). In *Koch Oil*, for example, the Second Circuit affirmed a lump-sum arbitral award of $1,670,000 arising from contracts for crude oil exchange, even though the award far exceeded the contract price for undelivered oil and the agreement expressly disallowed recovery for lost profits and consequential damages. *See Koch Oil*, 751 F.2d at 554.[5]

These cases serve as a cautionary tale to businesses considering arbitration, because the mere risk of arbitral excess can readily outweigh any of the perceived benefits of arbitration, especially when the financial stakes are high. To many, "arbitration [has become] a game of chance and an instrument of injustice." Younger, *Agreements to Expand the Scope of Judicial Review*, 63 Alb. L. Rev. at 250 (quoting *Advanced Micro Devices v. Intel.*, 885 P.2d at 1012 (Kennard, J., dissenting)).

Recent empirical studies indicate that sophisticated businesses are rejecting arbitration and are choosing not to include arbitration clauses in many of their commercial contracts.[6] While the reasons for this aversion to arbitration

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5 In *Advanced Micro Devices, Inc. v. Intel Corp*., the California Supreme Court affirmed, under California's comparable arbitration statute, Cal. Civ. Proc. Code § 1286.2, subd. (d), and § 1286.6, subd. (b), an arbitrator's award to a computer chip manufacturer of a license to make and sell a chip belonging to Intel, even though the manufacturer had no right to do so under the express terms of a technology exchange agreement with Intel. *See Advanced Micro Devices*, 885 P.2d at 1012.

6 For example, approximately 89% of 2,858 securities agreements filed with the SEC for the first half of 2002 contained no mandatory arbitration clause. *See* Eisenberg and Miller, *The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DePaul L. Rev. 335, 348-50 (2007).

could be manifold, other recent data confirm that the absence of judicial review on the merits is a significant factor causing attorneys to steer their clients away from arbitration.[7]

In light of this aversion to arbitration among many businesses and their counsel, a decision confirming parties' ability to contract for expanded judicial review could draw businesses back to arbitration as a viable alternative to litigation, thereby serving the interests of judicial economy. Whatever additional judicial resources courts might expend in reviewing substantive arbitral decisions would be insignificant compared to the judicial resources consumed in adjudicating entire cases, from the filing of a complaint to final judgment, as parties increasingly reject arbitration due to the absence of judicial review on the merits. "[A]rbitration with expanded judicial review . . . places a lesser burden on the judiciary than full litigation in the court system." Goldman, *Contractually Expanded Review*, 8 Harv. Negot. L. Rev., at 184 (with supporting authority at 184 n.82).

Some courts and commentators have expressed concern that expanded judicial review could involve courts in a

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7 A 2005 survey of business litigators in California showed that approximately 84% of the responding attorneys prefer litigation over arbitration most of the time, and that the absence of appellate review is a significant reason for this preference. Rebecca Callahan, *Arbitration v. Litigation: The Right to Appeal and Other Misperceptions Fueling the Preference for a Judicial Forum* 39-41 (Apr. 7, 2006) (unpublished manuscript) (available at http://law.bepress.com/expresso/eps/1248), *cited in* Henry S. Noyes, *If You (Re)Build it, They Will Come: Contracts to Remake the Rules of Litigation in Arbitration's Image*, 30 Harv. J.L. & Pub. Pol'y 579, 588 n.30 (2007); *and* Eisenberg and Miller, *The Flight from Arbitration*, 56 DePaul L. Rev. at 350 n.72.

difficult and compromising task of reviewing incomplete or cryptic arbitral records that lack written opinions, thereby requiring courts to enforce or vacate arbitral awards without a principled legal basis. *See, e.g., Bowen v. Amoco Pipeline, Inc.*, 254 F.3d 925, 936 (10th Cir. 2001); Cole, *Managerial Litigants?*, 51 Hastings L.J. at 1259. This concern is unfounded because the parties can require an arbitral statement of reasons, with findings of fact and conclusions of law, as did the parties in this case. A written decision should provide an adequate basis for judicial review, along with access to any relevant documentary or testimonial evidence. "It is likely that parties wanting expanded review will provide a record of the arbitration and require a written opinion." Goldman, *Contractually Expanded Review*, 8 Harv. Negot. L. Rev. at 186.

Courts that have ruled against parties' right to expand the FAA's standard of judicial review have rejected these contractual record-building measures on the basis that arbitration *ought not* entail such formal requirements as a legal opinion or trial-type record.[8] This concern is unfounded because, as amici have already discussed above, this Court has held that the FAA does not prescribe any particular procedural rules and allows parties to define their own arbitral requirements, even when these requirements may affect the traditional simplicity and finality of arbitration. *See First Options of Chicago*, 514 U.S. at 947; *Volt Info. Sciences*, 489 U.S. at 469; *Dean Witter Reynolds*, 470 U.S. at 219-20.

Finally, it is worth noting that federal courts are

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8 "[E]xpanded judicial review would require arbitrators to issue written opinions with conclusions of law and findings of fact, further sacrificing the simplicity, expediency, and cost-effectiveness of arbitration." *Bowen v. Amoco Pipeline*, 254 F.3d at 936 n.7.

seasoned in reviewing informal records under the Administrative Procedure Act, 5 U.S.C. § 706(2), and should be equally capable of reviewing arbitral decisions under similar standards of review. *See* Cole, *Managerial Litigants*, 51 Hastings L.J. at 1260. If parties who have contracted for expanded judicial review have failed to provide a record of the arbitral proceedings sufficient for judicial review on the merits, then the reviewing court would simply deny the aggrieved party's motion to vacate on that basis. *See* Goldman, *Contractually Expanded Review*, 8 Harv. Negot. L. Rev. at 187. *See also D.H. Blair & Co., Inc. v.Gottdiener*, 462 F.3d 95, 110 (2d Cir. 2006) (moving party has weighty burden of proof to establish ground for vacatur under FAA).

In sum, a decision recognizing parties' right to contract for expanded judicial review under the FAA would not only serve the FAA's fundamental purpose of upholding the parties' freedom of contract, but it would also rejuvenate arbitration as an attractive alternative to litigation. Such a decision would have the beneficial consequence of lessening the judiciary's caseload, with no identifiable adverse consequences to the judiciary and substantial advantage to parties considering arbitration.

CONCLUSION

For the reasons stated above, this Court should reverse the decision of the Court of Appeals for the Ninth Circuit.

Respectfully submitted,

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