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Arbitration in the Aftermath of *Hall Street Associates v. Mattel, Inc.*

By E. Glenn Waldrop, Jr.

In March 2008, the U.S. Supreme Court issued its 6–3 opinion in *Hall Street Associates v. Mattel, Inc.*, a ruling that eliminated what many considered an established ground for judicial review of an arbitration award. The Court held that an arbitrator's failure to properly apply governing law was not one of the grounds articulated in the Federal Arbitration Act (FAA) for vacating or modifying an arbitration award and that "manifest disregard for the law" was not a legitimate basis for judicial review of the award. The Court reached this result notwithstanding the parties' contractual agreement that the arbitrator's rulings of law would be subject to *de novo* judicial review. Many believed that *Hall Street* would discourage parties from submitting their disputes to arbitration for fear that they could not be assured that valuable legal rights would be enforced according to the letter of the law. While that concern has not materialized, practitioners have begun adapting their arbitration agreements in light of the *Hall Street* opinion.

Although arbitration is a creature of contract, the import of *Hall Street* is that the right to contract on the rules governing arbitration is not unlimited. Specifically, any attempt of the parties to create rights of judicial review beyond those enumerated in the FAA will not be enforceable because parties are not free by agreement to alter a statutory scheme nor to impose on the federal courts obligations not authorized by Congress or the Constitution. The FAA limits judicial review to (1) awards procured by corruption, fraud, or undue means; (2) cases where the arbitrators are obviously biased or corrupt; (3) where there is misbehavior prejudicing a party's rights; or (4) where the arbitrators exceeded their power or so imperfectly exercised their powers so that no mutual, final, and definite award was made.

In May 2007, the Supreme Court granted certiorari in *Hall Street Associates v. Mattel, Inc.*, a case originating from the Ninth Circuit Court of Appeals. The issue presented was whether the parties to an agreement to arbitrate could contract for more expansive judicial review of an arbitration award than the narrow standards articulated in the FAA. The underlying dispute arose out of a property lease between Mattel, as tenant, and Hall Street, as landlord. The arbitration agreement provided for judicial review *de novo* of the arbitrator's rulings of law but not findings of fact.

Following an award by the arbitrator, Hall Street moved the district court to vacate the award. The district court ruled that the arbitrator had erred in his legal conclusions and remanded the case to the arbitrator. The arbitrator then reversed his ruling. The district court confirmed the modified award. On appeal, the Ninth Circuit reversed on the grounds that the agreement expanding judicial review of the arbitration award was unenforceable and held that the district court erred when it conducted a *de novo* review and vacated the original arbitral award.

On remand, the district court again vacated the original arbitration award, ruling that the arbitrator exceeded his authority when he rendered an "implausible interpretation of the contract." The Ninth Circuit again reversed, holding that "implausibility" was not one of the enumerated grounds under the FAA empowering a court to vacate an arbitrator's award. Hall Street then sought certiorari. The Supreme Court affirmed the Ninth Circuit, ruling that the FAA contains the sole and exclusive grounds for vacating or modifying an arbitration award and that the right of a court to vacate or modify an award based upon "manifest disregard of the law," as articulated in *Wilko v. Swann*, must be read narrowly as mere shorthand for statutory grounds, such as where the arbitrator is guilty of misconduct. The Supreme Court expressly rejected the argument that parties could contract for a more expansive judicial review.

In the wake of *Hall Street*, many practitioners feared that arbitration would fall from favor. The rationale for this concern was that parties possessing valuable legal rights would be loathe to settle their disputes in a forum where the decision maker could err on issues of law with no practical means of review. This author has not observed or found any definitive studies that indicate this fear has matured into reality. However, lawyers are creative beings, and there have been numerous attempts to craft arbitration clauses that appear motivated by the Supreme Court's ruling in *Hall Street*.

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One response to *Hall Street* has been to include in the arbitration clause a provision that either party aggrieved by an arbitration award can appeal to a second arbitration panel but only for review of errors of law. The original panel is required to render an award with both findings of fact and conclusions of law. The second panel is empowered to reverse, modify, or vacate the original award based upon errors of law. Although such a scheme does not appear to have been tested in court, there is no reason that it should run afoul of the rule of law set forth in *Hall Street*. That is because the arbitration clause does not in any way affect judicial review. Rather, it merely makes the initial arbitration award temporary and nonfinal, subject to further arbitration proceedings. Presumably, the award as confirmed, modified, or vacated by the second panel would be subject to judicial review only on the grounds set forth in the FAA.

A second but more questionable response to *Hall Street* has been to limit the power of the arbitrators only to making findings of fact but not rulings or conclusions of law. The findings of fact would be in the nature of judicial stipulations, binding upon the parties, and could be presented to a court for the court to enter legal rulings appropriate to the factual findings. It is questionable whether this concept is workable or enforceable for a host of reasons. A more practical approach, which might obtain the same objective, would be for the parties to agree that factual issues would be referred to a special master consisting of a single person or three-member panel, who would follow the procedural rules of arbitration. Many courts would be receptive to "outsourcing" fact finding to a special master, particularly in complex cases that would otherwise consume an undue amount of the court's resources.

A third and perhaps more measured response to *Hall Street* is to provide, in the agreement to arbitrate, a stipulation that only retired judges may serve as arbitrators. While this does not provide any form of judicial or other review of the arbitrator's rulings of law, it does insure that the arbitrator is experienced in making legal rulings. Parties have always been free in their agreements to stipulate to the qualifications of the arbitrators, so there is no reason that a provision requiring that the arbitrator have judicial experience should not be enforceable.

The import of *Hall Street* appears not to be an exodus from arbitration. Rather, parties have either resigned themselves to forego judicial review of legal findings in exchange for the assumed advantages of arbitration (over litigation), or they have attempted to craft "solutions" to address the fiat of *Hall Street* that arbitration awards cannot be vacated or modified except for the specific reasons set forth in the FAA.

NEXTSTEPS
The Client's Guide to Mediation and Arbitration: The Strategy for Winning. 2008. PC # 1620388. ABA Book Publishing.

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