No. ___

IN THE

Supreme Court of the United States

HALL STREET ASSOCIATES, L.L.C.,
Petitioner,

v.

MATTEL, INC.,
Respondent.

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

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PETITION FOR A WRIT OF CERTIORARI

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Hall Street Associates, L.L.C. ("Petitioner" or "Hall Street") respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the district court in which the court vacated the arbitrator's initial arbitration award because of legal error is unreported. (App., *infra*, 39a-58a). The original opinion of the Ninth Circuit Court of Appeals in which the court reversed the district court's enforcement of the parties' "expanded judicial review" agreement and remanded so that the district court could apply the standard of review set forth in the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1 *et seq.*,

is unreported. (App., *infra*, 114a-116a). The district court's opinion on remand in which the district court vacated the arbitration award based on the FAA standard of review is unreported. (App., *infra*, 117a-128a). The Ninth Circuit's most recent opinion reversing the district court is also unreported. (App., *infra*, 129a-134a).

JURISDICTION

The Ninth Circuit's most recent opinion was entered on August 1, 2006. The Ninth Circuit denied a timely petition for rehearing *en banc* on October 17, 2006. The jurisdiction of the United States Supreme Court is invoked in a timely manner under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant provisions of the FAA are set forth at App., *infra*, 1a-3a.

STATEMENT OF THE CASE

This case involves the Ninth Circuit's refusal to enforce the clear and unambiguous terms of the parties' arbitration agreement, an agreement that was entered into with district court approval after the commencement of this litigation. The arbitration agreement expressly states that the district court shall vacate, modify or correct the arbitration award "where the arbitrator's conclusions of law are erroneous." (App., *infra*, 16a). Because of the Ninth Circuit's refusal to enforce the parties' agreement as written, Petitioner is saddled with an arbitration decision that dissenting Judge Susan Graber held was "completely irrational" (App., *infra*, 134a) and which the majority on the Ninth Circuit panel recognized contained "possible errors of law." (App., *infra*, 132a).

STATUTORY FRAMEWORK

Congress enacted the FAA for the "central purpose" of "ensur[ing] that private agreements to arbitrate are enforced

according to their terms." *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53-54 (1995) (internal quotations and citations omitted). Section 2 of the FAA states that a "written provision * * * to settle by arbitration" a controversy arising out of "any contract evidencing a transaction involving commerce" shall be "valid, irrevocable and enforceable, save upon any grounds that exist at law, or in equity for the revocation of any contract." 9 U.S.C. § 2. "The effect of this section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). The FAA as a whole "creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate * * *." *Id.* at 26.

The FAA further provides that "[i]f the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration," the court, upon application by a party to confirm the award, "must grant such an order unless the award is vacated, modified or corrected as prescribed in sections 10 and 11." 9 U.S.C. § 9. Section 10 sets forth several very narrow grounds upon which the court "may make an order vacating the award," while section 11 sets forth limited grounds upon which the court "may make an order modifying or correcting the award." 9 U.S.C. §§ 10, 11. The arbitration agreement in this case provides for judicial review beyond the review provided for under sections 10 and 11.

FACTUAL BACKGROUND

This case arose from a property lease between Petitioner Hall Street, the landlord, and Respondent Mattel, Inc. ("Mattel"), the tenant. The lease did not contain an agreement to arbitrate disputes and both parties therefore had the absolute right to have all claims arising under the lease resolved in court. The property that was subject to the lease

had been used for many years by both Mattel and its predecessors as a toy manufacturing facility. (App., *infra*, 18a).[1] It is undisputed that the well water on the property, which employees had used for many years for drinking and bathing, was contaminated by trichloroethylene ("TCE") in concentrations well in excess of federal limits. (App., *infra*, 26a-27a). It is also undisputed that Mattel and its predecessors failed to test the well water on the property for contaminates as they were required to do under the Oregon Drinking Water Quality Act ("ODWQA"), ORS 448.114 *et seq.* (App., *infra*, 26a, 52a, 81a).

On February 11, 2000, Hall Street filed suit in Oregon state court seeking injunctive relief, declaratory relief and damages. (2005 ER 004). Included amongst Its claims was a claim that Mattel was required to indemnify it from all actions by any parties relating to the condition of the property. (2005 ER 016). Mattel removed the case to the United States District Court for the District of Oregon, which possessed diversity jurisdiction under 28 U.S.C. § 1332. (2005 ER 002).

The parties proceeded to a court trial of one of the issues in the case, regarding Mattel's termination of the lease. After the district court decided that issue and after a subsequent unsuccessful attempt to settle the entire case through mediation, the parties informed the district court that they would seek the court's approval of an agreement to arbitrate the remaining issues, an agreement that allowed for *de novo* judicial review of the arbitrator's legal rulings. (2003 SER 148-49). This agreement for expanded judicial review was central to the parties' agreement to arbitrate their dispute, a dispute which was not subject to a preexisting agreement to

[1] Mattel's Excerpt of Record in the earlier 2003 appeal to the Ninth Circuit is cited as "2003 ER." Hall Street's Supplemental Excerpt of Record in the 2003 appeal is cited herein as "2003 SER." Mattel's Excerpt of Record in the 2005 appeal to the Ninth Circuit is cited as "2005 ER." Otherwise, all citations are to the Appendix.

arbitrate and which could have been properly litigated in federal court in the first instance. (2003 SER 153).[2] The agreement to arbitrate executed by the parties stated that the district court retained authority to review the arbitrator's factual findings for substantial evidence and to review the arbitrator's legal conclusions for legal error. (App., *infra*, 16a).

Relying on the Ninth Circuit's decision in *LaPine Tech. Corp. v. Kyocera Corp.*, 130 F.3d 884 (9th Cir. 1997), which upheld expanded judicial review of arbitration awards, the district court approved the parties' agreement to arbitrate with *de novo* review of legal issues in the district court.[3] (App., *infra*, 8a, 46a). The case proceeded to arbitration under this judicially approved arbitration agreement.

In early January of 2002, the arbitrator issued his Findings of Fact and Conclusions of Law. (App., *infra*, 17a to 38a). The arbitrator's initial decision was based on his legal conclusion that, despite the fact that Mattel had violated the ODWQA by failing over many years to test the water supply on the property for contaminants, it had not violated any "applicable" environmental laws. (App., *infra*, 35a). The arbitrator recognized (1) that the lease was negotiated in the context that Mattel's predecessor, View-Master, was "the only party with intimate knowledge of the property" and (2) that the lease therefore contained a <u>broad indemnification</u>

[2] Hall Street's attorney, Jim Finn, executed an affidavit that was filed in the trial court stating as follows: "One of the *primary factors* of this arbitration agreement was that, unlike ordinary binding arbitration, the arbitrator's decision would be reviewable by Judge Jones, and then entered as a judgment of the Federal District Court, which would then be reviewed by the 9th Circuit Court of Appeals." (2003 SER 153) (emphasis added).

[2] Nearly two years <u>after</u> the district court approved the parties' expanded judicial review agreement in reliance on existing law, the Ninth Circuit reversed *LaPine* in *Kyocera v. Prudential-Bache Trade Services, Inc.*, 341 F.3d 987 (9th Cir. 2003), *cert dismissed*, 540 U.S. 1098 (2004).

clause that required Mattel to "indemnify Hall Street for all activities with respect to the premises whether or not they occurred before the date of the original lease." (App., *infra*, 19a). The arbitrator further concluded that Mattel agreed to assume all liability for the presence of hazardous waste on the property under this "comprehensive" indemnification clause, irrespective of when the presence or use of the hazardous waste occurred. (App., *infra*, 35a). The arbitrator also recognized that the "only exception" to the indemnity obligation was if Mattel was in compliance with applicable environmental laws and did not directly or indirectly contribute to the presence or use of hazardous waste. (*Id.*).

Despite these findings, the arbitrator concluded that Mattel's admitted failure to test the well water on the property over the course of many years was not a violation of an "applicable" environmental law because the ODWQA was designed to protect human health and was "not designed to protect landowners from having their property protected from environmental contamination." (App., *infra*, 35a-36a). The arbitrator recognized that Mattel and its predecessors did not test the well water for a period of approximately 18 years but found that this failure "may constitute a violation of other laws, but does not constitute a violation of 'applicable environmental laws' regarding TCE." (*Id.*). Based on this conclusion, the arbitrator decided that Mattel was entitled to the contractual exception to the broad indemnification requirements of the lease.

Petitioner moved to vacate the arbitrator's award, seeking *de novo* review of the arbitrator's legal conclusion that Mattel's admitted violation of the ODWQA was not a violation of an "applicable environmental law" within the meaning of the lease. On April 29, 2002, the district court granted Hall Street's motion to vacate and remanded to the arbitrator for further consideration. (App., *infra*, 39a to 58a). The district court held, in agreement with the arbitrator's findings,

that Mattel and its predecessors had failed to test for TCE contamination on the property and that this failure constituted a violation of the ODWQA. (App., *infra*, 42a-43a, 53a-54a). The district judge also agreed with the arbitrator's legal conclusion that the lease was "written to impose broad liability on the tenant for any environmental damage on the property" and that the exceptions to this broad liability contained in the lease "freed the tenant from liability only if it was in compliance with all 'applicable environmental laws.'" (App., *infra*, 53a).

However, the district court ruled that the arbitrator's conclusion that the ODWQA was not an applicable environmental law was erroneous. (App., *infra*, 53a). The district court stated:

> The arbitrator's contrary reasoning – that Oregon's Drinking Water Quality Act ("ODWQA") does not constitute "applicable environmental laws" because "these health provisions are designed to protect a specific type of injury, *i.e.*, health injury to people from drinking the water, and are not designed to protect landowners from having their property protected from environmental contamination" – is an overly restrictive construction of "applicable environmental laws that is not warranted by the language of the lease." (App., *infra*, 53a-54a).

The court disagreed with the arbitrator's conclusion that a law must protect property to be deemed an "environmental law" and stated that: "*No* environmental statute advances such a purpose; the *purpose* of such statutes is to protect the environment and human health." (App., *infra*, 54a-55a) (emphasis in original). The court further stated that the contention that the ODWQA was not an applicable environmental statute "defies logic." (App., *infra*, 55a).

On remand, the arbitrator entered an amended decision based upon the legally correct ruling that the ODWQA was an applicable environmental law which Mattel had violated.

(App., *infra*, 81a). Therefore, the exceptions contained in the lease to Mattel's broad indemnification responsibility did not apply. (*Id.*). Based on this conclusion, the arbitrator rendered a decision in favor of Hall Street in the amount of $583,971.60 and also awarded declaratory relief against Mattel for all future costs that Hall Street might be required to pay relating to the environmental cleanup of the property. (App., *infra*, 85a). The arbitrator then rendered a supplemental decision awarding attorney fees and costs. (2005 ER 138-141).

Both sides sought review of the arbitrator's amended decision by the district court. (App., *infra*, 87a). Other than with regard to Mattel's assertion that the arbitrator made a mistake in computing prejudgment interest, the district court upheld the arbitrator's amended award. (App. *infra*, 95a, 110a). On May 15, 2003, a district court judgment was entered incorporating both the trial court's initial decision regarding the lease termination issue (which had been tried before the court) and the arbitrator's amended award in favor of Hall Street. (App. *infra*, 111a-113a). The money judgment in Hall Street's favor was for $810,107.49 with six percent (6%) postjudgment interest. (App., *infra*, 112a to 113a).

Both sides appealed from certain aspects of that judgment. Mattel challenged the district court's enforcement of the parties' agreement that the arbitrator's conclusions of law could be reviewed *de novo*, arguing that the Ninth Circuit's intervening *en banc* decision in *Kyocera Corp.* had reversed *LaPine* and that the FAA did <u>not</u> permit judicial review of an arbitrator's decision beyond the standards of review allowed under the FAA. (Mattel's Opening Brief on Appeal, Ninth Circuit Case Nos. 03-35525 and 03-35526, pp. 12-13). Hall Street contended that *Kyocera* was distinguishable because, in that case, the parties' underlying contract contained an arbitration clause allowing for expanded judicial review while, in this case, the parties did not have an arbitration agreement when the lawsuit was instituted and agreed to the expanded

judicial review provision with district court approval after the case had been partially tried. (Hall Street's Combined Opening Brief and Answering Brief, Case Nos. 03-35525 and 03-35526, pp. 31 & n 5). Hall Street further argued that the *de novo* review provision was so inextricably intertwined with the agreement to arbitrate that it could not be severed and still give effect to the parties' intentions regarding arbitration. (*Id.* at 33 n 7).

On November 16, 2004, the Ninth Circuit reversed the district court's vacation of the arbitrator's initial erroneous award holding, without substantial comment, that "*Kyocera* compels us to vacate the district court's judgment based on the arbitration agreement and remand to the district court." (App., *infra*, 115a). The court further stated that, under *Kyocera*, "the terms of an arbitration agreement controlling the mode of judicial review are unenforceable and severable." (*Id.*). The Ninth Circuit remanded to the district court with instructions for the district court to confirm the arbitrator's initial award in favor of Mattel, "unless the district court determines that the award should be vacated on the grounds allowable under 9 U.S.C. § 10, or modified or corrected under the grounds allowable under 9 U.S.C. § 11." (App., *infra*, 116a).

On remand, the district court held that grounds for vacating the arbitrator's award existed under 9 U.S.C. § 10. (App., *infra*, 117a-128a). The district court held, in express reliance on the Ninth Circuit's decisions in *Theis Research Inc. v. Brown & Bain*, 386 F.3d 1180 (9th Cir. 2004), *amended on denial of rehearing*, 400 F.3d 659 (9th Cir. 2005), and *Employer's Ins. of Wausau v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 933 F.2d 1481 (9th Cir. 1991), that an arbitrator exceeds his or her powers within the meaning of 9 U.S.C. § 10 when the award is based on an "implausible interpretation of a contract." (App., *infra*, 124a). The district court, noting that neither party seriously disputed that the ODWQA

was an environmental law or that Mattel had violated it, reversed the arbitrator's initial conclusion that Mattel was in compliance with applicable environmental laws on the grounds that this conclusion was implausible. (App., *infra*, 125a-127a). The district court stated that nothing in the lease supported the arbitrator's conclusion that the phrase "applicable environmental laws" meant "anything other than its plain meaning, *i.e.*, the body of environmental law that generally applies to Mattel and with which Mattel's non-compliance could expose Mattel or Hall Street to civil or criminal penalties." (App., *infra,* 126a). The trial court again vacated the arbitration award, granted Hall Street additional attorney fees and costs and again entered judgment for Hall Street. (App., *infra*, 127a-128a).

Mattel again appealed to the Ninth Circuit. On August 1, 2006, a panel of the Ninth Circuit reversed and held that "[i]mplausibility is not a valid ground for voiding an arbitration award under either 9 U.S.C. §§ 10 or 11." (App., *infra*, 132a). The panel majority stated: "Although the arbitrator's assessment of the merits in this case contains possible errors of law, those errors are not a sufficient basis for a federal court to overrule an arbitration award." (*Id.*). Despite its finding regarding the presence of possible errors of law, the panel majority held that the arbitrator's decision was not "completely irrational," which it recognized as a valid (albeit unstated) basis for vacating an arbitration award under the FAA. (App. *infra*, 133a). The panel majority therefore remanded the case to the district with instructions to review the original award and declare Mattel the prevailing party. (*Id.*).

Judge Susan Graber dissented on the grounds that the arbitrator's award was "completely irrational." (*Id.*). She stated that "the only rational reading" of the term "applicable environmental laws" was "all federal, state, and local environmental laws and regulations" which Mattel was required

to comply with in its use of the premises. (*Id.*). Because it was undisputed that the ODWQA was an environmental law that Mattel violated, Judge Graber would have either upheld the district court under the "completely irrational" standard or remanded the case to the district court for reconsideration under that standard. (App., *infra*, 134a).

Petitioner sought *en banc* review of the Ninth Circuit's opinion. *En banc* review was denied by order of the Ninth Circuit on October 17, 2006. (App., *infra*, 138a). At all relevant times, the Ninth Circuit had jurisdiction over this case under 28 U.S.C. § 1291.

REASONS FOR GRANTING THE PETITION

I. There is a Wide, Irreconcilable and Deepening Split Between the Courts of Appeals Over Whether Parties May Agree to Non-statutory Grounds for Vacating an Arbitration Award, a Split which this Court Should Resolve by Granting Certiorari.

In this case, the Ninth Circuit has ruled, in strict reliance on its *en banc* decision in *Kyocera*, that parties to an arbitration agreement cannot agree to judicial review on grounds that expand on those provided for in sections 10 and 11 of the FAA. In *Kyocera*, the Ninth Circuit, reversing its earlier decision in *LaPine*, invalidated as contrary to the FAA the parties' agreement that an arbitration award should be vacated, modified, or corrected if legally erroneous or not supported by substantial evidence. The *Kyocera* court recognized that other circuits had enforced such "expanded judicial review" agreements based on this Court's decisions, including *Volt Information Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989), which emphasized that the primary purpose of the FAA is to enforce the agreement of the parties according to its terms. *Kyocera*, 341 F.3d at 999. However, the Ninth Circuit reversed its prior decision in *LaPine* because of its policy judgment that "[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." *Id.* at 998.

The Ninth Circuit's decision in *Kyocera*, as followed by the panel in this case, directly conflicts with the decisions of the First, Third, Fourth, Fifth and Sixth Circuits and is inconsistent with this Court's rulings that the primary purpose of the FAA is to give full effect to the parties' agreement to arbitrate as written. The FAA was intended to create a uniform federal substantive law of arbitration that preempts inconsistent state law. *Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Moses H. Cone*, 460 U.S. at 24. As such, the FAA should not create conflicting outcomes with regards to the enforcement of arbitration agreements in different parts of the country. With the current and deepening split between the circuits on the validity of expanded judicial review under the FAA, many companies that do business on a nationwide basis are faced with such conflicting outcomes based simply on the circuit where the action to confirm or vacate an arbitration award is filed.[4] The widespread disagreement between the federal courts of appeals on an issue of such fundamental importance under a federal statute which has as its goal the creation of a uniform law of arbitration warrants review by this Court.[5]

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[4] Under the FAA, the proper venue for an action to confirm or vacate an arbitration award is the district agreed to by the parties in the arbitration agreement or, if there is none, where the award was made. 9 U.S.C. § 9. However, this Court has held that this venue provision is permissive, not mandatory, and that any venue allowable under the general venue statute for diversity actions, 28 U.S.C. § 1391, is proper. *Cortez Byrd Chips v. Bill Harbert Constr. Co.*, 529 U.S. 193 (2000). This raises the specter of forum shopping by parties who will seek to further their chances of either confirming or vacating an arbitration award based on whether the district court sits in a circuit that permits or prohibits expanded judicial review.

[5] A party petitioning for a writ of certiorari is entitled to seek review of all interlocutory decisions preceding the entry of judgment, including

A. The Ninth Circuit's Decision Directly Conflicts with the Decisions of Five Other Circuits.

The Ninth Circuit's decision in reliance on *Kyocera* directly conflicts with decisions from the First, Third, Fourth, Fifth and Sixth Circuits.

In *LaPine*, the Ninth Circuit initially upheld the validity of expanded judicial review under the FAA and followed the decision of the Fifth Circuit in *Gateway Technologies, Inc. v. MCI Telecommunications Corp.*, 64 F.3d 993 (5th Cir. 1995). *LaPine*, 130 F.3d at 889.[6] In *Gateway*, the parties' arbitration agreement stated that errors of law were subject to judicial review. *Id.* at 996. Recognizing that this provision expanded the extremely narrow standard of judicial review normally applicable under section 10 of the FAA, the Fifth Circuit held that "[s]uch a contractual modification is acceptable because, as the Supreme Court has emphasized, arbitration is a creature of contract * * *." *Id.* The court in *Gateway* held that the FAA's standard of review provision was the "default standard of review" which would apply under a silent arbitration agreement but that "the FAA does not prohibit parties who voluntarily agree to arbitration from providing contractually for more expansive judicial review of the award." *Id.* at 997 n.3. The court, quoting *Volt*, 489 U.S. at 469, held that "the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate." *Id.* The court reasoned that a refusal to enforce the parties' contractual expansion of the FAA's default standard of review "would be quite inimical to the FAA's purpose of

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rulings made in an earlier appeal. *See, e.g., Major League Baseball Ass'n v. Garvey*, 532 U.S. 504, 508 n.1 (2001); *Mercer v. Theriot*, 377 U.S. 152, 153 (1964); *Hamilton-Brown Shoe Co., v. Wolf Bros. & Co.*, 241 U.S. 251, 257-58 (1916).

[6] The Ninth Circuit in *LaPine* also based its holding on *Volt* and other decisions of this Court, which permitted parties to arbitrate under rules other than those established by the FAA. *LaPine*, 130 F.3d at 888.

ensuring that private agreements to arbitrate are enforced according to their terms." *Id.* at 996 (quoting *Mastrobuono*, 514 U.S. at 57, quoting in turn *Volt*, 489 U.S. at 479). The holding of *Gateway* has been reaffirmed by the Fifth Circuit in subsequent cases. *See Harris v. Parker College of Chiropractic*, 286 F.3d 790, 793 (5th Cir. 2002); *Hughes Training, Inc. v. Cook*, 254 F.3d 588, 592-93 (5th Cir. 2001), *cert. denied*, 534 U.S. 1172 (2002).

In *Syncor Int'l Corp. v. McLeland*, 1997 U.S. App. LEXIS 21248 (4th Cir., August 11, 1997), *cert. denied*, 522 U.S. 1110 (1998), the Fourth Circuit followed *Gateway*.[7] In *Syncor*, the arbitration agreement, as in this case, allowed for *de novo* judicial review of legal issues. The court, applying *Gateway*'s reasoning that nothing in the FAA prohibits the parties from "providing contractually for an expanded judicial review of the award," engaged in *de novo* review of the arbitrator's decision. *Syncor*, 1997 U.S. App. LEXIS 21248 at *17.

The next circuit to follow *Gateway* was the Third Circuit. In *Roadway Package System, Inc. v. Kayser*, 257 F.3d 287 (3d Cir.), *cert denied*, 534 U.S. 1020 (2001), the court stated: "We now join with the great weight of authority and hold that parties may opt out of the FAA's off-the-rack vacatur standards and fashion their own (including by referencing state law standards)." *Id.* at 293. The court ruled that, where the parties have language in the arbitration agreement evidencing their intent to opt out of the FAA's standard of review, "federal law requires that the court enforce the agreement." *Id.* at 292. While the court ultimately held that the arbitration agreement before it did not evidence such an intent, the

[7] Although the *Syncor* opinion is unpublished, the Fourth Circuit's rules provide that an unpublished opinion issued prior to January 1, 2007, may be cited if the case has "precedential value in relation to a material issue in a case and that there is no published opinion that would serve as well." (4th Cir. Local R. 32.1). There is no published opinion from the Fourth Circuit on the issue cited.

holding of the court on the overarching legal issue is clear: An arbitration agreement which evidences a "clear intent to displace the FAA's default standards for judicial review" is enforceable. *Id.* at 295.

The Sixth Circuit has also ruled that parties may contract for expanded judicial review. In *Jacada, Ltd. v. Int'l Mktg. Strategies*, 401 F.3d 701 (6th Cir.), *cert. denied*, 126 S. Ct. 735 (2005), the court stated that "the central purpose of the FAA is to ensure that private agreements to arbitrate are enforced according to their terms" and proceeded to decide whether the judicial review provision of the FAA applied as opposed to the standard of review provision contained in the arbitration agreement. *Id.* at 709-10. Although the court ultimately held that the parties did not intend to displace the federal standard for vacatur under the contractual language used in their arbitration agreement, the court's decision is based upon the clear recognition that such displacement is <u>not</u> prohibited by the FAA. *Id.* at 711-12.

The latest circuit to rule that the FAA permits expanded judicial review is the First Circuit. In *Puerto Rico Telephone Co., Inc. v. U.S. Phone Mfg. Corp.*, 427 F.3d 21 (1st Cir. 2005), *cert. denied*, 126 S. Ct. 1785 (2006), the court was faced with a similar issue as in *Roadway* and *Jacada*, whether a generic choice-of-law provision was sufficient to establish the parties' intent to supplant the FAA standard of review of an arbitration award. The court stated that "[t]he issue whether parties by contract can supplant the FAA standard of review has generated substantial litigation." *Id.* at 30. After carefully analyzing *Gateway* and other cases supporting expanded judicial review as well as *Kyocera* and other cases opposing it, the court held: "We agree with the other circuits that have concluded that parties can by contract displace the FAA standard of review but that displacement can be achieved only by clear contractual language." *Id.* at 31. Where, as here, there is no question but that the parties used such clear language in their arbitration agreement, the court in

Puerto Rico Telephone would have certainly enforced the parties' expansion of the FAA's standard of review.

B. The Tenth Circuit, Along with the Ninth Circuit, Has Held that Expanded Judicial Review Undermines Public Policy Under the FAA.

Joining the Ninth Circuit in opposition to the First, Third, Fourth, Fifth and Sixth Circuits is the Tenth Circuit in *Bowen v. Amoco Pipeline, Inc.*, 254 F.3d 925 (10th Cir. 2001). In *Bowen*, the court held that the enforceability of the parties contractually "expanded standard" of judicial review "presents a difficult question." *Id.* at 933. Recognizing that its decision not to enforce such a contractual agreement conflicted with the law in the Fourth and Fifth Circuits, as well as the then-governing law in the Ninth Circuit as set forth in *LaPine*, the court, as in *Kyocera*, cited policy reasons for its holding. *Id.* at 933-35. While recognizing that arbitration even with expanded judicial review "reduces the burden on the courts," the court nonetheless found, on public policy grounds, that expanded judicial review "would threaten the independence of arbitration and weaken the distinction between arbitration and adjudication." *Id.* at 936 & n.6.[8] As stated earlier, *Bowen* and *Kyocera* directly conflict with the decisions of five other circuits.

C. Other Circuits Have Discussed the Issue of Expanded Judicial Review Without Definitive Holdings.

Three other circuits, the Second, Seventh and Eighth, have discussed the issue of expanded judicial review without definitive holdings. For example, in *Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc.*, 935 F.2d 1501, 1504-05 (7th Cir. 1991), the Seventh Circuit, in a case involv-

[8] The Ninth Circuit cited *Bowen* approvingly and adopted its public policy rationale in *Kyocera*. *Kyocera*, 341 F.3d at 999-1000.

ing an arbitration award under section 301 of the Labor-Management Relations Act, 29 U.S.C. § 185, stated in dicta that "[a]n agreement to submit a dispute over the interpretation of a labor or other contract to arbitration is a contractual commitment to abide by the arbitrator's interpretation," and the parties "cannot contract for a judicial review of that award because federal jurisdiction cannot be created by contract." *Id.* at 1505.[9] This case did not directly involve the FAA and is thus questionable precedent in cases involving that statute.

In *Schoch v. InfoUSA, Inc.*, 341 F.3d 785 (8th Cir. 2003), the court noted the split in the circuits "on whether parties to an arbitration agreement can expand the scope of judicial review of arbitration awards." *Id.* at 788. Citing its prior decision in *UHC Mgt. Co. v. Computer Sciences Corp.*, 148 F.3d 992 (8th Cir. 1998), the court stated that the ability to contract for a heightened standard of review is "not yet a foregone conclusion" and expressed "grave skepticism" as to whether parties could do so consistent with the policies underlying the FAA. *Id.* at 789. However, the court chose not to expressly adopt the Tenth Circuit's holding in *Bowen* and instead resolved the case on the narrow ground that the arbitration agreement did not contain clear and unmistakable language establishing the intent to impose a heightened standard of judicial review. *Id.* at 789-90.

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[9] The notion that expanded judicial review creates federal jurisdiction "by contract" was also stated by the Ninth Circuit in *Kyocera*, which quoted *Chicago Typographical* to this effect. *Kyocera*, 341 F.3d at 999. However, as recognized by the First Circuit in *Puerto Rico Telephone*, this concern is "misplaced, as it is well settled that federal courts have jurisdiction over suits to compel arbitration (or to vacate or enforce arbitration awards) only if the parties are of diverse citizenship, or some separate grant of jurisdiction applies." *Puerto Rico Telephone*, 427 F.3d at 30-31. *See also Moses H. Cone*, 460 U.S. at 26 (the FAA "creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate, yet it does not create any independent federal-question jurisdiction* * *").

The Second Circuit has similarly avoided the issue. In *Hoeft v. MVL Group, Inc.*, 343 F.3d 57, 63 (2d Cir. 2003), the arbitration agreement purported to "insulate the substance of the arbitration award from judicial review," even the very narrow review available under the FAA. The court acknowledged that, in those cases where courts "have enforced private agreements to alter the judicial review to be applied to arbitral awards, * * * the cases have involved attempts to raise the level of judicial review otherwise available under the FAA." *Id.* at 64. "While taking no position on the enforceability of agreements to raise the level of judicial review," the court noted "that there is a fundamental difference between an agreement to increase the scrutiny that courts apply when considering whether to confirm or vacate an arbitration award and an agreement to prevent courts from reviewing the substance of an arbitration award at all." *Id.* The court declined to allow private litigants to completely divest the courts of authority to review both the substance of the arbitration award and the arbitration process under section 10 of the FAA. *Id.* at 66. However, the court expressly chose not to address the issue of heightened judicial scrutiny.[10]

D. The Conflict Between The Circuits Will Continue to Deepen Without this Court's Resolution of the Issue.

The substantial divide between the circuits is based on a fundamental, philosophical difference about the purposes of the FAA and is bound to deepen without resolution of the issue by this Court. As recognized by the First Circuit in *Puerto Rico Telephone*, those courts which have upheld expanded judicial review "have held that the Act's ultimate purpose is to enforce the terms of the agreement to arbitrate,

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[10] The court in *Kyocera* went the other route and stated that contracting for a narrower standard of review "may be less troublesome" than a broader, more searching, standard of review, such as is present here. *Kyocera*, 341 F.3d at 999 n.16.

and that they are therefore bound by federal law to enforce the arbitration agreements as drafted." *Puerto Rico Telephone*, 427 F.3d at 31. Those courts which have construed the FAA to preclude expanded judicial review have done so based "on the theory that allowing private parties to contract for more searching review standards would create federal jurisdiction by contract" and "on a public policy concern" that broad judicial review of arbitration decisions would jeopardize the benefits of arbitration. *Id.* at 30-31.

The circuit courts are thus in a square and irreconcilable conflict which is unlikely to resolve itself without guidance by this Court. The issue has gained the attention of several legal commentators, *See, e.g.*, Milana Koptsiovsky, *A Right to Contract for a Judicial Review of an Arbitration Award: Does Freedom of Contract Apply to Arbitration Agreements?*, 36 Conn. L. Rev. 609 (2004); Lee Goldman, *Contractually Expanded Review of Arbitration Awards*, 8 Harv. Negotiation L. Rev. 171 (2003); Eric van Ginkel, *Reframing the Dilemma of Contractually Expanded Judicial Review: Arbitral Appeal vs. Vacatur*, 3 Pepp. Disp. Resol. L. Rev. 47 (2003).[11]

The issue can have important consequences in a particular case. For example, in *Kyocera* the arbitration award at issue was for approximately one quarter of a billion dollars. *Kyocera*, 341 F.3d at 990. The case at bar involves claims that exceed one million dollars. In very large cases, the

[11] State courts are also in conflict on this issue. For instance, a Texas appellate court followed the Fifth Circuit rule and interpreted the FAA to permit the parties to expand the scope of judicial review. *Tanox, Inc. v. Akin, Gump, Strauss, Hauer & Feld, L.L.P.*, 105 S.W.3d 244, 250-51 (Tex. Ct. App. 2003). However, the California Court of Appeals in *Cable Connection, Inc. v. DIRECTV, Inc.*, 143 Cal. App. 4th 207, 223 (2006), following *Kyocera*, held that the FAA did not permit expanded judicial review. However, on December 20, 2006, the California Supreme Court granted review and depublished this decision. *Cable Connection, Inc. v. DIRECTV, Inc.*, 2006 Cal. Lexis 15057 (Cal. Dec. 20, 2006).

parties may not want to take the risk that an arbitrator will make a legal error, which is not correctable through judicial review. While these parties may very well have good reason to choose the flexibility, economy and speed which arbitration may offer with regards to the factual issues of the case, they may not be willing to give up the right to meaningful and searching judicial review on the controlling principles of law. The narrow default standards of the FAA simply do not meet their needs.[12]

Petitioner contends that parties should be free to contract for judicial review of an arbitration award beyond the limited scope of review set forth in the FAA. Parties that bargain for expanded judicial review do so with the expectations that the arbitration award will not be permeated with legal error. These contractual expectations should not be frustrated. Certainly, the question of whether such an agreement is enforceable should not depend solely on the circuit in which the arbitration award is issued, a situation which prevails because of the current split in the circuits.

II. The Ninth Circuit's Decision Is Fundamentally in Conflict with this Court's Cases Interpreting the FAA.

This Court has enforced in several cases contract terms that have called for arbitration under rules other than those established by the FAA itself. The Ninth Circuit's decision in this case is in direct conflict with these decisions.

For example, in *Volt*, the parties agreed that their arbitration agreement would be governed by California law. *Volt*, 489 U.S. at 470. California law permitted the trial court to stay an arbitration pending the outcome of other litigation.

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[12] In fact, the court in *Kyocera* stated that the issue of expanded judicial review was "of <u>exceptional importance</u> to future contracting parties and litigants within this circuit." *Kyocera*, 341 F.3d at 997 (emphasis added).

Id. at 471 n.3. Respondent argued that this provision conflicted with sections 3 and 4 of the FAA, which call for the direction of arbitration and a stay of the court proceeding pending arbitration, but which do not permit a stay of the arbitration itself. *Id.* at 476-77. *See also* 9 U.S.C. §§ 3, 4.

The Court rejected this argument in clear and forceful terms:

> In recognition of Congress' principal purpose of ensuring that private arbitration agreements are enforced according to their terms, we have held that the FAA preempts state laws which require a judicial forum for the resolution of claims which the contracting parties agree to resolve by arbitration. But it does not follow that the FAA prevents 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. Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted.

Id. at 478-79 (citations and quotations omitted).

Similarly, in *Mastrobuono*, the parties' arbitration agreement contained a provision stating that New York law applied. *Mastrobuono*, 514 U.S. at 53. Because New York courts had decided that the power to award punitive damages was limited to judicial tribunals and could not be exercised by arbitrators, the Court was faced with the issue of "whether a contractual choice-of-law provision may preclude an arbitral award of punitive damages that otherwise would be proper." *Id.* at 55. Although the Court ultimately held that the parties did not intend to foreclose an arbitral award of punitive damages, the decision clearly supports the parties' freedom to

contract for such an exclusion if they so desired. In this regard, the Court, citing *Volt*, made the familiar statement that the "central purpose" of the FAA was to ensure that private agreements to arbitrate are enforced according to their terms. *Id.* at 53. Holding that "the FAA's pro-arbitration policy does not operate without regard to the wishes of the contracting parties," the Court was prepared to enforce the parties' agreement whether it included or excluded punitive damages. *Id.* at 57-58.

Similarly, in *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), the Court again gave free reign to the parties to structure their arbitration agreement as they saw fit, <u>even if the agreement altered the role of the reviewing court as prescribed by the FAA</u>. In *First Options*, the Court permitted the parties to an arbitration agreement to alter the role of the reviewing court as prescribed in the FAA and to allow the arbitrator to determine, in the first instance, whether the dispute was arbitral. Under the FAA, the determination as to whether a dispute is arbitrable is reserved for the court. For example, section 3 of the FAA states that the court in any proceeding brought upon any issue referable to arbitration shall stay the action until such arbitration has been held in accordance with the terms of the arbitration agreement if the court "is satisfied that the issue in such suit or proceeding is referable to arbitration." 9 U.S.C. § 3. Section 4 states that, in the event that a party to an arbitration agreement fails to proceed to arbitration, the court shall make an order directing the parties to proceed "in accordance with the terms of the agreement." 9 U.S.C. § 4. The normal rule is thus that the court, not the arbitrator, decides arbitrability. *See, e.g.*, *Howsam v. Dean Witter Reynolds*, 537 U.S. 79, 82 (2002).

However, in *First Options*, this Court permitted the parties to alter the traditional role of the court by private agreement. The Court held that the question of "who has the primary power to decide arbitrability turns upon what the parties

agreed about *that* matter." *Id.* at 943 (emphasis in original). The Court's conclusion that the parties could decide the issue flowed "inexorably from the fact that arbitration is simply a matter of contract between the parties * * *." *Id.*

In this case, the Ninth Circuit held that *Kyocera* compelled reversal because the trial court had engaged in *de novo* review of the arbitrator's decision (according to the express terms of the parties' agreement) and had gone beyond the FAA standard of review. However, the reasoning behind *Kyocera*'s holding is contrary to this Court's precedents.

For example, the *Kyocera* rule as applied by the Ninth Circuit in this case gives short shrift to the oft-repeated holding of this Court that the "central purpose" of the FAA is to give effect to the parties' contractual agreement to arbitrate.[13] Rather, the court in *Kyocera* cited to modern views of arbitration, views which extol its supposed speed, economy and informality. *Kyocera*, 341 F.3d at 998.

Elevating these claimed benefits of arbitration over the central purpose of the FAA is contrary to this Court's precedents. As stated in *Volt*, while "Congress was no doubt aware that the Act would encourage the expeditious resolution of disputes, its passage 'was motivated, first and foremost by a congressional desire to enforce agreements to which parties had entered.'" *Volt*, 489 U.S. at 477 (citing *Byrd*, 470 U.S. at 220). In *Byrd*, this Court expressly held that efficiency and speedy resolution of claims is not the main concern of the

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[13] This Court's holding that the central purpose of the FAA is to give effect to the parties' agreement is also supported by the FAA's legislative history. *See, e.g., Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219-20 (1985). Nowhere does the legislative history assert that an agreement to arbitrate must be enforced only in accordance with the FAA or that a court is precluded from enforcing a contract on its own terms if the contract expands on the FAA's terms. Koptsiovsky, *A Right to Contract for a Judicial Review of an Arbitration Award: Does Freedom of Contract Apply to Arbitration Agreements?*, 36 Conn. L. Rev. at 614-15.

FAA and that it would not overlook what it viewed to be the principal objective of the FAA – specific enforcement of arbitration agreements – in favor of a mere "efficient" dispute resolution. *Id.* at 219-20.[14] Similarly, in *First Options*, this Court held that "the basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes," but rather to ensure that arbitration agreements, like other contracts, are enforced according to their terms. *First Options*, 514 U.S. at 947.

As stated earlier, the Ninth Circuit's decision in *Kyocera* was also based on its assumption that expanded judicial review allowed the parties to define the jurisdiction of the district court by contract and/or that the parties were attempting to dictate how the court functioned. *Kyocera*, 341 F.3d at 999. However, this concern is misplaced because the FAA does not create an independent ground for federal court jurisdiction. *Moses H. Cone*, 460 U.S. at 26. In this case, the district court had independent jurisdictional grounds to decide the case based on its diversity jurisdiction and had the power to decide all factual and legal issues in the case until the parties entered into an arbitration agreement after the case was partially decided. The expanded judicial review provision was specifically approved by the district court, which relied on the Ninth Circuit's decision in *LaPine*, which had held that such provisions were enforceable.

As to the Ninth Circuit's concern that allowing expanded judicial review permits the parties to dictate how the court functions, this Court's decisions support the rights of parties to agree to waive statutory and other rights, even if such waiver affects the conduct of the court's proceedings. *See, e.g., United States v. Mezzanatto*, 513 U.S. 196, 200-01

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[14] The Court in *Byrd* held that the "preeminent concern of Congress in passing the Act was to enforce private agreements to arbitrate***." *Byrd*, 470 U.S. at 221.

(1995) (criminal defendant may waive evidentiary admissibility of plea negotiations); *Sac and Fox Indians of Miss. in Iowa v. Sac and Fox Indians of Miss. in Okl.*, 220 U.S. 481, 488-89 (1911) (waiver of evidentiary rule barring hearsay). It is thus clear that, "absent an affirmative indication of Congress' intent to preclude waiver, we have presumed that statutory provisions are subject to waiver by voluntary agreement of the parties." *Mezzanatto*, 513 U.S. at 201.

In addition, courts have permitted parties to waive affirmative defenses that would normally bar the court from deciding the case on the merits. Thus, in *Photopaint Technologies., LLC v. Smartlens Corp.*, 335 F.3d 152, 160 (2d Cir. 2003), the court held that the parties could agree to waive the statute of limitations for confirming an arbitration award under Section 9 of the FAA. Absent the parties' stipulation, the court would have been directed by Congress pursuant to the terms of the FAA not to hear the dispute. *See also United States v. Wilson*, 26 F.3d 142, 154-56 (D.C. Cir. 1994) (discussing various cases which uphold agreements to waive statutes of limitations).

The Ninth Circuit's rule, enforced in this case, that parties cannot waive what would otherwise be their right to have an arbitration award judged under an extremely deferential standard of review is without support in this Court's cases. The rule reflects a judicial approach which applies subjective and varying public policy views over precedent and which affords greater weight to the supposed speed and efficiency of arbitration than to the rights of the parties to contract for the type of arbitration process which best suits their needs. *See Mezzanotto*, 513 U.S. at 207 (the Court criticized the Ninth Circuit for its reliance upon "public policy " to "override the presumption of waivability").

While the Ninth Circuit accepts that the FAA creates only a default standard which the parties can "contract around" for <u>all</u> purposes <u>prior</u> to the final arbitration award, its policy

views cause it to abandon that premise with regards to judicial review, despite the fact that there is nothing either in the text of the FAA or its legislative history to indicate that this was Congress' intent. *Kyocera*, 341 F.3d at 1000. In the face of clear and long-standing authority from this Court that the central purpose of the FAA is to give effect to the parties' agreement to arbitrate, the Ninth Circuit's avoidance of that purpose when it comes to judicial review (and that of the Tenth Circuit as set forth in *Bowen*) is without support and is based solely on the court's views of the public policy benefits of arbitration.

In this case, the parties had the right to have their dispute decided by the district court, which clearly possessed jurisdiction over the case. They sought to conserve their own resources, and that of the district court, by agreeing to try the remaining issues in the case before an arbitrator. However, the central premise of their agreement to arbitrate was that the district court would retain the authority to correct errors of law. Neither side bargained for an arbitration award which contained such errors. Their agreement to arbitrate with expanded judicial review was expressly approved by the district court in reliance on the Ninth Circuit's prior holding in *LaPine*, which approved expanded judicial review under the FAA. The arbitrator's initial decision contained a fundamental error of law, which was corrected by the district court in accordance with the parties' agreement and resulted in a final award in favor of Hall Street.

The Ninth Circuit's reliance on *Kyocera* in this case has the practical effect of reinstating an arbitral ruling on an issue of law which Judge Graber of the Ninth Circuit held was "completely irrational" and which the panel majority recognized might very well be erroneous. The parties' reasonable expectations as set forth in their agreement to arbitrate are thus being directly frustrated, to Hall Street's great disadvantage. However, if the arbitration award had been issued in Boston,

Philadelphia, New Orleans or a myriad of other locations throughout the First, Third, Fourth, Fifth and/or Sixth Circuits, Hall Street would be the prevailing party, not Mattel.

The central purpose of the FAA is to enforce agreements to arbitrate according to their express terms. The holdings of the Ninth and Tenth Circuits undermine this purpose while the holdings of the First, Third, Fourth, Fifth and Sixth Circuits follow this Court's precedents and give controlling weight to this principal purpose of the FAA.

The FAA was also intended to create a uniform federal substantive law of arbitration. The current deep split in the circuits concerning the important issue of expanded judicial review under the FAA frustrates this important statutory purpose as well. This Court should accept review to resolve this important issue of statutory construction under the FAA.

CONCLUSION

For the above reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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