No. 15-1537

In the Supreme Court of the United States

R.J. REYNOLDS TOBACCO COMPANY, PHILIP MORRIS USA INC., COMMONWEALTH BRANDS, INC., ET AL.

v.

STATE OF MARYLAND

On Petition For A Writ Of Certiorari To The Court Of Special Appeals Of Maryland

REPLY TO BRIEF IN OPPOSITION

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RULE 29.6 STATEMENT

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ARGUMENT

Respondent does not seriously dispute that state high courts have split on the first question presented here: whether the FAA preempts state laws that impose non-FAA standards of judicial review for FAA-governed arbitrations. Nor does Respondent meaningfully defend the holding below that state laws imposing non-FAA standards are not preempted. Indeed, Respondent entirely ignores that the holding's significant consequence would be to render the stringent FAA standard practically irrelevant since most FAA arbitrations are reviewed in state court. Thus, Respondent essentially concedes that that holding would warrant certiorari if it was the sole basis for the judgment below.

Respondent insists, however, that the decision below rests on two alternative holdings: (1) that the applicable state-law standard is virtually identical to the FAA standard; and (2) that the parties contractually agreed to the state-law standard. But both of those determinations are also erroneous under the FAA, and neither one makes this a bad vehicle; if anything, by further misapplying the FAA, they make this an especially good vehicle to clarify the FAA's proper application.

More specifically, Respondent invokes the determination below that the "completely irrational" standard under Maryland law is virtually identical to the FAA standard. But that begs the second question presented here. And Respondent ignores Petitioners' showing that certiorari is also warranted on it since the FAA standard, as construed in *Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064 (2013), forbids *any merits review* — even if limited to

"irrational" errors — and allows vacatur only if the arbitrators acted *dishonestly* or *without jurisdiction*.

Respondent also invokes the determination below that the parties agreed to the state-law judicial-review standard in the MSA's general choice-of-law provision, notwithstanding that the MSA's arbitration-specific choice-of-law provision adopts the FAA. But Respondent errs in contending that this alleged contractual agreement was the affirmative basis of the holding below that the state standard applies and is not preempted by the FAA standard. Indeed, the court essentially *disclaimed* reliance on the alleged state-law agreement when it concluded that "the court, not the parties, … must determine the standard of review." Pet.App. 26a. In any event, Respondent entirely ignores Petitioners' additional showing that the court's determination that the MSA incorporated the state standard is itself preempted by the FAA under *DIRECTV, Inc. v. Imburgia*, 136 S. Ct. 463 (2015), because the court discriminated against arbitration in adopting that erroneous interpretation.

In sum, the decision below is riddled with cert-worthy errors under the FAA. It is also particularly important because it invalidated a multi-hundred-million-dollar award under the MSA, while casting a shadow over all future MSA arbitrations. Thus, whether this Court grants plenary review, summarily vacates and remands in light of *Oxford Health*, or at least GVRs in light of *Imburgia*, it should not allow the decision to stand.

I. RESPONDENT ESSENTIALLY CONCEDES THAT WHETHER THE FAA PREEMPTS STATE LAWS IMPOSING NON-FAA JUDICIAL-REVIEW STANDARDS IS A QUESTION THAT WARRANTS THIS COURT'S REVIEW

As Respondent does not dispute, the decision below includes a broad holding that the FAA does not preempt state laws imposing non-FAA judicial-review standards because such standards supposedly are "procedural" rules that do not frustrate the FAA's substantive enforcement of the arbitration agreement. Pet.App. 27a-29a; BIO 15-18. That holding gives rise to the first question presented here. Pet. i. And Respondent does not meaningfully dispute that the question is certworthy.

A. Notably, Respondent concedes that state high courts are divided on the preemptive effect of the FAA's judicial-review standard.

To begin, Respondent does not dispute that at least two (and arguably four) state high courts have held that the FAA review standard does not govern in state court. Pet. 17; BIO 18-21. Indeed, that side of the split has recently deepened given the New Hampshire Supreme Court's decision. BIO 21.

Conversely, Respondent admits that the Alabama Supreme Court has held that the FAA review standard governs in state court, *unless* the parties provide otherwise. Pet. 16-17; BIO 19-20. Moreover, Respondent admits that five additional state high courts have said the same as Alabama's court, and it fails in trying to distinguish those decisions:

First, Respondent erroneously asserts that the decisions of the Idaho and Georgia Supreme Courts (Pet. 17) "have been superseded by [the] intervening decisions of this Court" in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), and *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008). BIO 20. But *Volt* and *Hall Street* are relevant at most only to whether *parties can agree* to non-FAA standards, and *Hall Street* reserved even that question. *Volt*, 489 U.S. 477-79; *Hall St.*, 552 U.S. at 590; Pet. 20. Accordingly, post-*Volt*, the Idaho Supreme Court reaffirmed that, where the parties have *not* agreed that their FAA-governed arbitration will be subject to the state-law review standard, "[t]he narrow reach of *Volt* does not apply" and the FAA standard continues to preempt the state-law standard. *Reece v. U.S. Bancorp Piper Jaffray, Inc.*, 80 P.3d 1088, 1091-92 (Idaho 2003); *see also Adage, Inc. v. Bank of America, N.A.*, 600 S.E.2d 829, 830 (Ga. Ct. App. 2004) (post-*Volt* decision adhering to Georgia Supreme Court's decision).

Second, Respondent also observes that the high courts of New York, South Dakota, and Nebraska applied the FAA review standard without extensive analysis or evident dispute. BIO 19. But this does not undermine those courts' clear holdings that the FAA standard is "substantive" law that applies in state courts for arbitrations involving "interstate commerce." Pet. 16-17.

In sum, there is now a 6-3 or 6-5 split on whether the FAA standard governs in state courts absent the parties' contrary agreement. Indeed, even if the New York, South Dakota, and Nebraska decisions were

treated (incorrectly) as mere drive-by rulings, there still would be 3 state high courts (Alabama, Idaho, and Georgia) squarely on Petitioners' side of this well-developed conflict. That is more than sufficient to warrant certiorari, especially given the recognized importance of ensuring state-court compliance with the FAA. *Id.* 14.

B. Moreover, Respondent does not really defend the broad holding below that state laws can impose non-FAA review standards on FAA arbitrations. As with its erroneous reliance on *Hall Street*, Respondent regurgitates the court's reasoning but never disputes Petitioners' rejoinders.

For instance, Respondent reiterates that the FAA vacatur provision specifies a federal district court where review may be sought. BIO 14, 16. But Respondent does not deny that this venue provision is permissive rather than restrictive and thus does not excuse state courts from applying the FAA vacatur standard. Pet. 20-21.

Likewise, Respondent reiterates that the FAA's substantive goal is to prevent hostile states from undercutting enforcement of arbitration agreements. BIO 15. But Respondent does not deny that arbitration agreements are equally undercut if state courts can second-guess arbitration awards on the merits. Pet. 19-20. Nor does Respondent deny the significance of this question to the FAA's proper functioning, given that FAA-governed arbitration agreements are typically enforced in state court rather than federal court because the FAA does not confer federal-court jurisdiction. *Id.* 20.

C. Rather than disputing the state-court split or defending the broad holding below that state law can *require* the application of *non-FAA* review standards to FAA arbitrations, Respondent asserts that the decision also rested on two alternative grounds: (1) that the Maryland standard is *virtually identical* to the FAA standard; and (2) that the parties *agreed* to the state-law standard in the MSA. BIO 9-10, 11-14, 16-18, 19-21, 22-24.

Respondent's refusal to independently address the broad holding below effectively concedes that the first question presented warrants this Court's review. And Respondent errs in arguing that this is an inappropriate case to exercise review, because the purported alternative holdings present no vehicle problem. If anything, they make the case more certworthy, as shown below.

II. RESPONDENT FLOUTS *OXFORD HEALTH* AND ILLUSTRATES THE NEED FOR THIS COURT TO REAFFIRM THAT THE FAA DOES NOT ALLOW REVIEWING THE MERITS OF ARBITRATION AWARDS IN ANY RESPECT

In defending the holding below that the FAA standard is virtually identical to the Maryland standard — which gives rise to the second question presented here — Respondent resorts to *ipse dixit* rather than legal analysis. It asserts that the FAA standard is virtually identical because the court below said so, while ignoring Petitioners' showing that the FAA standard is fundamentally different because this Court has repeatedly held that it bars all merits review.

A. Respondent stresses that: (1) FAA § 10(a)(4) and MUAA § 3-224(b)(3) both authorize vacatur where arbitrators "exceeded their powers"; (2) federal and state cases both generally "defer" to arbitrators and grant relief only in "narrow" circumstances; and (3) the court below ruled that Maryland's "[no] rational construction" standard is virtually identical to the FAA's standard because the latter allegedly likewise allows vacatur where the arbitrators "disregarded" the contract's "plain" language. BIO 17-18, 22-24. Respondent thus contends that whether the Panel's award could have been vacated even under that purported FAA standard is "a fact-bound issue" that "does not present a substantial question of federal law." *Id.* 10 (formatting altered).

But that contention is willfully blind to the substantial federal question presented by the holding below: whether the FAA requires upholding the arbitrators' contractual interpretation *even if* a court concludes that it is "irrational" under the contract's "plain" language. Pet. i. As Petitioners showed, the court below answered that question erroneously: under the clear text of FAA § 10(a)(4) and the square holding of *Oxford Health*, courts cannot engage in *any* merits review, because arbitrators "exceed their powers" only if they act *without jurisdiction* or *dishonestly*, not if they interpret the contract *in good faith* yet (allegedly) make a plain and irrational error. *Id.* 22-24. Respondent never acknowledges this showing, much less refutes it. BIO 23-24.

Although Respondent mentions *Oxford Health*, it ignores that *Oxford Health* did not use any variant of the terms "irrational" or "plain" error. *Compare id.*, *with Oxford Health*, 133 S. Ct. at 2068-71. To the

contrary, *Oxford Health* made clear that it is "[o]nly if" an award "simply reflects [the arbitrators'] own notions of economic justice" that it does not "draw[ ] its essence from the contract." *Id.* at 2068. Absent such dishonesty, the arbitrators are "arguably construing or applying the contract" and thus their decision "must stand, regardless of a court's view of its (de)merits" — "however good, bad, or ugly," and "even [if] grave error." *Id.* at 2068, 2070-71.

Similarly, although Respondent invokes *United Paperworkers International Union v. Misco, Inc.*, 484 U.S. 29 (1987), it ignores that *Misco actually rejects* its position. *Compare* BIO 8, 24, *with* Pet. 23-24. Namely, in stating that arbitrators "may not *ignore* the plain language of the contract," *Misco* excluded those who merely "*misread* the contract" and instead included only those who willfully acted contrary to their own "*honest* judgment" about the contract's meaning. 484 U.S. at 38 (emphasis added). Indeed, in a post-*Misco* case, this Court *summarily reversed* the Ninth Circuit precisely because it vacated arbitral findings as "irrational." *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 510-11 & n.2 (2001) (per curiam).

Tellingly, Respondent does not actually contend that Maryland's "irrationality" standard is virtually identical to *Oxford Health*'s "own notions of justice" standard. Rather, Respondent suggests that the state-law standard is only "slightly broader" than the FAA standard, and sufficiently "similar" that it is not a preempted "obstacle" to the FAA's goals. BIO 11, 17, 22. But there is a fundamental difference in kind, not just a slight difference in degree, between non-merits review for subjective bad faith and merits

review for objective irrationality. Irrationality review frustrates the FAA's "national policy" of having only "limited review" for arbitral misconduct, because it "opens the door to … full-bore legal … appeals" that "render informal arbitration merely a prelude to a more cumbersome and time-consuming judicial review process." *Hall St.*, 552 U.S. at 588.[1]

In fact, this case illustrates the serious problem that "irrationality" review licenses hostile courts to second-guess arbitrators. Although Respondent insists that this case involves an "extreme outlier award," that characterization rests on the conclusory assertion that the arbitrators "disregarded" MSA § IX(d)(2)'s provisions. BIO 10, 24. In actuality, as the Missouri Court of Appeals held and Petitioners demonstrated — without refutation by Respondent — the Panel of three former federal judges carefully interpreted § IX(d)(2) in light of its plain text, the relevant background law, and the factual context. *Compare id.*, *with* Pet. 24-30. If Judge Mikva and the other distinguished arbitrators nevertheless can be charged with having "irrationally" "disregarded" the contract, then no FAA award is safe.

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[1] Respondent misleadingly emphasizes that Petitioners argued below that the Maryland and FAA standards were "virtually identical." BIO 18. Petitioners merely contended that the Maryland standard *at most* allowed "irrationality" review, *not "de novo" review* as Respondent claimed. Pet.App. 25a. Petitioners stressed that *even* "irrationality" review was "broader" than FAA review and "preempted." *Id.*

B. Respondent's refusal to respect *Oxford Health*'s prohibition on merits review underscores the need for this Court to grant the second question presented. Indeed, summary reversal is warranted, as in past cases of outright State defiance of the FAA. Pet. 33. That would be especially efficient here because it may well prompt the court below to reconsider its holding on the first question presented that state law may impose a non-FAA review standard on FAA arbitrations, since Respondent has now abandoned any real defense of that holding.

III. RESPONDENT CANNOT EVADE THIS COURT'S REVIEW BASED ON THE PARTIES' PURPORTED AGREEMENT TO THE STATE-LAW STANDARD

Finally, this Court should reject Respondent's attempt to manufacture a vehicle problem by asserting that (1) the court below "decided to apply the [state-law] judicial review standards based on a straightforward interpretation of the MSA," and that (2) this contract interpretation is "a question of state law" that "is not reviewable by this Court." BIO 9, 14. Neither assertion is correct.

A. To begin, Respondent mischaracterizes the decision below. It claims that the court "determined that MUAA standards of judicial review governed" because "the parties selected state law" in the MSA. *Id.* 12. But the court *never held* that this alleged agreement was *itself a valid basis* to apply the state review standard.

The court's affirmative basis for applying the state standard was *statutory*: it "agree[d] with Maryland" that "the pertinent state law" was not preempted "by the federal procedural provisions of

the FAA." Pet.App. 25a-26a. The court addressed the *contractual issue* whether the parties had agreed to a review standard only when rejecting Petitioners' alternative argument that the FAA standard should govern because the MSA incorporated it. *Id.* 26a-27a. Indeed, the court essentially *disclaimed* reliance on the alleged state-law agreement when it concluded that "the court, not the parties, … must determine the standard of review." *Id.* 26a.[2]

At a minimum, it is "not clear" that the court's decision to apply the state standard rested independently on the alleged agreement, and thus this Court can review the "primar[y]" holding below that the FAA standard does not preempt the state standard wholly apart from any agreement. *Michigan v. Long*, 463 U.S. 1032, 1040-41 (1983). Because that holding is both certworthy and erroneous, this Court should either reverse it after plenary review or summarily vacate it in light of *Oxford Health*.[3]

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[2] It is immaterial that the court reached that conclusion in rejecting Petitioners' argument that Respondent had *waived* the state standard by failing to raise it in the trial court. Pet.App. 26a. Respondent identifies no reason why the parties (1) cannot agree to the governing review standard in the trial court, (2) yet can do so in the contract. BIO 13 n.2.

[3] On remand from either disposition, the court below then can clearly decide whether the governing FAA standard could be displaced by the alleged agreement to the state-law standard. Although Respondent argues (BIO 14, 16) that such an agreement must be given effect due to the FAA's policy of enforcing arbitration agreements by their terms, this Court rejected that precise argument in *Hall Street*, which held that parties *cannot agree* to expand the FAA standard in federal court, but left the issue open for state court. *See* 552 U.S. at

B. Anyway, Respondent is wrong that this Court could not or should not review the state court's ruling that the MSA adopted the state standard. That erroneous interpretation discriminates against arbitration and thus is itself preempted by the FAA under this Court's decision in *Imburgia*.

Specifically, the state-law interpretation: (1) flouts the MSA's express direction that "[t]he arbitration shall be governed by the [FAA]" and be "binding"; (2) subordinates that arbitration-specific choice-of-law provision to the MSA's general choice-of-law provision by reading those provisions inconsistently and contrary to this Court's precedent; and (3) disfavors arbitration by enabling greater judicial review. Pet. 32-33. Respondent insists that the state-law interpretation is "clearly correct," but it does not respond to *any* of the points above, let alone explain why it *never* raised the state-law standard in the trial court if it so "clearly" applies. BIO 13.

Thus, under *Imburgia*, this Court could and should reject the state court's interpretation of the MSA if that were necessary to reach the certworthy questions presented on the FAA (though it is not, *supra* at 10-11). At a minimum, this Court should GVR in light of *Imburgia*, an intervening decision that could and should cause the state court to revisit its contract interpretation, thereby clearing the path for further review here as to the FAA's scope.

585-86, 590. This potential issue is not a reason to deny review: at most, it is a question for remand and a reason to hold for the parallel Pennsylvania case, No. 15-1299, where the state court *clearly* disavowed reliance on any alleged state-law agreement.

CONCLUSION

The decision below should not be allowed to stand, as it is riddled with certworthy errors and has massive financial and practical implications for the MSA parties. This Court should either grant plenary review, summarily vacate and remand in light of *Oxford Health*, or at least GVR in light of *Imburgia*.

September 2016

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