No. 08-1396

JUN 12 2009

In The
Supreme Court of the United States

THE COFFEE BEANERY LTD., ET AL.,

Petitioners,

v.

WW, LLC; RICHARD WELSHANS;
AND DEBORAH WILLIAMS,

Respondents.

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Sixth Circuit

BRIEF OF THE INTERNATIONAL FRANCHISE ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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STATEMENT OF INTEREST

The International Franchise Association ("IFA") submits this brief as *amicus curiae* in support of the petition for a writ of certiorari filed by the Coffee Beanery Ltd.[1]

Founded in 1960, the IFA is the oldest and largest trade association in the world devoted to representing the interests of franchising. The IFA is a membership organization of franchisors, franchisees, and suppliers. The IFA's mission is to safeguard and enhance the business environment for franchising worldwide. In addition to serving as a resource for current and prospective franchisors and franchisees, the IFA and its members advise public officials across the country about the laws that govern franchising, with the goals of promoting franchise growth and advancing the interests of franchisees, franchisors, and suppliers. The IFA is the only trade association that acts as a voice for both franchisors and franchisees throughout the United States and the world.

The IFA also supports arbitration, which many franchise systems select as an expeditious and cost-effective method of dispute resolution. The IFA submits

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[1] Letters of consent have been submitted concurrently with this filing. No counsel for any party has authored this brief in whole or in part and no person or entity, other than *amicus curiae*, its members or its counsel made any monetary contribution specifically for the preparation or submission of this brief. S. Ct. R. 37.6.

this brief as *amicus curiae* to illustrate the practical, real-world effects to which the current inconsistency in manifest disregard standards exposes national franchise systems that select arbitration.

SUMMARY OF THE ARGUMENT

The IFA urges the Court to grant the petition for certiorari in order to resolve a conflict among the Circuits that adversely affects every company that favors arbitration and does business nationwide. Since the Court's decision in *Hall Street Associates L.L.C. v. Mattel, Inc.*, 128 S. Ct. 1396 (2008), lower courts have diverged significantly over the existence and meaning of any extra-statutory grounds for vacating an arbitration award. Some courts have held that "manifest disregard of the law" is a judicially created doctrine that *Hall Street* abolished; some courts (like the Sixth Circuit in the decision below) have held that manifest disregard is a judicially created doctrine that remains intact after *Hall Street*; and some courts have interpreted manifest disregard as a judicial gloss on Section 10 of the FAA. Federal Arbitration Act, 9 U.S.C. §§ 1-16.

The current state of the law creates tremendous uncertainty about the finality and cost-effectiveness of arbitration – uncertainty that is especially problematic for national franchise systems that rely on arbitration. Franchisors select arbitration as an expeditious, efficient and cost-effective means of

resolving disputes, but they currently do not receive those benefits uniformly across the country. These inappropriate variations in the law governing enforcement of arbitration awards significantly undermine the FAA's purpose of establishing "a national policy favoring arbitration of claims that parties contract to settle in that manner." *Vaden v. Discover Bank*, 129 S. Ct. 1262, 1271 (2009) (citations and quotation marks omitted).

Coffee Beanery v. WW, LLC, 300 Fed. Appx. 415 (2008), is an appropriate candidate for this Court to resolve the unanswered questions in the wake of *Hall Street*. Granting the petition also provides an opportunity to reaffirm this Court's decision in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), and to reiterate the benefits of a single, consistent national policy favoring arbitration.

ARGUMENT

I. Franchising Has a Substantial Impact on the U.S. Economy.

Franchising is ubiquitous in the United States today. Respected names like Hilton, Holiday Inn, McDonald's, Avis, and Wendy's are in the franchise business, and franchising has become a major factor in the U.S. economy.

In 2008, PricewaterhouseCoopers published a study of economic data from 2005 that measured

franchising's direct and indirect impact on jobs and output in the American economy. According to this study, franchised businesses generate jobs for 21 million Americans, with an annual economic output of $2.3 trillion, or 11.4 percent of total private U.S. Sector Output. 2 Nat'l Econ. Consulting, The Economic Impact of Franchised Businesses 6-7 (2008).[2] The study also concludes that franchising continues to grow faster than other businesses. *Id.*

II. Many Franchise Systems Rely on Arbitration as a Cost-Effective and Efficient Means of Resolving Disputes.

Many franchise systems employ arbitration as an efficient and cost-effective method of resolving disputes. A recent study comparing data from major franchisors over a period of eight years (from 1999-2007) found that 43-45% of franchise agreements contained an arbitration clause. *See* Christopher R. Drahozal & Quentin R. Wittrock, *Is there a Flight from Arbitration?*, 37 HOFSTRA L. R. 71, 75 (2008) (hereinafter "Drahozal & Wittrock"). Arbitration is attractive to franchised businesses because it provides finality and certainty while resolving disputes quickly and efficiently. This is particularly important in franchise systems where disputes often arise over the course of the long-term contractual relationships between franchisor and

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franchisees. It benefits the particular franchisor-franchisee relationship and the entire franchise system to resolve such disputes quickly and economically, so that the parties can put the dispute behind them and continue with the business of the franchise. As this Court has recognized, arbitration can reduce the costs of resolving disputes and provide much-needed finality faster than litigating in court. *See, e.g., Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995) (arbitration is "usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices") (citations omitted). An added benefit is the ability to select an arbitrator with some expertise in franchising or the relevant industry, which can further streamline the evidentiary and decision-making process. *See, e.g., Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633 (1985) ("adaptability and access to expertise are hallmarks of arbitration. The anticipated subject matter of the dispute may be taken into account when the arbitrators are appointed . . . "). Arbitration's efficiency and cost-effectiveness benefit both franchisor and franchisee, as well as the entire franchise system. *See* Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An*

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III. The Current Circuit Split Threatens to Undermine the Finality and Cost-Effectiveness of Arbitration for National Franchise Systems.

As the petition details, a conflict among the Circuits has developed since this Court's *Hall Street*

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[3] There may be a misperception that franchisees do not willingly arbitrate, but are forced to accept arbitration when they execute the franchisor's standard form franchise agreement. *See* James A. Brickley, Sanjog Misra & R. Lawrence Van Horn, *Contract Duration: Evidence From Franchising* (2006), 49 J. LAW & ECON. 173 (2006) (discussing theory of the "naïve franchisee"); *see also* Arbitration Fairness Act of 2009, H.R. 1020 (111th Cong., 1st Sess., Feb. 12, 2009) (proposal to invalidate pre-dispute arbitration clauses in any consumer, employment or franchise contract). The evidence, however, does not support the theory that franchisees need protection from arbitration agreements. Instead, today's franchisees are often sophisticated multi-unit owners with bargaining power and corporate experience. *See* Drahozal & Wittrock at 87. Franchisors for different systems compete head-to-head to attract franchisees, and prospective franchisees have a wealth of information at their disposal because of federal and state pre-sale disclosure regulations, including whether the contract includes an arbitration clause. *See, e.g.*, 16 C.F.R. 436.1(q) (Franchise Disclosure Rule, Item 17) (requiring disclosure of, among other things, any provision for arbitration or mediation). Moreover, if 43-45% of franchise systems include arbitration in their standard franchise agreements, then 55-57% do not. Drahozal & Wittrock at 75. There is no evidence that prospective franchisees are choosing among franchise opportunities based upon a desire to avoid arbitration. *Id.* at 75, 97-99.

decision. *See* Petition at 3-4, 15-24; *see also* Aaron S. Bayer and Joseph M. Gillis, *Arbitration after Hall Street*, FOR THE DEFENSE 44, 47-48 (November 2008) (summarizing conflict). In the First and Fifth Circuits, manifest disregard no longer exists as a ground for vacating an arbitration award. In the Sixth Circuit, manifest disregard apparently survived *Hall Street*, according to the decision below. In the Second, Seventh, and Ninth Circuits, manifest disregard remains as a judicial gloss on Section 10 of the FAA, and can be used to vacate arbitration awards within certain (though varying) standards.

The result, as a practical matter, is that the same franchise system may be subjected to very different standards of judicial review for an arbitration award depending on where the arbitration occurred. A Tennessee franchisee who arbitrates with National Franchisor in Memphis may succeed in vacating the arbitral award based on manifest disregard of the law, under prevailing Sixth Circuit law. A Mississippi franchisee who arbitrates with the same National Franchisor in Tupelo (just 108 miles south of Memphis) will not succeed on claims of manifest disregard in the Fifth Circuit.[4] And if National Franchisor is

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Further, different franchise systems that arbitrate in different states will have different standards apply to their arbitration awards. The inconsistent body of law may lead to contractual forum shopping for arbitration. Franchise agreements and other commercial contracts may increasingly select arbitration venues in the First and Fifth Circuits, where they can be assured of some finality at the close of an arbitration. Federal arbitration law is supposed to be uniform: it should not be the source of such inappropriate incentives for important commercial decisions.

There is no reason to believe that the disharmony among the Circuits on manifest disregard will resolve itself without this Court's intervention. In the meantime, the benefits of arbitration for national franchise systems and other large businesses will continue to be undermined. For these reasons, the Court should grant the Coffee Beanery's petition so it can resolve the post-*Hall Street* Circuit split and promote a uniform and consistent federal policy favoring arbitration.

IV. The Time is Ripe for this Court to Resolve the Proper Bounds of Any Manifest Disregard Standard for Vacating Arbitration Awards.

Since the Court first enunciated the manifest disregard standard in dictum in *Wilko v. Swan*, 346 U.S. 427, 436 (1953), *overruled on other grounds, Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989), it has never had occasion to elaborate on the proper bounds of a manifest disregard test. *See Hall Street*, 128 S. Ct. at 1404 ("We, when speaking as a Court, have merely taken the *Wilko* language as we found it, without embellishment") (citation omitted). Nonetheless, *Hall Street*'s holding that the FAA provides the "exclusive" grounds for vacatur of arbitration awards does not square with a manifest disregard standard outside the four corners of the FAA, 9 U.S.C. § 10. The Coffee Beanery's petition provides an ideal opportunity for the Court to clarify, once and for all, the appropriate bounds of any continuing manifest disregard standard.

This is an important issue because the possibility of manifest disregard review may decrease the efficiency and cost-effectiveness of arbitration as a means for resolving disputes. A recent study concluded that the manifest disregard standard "wastes more judicial resources in reviewing awards than any other standard." Michael H. LeRoy & Peter Feuille, *Happily Never After: When Final and Binding Arbitration Has No Fairy Tale Ending*, 13 HARV. NEGOT. L. REV. 167, 189 (2008) (summarizing statistics showing that

manifest disregard is argued frequently and seldom successful). The study found that "[i]nconsistent approaches over the manifest disregard standard appear to spur the surprising popularity of this basis for challenging awards," *id.* at 203, and that "court review of arbitration is rapidly growing even though the chance of overturning an award is very poor." *Id.* at 205. The possibility of vacatur for manifest disregard also threatens arbitration's essential benefits of speed, cost-effectiveness and efficiency; to guard against claims of manifest disregard in post-arbitration motions, arbitrators may become more like judges, permitting expansive discovery and issuing lengthy, detailed opinions.[5] In short, maintaining the possibility of vacatur under the manifest disregard standard likely increases the overall costs of arbitration significantly, for very little practical effect.

Manifest disregard also provides an opportunity for parties to abuse the post-arbitration process by moving to vacate an award – despite slim chances of

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[5] *See, e.g.*, Amy J. Schmitz, *Ending a Mud Bowl: Defining Arbitration's Finality Through Functional Analysis*, 37 GA. L. REV. 123, 159 (2002-03) ("arbitration procedures subject to substantive review necessarily must be 'judicialized,' meaning they must incorporate formal judicial procedures that add significantly to the delay and expense of an arbitration hearing"); *id.* at 160-61 ("as the line between arbitration and litigation fades due to expanded judicial review of awards, arbitrators are likely to spend less time focusing on efficient resolution of disputes and more time producing court-like records created to withstand substantive appeals").

victory – in order to delay paying the award or force a more favorable settlement. The party that prevailed in arbitration may not have the resources to defend time-consuming motions to vacate. One example of this unfairness arose in *NetKnowledge Technologies, L.L.C. v. Rapid Transmit Technologies*, 2007 WL 518548 at *3-5 (N.D. Tex. 2007), *aff'd*, 269 Fed. Appx. 443, 444 (5th Cir. 2008), where motions to vacate based on manifest disregard forestalled payment of the arbitrator's $3 million award more than two years. The prevailing party at the arbitration, a company named WaKuL, lacked the resources to defend the post-arbitration litigation and persevered to confirm the award only with the help of hedge fund investors, who fronted the attorneys' fees in exchange for a share of the award. *See* Jonathan D. Glater, *Investing in Lawsuits, for a Share of the Awards*, NEW YORK TIMES, June 3, 2009 (noting that "[t]he lawyers in the case received a total of more than $650,000"). Having bargained for the efficiency and finality of arbitration, WaKuL instead got mired in lengthy and expensive litigation that required it to turn to third-party investors, all because of an allegation that the arbitrator acted in manifest disregard of the law.

Finality and freedom from judicial interference are central to the arbitration process, and that is what parties bargain for when they enter arbitration agreements. *See Hall Street*, 128 S. Ct. at 1405 (highlighting the "national policy favoring arbitration with just the limited review needed to maintain arbitration's ***essential virtue of resolving disputes***

straightaway" and rejecting arguments that might "open[ ] the door to the full-bore legal and evidentiary appeals that can render informal arbitration merely a prelude to a more cumbersome and time-consuming judicial review process . . . and bring arbitration theory to grief in post-arbitration process.") (emphasis added; citations and punctuation omitted). Allowing courts to review an arbitral award based on a flexible and nebulous manifest disregard standard – even if only in certain Circuits – threatens to undermine the core feature of final and binding arbitration.

For these reasons, the Court should grant the petition for certiorari and resolve the proper bounds of any continuing manifest disregard standard for vacating arbitration awards.

V. The Sixth Circuit Decision Also Conflicts With this Court's Precedents.

The decision below overlooked decades of this Court's precedents when it vacated the arbitration award and remanded for the parties to litigate their dispute. Concluding that respondent "should not be bound by the arbitration provisions of the agreement which it was fraudulently induced into signing," the Sixth Circuit remanded for respondents to "seek appropriate relief in a court of law." 300 Fed. Appx. at 421 (Pet. App. 15). There is no evidence that the Coffee Beanery's alleged failure to disclose/fraudulent inducement related specifically to the arbitration

clause. This Court held over 40 years ago, that the FAA "does not permit the federal court to consider claims of fraud in the inducement of the contract generally." *Prima Paint*, 388 U.S. at 403-04. *See also Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445 (2006) (same). The Sixth Circuit's decision to invalidate the arbitration clause based on fraud in the underlying contract flies in the face of well-established law.

Many commentators have noted a renewed hostility to enforcing agreements to arbitrate. *See, e.g.,* Steve J. Burton, *The New Judicial Hostility to Arbitration: Federal Preemption, Contract Unconscionability, and Agreements to Arbitrate*, 2006 J. DISP. RESOL. 469 (2006); *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257 (9th Cir. 2006) (*en banc*) (invalidating arbitration clause in franchise agreement as unconscionable). That hostility usually appears at the front end of a dispute, when a court is considering the enforceability of an agreement to arbitrate in deciding a petition to compel arbitration or a motion to stay litigation in favor of arbitration. In contrast, here, the Sixth Circuit invalidated the arbitration clause ***after*** the parties had already submitted the dispute to arbitration, presenting volumes of evidence and testimony over the course of eleven hearing days. The finality of arbitration is meaningless if, after four years of legal battles including a lengthy arbitration, an appellate court can suddenly and without

justification decide that the issue should never have been arbitrated and remand for a "do over" in court.

CONCLUSION

The Coffee Beanery decision is an appropriate vehicle for this Court to resolve the post-*Hall Street* conflict among the Circuits and clarify the proper bounds of any continuing "manifest disregard" standard for reviewing arbitration awards. The case also provides an important opportunity for the Court to reiterate the national policy favoring arbitration. For these reasons, *amicus curiae* The International Franchise Association respectfully asks the Court to grant the Coffee Beanery's petition for a writ of certiorari.

Dated: June 12, 2009

Respectfully submitted,

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ARGUMENT

I. Franchising Has a Substantial Impact on the U.S. Economy.

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There is no reason to believe that the disharmony among the Circuits on manifest disregard will resolve itself without this Court's intervention. In the meantime, the benefits of arbitration for national franchise systems and other large businesses will continue to be undermined. For these reasons, the Court should grant the Coffee Beanery's petition so it can resolve the post-*Hall Street* Circuit split and promote a uniform and consistent federal policy favoring arbitration.

IV. The Time is Ripe for this Court to Resolve the Proper Bounds of Any Manifest Disregard Standard for Vacating Arbitration Awards.

Since the Court first enunciated the manifest disregard standard in dictum in *Wilko v. Swan*, 346 U.S. 427, 436 (1953), *overruled on other grounds, Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989), it has never had occasion to elaborate on the proper bounds of a manifest disregard test. *See Hall Street*, 128 S. Ct. at 1404 ("We, when speaking as a Court, have merely taken the *Wilko* language as we found it, without embellishment") (citation omitted). Nonetheless, *Hall Street*'s holding that the FAA provides the "exclusive" grounds for vacatur of arbitration awards does not square with a manifest disregard standard outside the four corners of the FAA, 9 U.S.C. § 10. The Coffee Beanery's petition provides an ideal opportunity for the Court to clarify, once and for all, the appropriate bounds of any continuing manifest disregard standard.

This is an important issue because the possibility of manifest disregard review may decrease the efficiency and cost-effectiveness of arbitration as a means for resolving disputes. A recent study concluded that the manifest disregard standard "wastes more judicial resources in reviewing awards than any other standard." Michael H. LeRoy & Peter Feuille, *Happily Never After: When Final and Binding Arbitration Has No Fairy Tale Ending*, 13 HARV. NEGOT. L. REV. 167, 189 (2008) (summarizing statistics showing that

manifest disregard is argued frequently and seldom successful). The study found that "[i]nconsistent approaches over the manifest disregard standard appear to spur the surprising popularity of this basis for challenging awards," *id.* at 203, and that "court review of arbitration is rapidly growing even though the chance of overturning an award is very poor." *Id.* at 205. The possibility of vacatur for manifest disregard also threatens arbitration's essential benefits of speed, cost-effectiveness and efficiency; to guard against claims of manifest disregard in post-arbitration motions, arbitrators may become more like judges, permitting expansive discovery and issuing lengthy, detailed opinions.[5] In short, maintaining the possibility of vacatur under the manifest disregard standard likely increases the overall costs of arbitration significantly, for very little practical effect.

Manifest disregard also provides an opportunity for parties to abuse the post-arbitration process by moving to vacate an award – despite slim chances of

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[5] *See, e.g.*, Amy J. Schmitz, *Ending a Mud Bowl: Defining Arbitration's Finality Through Functional Analysis*, 37 GA. L. REV. 123, 159 (2002-03) ("arbitration procedures subject to substantive review necessarily must be 'judicialized,' meaning they must incorporate formal judicial procedures that add significantly to the delay and expense of an arbitration hearing"); *id.* at 160-61 ("as the line between arbitration and litigation fades due to expanded judicial review of awards, arbitrators are likely to spend less time focusing on efficient resolution of disputes and more time producing court-like records created to withstand substantive appeals").

victory – in order to delay paying the award or force a more favorable settlement. The party that prevailed in arbitration may not have the resources to defend time-consuming motions to vacate. One example of this unfairness arose in *NetKnowledge Technologies, L.L.C. v. Rapid Transmit Technologies*, 2007 WL 518548 at *3-5 (N.D. Tex. 2007), *aff'd*, 269 Fed. Appx. 443, 444 (5th Cir. 2008), where motions to vacate based on manifest disregard forestalled payment of the arbitrator's $3 million award more than two years. The prevailing party at the arbitration, a company named WaKuL, lacked the resources to defend the post-arbitration litigation and persevered to confirm the award only with the help of hedge fund investors, who fronted the attorneys' fees in exchange for a share of the award. *See* Jonathan D. Glater, *Investing in Lawsuits, for a Share of the Awards*, NEW YORK TIMES, June 3, 2009 (noting that "[t]he lawyers in the case received a total of more than $650,000"). Having bargained for the efficiency and finality of arbitration, WaKuL instead got mired in lengthy and expensive litigation that required it to turn to third-party investors, all because of an allegation that the arbitrator acted in manifest disregard of the law.

Finality and freedom from judicial interference are central to the arbitration process, and that is what parties bargain for when they enter arbitration agreements. *See Hall Street*, 128 S. Ct. at 1405 (highlighting the "national policy favoring arbitration with just the limited review needed to maintain arbitration's ***essential virtue of resolving disputes***

straightaway" and rejecting arguments that might "open[ ] the door to the full-bore legal and evidentiary appeals that can render informal arbitration merely a prelude to a more cumbersome and time-consuming judicial review process . . . and bring arbitration theory to grief in post-arbitration process.") (emphasis added; citations and punctuation omitted). Allowing courts to review an arbitral award based on a flexible and nebulous manifest disregard standard – even if only in certain Circuits – threatens to undermine the core feature of final and binding arbitration.

For these reasons, the Court should grant the petition for certiorari and resolve the proper bounds of any continuing manifest disregard standard for vacating arbitration awards.

V. The Sixth Circuit Decision Also Conflicts With this Court's Precedents.

The decision below overlooked decades of this Court's precedents when it vacated the arbitration award and remanded for the parties to litigate their dispute. Concluding that respondent "should not be bound by the arbitration provisions of the agreement which it was fraudulently induced into signing," the Sixth Circuit remanded for respondents to "seek appropriate relief in a court of law." 300 Fed. Appx. at 421 (Pet. App. 15). There is no evidence that the Coffee Beanery's alleged failure to disclose/fraudulent inducement related specifically to the arbitration

clause. This Court held over 40 years ago, that the FAA "does not permit the federal court to consider claims of fraud in the inducement of the contract generally." *Prima Paint*, 388 U.S. at 403-04. *See also Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445 (2006) (same). The Sixth Circuit's decision to invalidate the arbitration clause based on fraud in the underlying contract flies in the face of well-established law.

Many commentators have noted a renewed hostility to enforcing agreements to arbitrate. *See, e.g.*, Steve J. Burton, *The New Judicial Hostility to Arbitration: Federal Preemption, Contract Unconscionability, and Agreements to Arbitrate*, 2006 J. DISP. RESOL. 469 (2006); *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257 (9th Cir. 2006) (*en banc*) (invalidating arbitration clause in franchise agreement as unconscionable). That hostility usually appears at the front end of a dispute, when a court is considering the enforceability of an agreement to arbitrate in deciding a petition to compel arbitration or a motion to stay litigation in favor of arbitration. In contrast, here, the Sixth Circuit invalidated the arbitration clause ***after*** the parties had already submitted the dispute to arbitration, presenting volumes of evidence and testimony over the course of eleven hearing days. The finality of arbitration is meaningless if, after four years of legal battles including a lengthy arbitration, an appellate court can suddenly and without

justification decide that the issue should never have been arbitrated and remand for a "do over" in court.

CONCLUSION

The Coffee Beanery decision is an appropriate vehicle for this Court to resolve the post-*Hall Street* conflict among the Circuits and clarify the proper bounds of any continuing "manifest disregard" standard for reviewing arbitration awards. The case also provides an important opportunity for the Court to reiterate the national policy favoring arbitration. For these reasons, *amicus curiae* The International Franchise Association respectfully asks the Court to grant the Coffee Beanery's petition for a writ of certiorari.

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Respectfully submitted,

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