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## **The Rejection Of Contractually Expanded Judicial Review Under The Federal Arbitration Act In Hall Street v. Mattel (06-989)**

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# Commentary

## The Rejection Of Contractually Expanded Judicial Review Under The Federal Arbitration Act In Hall Street v. Mattel (06-989)

By  
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*[Editor's Note: Mr. Suskin is an associate in the New York office of Latham & Watkins LLP and a member of the firm's International Dispute Resolution Practice. Mr. Suskin assisted in preparing the amicus brief submitted by the United States Council for International Business in support of Respondent Mattel, Inc., in Hall Street Associates, L.L.C. v. Mattel, Inc. (06-989). The views expressed in this commentary do not necessarily reflect that of Latham & Watkins LLP or its clients. Replies to this commentary are gratefully received. Copyright 2008 by the author.]*

### I. Introduction

The recent ruling of the Supreme Court of the United States in Hall Street Associates, L.L.C. v. Mattel, Inc., No. 06-989 (U.S. Mar. 25, 2008) clarifies the scope of judicial review over arbitral awards. The question before the Court was whether the statutory grounds for vacatur and modification under the FAA may be supplemented by contract.<sup>1</sup> Justice Souter wrote the majority opinion for the divided Court (6-3), and held that “[Sections] 10 and 11 respectively provide the FAA’s exclusive grounds for vacatur and modification.”<sup>2</sup> In other words, parties whose review of an arbitral award is governed by the FAA may not contractually expand the scope of judicial review beyond the grounds enumerated in the FAA.

### II. Background

The long and complicated dispute in Hall Street arose out of a property lease agreement between Hall Street, as landlord, and Mattel, as tenant. The lease called for Mattel to indemnify Hall Street for costs associated with any violation of environmental laws that occurred during Mattel’s tenancy. Tests later showed

that the water on the property was contaminated with trichloroethylene, for which Mattel had failed to test in violation of the Oregon Drinking Water Quality Act. After Mattel gave notice to terminate the lease, Hall Street commenced suit in Oregon state court, contesting Mattel’s ability to vacate the premises and requesting that Mattel indemnify Hall Street for the costs associated with the clean-up under the lease’s indemnity provision. Mattel removed the case to the District Court for the District of Oregon on the basis of diversity jurisdiction.

Following Mattel’s victory in a bench trial before the District Court on the termination issue, the parties agreed to a court-approved arbitration agreement for the indemnification dispute. As part of the arbitration agreement, the parties consented to judicial review of an arbitral award “where the arbitrator’s findings of facts are not supported by substantial evidence” or “where the arbitrator’s conclusions of law are erroneous.”<sup>3</sup> The arbitrator ruled that Hall Street need not be indemnified because Mattel’s violation of the Oregon Drinking Water Quality Act was not a violation of environmental laws. Hall Street then successfully moved the District Court to vacate the arbitrator’s erroneous finding on the basis of the arbitration agreement’s expanded judicial review for legal error. On remand, the arbitrator followed the District Court’s instruction that the Oregon Drinking Water Quality Act was an environmental law and ordered Mattel to indemnify Hall Street.

The case was appealed to the Ninth Circuit, where Mattel argued that, pursuant to the Ninth Cir-

cuit's recent en banc decision in Kyocera Corp. v. Prudential-Bache Trade Servs., Inc., 341 F.3d 987 (9th Cir. 2003), the parties' agreement to expand judicial review was unenforceable. The Ninth Circuit agreed with Mattel, ruling that pursuant to Kyocera the parties' agreement to "control[] the mode of judicial review [was] unenforceable and severable," and instructed the District Court on remand to "confirm the original arbitration award . . . unless . . . the award should be vacated on the grounds allowable under [Sections 10 and 11 of the FAA]."<sup>4</sup> The District Court refused to abide by the instruction on remand, again ruling in Hall Street's favor; later, the Ninth Circuit again reversed on the same grounds.

The Supreme Court granted the writ of certiorari on May 29, 2007.<sup>5</sup> The Supreme Court considered whether the Ninth Circuit erred when it held that the FAA precludes a federal court from enforcing the parties' agreement providing for more expansive judicial review of an arbitration award than that expressly permitted under the FAA. The granting of certiorari was appropriate given the split amongst the Circuit Courts on whether parties could contractually expand judicial review under the FAA. The Ninth and Tenth Circuits had held that parties cannot agree to expanded review beyond that provided in the FAA.<sup>6</sup> Conversely, the First, Third, Fourth, Fifth and Sixth Circuits had ruled that parties' private agreement to expand judicial review of their arbitral award should be upheld.<sup>7</sup>

### III. Sections 10 And 11 Provide The Exclusive Grounds For Vacatur And Modification Under The FAA

#### A. Expanded Judicial Review Has Not Been Judicially Accepted

In dismissing the availability of expanded judicial review, the Court first addressed Hall Street's contention that the principle of review beyond the FAA's enumerated grounds had been judicially accepted since Wilko v. Swan, 346 U.S. 427 (1953). In Wilko, the dicta of the Court suggested that an arbitral award could be vacated if it was made in "manifest disregard" of the law.<sup>8</sup> Similarly, argued Hall Street, federal courts since Wilko have provided grounds for vacatur or modification of an arbitration award outside of the FAA's enumerated grounds, including where the award "violates public policy," is "arbitrary or capricious," or is "completely irrational."<sup>9</sup> If the courts

have expanded the grounds for review, why should parties not be able to do the same?

The Court rejected out of hand the suggestion that Wilko supported an expansion of judicial review.<sup>10</sup> First, the court distinguished Wilko, making clear that the holding in that case — that arbitration agreements concerning violations of the Securities Act of 1933 are void under Section 14 of the Act — was overruled in Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 484 (1989). Second, the Court noted that Hall Street overlooked that manifest disregard was created judicially rather than by the parties, and that in Wilko the arbitrator's interpretation of law, in contrast to manifest disregard of the law, was deemed not subject to review. Third, the Court questioned whether the vague phraseology of Wilko did, in fact, establish a new ground for review. The Court suggested that "manifest disregard" could refer either to the Section 10 grounds collectively or more specifically to Sections 10(a)(3) or (4), which provide for vacatur where the arbitrators were "guilty of misconduct" or had "exceeded their powers."

#### B. Parties May Not Contractually Expand Judicial Review

The second question facing the Court was whether party autonomy — the foundation of the arbitral process — allows parties to agree to expanded review.<sup>11</sup> Although the Court admitted that, to a certain extent, the FAA gives parties the ability to tailor many features of arbitration contractually, the FAA's text expressly provides for judicial review based exclusively on the enumerated grounds. Accordingly, the general policy favoring the enforcement of arbitration agreements does not allow parties to expand judicial review where "textual features" of the FAA limit contractual autonomy with regard to vacatur and modification of an award.

The Court's textual analysis of the FAA began with the language of Sections 10 and 11, which addresses only what the Court characterized as "egregious departures" from arbitral norms, including "corruption," "fraud," "evident partiality," "misconduct," "misbehavior," "exceed[ing] . . . powers," "evident material miscalculation," "evident material mistake," etc. Where the enumerated grounds for vacatur and modification establish such an extreme threshold, it would be il-

logical and a strain of interpretive principles to add the more mundane legal error to that list. Moreover, the Court referred to the *ejusdem generis* principle<sup>12</sup> to show that where “no textual hook for expansion” exists, the parties cannot supplement a statute, which lists only “outrageous conduct” as grounds for judicial review, with plain legal error.

Ultimately, the Court’s interpretation of the FAA centered on the shared purpose of Sections 9-11. To the Court, these sections “substantiat[e] a national policy favoring arbitration with just the limited review needed to maintain arbitration’s essential virtue of resolving disputes straightaway.”<sup>13</sup> The very limited availability of judicial review was also evident in the language of Section 9, which instructs that a court “must grant” an order confirming an arbitral award “unless the award is vacated, modified or corrected” in accordance with Sections 10 and 11. Alternative interpretations of Sections 9-11 allowing for expanded review would undermine the benefits of arbitration, “open[ing] the door to the full-bore legal and evidentiary appeals” which would eventually “bring arbitration theory to grief in post-arbitration process.”<sup>14</sup> The Court concluded that “the statutory text gives us no business to expand the statutory grounds.”<sup>15</sup>

#### IV. Expanded Review Outside The FAA May Still Be Available

Notably, the Court did not foreclose the possibility of expansive review outside of the FAA. In dicta, the Court made evident that its holding related only to review under Sections 9-11 of the FAA, and decided “nothing about other possible avenues for judicial enforcement of awards.”<sup>16</sup> In fact, the Court specifically stated that statutory schemes other than the FAA could lead to a different result.<sup>17</sup> As a result, some areas of law, such as collective bargaining agreements, that are governed by a different statutory regime may not be limited by the ruling in *Hall Street*.

In an interesting tangent, the Court inquired at oral argument and in additional briefing whether, because the arbitration agreement at issue was adopted by court order, the agreement should be interpreted pursuant to Federal Rule of Civil Procedure 16, which gives the District Court the inherent authority to manage its cases, rather than under the FAA.<sup>18</sup> In the end, the Court expressed no opinion on the issue, finding that the parties had consistently as-

sumed the case fell under the FAA, and leaving it open to *Hall Street* to argue the issue on remand. This would not, however, affect the applicability of the Court’s ruling to arbitration agreements governed by the FAA.

#### V. The Future Of Judicial Review

Although *Hall Street* appears to render a straightforward ruling that Sections 10 and 11 comprise the exclusive grounds for vacatur and modification under the FAA, it leaves certain important questions unanswered. The Court’s treatment of *Wilko* may lead some to argue that the “manifest disregard” standard has been eliminated. It remains to be seen, however, if the Court’s discussion of *Wilko* will be interpreted in that way. If the Court wished, it could have rejected manifest disregard outright; yet the Court took pains not only to imply that manifest disregard was somehow grounded in Section 10, but also that the Court has consistently “merely taken the *Wilko* language as [it] found it, without embellishment.”<sup>19</sup> Because the other judicially prescribed grounds for vacatur or modification — violation of public policy, arbitrary and capricious, and completely irrational — do not fall under Sections 10 and 11, it is unlikely that they survive the decision in *Hall Street*.

The *Hall Street* decision will please arbitration users, and presumably many corporate in-house counsel, who believe in the merits of arbitration and regard finality as one of arbitration’s chief virtues. It will, of course, frustrate arbitration phobics, skeptics and agnostics who yearn for the security of substantive judicial review. However, even though the Court’s decision precludes parties from invoking corrective judicial review of substantive errors, it remains open to arbitral institutions to provide for arbitral appellate mechanisms.<sup>20</sup> Some institutions have already done so; for example, the Judicial Arbitration & Mediation Services, Inc. (“JAMS”) and the International Institute for Conflict Prevention & Resolution (“CPR”) offer limited internal appellate procedures.<sup>21</sup> Parties themselves might also attempt to provide for appellate review through a second appellate arbitral tribunal, instead of expanded review of awards by the courts, although any bespoke provisions will have to be drafted with care.

In the wake of the Supreme Court’s decision, parties would be prudent to avoid stipulating for expanded

judicial review in their arbitration agreements. If review is a critical component of the decision to arbitrate, parties should consider incorporating alternative non-judicial means of review into their arbitration agreement or providing for arbitration in jurisdictions that will permit expanded review. Parties who continue to provide for arbitration in the United States must now put their faith in the process, rather than rely on the courts to scrutinize the merits of arbitration awards simply because parties had agreed that the courts could do so.

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## Endnotes

1. Under the Federal Arbitration Act (“FAA”), federal courts may only confirm, vacate or modify arbitral awards. 9 U.S.C. §§ 9-11.
2. Hall St. Assocs., L.L.C. v. Mattel, Inc., No. 06-989, slip op. at 7 (Mar. 25, 2008).
3. Id. at 2.
4. Hall St. Assocs., L.L.C. v. Mattel, Inc., 113 Fed. Appx. 272, 273 (9th Cir. 2004).
5. Hall St. Assocs., L.L.C. v. Mattel, Inc., 127 S. Ct. 2875 (2007).
6. See Kyocera Corp. v. Prudential-Bache Trade Servs., Inc., 341 F.3d 987 (9th Cir. 2003); Bowen v. Amoco Pipeline, Inc., 254 F.3d 925 (10th Cir. 2001).
7. See 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); Jacada, Ltd. V. Int’l Mktg. Strategies, 401 F.3d 701 (6th Cir. 2005), cert. denied, 126 S. Ct. 735 (2005); Roadway Package System, Inc. v. Kayser, 257 F.3d 287 (3d Cir. 2001), cert. denied, 122 S. Ct. 545 (2001); Syncor Int’l Corp. v. McLeland, No. 96-2261, 1997 U.S. App. LEXIS 21248 (4th Cir. Aug. 11, 1997), cert. denied, 118 S. Ct. 1039 (1998); Gateway Technologies, Inc. v. MCI Telecommunications Corp., 64 F.3d 993 (5th Cir. 1995).
8. Wilko, 346 U.S. at 436-7 (“the interpretations of the law by the arbitrators in contrast to manifest disregard [of the law] are not subject, in the federal courts, to judicial review for error in interpretation”). Other federal courts have adopted Wilko’s “manifest disregard” standard as an additional ground for vacatur and/or modification of an arbitral award. See e.g., McCarthy v. Citigroup Global Markets, Inc., 463 F.3d 87, 91 (1st Cir. 2006); Hoelt v. MVL Group, Inc., 343 F.3d 57, 62 (2d Cir. 2003).
9. See Brief for the Petitioner, Hall St. Assocs., L.L.C. v. Mattel, Inc., No. 06-989 (Jul. 27, 2007), at 24-5, citing W.R. Grace & Co. v. Local Union 759, 461 U.S. 757, 766 (1983) (violation of public policy); Brown v. ITT Consumer Fin. Corp., 211 F.3d 1217, 1223 (11th Cir. 2000) (arbitrary and capricious); French v. Merrill Lynch, Pierce, Fenner & Smith, 784 F.2d 902, 906 (9th Cir. 1986) (completely irrational).
10. See Hall St. Assocs., L.L.C. v. Mattel, Inc., No. 06-989, slip op. at 8 (Mar. 25, 2008).
11. See Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 220 (1985) (“[The FAA is] motivated, first and foremost, by a congressional desire to enforce agreements in to which parties ha[ve] entered.”). The Court later dismissed Hall Street’s arguments about Dean Witter, characterizing the decision as one “manda[ing] immediate enforcement of an arbitration agreement.” Hall St. Assocs., L.L.C. v. Mattel, Inc., No. 06-989, slip op. at 11 (Mar. 25, 2008).
12. The *ejusdem generis* principle is a canon of construction that provides that when a statute lists specific terms followed by a general term, the latter must be interpreted only to include terms of the same quality as those listed.
13. Hall St. Assocs., L.L.C. v. Mattel, Inc., No. 06-989, slip op. at 11 (Mar. 25, 2008).
14. Id.
15. Id. at 12. Although emphasizing the statutory text, the Court also discussed the legislative history of the FAA as being consistent with the Court’s determina-

- tion. Sections 10 and 11 of the FAA were based on the New York arbitration statute, which, in contrast to the competing Illinois statute, allowed for strictly limited vacatur or modification of arbitral awards. See *Id.*, at n.7.
16. *Id.* at 13.
17. *Id.* (“The FAA is not the only way into court for parties wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable.”).
18. *Id.* at 15.
19. *Id.* at 8.
20. See Erin E. Gleason, *International Arbitral Appeals: What Are We Afraid Of?*, 7 Pepp. Disp. Resol. L.J. 269 (2007); Judge Rudolph Kass, *A Private Path To Appellate Arbitration*, 50 B.B.J. 35 (2006); Paul B. Marrow, *A Practical Approach To Affording Review Of Commercial Arbitration Awards: Using An Appellate Arbitrator*, 60-OCT Disp. Resol. J. 10 (2005); William H. Knull, III & Noah D. Rubins, *Betting the Farm on International Arbitration: Is it Time to Offer an Appeal Option?*, 11 Am. Rev. Int’l Arb. 531 (2000).
21. See CPR Arbitration Appeal Procedure, available at [http://www.cpradr.org/arb\\_appeal\\_procedure.asp?M=9.2.3.3](http://www.cpradr.org/arb_appeal_procedure.asp?M=9.2.3.3) (last visited April 5, 2008); JAMS Optional Arbitration Appeal Procedure, available at <http://www.jamsadr.com/rules/optional.asp> (last visited April 5, 2008). ■

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