How Recent Court Developments Could Affect Arbitration's Future

From Hall Street *to* Stolt-Nielson *to* *Anti-Arbitration Legislative Proposals*

BY JOSHUA HORN AND AMIT SHAH

How court decisions could affect efforts to persuade Congress to respond to political pressure to change the landscape of employment and consumer arbitration.

Joshua Horn is a partner at Fox Rothschild LLP and co-chair of the Securities Industry Practice Group. Amit Shah, an associate at the firm, works in the same practice group. Their e-mail addresses are Jhorn@foxrothschild.com and Ashah@foxrothschild.com.

The Supreme Court reinforced the longstanding policy in favor of arbitration in *Hall Street Associates v. Mattel* by narrowly restricting the grounds to vacate an award under the Federal Arbitration Act (FAA).[1] Nevertheless, the practical impact of this decision has been less than clear in the federal appeal courts that have interpreted *Hall Street*.[2] This uncertainty has fueled the movement against enforcing pre-dispute arbitration agreements in all employment, consumer and franchise agreements based on the belief that such agreements unfairly favor corporations and business.[3]

The Supreme Court recently agreed to review *Stolt-Nielson v. AnimalFeeds International Corp.*,[4] a 2nd Circuit decision interpreting *Hall Street*. This puts the Supreme Court in a position to clarify any remaining ambiguities regarding the grounds available to vacate or modify an arbitration award. This article suggests that Congress allow the Supreme Court to clarify the scope of review under the FAA before taking any action on proposed legislation that could irreparably harm the arbitration process.

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The FAA and "Hall Street"

In enacting the FAA, Congress embraced the notion that arbitration awards should be upheld barring unusual procedural injustice or fraud. Section 10 of the FAA enumerates four grounds for a court to vacate an arbitration award[5]: where the award was procured by fraud, corruption or undue means; there was evident partiality or corruption in the arbitrators; the arbitrators were guilty of misbehavior that prejudiced the rights of a party; and the arbitrators exceeded their power, or failed to render a final award upon the subject matter.

Prior to *Hall Street*, most federal appeals courts recognized common law grounds to vacate awards, especially the doctrine called manifest disregard of the law.[6] However, manifest disregard is not supposed to be an opportunity for the court to vacate an arbitration award because it disagrees with the arbitrator about the merits.[7]

The majority of circuits have ruled that manifest disregard of law can be found only when there is evidence that the arbitrators were fully aware of the existence of a clearly defined governing legal principle, but chose to ignore it.[9] The party seeking to vacate the award bears the burden of proving these elements of the doctrine.

The *Hall Street* decision stated that the FAA provides the exclusive grounds for vacatur or modification of an arbitrator's decision.[10] The Supreme Court reasoned:

> Instead of fighting the text, it makes sense to see three provisions, §§ 9-11, as substantiating a national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straight-away. Any other reading opens the door to the full-bore legal and evidentiary appeals that can "rende[r] informal arbitration merely a prelude to a more cumbersome and time consuming judicial review process."[11]

Even though *Hall Street*'s *dicta* abandons common law grounds for judicial review, the courts are not in agreement on this. For example, in *Stolt-Nielson*, the 2nd Circuit recognized that there are differing interpretations of *Hall Street* and then held that manifest disregard of the law was "shorthand" for Section 10(a)(4) of the FAA, so there was no need to treat it as a separate ground for review.[12]

In a convoluted unpublished opinion, the 6th Circuit limited the application of *Hall Street* to cases in which the parties contractually expanded the standards for judicial review of arbitration awards.[13] It found that the manifest disregard doctrine still had vitality because the Supreme Court did not come right out and overrule it.

By contrast, the 5th Circuit, in *Citigroup Global Markets, Inc. v. Bacon*,[14] the most recent federal appeals court to interpret *Hall Street*, held that a district court can no longer review an arbitrator's decision under the manifest disregard of law standard because *Hall Street* held that the statutory grounds to vacate are exclusive. The 1st Circuit earlier held that the manifest disregard standard did not survive *Hall Street*.[15]

The authors suggest that Congress resist political pressure to take action on proposed arbitration legislation and allow the Supreme Court to clarify the scope of review under the FAA.

The varying views of the federal courts of appeal regarding the meaning of *Hall Street* is serving as a justification for the critics of employment and consumer arbitration to pursue a wholesale change to arbitration as it currently exists under the FAA.

Proposed Fairness in Arbitration Act

Prior to *Hall Street*, on July 12, 2007, the bill called the Fairness in Arbitration Act of 2007 was introduced into the Senate.[16] Less than a year after *Hall Street* was decided, on Feb. 12, 2009, a virtually identical bill was introduced in the House.[17] Both versions purported to be based on the notion that mandatory arbitration undermines the development of the law for civil rights and consumers because of limited judicial review of the arbitrator's decisions.

The drafters of the bill complained in the so-called legislative findings section of the bill that the Supreme Court, in a series of decisions, changed the meaning of the FAA to permit arbitration of disputes between parties of greatly disparate economic power.[18] The drafters would remedy this by proposing to amend the FAA to render unenforceable arbitration agreements that require arbitration of employment, consumer and

franchise disputes, or disputes arising under civil rights statutes.[19]

If the bill were to pass, its impact could be profound. It would invalidate arbitration agreements in employment and franchise disputes[20] and in any industry in which one party could be considered a consumer. One such industry is the credit card industry. It would be affected because the bill defines "consumer dispute" as a dispute involving consumer credit. If credit card arbitration agreements were to be invalidated altogether, the cost of litigating consumer claims or of creating another method of resolving disputes almost certainly would be passed on to consumers.

Another industry that could be affected is the securities industry, which has institutionalized arbitration for employment and investor-broker disputes.[21] Many issues that arise in the securities context are complex and require expertise to resolve them. Judge and jurors usually lack this expertise (jurors may not even know the definition of the term "securities") and they must hear a great deal of evidence in order to understand the dispute, making a jury trial significantly more costly, complicated and cumbersome than arbitration. The great advantage of securities arbitrations today is that one member of the arbitrator panel is an industry arbitrator. (There are, however, changes afoot to allow a single public arbitrator to resolve many disputes.) Moreover, securities arbitration panels frequently include active or retired lawyers with an expertise in securities matters.

Thus, if securities disputes are handled outside of arbitration, the parties' lawyers would have to spend a significant amount of time and client money in explaining basic terminology and industry practices, which may not be relevant to the ultimate issue in the dispute. This is just one reason why arbitration has become part of the lexicon to resolve customer disputes in the securities industry.

The proposed legislation could also have a profound negative impact on the world of consumer finance, franchise/franchisor relationships, insurance of all kinds, residential construction and certain segments of the healthcare industry (e.g., doctor-patient arbitration agreements). It is hard to imagine a segment of society that would not be affected by the bill.

Moreover, the bill could influence federal appeals courts that have held that manifest disregard survives *Hall Street*. They could be influenced by the political rhetoric of the anti-arbitration movement to invalidate "unfair" arbitration agreements.

The split in the circuits, which could result in inconsistent decisions on similar facts, could persuade Congress to step in and pass sweeping "reforms" curbing the use of arbitration agreements.

Conclusion

Congress should resist the political pressure to enact legislation making wholesale changes to the use of arbitration until the Supreme Court, via a decision in *Stolt-Nielson*, provides clarification of the proper scope of review of an arbitration award. It is likely that the Supreme Court agreed to review the case precisely in order to resolve the split within the circuits in the aftermath of *Hall Street*.

The Supreme Court has consistently held over many years that the FAA created a national policy in favor of arbitration and ruled that industry-wide agreements to arbitrate must be uniformly enforced.[22] This policy not only applies to federal courts, it also forecloses state attempts to undercut the enforceability of arbitration agreements.[23] Congress has also recognized the importance of reducing the cost of litigation and approved the use of ADR by courts. Indeed, courts have adopted their own ADR programs, urging parties to resolve their disputes out of court. In addition, many overwhelmed trial courts have benefited from the recognition of arbitration as a legitimate and fair method of addressing disputes.

The Supreme Court will shortly hear argument in *Stolt-Nielson*. To address the lack of clarity in *Hall Street*, we think that the Court should make clear in its forthcoming decision that *Hall Street's* holding is not limited to cases involving contracts in which the parties have expanded the grounds for judicial review: it is applicable to all kinds of cases. In addition, the Court should plainly state that its intention in *Hall Street* was to do away with the manifest disregard of the law doctrine. These clarifications would eliminate the ground for disagreement among the federal circuit courts of appeal and end the possibility of inconsistent judgments in different parts of the country. If the Court does not make these clarifications, there is a substantial risk that Congress will enact legislation to end consumer and employment arbitration as we know it. ■

ENDNOTES

[1] 128 S. Ct. 1396, 1403 (2008).

[2] See *Citigroup Global Markets v. Bacon*, 562 F.3d 349, 358 (5th Cir. 2009).

[3] See e.g., Arbitration Fairness Act of 2007, S. 1782, 110th Cong. (2007); Arbitration Fairness Act of 2009, H.R. 1020, 111th Cong. (2009).

[4] 2009 U.S. LEXIS 4345 (2009).

[5] 9 U.S.C. § 10.

[6] *McCarthy v. Citigroup Global Markets*, 463 F.3d 87, 91 (1st Cir. 2006); *Hoeft v. MVL Group*, 343 F.3d 57, 64 (2d Cir. 2003); *Prestige Ford v. Ford Dealer Computer Serv.*, 324 F.3d 391, 395-96 (5th Cir. 2003); *Scott v. Prudential Sec.*, 141 F.3d 1007, 1017 (11th Cir. 1998).

[7] *Local 853 Int'l Brotherhood of Teamsters v. Jersey Coast Egg Producers*, 773 F.2d 530, 534 (3d Cir. 1983).

[9] See *Black Box Corp. v. Markham*, 127 Fed. Appx. 22, 25 (3d Cir. 2005); see also *Merrill Lynch, Pierce, Fenner & Smith v. Jaros*, 70 F.3d 418, 421 (6th Cir. 1995) ("the decision must fly in the face of clearly established legal precedent").

[10] *Hall Street*, *supra* n. 1, 128 S. Ct. at 1403.

[11] *Id.* at 1404.

[12] 548 F.3d 85, 94 (2d Cir 2008). The 2nd Circuit recognized that the *Stolt-Nielson* holding was inconsistent with 2nd Circuit precedent that described manifest disregard of the law as a separate basis for review. See also *Comedy Club, Inc. v. Improv West Assoc.*, 553 F.3d 1277, 1290 (9th Cir. 2009) (agreeing with the 2nd Circuit that the manifest disregard of the law standard is a shorthand for Section 10(a)(4) of the FAA).

[13] *Coffee Beanery v. WW, L.L.C.*, 300 Fed. Appx. 415, 418-19 (6th Cir. 2008).

[14] *Supra* n. 2, 562 F.3d at 358.

[15] *Ramos-Santiago v. United Parcel Serv.*, 524 F.3d 120, 124 n. 3 (1st Cir. 2008).

[16] See Senate version of the Arbitration Fairness Act of 2007, *supra* n. 3.

[17] See House version of the Arbitration Fairness Act of 2009, *supra* n. 3.

[18] See Section 2(2) of the House and Senate bills.

[19] See Section 4 of both versions of the bill.

[20] See Arbitration Fairness Act of 2007, *supra* n. 22. H.R. 1020, 111th Cong. (2009).

[21] These arbitration agreements are governed by the Financial Industry Regulatory Authority (FINRA) Rules of Arbitration.

[22] See *Preston v. Ferrer*, 128 S. Ct. 978, 983 (2008); *Southland Corp. v. Keating*, 465 U.S. 1, 9 (1984).

[23] *Southland Corp. supra* n. 22, at 16.