

2009

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28 Miss. C. L. Rev. 249 (2008-2009)

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THE ARBITRATION EXCEPTION IN THIRD PARTY LEGAL OPINIONS: DEAD OR ALIVE?

Jane B. Morgan

In the light of strong Mississippi Supreme Court opinions that support commercial arbitration and equally strong holdings in favor of arbitration from the federal courts, coupled with longstanding federal¹ and state² arbitration statutes, business lawyers in Mississippi might be tempted to forget about taking an exception for an arbitration provision in a commercial agreement when they deliver third-party legal opinions. Some recent cases and commentary suggest, however, that there is still ample room for caution when issuing a remedies opinion on a commercial agreement that contains an arbitration provision.³

Since the Mississippi Supreme Court rendered its decision in *IP Timberlands Operating Co. v. Denmiss Corp.*,⁴ our state Supreme Court has clearly announced its intent to liberally construe arbitration agreements in commercial settings⁵ by confirming that “every reasonable presumption will be indulged in favor of the validity of arbitration proceedings.”⁶ The United States Supreme Court and the United States Court of Appeals for the Fifth Circuit have been no less bashful in proclaiming a national policy in favor of arbitration in commercial agreements.⁷

Against this backdrop, a Mississippi business lawyer might conclude it safe to opine at closing that the transaction documents are legal, valid, and binding without the need to include an express exception for an arbitration

1. Federal Arbitration Act (FAA), 9 U.S.C.A. §§ 1-307 (West 2009).

2. Mississippi Arbitration and Award, Miss. CODE ANN. §§ 11-15-1 to -37 (1972); Arbitration of Controversies Arising from Construction Contracts and Related Agreements, Miss. CODE ANN. §§ 11-15-101 to -143 (1972).

3. A special report of the TriBar Opinion Committee gives the following example of a typical remedies opinion (also known as an enforceability opinion): “The Agreement is a valid and binding obligation of the company, enforceable against the company in accordance with its terms.” The TriBar Opinion Committee, *The Remedies Opinion*, 59 BUS. LAW. 1483, 1484, n.4 (2004).

4. 726 So. 2d 96 (Miss. 1998).

5. The Mississippi Supreme Court arguably has drawn a distinction between the enforcement of arbitration agreements in commercial settings with those in consumer contracts. See *East Ford, Inc. v. Taylor*, 826 So. 2d 709 (Miss. 2002) (holding consumer arbitration agreement unconscionable under general state law principles). Because business lawyers are commonly required to issue third-party legal opinions as a condition precedent to the closing of commercial transactions, the analysis in this article is restricted to arbitration clauses in commercial agreements and does not address issues unique to the enforceability of an arbitration agreement in a consumer contract.

6. *IP Timberlands*, 726 So. 2d at 106 (quoting *Hutto v. Jordan*, 36 So. 2d 809, 812 (1948)). See also *Doleac v. Real Estate Profs., LLC*, 911 So. 2d 496 (Miss. 2005).

7. E.g., *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983); *Personal Sec. & Safety Sys. Inc. v. Motorola Inc.*, 297 F.3d 388 (5th Cir. 2002); *Grigson v. Creative Artists Agency L.L.C.*, 210 F.3d 524, 526 (5th Cir. 2000) (citing *Moses H. Cone*, 460 U.S. at 24-25); *Neal v. Hardee's Food Sys., Inc.*, 918 F.2d 34, 37 (5th Cir. 1990) (“We resolve doubts concerning the scope of coverage of an arbitration clause in a contract in favor of arbitration”).

provision in one or more of the documents. But business lawyers beware: a recent United States Supreme Court decision, *Hall Street Associates, L.L.C. v. Mattel, Inc.*,⁸ as followed by the Fifth Circuit in *Citigroup Global Markets Inc. v. Bacon*,⁹ may suggest otherwise.

In *Hall Street*, the landlord (Hall Street) sued its tenant (Mattel) in federal district court for improper lease termination and for indemnification of environmental clean-up costs.¹⁰ Following a bench trial and a failed attempt at mediation, the parties agreed, with the district court's blessing, to submit the environmental indemnification issue to arbitration.¹¹ The lawyers for Hall Street and Mattel drew up an arbitration agreement that was reviewed by the district court and entered as an order.¹² In an attempt to hedge their bets against an off-the-wall decision by the arbitrator, the lawyers crafted the now infamous judicial review paragraph:

The United States District Court for the District of Oregon may enter judgment upon any award, either by confirming the award or by vacating, modifying or correcting the award. *The Court shall vacate, modify or correct any award: (i) where the arbitrator's findings of facts are not supported by substantial evidence, or (ii) where the arbitrator's conclusions of law are erroneous.*¹³

The arbitrator found for Mattel.¹⁴ Hall Street, pursuant to the court-sanctioned judicial review provision, moved the district court to vacate and correct the arbitrator's ruling.¹⁵ After a series of remands, appeals, and further remands and reversals among the district court, the arbitrator and the Ninth Circuit Court of Appeals, the United States Supreme Court granted certiorari to decide whether the grounds for vacatur and modification provided in Sections 10 and 11 of the FAA¹⁶ are exclusive.

8. 128 S. Ct. 1396 (2008).

9. No. 07-20670, 2009 U.S. App. LEXIS 4543 (5th Cir. Tex. Mar. 5, 2009, revised Mar.18, 2009).

10. *Hall St.*, 128 S. Ct. at 1400.

11. *Id.*

12. *Id.*

13. *Id.* at 1400-01 (emphasis added).

14. *Id.*

15. *Id.*

16. Sections 10 and 11 of the FAA provide:

10. Same; vacation; grounds; rehearing

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

(1) where the award was procured by corruption, fraud, or undue means;

(2) where there was evident partiality or corruption in the arbitrators, or either of them;

(3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or

(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

[(5) Redesignated (b)]

(b) If an award is vacated and the time within which the agreement required the award to be made has not expired, the court may, in its discretion, direct a rehearing by the arbitrators.

In a 6-3 opinion, Justice Souter, writing for the majority, held that the FAA's statutory grounds for review are exclusive and cannot be expanded by contract.¹⁷ In reaching its decision, the Court recognized that many federal circuits, including the Fifth Circuit in *Gateway Technologies, Inc. v. MCI Telecommunications Corp.*,¹⁸ have held that parties may contract for expanded judicial review in arbitration agreements.¹⁹ The Court put to rest such creative drafting on the part of business lawyers, despite Justice Stevens's objections:

Today, however, the Court holds that the FAA does not merely authorize the vacation or enforcement of awards on specified grounds, but also forbids enforcement of perfectly reasonable judicial review provisions in arbitration agreements fairly negotiated by the parties and approved by the district court. Because this result conflicts with the primary purpose of the FAA and ignores the historical context in which the Act was passed, I respectfully dissent.²⁰

Notwithstanding the Court's firm prohibition against expanded judicial review of arbitration awards governed by the FAA, the Court noted that the "FAA is not the only way into court" and left open the possibility that judicial review under state statutory or common law authorities might differ in scope.²¹ With respect to the Hall Street dispute, the Court observed that it never appeared to be anything but an FAA case because the

(c) The United States district court for the district wherein an award was made that was issued pursuant to section 580 of title 5 may make an order vacating the award upon the application of a person, other than a party to the arbitration, who is adversely affected or aggrieved by the award, if the use of arbitration or the award is clearly inconsistent with the factors set forth in section 572 of title 5.

11. Same; modification or correction; grounds; order

In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration—

(a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.

(b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.

(c) Where the award is imperfect in matter of form not affecting the merits of the controversy.

The order may modify and correct the award, so as to effect the intent thereof and promote justice between the parties.

U.S.C.A. §§ 10, 11 (West 2009).

17. *Hall St.*, 128 S. Ct. at 1401-05.

18. 64 F.3d 993 (5th Cir. 1995).

19. *Hall St.*, 128 S. Ct. at 1403, n. 5.

20. *Id.* at 1408 (Stevens, J., dissenting, joined by Kennedy, J.).

21. *Id.* at 1406. Mississippi's general arbitration statute contains provisions similar in substance (but not identical) to §§ 10(a) and 11 of the FAA. Sections 11-15-23 and 11-15-25 of the Mississippi Code provide:

§ 11-15-23. Vacation of award; grounds.

Any party complaining of an award may move the court to vacate the same upon any of the following grounds:

(a) That such award was procured by corruption, fraud, or undue means;

(b) That there was evident partiality or corruption on the part of the arbitrators, or any one of them;

(c) That the arbitrators were guilty of misconduct in refusing to postpone the hearing upon sufficient cause shown, or in refusing to hear evidence pertinent or material to the

lease at issue was a contract “involving commerce,” as required by Section 2 of the FAA.²² In addition, the Court mentioned, but left unanswered, a final question: whether the Hall Street arbitration agreement, which was entered into in the course of district-court litigation, could have been enforced as an exercise of the district court’s case management authority under Federal Rule of Civil Procedure 16.²³

Since *Hall Street*, at least five federal circuit courts (including the Fifth Circuit) and a number of state appellate courts²⁴ (but not including any Mississippi courts) have addressed whether “manifest disregard of the law,” the old stalwart for vacating an arbitration award, remains viable under the FAA. The Fifth Circuit recently overruled its previous precedent and held that manifest disregard, “. . . a term of legal art, is no longer useful in actions to vacate arbitration awards” under the FAA.²⁵ In dictum, the First Circuit concurred with this conclusion in *Ramos-Santiago v. United Parcel Service*,²⁶ but the Second and Ninth Circuits each held that manifest disregard survives *Hall Street* because the term is a shorthand for the statutory grounds in Section 10(a)(4) of the FAA.²⁷ The Sixth Circuit, in an

controversy, or other misbehavior by which the rights of the party shall have been prejudiced;

(d) That the arbitrators exceeded their powers, or that they so imperfectly executed them that a mutual, final, and definite award on the subject matter was not made.

§ 11-15-25. Correction of award.

Any party to the submission may also move the court to modify or correct the award in the following cases:

(a) Where there is an evident miscalculation of figures, or an evident mistake in the description of any person, thing, or property referred to in such award;

(b) Where the arbitrators shall have awarded upon some matter not submitted to them, nor affecting the merits of the decision of the matter submitted;

(c) Where the award shall be imperfect in some matter of form, not affecting the merits of the controversy, and when, if it had been a verdict of a jury rendered in such court, the defect could have been amended or disregarded by the court.

MISS. CODE ANN. §§ 11-15-23, 11-15-25 (1972).

22. *Hall St.*, 128 S. Ct. at 1407. Section 2 of the FAA provides: §2. Validity, irrevocability, and enforcement of agreements to arbitrate. “A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C.A. § 2 (West 2009).

23. *Id.*

24. Noting that the U.S. Supreme Court “left the door ajar” in *Hall Street*, the California Supreme Court concluded in *Cable Connection, Inc. v. DIRECTV, Inc.*, that the *Hall Street* majority did not intend “to declare a policy with preemptive effect in all cases involving interstate commerce.” 190 P.3d 586, 599 (Cal. 2008). The California Supreme Court explained that it read *Hall Street* as being limited to the review of arbitration awards under the FAA and did not require state arbitration laws to conform with its limitations. *Id.* Interpreting the California Arbitration Act, the court held that parties may obtain judicial review of the merits of an arbitral award by express agreement. *Id.* at 589. The analysis in *Cable Connection* may provide some insight to lawyers faced with the challenge of drafting an arbitration clause under state law that side-steps the pitfalls of *Hall Street*.

25. *Citigroup Global Mkts. Inc. v. Bacon*, No. 07-20670, 2009 U.S. App. LEXIS 4543 at 1 (5th Cir. Tex. Mar. 5, 2009) (majority opinion by Jolly, J., joined by Barksdale, J. and Haynes, J.).

26. 524 F.3d 120, 124, n.3 (1st Cir. 2008).

27. *Stolt-Nielsen SA v. Animal Feeds Int’l Corp.*, 548 F.3d 85, 93-95 (2d Cir. 2008); *Comedy Club Inc. v. Improv West Assocs.*, 553 F.3d 1277, 1283 (9th Cir. 2009).

unpublished opinion, concluded that it would be imprudent to cease vacating arbitration awards made in manifest disregard of the law.²⁸

In addition to the federal circuit courts' disagreements over contractual attempts to expand judicial review, one commentator has entered the debate and offered an Article III constitutional analysis which concludes, in sum, that the manifest disregard doctrine is necessary to preserve a limited role for the federal courts in an arbitration scheme, thereby saving arbitration from constitutional infirmity.²⁹ Under this analysis, arbitration clauses that expand the scope of judicial review should be enforceable and those that limit grounds for judicial review should be unenforceable.³⁰

Where does all this litigation and controversy leave the humble opinion-giver who is just trying to close a deal? The simple lesson of *Hall Street* may be that an opinion-giver better know the FAA and the applicable state statutes inside and out before commenting on the enforceability of an arbitration provision in a transaction that involves interstate commerce. For those not so sanguine as to presume infallible their FAA and state law expertise, the better approach may be to include an exception in the remedies opinion for the arbitration clause, particularly in those cases where the arbitration provision reflects a negotiated expansion of statutory provisions such as the limitations on judicial review.

28. *Coffee Beanery, Ltd. v. WW, L.L.C.*, No. 07-1830, 2008 U.S. App. LEXIS 23645 at 419 (6th Cir. Nov. 14, 2008).

29. Peter B. Rutledge, *Arbitration and Article III*, 61 VAND. L. REV. 1189, 1225-28 (2008).

30. *Id.* at 1227-28.

