Docket Nos. 05-55739(L), 05-56100
Opinion Filed September 7, 2007
Before: Jerome Farris and Ronald M. Gould, Circuit Judges,
and Kevin Thomas Duffy, District Judge

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

COMEDY CLUB, INC. and AL COPELAND INVESTMENTS, INC.,

Appellants,

vs.

IMPROV WEST ASSOCIATES and CALIFORNIA COMEDY, INC.,

Appellees.

Appeal from the United States District Court for the Central District of California,
District Court No. CV 03-8134 WMB
Hon. Wm. Matthew Byrne, Jr.

REPLY BRIEF OF APPELLEES RE APPLICATION OF *HALL STREET ASSOCIATES*

IRELL & MANELLA LLP
Richard B. Kendall (90072)
Robert N. Klieger (192962)
1800 Avenue of the Stars, Suite 900
Los Angeles, California 90067-4276
Telephone: (310) 277-1010
Facsimile: (310) 203-7199

Attorneys for Appellees

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In opposing Appellees' Petition for Writ of Certiorari, Appellants advanced the same arguments that they now advance in this Court—namely, that *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 522 U.S. __, 128 S. Ct. 1396 (2008), is inapposite to the present case, established no new principles, and does not conflict in any way with this Court's prior decision. The Supreme Court implicitly rejected Appellants' arguments, granted the Petition, vacated this Court's judgment, and remanded for further consideration in light of *Hall Street*. Plainly, the Supreme Court regarded *Hall Street* as apposite to the present case, even if Appellants do not.

A. ***Hall Street* Bars "Manifest Disregard" As A Ground For Vacatur**

The reason *Hall Street* is apposite is that the Supreme Court's decision precludes "manifest disregard"—upon which this Court relied in vacating in part the arbitrator's award—as an additional ground for vacatur. More than fifty years before *Hall Street*, the Supreme Court suggested in dictum that "interpretations of law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for errors in interpretation." *Wilko v. Swan*, 346 U.S. 427, 436-37 (1953). In the half century that followed, many courts—including this Court[1]—read *Wilko* as recognizing "manifest disregard" as an

[1] *See, e.g., Collins v. D.R. Horton, Inc.*, 505 F.3d 874, 879 (9th Cir. 2007); *Carter v. Health Net of Cal., Inc.*, 374 F.3d 830, 837 (9th Cir. 2004); *Luong v. Circuit City Stores, Inc.*, 368 F.3d 1109, 1112 (9th Cir. 2004); *Sheet Metal Workers Int'l Ass'n Local Union #420 v. Kinney Air Conditioning Co.*, 756 F.2d 742, 746 (9th Cir. 1985); *Coast Trading Co., Inc. v. Pacific Molasses Co.*, 681 F.2d 1195, 1197 n.2 (9th Cir. 1982).

additional ground for vacatur, beyond those prescribed in § 10 of the FAA. The petitioner in *Hall Street* pointed to *Wilko* and those subsequent cases as support for the position that the § 10 grounds are not exclusive and argued that just as those grounds may be judicially expanded, so they may be expanded by contract. The Supreme Court rejected the central premise of the petitioner's argument—namely, that the statutory grounds for vacatur may be judicially expanded. *Hall Street*, 128 S. Ct. at 1403-04; *see id.* at 1406 ("[W]hatever the consequences of our holding, the statutory text gives us no business to expand the statutory grounds."). The Supreme Court held unequivocally in *Hall Street* that the § 10 grounds for vacatur are "exclusive." *Id.* at 1403-04. Thus, however "manifest disregard" may have been regarded in the past, it is not a ground for vacatur going forward.

Appellants nonetheless assert that "*Hall Street* did … make allowance for the assumption that Sections 10 and 11 of the FAA 'could be supplemented to some extent.'" Appellants' Br. at 10 (citing *Hall Street*, 128 S. Ct. at 1404). Then, citing this Court's decisions in *Kyocera Corp. v. Prudential Bache Trade Servs., Inc.*, 341 F.3d 987 (9th Cir. 2003), and *Schoenduve Corp. v. Lucent Techs., Inc.*, 442 F.3d 727 (9th Cir. 2006), Appellants argue that manifest disregard falls within "the enumerated penumbra in the FAA." Appellants' Br. at 1, 2, 14, 15 & n.7; Appellants' Reply Br. at 7. Appellants misread *Hall Street*. *Hall Street* did not "make allowance" for any assumption that the exclusive statutory grounds for

vacatur "could be supplemented to some extent." Rather, *Hall Street* rejected that assumption and held precisely the opposite:

> [E]xpanding the detailed categories [in § 10] would rub too much against the grain of the § 9 language, where provision for judicial confirmation carries no hint of flexibility. On application for an order confirming the arbitration award, the court "must grant" the order "unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title." There is nothing malleable about "must grant," which unequivocally tells courts to grant confirmation in all cases, except when one of the "prescribed" exceptions applies.

128 S. Ct. at 1405.[2] In short, the FAA does not allow for *any* supplementation of the statutory grounds for vacatur, and the "penumbra" of § 10 upon which Appellants' argument rests simply does not exist.

[2] Appellants' erroneous belief that *Hall Street* allowed for an assumption that the statutory grounds could be supplemented arises from the passage of the *Hall Street* decision in which the Supreme Court explains that, "*even if we assumed §§ 10 and 11 could be supplemented to some extent*, it would stretch basic interpretive principles to expand the stated grounds to the point of evidentiary and legal review generally." 128 S. Ct. at 1404 (emphasis added). Appellants overlook the fact that, in the very next page of the *Hall Street* decision, the Supreme Court specifically *rejects* the assumption that the statutory grounds for vacatur can be supplemented in the least. *Id.* at 1405.

B. The Supreme Court Did Not Endorse This Court's Application Of The Doctrine Of "Manifest Disregard"

Nor did the Supreme Court in *Hall Street* endorse this Court's application of the doctrine of "manifest disregard," as Appellants repeatedly assert. In hypothesizing about the origins of the phrase "manifest disregard," the Supreme Court suggested that "maybe [the term] merely referred to the § 10 grounds collectively." *Hall Street*, 128 S. Ct. at 1404. Or, the Supreme Court suggested, it may be that *Wilko* used the phrase as "shorthand for § 10(a)(3) or § 10(a)(4)," as this Court had suggested in *Kyocera*. *Id.* at 1404.[3] It is one thing to suggest, as the Supreme Court did in *Hall Street*, that *the phrase* "manifest disregard" may have been used in *Wilko* as shorthand for one or more of the statutory grounds for vacatur.[4] It is quite another to assert, as Appellants do here, that *the doctrine* of "manifest disregard," as developed by the courts after *Wilko*, fits within and lends substance to the statutory grounds for vacatur. *Hall Street* offers no support for Appellants' position. To the contrary, by limiting courts to a strict application of

[3] That is as far as *Kyocera* went. This Court did not define in *Kyocera* what constitutes "manifest disregard," much less apply the doctrine so as to allow review of an arbitrator's decision on the merits.

[4] In other words, an award is in "manifest disregard of the law" if it is procured by corruption, fraud, or undue means (§ 10(a)(1)); where there was evident partiality or corruption in the arbitrators (§ 10(a)(2)); where the arbitration hearing itself was not full and fair (§ 10(a)(3)); or where the award clearly goes beyond the substantive issues submitted by the parties or is too interim or indefinite to enforce (§ 10(a)(4)). In this formulation, the phrase has no independent substance, and an award cannot be in "manifest disregard of the law" unless one or more of the express statutory grounds for vacatur are triggered.

the statutory grounds for vacatur—which, as this Court has acknowledged, do not allow for *any* judicial review of the merits of an arbitration award (*see Collins*, 505 F.3d at 879)—*Hall Street* requires that every procedurally proper arbitration award be confirmed.

Moreover, even if the doctrine of "manifest disregard" could inform the § 10 grounds, *Hall Street* expressly limits vacatur under the FAA (and thus, necessarily, the scope of "manifest disregard" to the extent it survives at all) to instances of "outrageous" and "extreme arbitral conduct" that is tantamount to bad faith. 128 S. Ct. at 1404. As the Court explained in *Hall Street*:

> Sections 10 and 11 … address *egregious departures* from the parties' agreed-upon arbitration: "corruption," "fraud," "evident partiality," "misconduct," "misbehavior," "exeed[ing] … powers," "evident material miscalculation," "evident material mistake," "award[s] upon a matter not submitted"; the only ground with any softer focus is "imperfect[ions]," and a court may correct those if they go to "[a] matter of form not affecting the merits."

Id. (emphasis added). That a finding of malicious conduct is required for vacatur is confirmed by the legislative history of the FAA, *see id.* at 1406 n.7, as well as by

a leading law review article from the time of the FAA's enactment, which explains: "The courts are bound to accept and enforce the award of the arbitrator unless there is in it a defect so inherently vicious that, as a matter of common morality, it ought not be enforced." Julius Henry Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265, 272-73 (1926). Thus, the fact that an award can be characterized as incorrect or fundamentally incorrect, as erroneous or clearly erroneous, or as misstating or ignoring the law will not, standing alone, allow for vacatur. Rather, after *Hall Street*, a finding of *willful* misconduct by the arbitrator is plainly required before an otherwise procedurally proper arbitration award may be vacated.

C. Appellants Have Not Shown Any Willful Misconduct As Required For Vacatur After *Hall Street*

Appellants contend that the arbitrator here engaged in willful misconduct by "refus[ing] to follow settled law." Appellants' Br. at 13. There has been no such showing by Appellants, and no such finding by this Court. Admittedly this Court did hold that the arbitrator's ruling conflicts with *Dayton Time Lock Serv., Inc. v Silent Watchman Corp.*, 52 Cal. App. 3d 1 (1975). Even assuming the Court's reading of *Dayton Time Lock* were correct, however, that case cannot be regarded as "settled" law where this Court (in *Shaklee*) and at least two District Courts (in *Keating* and *Great Frame Up*) have applied CBPC § 16600 to in-term covenants

against competition precisely as the arbitrator applied the statute here. This is especially so given that *Dayton Time Lock* was a decision of an *intermediate* state appellate court and therefore is not even "authoritative." *Dimidowich v. Bell & Howell*, 803 F.2d 1473, 1482 (9th Cir. 1987).[5]

Moreover, the arbitrator did not "refuse[] to follow" *Dayton Time Lock*. Rather, he engaged in a lengthy and deliberate analysis of applicable precedent and determined in good faith that *Dayton Time Lock* had not grafted a "rule of reason" analysis into CBPC § 16600. As the District Court correctly observed in confirming the award, the arbitrator's ruling that the "rule of reason" is not applicable in the context of non-competes "finds support in the case law." ER at 184. Whether the arbitrator and the federal and state cases upon which he relied were correct or incorrect in this regard lies far outside the scope of this Court's review under § 10 of the FAA. *See Kyocera*, 341 F.3d at 1003.

[5] Where the state's highest court has not decided an issue, the task of the arbitrator, like that of a federal court, is to predict how the state high court would resolve it. *Dimidowich*, 803 F.2d at 1482. In answering that question, the arbitrator may look for guidance not only to the intermediate state appellate courts but also to the courts of other jurisdictions. *Id.* Here, the arbitrator considered *Dayton Time Lock*. He also considered another California Court of Appeal decision, the decisions of two United States District Courts, and an unpublished decision of this Court, all rejecting CBPC § 16600 challenges to *in-term* covenants against competition without undertaking any "rule of reason" analysis. *See Shaklee U.S. Inc. v. Giddens*, 934 F.2d 324 (9th Cir. 1991); *Keating v. Baskin-Robbins USA Co.*, 2001 WL 407017 (E.D.N.C. Mar. 27, 2001); *Great Frame Up Sys., Inc. v. Jazayeri Enters., Inc.*, 789 F. Supp. 253 (N.D. Ill. 1992); *Fowler v. Varian Assocs. Inc.*, 196 Cal. App. 3d 34 (1987). These cases were persuasive data points that the arbitrator could, and did, properly consider in reaching his decision. *See Dimidowich*, 803 F.2d at 1482.

Even in their reply brief, Appellants do not charge the arbitrator with any willful misconduct, but instead stand on the fact that this Court has not made a finding that the arbitrator conducted himself in "good faith." Appellants' Reply Br. at 6. Appellants have it backwards. The party seeking to confirm an arbitration award is not required to prove good faith; rather, the party seeking to vacate an award bears the burden of proving *bad faith*. Appellants have made no showing that the arbitrator conducted himself in bad faith, and this Court cannot in good conscience conclude that the arbitrator did anything other than construe and apply the law as he understood it. In these circumstances, none of the statutory grounds for vacatur apply. *See Schoenduve*, 442 F.3d at 736 ("The arbitrator made a 'good faith' attempt to apply [California law]. Consequently, there are no grounds to vacate or modify his decision under the FAA."). Accordingly, *Hall Street* requires that the award be confirmed.

Dated: December 8, 2008

IRELL & MANELLA LLP

By: /s/ Robert N. Klieger
Robert N. Klieger
Counsel for Appellants

CERTIFICATE OF COMPLIANCE

I certify that pursuant to Fed. R. App. P. 32(a)(7)(C) and Ninth Circuit Rule 32-1, the attached brief is proportionately spaced, has a typeface of 14 points, and contains 2,098 words.

Dated this 8th day of December, 2008.

/s/ Robert N. Klieger
Robert N. Klieger

CERTIFICATE OF SERVICE

I hereby certify that on December 8, 2008, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

Dated this 8th day of December, 2008.

/s/ Robert N. Klieger
Robert N. Klieger