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SUPREME COURT OF TEXAS
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No. 16-0080

IN THE SUPREME COURT OF TEXAS

PARALLEL NETWORKS, LLC,

***Petitioner*,**

v.

JENNER & BLOCK LLP,

***Respondent*.**

From the Court of Appeals for the Fifth District of Texas at Dallas
No. 05-13-00748-CV
On Appeal from the 101st Judicial District Court, Dallas County, Texas
No. DC-13-01146-E

Brief of Law Professor Imre S. Szalai
as *Amicus Curiae*
in Support of Petitioner

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INTEREST OF *AMICUS CURIAE*

Amicus curiae Imre S. Szalai is the Judge John D. Wessel Distinguished Professor of Social Justice at Loyola University New Orleans College of Law. He graduated from Yale University, double majoring in Economics and Classical Civilizations, and he received his law degree from Columbia University, where he was named a Harlan Fiske Stone Scholar.

Professor Szalai is a legal scholar in the field of arbitration law. He is the author of OUTSOURCING JUSTICE: THE RISE OF MODERN ARBITRATION LAWS IN AMERICA (2013), the definitive book about the development and enactment of the Federal Arbitration Act and similar state statutes during the 1920s. His scholarship has appeared in the top journals of dispute resolution, such as the Harvard Negotiation Law Review, Pepperdine's Dispute Resolution Law Journal, and Missouri's Journal of Dispute Resolution, and he maintains a blog focusing on arbitration law. He has provided written testimony to Congress regarding arbitration law developments and amending the Federal Arbitration Act. Professor Szalai has also appeared in national media, such as Forbes and national public radio, in connection with stories about arbitration. As a scholar and recognized expert in this field, he is regularly invited to speak at conferences and symposia about arbitration law developments.

Professor Szalai believes that arbitration is an invaluable part of a well-functioning legal system in a democratic society. He also believes arbitration law should promote the equitable resolution of disputes. The legal issues in this case raise fundamental questions about arbitration law, and Professor Szalai respectfully submits this *amicus curiae* brief to assist the Court in considering these issues.

Professor Szalai is not receiving any compensation for preparing this brief, and his sole concern regarding this case is the proper development of arbitration law. Tex. R. App. P. 11(c).

SUMMARY OF THE ARGUMENT

This Court has the power to review an arbitration award that violates Texas public policy as expressed by the Texas Disciplinary Rules of Professional Conduct and this Court's opinions about the regulation of the legal profession. This power flows from three independent sources: the text of the Federal Arbitration Act (FAA), state law, and the Court's unquestioned authority to regulate the practice of law in Texas.

Vacating an arbitration award for violating public policy is best understood as authorized by the text of section 10(a)(4) of the FAA, which provides for vacating awards that exceed an arbitrator's powers. Furthermore, assuming *arguendo* that the FAA does not provide for such vacatur, the United States Supreme Court has endorsed the power of states to develop their own judicial vacatur standards

providing for more searching review of arbitration awards than the FAA provides. Finally, the State of Texas is not a party to the arbitration agreement at issue. As a result, the arbitration agreement does not prevent this Court, which has the power to regulate the practice of law in the State of Texas, from exercising its authority over the legal profession. The Court's authority to regulate the practice of law provides an independent reason to vacate awards that contravene the Texas Disciplinary Rules of Professional Conduct.

ARGUMENT

I. Section 10(a)(4) Of The Federal Arbitration Act Authorizes A Court To Vacate An Award That Violates Public Policy

At first glance, it seems that courts have developed what appear to be independent, non-statutory grounds for vacating arbitrator's awards, such as "manifest disregard of the law" or "against public policy." *See* 4 I. MACNEIL, R. SPEIDEL, & T. STIPANOWICH, FEDERAL ARBITRATION LAW § 40.1.3.2 (1999). The text of the FAA does not explicitly mention "manifest disregard of the law" or "public policy" as a reason for vacating an award. *See* 9 U.S.C. § 10 (setting forth grounds for vacating an award). However, these grounds of "manifest disregard of the law" or "public policy" are best understood as "simply definitions of what it means for the arbitrators to exceed their powers [under 9 U.S.C. § 10(a)(4).]" 4 I. MACNEIL, R. SPEIDEL, & T. STIPANOWICH, FEDERAL ARBITRATION LAW § 40.1.3.2

(1999). Simply put, the public policy basis for vacatur is one manifestation or example of an arbitrator exceeding his or her powers.

To help understand why vacatur for public policy grounds is a statutory basis for vacating an award, it is important to acknowledge the foundational principle of arbitration law. The most fundamental principle of arbitration law is that arbitration is a matter of contract between the parties. *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 682 (2010) ("Whether enforcing an agreement to arbitrate or construing an arbitration clause, courts and arbitrators must give effect to the contractual rights and expectations of the parties. In this endeavor, as with any other contract, the parties' intentions control. This is because an arbitrator derives his or her powers from the parties' agreement . . . .") (citations and internal quotations omitted); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995) ("[A]rbitration is simply a matter of contract between the parties.") (citations omitted). All aspects of arbitration -- the power of the arbitrator, the legitimacy of the arbitrator's award, and the constitutionality of the arbitration process -- flow from the parties' agreement.

Section 10(a)(4) authorizes judicial vacatur of an award "where the arbitrators exceeded their powers." 9 U.S.C. § 10(a)(4). But this standard, by itself, is utterly meaningless or hollow unless one first defines the powers of an arbitrator. Who or what defines the powers of an arbitrator, in order to apply section 10(a)(4)'s vacatur

standard? The parties' contract, the foundation for all arbitration, defines the scope of the arbitrator's powers. *See* 4 I. MACNEIL, R. SPEIDEL, & T. STIPANOWICH, FEDERAL ARBITRATION LAW § 40.1.3.2 (1999); *see also Czarina, L.L.C. v. W.F. Poe Syndicate*, 358 F.3d 1286, 1293 (11th Cir. 2004) ("arbitration is a creature of contract, and thus the powers of an arbitrator extend only as far as the parties have agreed they will extend"); *R.J. O'Brien & Assocs., Inc. v. Pipkin*, 64 F.3d 257, 263 (7th Cir. 1995) ("The arbitrators' powers are derived from the parties' agreement.") (citation omitted); *I.S. Joseph Co. v. Mich. Sugar Co.*, 803 F.2d 396, 399 (8th Cir. 1986) ("[A]ny power that the arbitrator has to resolve the dispute must find its source in a real agreement between the parties. He has no independent source of jurisdiction apart from the consent of the parties."); *Totem Marine Tug & Barge, Inc. v. North Am. Towing, Inc.*, 607 F.2d 649, 651 (5th Cir. 1979) ("Arbitration is contractual and arbitrators derive their authority from the scope of the contractual agreement."); *Swift Indus., Inc. v. Botany Indus., Inc.*, 466 F.2d 1125, 1131 (3d Cir. 1972) ("It is, of course, fundamental that the authority of the arbitrator springs from the agreement to arbitrate."); *Lundgren v. Freeman*, 307 F.2d 104, 109-10 (9th Cir. 1962) ("The scope of the arbitrators' power rests ultimately on the agreement of the parties.") (citations omitted). In sum, when a court analyzes section 10(a)(4) with a view as

to whether or not an arbitrator has exceeded his or her powers, the parties' contract defines these powers.[1]

An arbitrator's powers, including the ultimate power to issue an award, arise from the parties' contract. In fact, an arbitrator's award is tantamount to, and indistinguishable from, the agreement of the parties. One can conceptualize an arbitration award as involving two parties who could not reach an agreement, and thus the parties jointly grant an agent, the arbitrator, the authority to make a contract for them through the arbitration process. In other words, the arbitrator's award represents the contract of the parties. *Cf. E. Associated Coal Corp. v. United Mine Workers of Am.,* 531 U.S. 57, 62 (2000) ("we must treat the arbitrator's award as if it represented an agreement between [the parties]," and the arbitrator's "award is not distinguishable from the contractual agreement.").

[1] To illustrate that section 10(a)(4)'s exceeding powers standard is hollow by itself and that the parties' contract serves to define the arbitrator's powers, consider the following hypothetical involving an arbitration clause with a narrow scope. Suppose that an arbitrator issues an award of damages regarding a tort claim. Should a court vacate the award because the arbitrator exceeded his or her powers? It is impossible to consider this issue in the abstract without consideration of the parties' agreement, the bedrock for all arbitration and the source of the arbitrator's powers. If the parties have a narrow arbitration clause requiring arbitration of only contract disputes, as opposed to tort disputes, an arbitrator would exceed his or her powers by issuing an award regarding a tort dispute, and thus a court must vacate such an award pursuant to section 10(a)(4) of the FAA. An arbitrator ruling on matters that fall beyond the scope of the arbitration clause is one example of an arbitrator exceeding his or her powers, which flow from the parties' contract. If an arbitrator were permitted to exercise authority beyond the powers granted by the parties' contract, such an illegitimate exercise of authority would chill the willingness of parties to enter into arbitration agreements.

When parties ask a court to confirm or vacate an arbitrator's award, the parties are in effect asking for the court to enforce the parties' contract, and inherent in all contracts is a limitation that contracts cannot violate public policy. *In re Prudential Ins. Co. of Am.*, 148 S.W.3d 124, 129 (Tex. 2004) ("As a rule, parties have the right to contract as they see fit as long as their agreement does not violate the law or public policy."). This inherent limit applicable to all contracts restricts the power of an arbitrator, whose authority flows from the parties' contract, and this inherent public policy limitation also restricts the validity of an arbitrator's award. An arbitrator's award that violates public policy would exceed the powers of the arbitrator because a contract cannot give rise to powers that violate public policy. For example, suppose a marijuana cultivator enters into a sales agreement with a distributor who will market and sell the cultivator's marijuana to the public, and suppose that the cultivator fails to deliver the marijuana. Although such distribution agreements may be lawful in other states, an agreement to distribute and sell marijuana is likely not enforceable in Texas as against public policy. Similarly, an arbitrator's award or order to distribute or deliver marijuana is just as against public policy and unenforceable as a contract to deliver marijuana. Just as a contract that violates public policy is unenforceable, an arbitrator's award that violates public policy is also unenforceable. *Cf. E. Associated Coal Corp. v. United Mine Workers of Am.*, 531 U.S. 57, 62 (2000) ("we must treat the arbitrator's award as if it represented an

agreement between [the parties]," and the arbitrator's "award is not distinguishable from the contractual agreement."). Such an award that contravenes public policy would be unenforceable and subject to vacatur for exceeding an arbitrator's contractual powers pursuant to section 10(a)(4). In sum, a violation of public policy is a statutory ground for vacatur authorized by the text of the FAA.

II. The United States Supreme Court Has Recognized That States Can Develop Their Own Vacatur Standards Providing For "More Searching Review" Of An Arbitrator's Award

As explained above in Section I, the judicial vacatur of an award for contravening public policy is best understood as authorized under section 10(a)(4) of the FAA. However, assuming *arguendo* that the FAA does not authorize such a public policy review, another source for such a review exists. As recognized by the United States Supreme Court, the FAA does not provide the sole basis for vacating an arbitrator's award. The United States Supreme Court has endorsed the power of states to develop more expansive grounds for judicial vacatur of an arbitrator's award than the grounds set forth in the FAA.

In *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008), the Supreme Court of the United States held that §§ 10 and 11 of the FAA provide the exclusive grounds for vacating or modifying an award under the FAA. *Id.* at 584. But the Supreme Court in *Mattel* was very careful to emphasize that "[t]he FAA is not the only way into court for parties wanting review of arbitration awards." *Id.* at

590. The Supreme Court acknowledged that there could be enforcement or review of arbitration awards pursuant to "state statutory or common law." *Id.* Thus, even if section 10(a)(4) does not cover public policy grounds for vacatur, "state statutory or common law" may provide a different and "more searching review" of arbitration awards than the grounds set forth in the FAA. *Id*. at 590.[2]

III. Because The State Of Texas Is Not Bound By A Private Arbitration Agreement, An Arbitration Agreement Cannot Stop The Court From Exercising Its Authority Over the Legal Profession

As explained above, all arbitration law flows from the core principle that arbitration is a matter of contract. It is this core principle that provides another independent reason why this Court can set aside any agreement or award that contravenes the Texas Disciplinary Rules of Professional Conduct. This Court, which is not bound by the parties' agreement, has control over the State Bar and the regulation of the practice of law in Texas.

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[2] Despite the Supreme Court's holding in *Southland Corp. v. Keating*, 465 U.S. 1 (1984) (the FAA is applicable in both federal and state courts), it is important to remember that the FAA was never originally intended to apply in state courts. *See generally* IAN R. MACNEIL, AMERICAN ARBITRATION LAW: REFORMATION, NATIONALIZATION, INTERNATIONALIZATION (1992). Under the original understanding of the FAA as a procedural statute applicable solely in federal courts, the sole basis for vacating an arbitration award in state court would be state statutory or common law. *See also Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 287 & n.1 (1995) (Thomas, J., dissenting, joined by Scalia, J.) (*Southland* is fundamentally flawed because the FAA was intended to apply solely in federal court); *id.* at 285 (Scalia, J., dissenting) ("I will, however, stand ready to join four other Justices in overruling [*Southland*]."); *Southland*, 465 U.S. at 23 (O'Connor, J., dissenting, joined by Rehnquist, J.) ("Congress intended to require federal, not state, courts to respect arbitration agreements."). In *Mattel*, the Supreme Court affirmed the critical role of state law in connection with the judicial review of arbitration awards. 552 U.S. at 590.

It is axiomatic that the government is not bound by an agreement to arbitrate between two private parties. In the landmark case of *Equal Employment Opportunity Commission v. Waffle House, Inc.*, 534 U.S. 279 (2002), the United States Supreme Court held that an arbitration agreement between an employer and employee does not prevent the Equal Employment Opportunity Commission (EEOC), the government agency in charge of enforcing civil rights laws, from exercising its full authority to remedy violations of such laws. As explained by the United States Supreme Court:

> Arbitration under the [FAA] is a matter of consent, not coercion. Here there is no ambiguity. No one asserts that the EEOC is a party to the contract, or that it agreed to arbitrate its claims. It goes without saying that a contract cannot bind a nonparty. Accordingly, the proarbitration policy goals of the FAA do not require the agency to relinquish its statutory authority if it has not agreed to do so.

Waffle House, 534 U.S. at 294 (citation and internal quotations omitted). Just as the EEOC can step in to enforce the laws within its province, administrative agencies of the State of Texas, such as the Texas Commission on Environmental Quality or the Texas Workforce Commission, can step in to remedy violations of laws within their province without being blocked by a private arbitration clause. Similarly, an arbitration agreement cannot prevent this Court, as the government body with the power to regulate the legal profession, from exercising its inherent authority. If there is a violation of an ethics rule, an arbitration agreement between two private parties

cannot shield or insulate such a violation from the state's authority to regulate the legal profession and remedy such violations. Any contract, including a contractually-based arbitrator's award, is subject to review for a violation of the Texas Disciplinary Rules of Professional Conduct. As recognized by the Supreme Court in *Waffle House*, when a government agency administers the laws within its charge, the government agency is simply vindicating the public interest, and a private arbitration clause does not limit the government's authority to do so. 534 U.S. at 296 (when the EEOC enforces its laws, the EEOC is "seeking to vindicate a public interest, not simply provide make-whole relief for the employee, even when it pursues entirely victim-specific relief."). Thus, even if the text of the FAA does not permit vacatur on public policy grounds, the State's authority to regulate the practice of law provides an independent reason to vacate awards that contravene the Texas Disciplinary Rules of Professional Conduct.[3]

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[3] In *Waffle House*, the EEOC filed its own separate, independent proceeding in court to enforce the laws within its jurisdiction, and *Waffle House* did not involve the judicial vacatur of an arbitrator's award. 534 U.S. at 283. At first glance, *Waffle House* perhaps suggests that the State of Texas should bring its own separate proceeding to remedy a violation of the Texas Disciplinary Rules of Professional Conduct, without touching or vacating the award here. However, it would be incongruous for the State to bring a separate enforcement action to remedy violations of the Texas Disciplinary Rules of Professional Conduct while permitting the arbitrator's award to stand in this proceeding if the award contravenes the Texas Disciplinary Rules of Professional Conduct. Furthermore, in the *Waffle House* case, the EEOC, which was the government body in *Waffle House* in charge of enforcing the laws at issue, was distinct from the government body reviewing arbitration awards, the judiciary. An independent enforcement action was filed in the *Waffle House* case because no arbitration proceeding was ever filed, and if an arbitration proceeding had been filed, the EEOC does not review arbitration awards. 534 U.S. at 283. Here, however, a separate enforcement action is not necessary. In this case, the government body with the power to regulate the practice of law is also the same body that can review arbitration

PRAYER

The Court should hold that judges are authorized to vacate an arbitrator's award that contravenes public policy. The text of the FAA permits judicial vacatur under these circumstances. Furthermore, the United States Supreme Court has recognized that states can develop their own vacatur standards and provide for more searching review of arbitration awards. Finally, a private arbitration clause cannot block the State of Texas from vindicating a strong public policy as expressed by the Texas Disciplinary Rules of Professional Conduct and the Court's opinions about the regulation of the legal profession.

Respectfully submitted,
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awards, and thus a separate enforcement proceeding to vindicate the Texas Disciplinary Rules of Professional Conduct is not necessary. Also, it would be incongruous for the Court to allow an award to stand if the award contravenes the Texas Disciplinary Rules of Professional Conduct. The core holding of *Waffle House* is that a private arbitration agreement cannot prevent the government from enforcing its own laws, and as a result, the arbitration agreement in this case cannot block the State of Texas from regulating the legal profession and enforcing the State's ethics rules.

CERTIFICATE OF SERVICE

I hereby certify that on the 22nd day of March, 2016, a true and correct copy of the foregoing *Amicus Curiae* Brief was served via e-mail and e-service through efile.txcourts.gov on Petitioner and Respondent through counsel of record, listed below:

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CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing brief contains 3,222 words, not counting the items excluded under Texas Rule of Appellate Procedure 9.4(i)(1), as counted by Microsoft Word. I also certify that the brief is in Times New Roman typeface in 14-point font, with the footnotes in 12-point font.

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