No. 13-879

In The Supreme Court of the United States

PITCAIRN PROPERTIES, INC.,

Petitioner,

vs.

LJL 33RD STREET ASSOCIATES, LLC,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

REPLY BRIEF FOR THE PETITIONER IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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The policy underlying arbitration requires that each party be given a full and fair opportunity to present its case. *See Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 393 U.S. 145, 147 (1968); *Tempo Shain Corp. v. Bertek, Inc.*, 120 F.3d 16, 20 (2d Cir. 1997); *Hoteles Condado Beach v. Union de Tronquistas Local 901*, 763 F.2d 34, 39 (1st Cir. 1985). Arbitration is intended to be informal, expedient and cost-effective. *See Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 685 (2010). To further these twin goals, many circuit courts have held that the FAA requires vacatur of an arbitration award if an arbitrator does not allow the parties to present all pertinent and material evidence in support of their positions. However, other circuit courts require that a party show prejudice, affirmative misconduct, or bad faith to justify vacatur of an arbitral award under §10(a)(3) of the FAA. In this case, the decision of the United States Court of Appeals for the Second Circuit undermines the twin goals of arbitration and injects additional confusion into an already-unsettled area of law. Respondent's Brief in Opposition highlights the reasons why this Court should grant the Petition for Certiorari and resolve the present uncertainty among the circuit courts regarding the standard for vacating an arbitration award pursuant to §10(a)(3).

The Issue Presented In The Petition Is Not Whether Hearsay Is Admissible In An Arbitration

LJL[1] argues that the arbitrator correctly excluded the Excluded Evidence as hearsay.[2] This contention is a red herring and mischaracterizes the issue in the Petition. The issue presented in the Petition is whether an arbitration award should be vacated under §10(a)(3) when an arbitrator excludes the sole pertinent and material evidence in support of a disputed fact.

There is no dispute that the Excluded Evidence was pertinent and material to determining the fair market value of the Property, which was the sole issue before the arbitrator. Indeed, nowhere in its Brief in Opposition does LJL argue that the evidence was irrelevant. Moreover, there is no dispute that the Excluded Evidence was the sole evidence presented of

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[1] Unless otherwise noted, the terms used by Pitcairn in this Reply Brief have the meanings ascribed in the Petition.

[2] Contrary to LJL's assertions, neither the arbitrator nor the District Court found the Excluded Evidence to be hearsay. The District Court noted that LJL objected on multiple grounds to the Excluded Evidence, and that the arbitrator did not state the reasons for his ruling. (App. 28, 41.) In fact, the Letter of Intent was an offer to contract, which is considered a legal act under Fed. R. Evid. 801(c). *See, e.g.*, Advisory Committee Notes. However, given that the parties' contract incorporates rules that explicitly provide that the rules of evidence do not apply, hearsay was not a basis on which to exclude evidence. *See* JA 82; App. 42; *Petroleum Separating Co. v. InterAm. Ref. Corp.*, 296 F.2d 124 (2d Cir. 1961) (per curiam).

what the District Court termed "genuine market activity" regarding the Property.[3] (App. 42.) Finally, both the District Court and the Second Circuit agreed that Pitcairn was prejudiced by the exclusion of the Excluded Evidence. (App. 40-41; 20.) LJL does not contest this.

The District Court correctly determined that the issue presented was whether the arbitrator committed "misconduct" within the meaning of §10(a)(3) by excluding "every piece of factual evidence that Pitcairn proffered regarding genuine market activity and valuations of the Property – evidence that might well have changed the outcome of the arbitration." (App. 42-43.) The Second Circuit's holding that the evidence properly was excluded because it was hearsay and because LJL would have been prejudiced by its admission[4] has no foundation in the FAA, case law,

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[3] Although LJL repeatedly asserts that there was "ample" other evidence of the Property's market value, (BIO 12), in reality, the only permitted evidence of the Property's value was presented through expert appraisers hired by each of the parties. Without the Excluded Evidence, the arbitration was thus nothing more than a battle of the experts. Expert evidence is not fact evidence.

[4] The Second Circuit asserted, without citation to authority, or the record, that Pitcairn could have called the makers of the exhibits. As demonstrated in the Petition at 9, the witnesses were unavailable because they refused to appear voluntarily and resided more than 100 miles from the situs of the arbitration. LJL's citation to current AAA Rule 11 is misplaced, as that rule was not in effect at the time of the arbitration. *Compare* http://webcache.googleusercontent.com/search?q=cache:6Rl6gUtraTwJ:https://www.adr.org/cs/idcplg%3FIdcService%3DGET_FILE%26d

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or the parties' contract. The Second Circuit's decision shows the malleability of current law and it demonstrates the potential, through technical application of the rules of evidence, to create myriad new exceptions to the simple command of §10(a)(3) to hear pertinent evidence.

The Second Circuit's Decision Further Confuses the Unsettled Standard For Vacatur Under §10(a)(3)

As detailed in Pitcairn's Petition, the absence of guidance from this Court has led the circuit courts to apply varying standards when determining whether an arbitrator committed misconduct pursuant to §10(a)(3) by refusing to hear pertinent and material evidence. The absence of a settled standard leaves parties without any predictability or consistency and acts as a disincentive to arbitrate. The confusion in this area presents in two ways: whether, to obtain vacatur, a party must show (1) that it was prejudiced by the exclusion of evidence; and (2) that the arbitrator's exclusion of evidence constituted affirmative misconduct or was committed in bad faith. Although

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DocName%3DADRSTAGE2011601%26RevisionSelectionMethod%3DLatestReleased+&cd=2&hl=en&ct=clnk&gl=us (current rules as of June 1, 2009), *with* https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTG_004103&revision=latestreleased (updated rules as of October 1, 2013). Further, if the witnesses truly were available to testify, then LJL could have called them, just as readily as Pitcairn, to cross-examine regarding the Excluded Evidence, thereby eliminating any purported "prejudice."

arbitration awards should not be vacated lightly, the grounds for vacatur under §10(a) of the FAA exist for a reason. Those statutory grounds should be enforced in appropriate cases, and clear standards enunciated, to encourage greater predictability in the conduct of arbitration proceedings and fewer challenges to arbitral awards.

In their analysis of §10(a)(3) cases, some circuit courts have suggested that whether a party was prejudiced by the exclusion of evidence is not dispositive. For example, the Third Circuit has indicated that prejudice is not a consideration under §10(a)(3). *Century Indem. Co. v. Certain Underwriters at Lloyd's London*, 584 F.3d 513, 557 (3d Cir. 2009) (omitting portion of §10(a)(3) referring to prejudice and stating that "a court reviewing an arbitrator's decision to reject evidence might uphold an award even if an appellate court when reviewing a trial court's erroneous rejection of the evidence in similar circumstances might not find that the error was harmless."); *see also Tempo Shain*, 120 F.3d 16 (not addressing prejudice to party from exclusion of critical testimony); *Flender Corp. v. Techna-Quip Co.*, 953 F.2d 273 (7th Cir. 1992) (quoting §10(a)(3) without reference to language requiring prejudice).

Other circuits disagree. The Ninth, Eleventh and District of Columbia Circuits all have determined that the language of the statute requires a showing of prejudice to vacate an award. *U.S. Life Ins. Co. v. Superior Nat'l Ins. Co.*, 591 F.3d 1167, 1174 (9th Cir. 2010); *Lessin v. Merrill Lynch, Pierce, Fenner &*

Smith, Inc., 481 F.3d 813, 818 (D.C. Cir. 2007); *Scott v. Prudential Secs., Inc.*, 141 F.3d 1007, 1017 (11th Cir. 1998).

LJL, by dismissing the circuit courts' confusion on this issue, ignores the very real impact this lack of clarity has on litigants seeking vacatur under §10(a)(3) – some may be able to obtain vacatur of an award without showing prejudice, some are required to show the exclusion of evidence caused prejudice, and some, like Pitcairn, may be unable to obtain vacatur even with a strong showing of prejudice.

Some circuit courts hold that, to prove the "misconduct" required under §10(a)(3), a party must make a showing that the arbitrator's decision constitutes affirmative misconduct or was made in bad faith. In *Wachovia Securities, LLC v. Brand*, the Fourth Circuit refused to vacate an award because, even assuming that the arbitrator had made a mistake in refusing to hold a hearing on an issue, such a mistake "lack[ed] the requisite intentionality to fall within §10(a)(3)'s reach." 671 F.3d 472, 479 (4th Cir. 2012). The Third Circuit appears to have adopted a similar standard in *Century Indemnity*. 584 F.3d at 557 ("even district courts sometimes reject evidence they should admit and yet such erroneous rulings hardly can be characterized as 'misconduct' ").

To date, this Court has not provided definitive guidance on how §10(a)(3) is to be interpreted and applied. In *United Paperworkers International Union v. Misco, Inc.*, 484 U.S. 29 (1987), the Court's decision

was not driven by an interpretation of §10(a)(3). Rather, the Court's holding that the arbitrator did not commit misconduct by refusing to hear evidence was premised on the language of the parties' collective bargaining agreement, which permitted the arbitrator to consider only evidence that was known to the employer at the time the employee was discharged. *Id.* at 39. Thus, it was not an exercise of the arbitrator's discretion to refuse to hear the evidence, but rather, it "was a construction of what the contract required when deciding discharge cases." *Id.* Despite the variety of cases in the lower courts in which parties argue that an arbitrator erred in refusing to hear evidence pertinent and material to the controversy, there is no decision of this Court that provides comprehensive guidance for when such a refusal requires vacatur under §10(a)(3) of the FAA.

Given the unsettled state of the law, the Second Circuit was able to develop reasoning to justify reversing the District Court after the District Court held that the arbitrator's refusal to hear the Excluded Evidence did constitute "affirmative misconduct" that rendered the arbitral proceeding fundamentally unfair. (App. 42.) Without analysis or citation, the Second Circuit determined that "we do not think this was an instance of such fundamental unfairness." (App. 18.) The Second Circuit based its decision on two factors not found in §10(a)(3): that the excluded evidence was hearsay and that its admission into evidence would be prejudicial to LJL. The circuit court's departure from the language of the statute

illustrates the need for a uniform construction of §10(a)(3).

A rule has emerged in many cases holding that an arbitrator commits "misconduct" within the meaning of §10(a)(3) by excluding the only relevant, non-cumulative evidence of a fact at issue in the arbitration. *See* Petition 27-28. In *Hoteles Condado*, the First Circuit held that the arbitrator's refusal to give any weight to a criminal trial transcript – which, because the witness refused to testify at the hearing, was the only evidence of a material fact – constituted misconduct requiring vacatur. 763 F.2d at 39.

LJL argues that this case is "dramatically different" from *Hoteles Condado*. But in that case, like here, the proponent was permitted to submit the transcript into evidence, but the arbitrator later determined that he should not consider the testimony therein because he was unable to assess the credibility of the witnesses from the transcript. *Id.* at 39, 40. Moreover, like this case, "no live testimony was available" in *Hoteles Condado*. *Id.* at 40. Central to the First Circuit's holding was the fact that no other evidence was available and that the evidence excluded was "central and decisive" to the proponent's position. *Id.* Thus, although the First Circuit did not use the term "*per se* rule," the decision reflects the sound principle that, where evidence is pertinent, material and non-cumulative, an arbitrator's failure to hear it constitutes misconduct.

Other courts follow this principle. In *Tempo Shain*, the Second Circuit found that the arbitrator's refusal to hear testimony from a witness who was the only person with knowledge of facts pertinent to a cause of action was misconduct within the meaning of §10(a)(3).[5] 120 F.3d at 21. In that case, the excluded evidence was relevant and non-cumulative. *Id.* at 20-21. Whether evidence is relevant and non-cumulative should be the critical inquiry when determining if an arbitrator's refusal to hear pertinent and material evidence constitutes "misconduct" under §10(a)(3).

The *Per Se* Rule Pitcairn Proposes Has Its Basis in the FAA, Would Further the Policies Underlying Arbitration, and Would Clarify the Existing Confusion in the Law

Pitcairn proposes that this Court adopt a *per se* rule that, when an arbitrator excludes the sole evidence of a material fact, the arbitrator has committed "misconduct" within the meaning of §10(a)(3), without a need for the party to show bad faith or affirmative misconduct, proof that is highly subjective. This rule has its basis in the language of the FAA and is consistent with the policies underlying arbitration.

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[5] LJL states that this was the *only* witness who would have testified at the hearing. (BIO 9.) Commentary in the court's decision and quotes from the arbitrator's decision show this was not the case. *Tempo Shain*, 120 F.3d at 18, 20.

Section 10(a)(3) of the FAA provides that an arbitral award may be vacated "where the arbitrators were guilty of misconduct . . . in refusing to hear evidence pertinent and material to the controversy." The plain language of the statute provides that arbitrators are under a legal duty to hear pertinent and material evidence submitted by the parties to ensure the fairness of the proceeding. As this Court has recognized, this liberal admission of evidence is an "important counterweight" to reduced discovery in arbitration. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991). A fair hearing necessarily affords each party the opportunity to present relevant and material evidence. *Bowles Fin. Group, Inc. v. Stifel, Nicolaus & Co.*, 22 F.3d 1010, 1013 (10th Cir. 1994); *Employers Ins. of Wausau v. Nat'l Union Fire Ins. Co.*, 933 F.2d 1481, 1491 (9th Cir. 1991); *Hoteles Condado*, 763 F.2d at 39. Read literally, this portion of §10(a)(3) means that it is misconduct when pertinent and material evidence is disregarded. The statute speaks in terms of a "refusal to hear" evidence, and not prejudice to the opponent of the evidence.

Further, the *per se* rule Pitcairn proposes would comply with the requirement that contracts to arbitrate be "rigorously" enforced according to their terms. *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2309 (2013); BIO 12, 14. Unless the parties specify otherwise, formal rules of evidence do not apply in arbitration. Here, the arbitration clause in the Operating Agreement specifies that "a dispute

. . . shall be resolved by the Expedited Arbitration procedures of the American Arbitration Association." (JA 82.) The applicable AAA rules permit the arbitrator to exclude only cumulative or irrelevant evidence. (App. 42.) Thus, Pitcairn contracted for an arbitration in which evidence would be admitted unless it was irrelevant or cumulative.[6] Yet, in violation of the parties' contract and without notice to Pitcairn,[7] the arbitrator excluded relevant, non-cumulative evidence. The Second Circuit sanctioned this decision in contravention of §10(a)(3), in effect, giving an arbitrator unfettered discretion to apply or not apply rules of evidence as he or she sees fit.

The Second Circuit's decision, based on a technical application of the hearsay rules and a claim of unfair prejudice to the opponent, is inconsistent with the well-settled goals of arbitration and the

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[6] LJL suggests that Pitcairn agreed to arbitration rules that "expressly forbid consideration of hearsay evidence or leave its admission to the arbitrator's discretion." (BIO 14-15.) As demonstrated by the plain text of AAA Rule 31 (now codified at Rule 34), Pitcairn did no such thing. *See* http://webcache.googleusercontent.com/search?q=cache:6Rl6gUtraTwJ:https://www.adr.org/cs/idcplg%3FIdcService%3DGET_FILE%26dDocName%3DADRSTAGE2011601%26RevisionSelectionMethod%3DLatestReleased+&cd=2&hl=en&ct=clnk&gl=us.

[7] The arbitrator decided not to admit the Excluded Evidence after the close of evidence. Moreover, the arbitrator allowed both parties' experts to testify about and rely on many other instances of hearsay. For example, LJL's expert relied on a conversation with a broker, who spoke to his father, who spoke to a banker, who e-mailed a colleague. (JA 337, 584.)

provisions of the FAA. The decision also is emblematic of other troubling possibilities. If an arbitrator may exclude evidence because it is hearsay, then what prevents an arbitrator from excluding evidence that has not been officially authenticated or evidence that is not an original document? Parties in arbitration will be forced to prepare as if hearings may be conducted according to the rules of evidence, to call sponsoring witnesses, and lay an evidentiary foundation for each piece of evidence they wish to submit. To encourage such behavior is contrary to the policy that arbitration remain informal, expedited and less costly. The better rule is to require arbitrators to hear all pertinent, material, and non-cumulative evidence, assigning such weight to the evidence as the arbitrator deems proper.[8]

Conclusion

In arbitration, where there are few rules, the first rule should be one of fairness. Fundamentally, this means that each party have a full and fair opportunity to present its case. The current state of the law creates opportunities for parties to be deprived of fairness when they arbitrate. Clarification of the standard for vacatur under §10(a)(3) of the FAA would serve desirable policy goals that further

[8] Parties of course would always remain free to agree by contract to adopt different evidentiary standards in arbitral proceedings governing their disputes.

arbitration as a means of resolving disputes. Therefore, this Court should grant certiorari in this matter.

Respectfully submitted,

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