

Overbroad arbitration awards are no laughing matter, says Ninth Circuit

United States - McDermott Will & Emery UK LLP

March 06 2009

Licensing
Other issues

In *Comedy Club Inc v Improv West Assoc Associates* (Cases 05-55739 and 05-56100, January 29 2009), the US Court of Appeals for the Ninth Circuit has vacated in part an arbitrator's award in a dispute over a breached trademark licensing agreement.

Comedy Club Inc owns and operates comedy clubs throughout the United States. On June 13 1999 Comedy Club entered into a trademark licensing agreement with Improv West Associates whereby Comedy Club was granted the exclusive right to use Improv's trademarks (IMPROV and IMPROVISATION) in opening comedy clubs around the country. The agreement contained an in-term covenant not to compete, prohibiting Comedy Club and its affiliates from owning or operating any non-Improv comedy venues until the agreement expired in 2019. Comedy Club breached the agreement by failing to adhere to a development schedule set forth in the contract.

When Improv attempted to withdraw Comedy Club's licence due to breach, Comedy Club filed an action in district court seeking declaratory relief that:

- it still retained rights to the trademarks; and
- the covenant not to compete was void under California law.

The district court granted Improv's request for arbitration. The arbitrator held that:

- Comedy Club's breach forfeited its rights to the trademarks; and
- the covenant not to compete was valid until 2019.

Comedy Club and its affiliates were thus enjoined from owning or operating any non-Improv comedy clubs pursuant to the covenant not to compete for the duration of the agreement.

While the district court upheld the arbitration award in its entirety, the Ninth Circuit held that the arbitrator had exhibited manifest disregard of the law by upholding the covenant not to compete and exceeded his authority in binding Comedy Club's affiliates to the arbitration award (for further details please see "[Ninth Circuit restricts scope of non-compete obligations under trademark agreement](#)"). The Supreme Court, on a petition for a writ of *certiorari*, vacated the Ninth Circuit's opinion and remanded the case for reconsideration in light of the Supreme Court's holding in *Hall Street Associates v Mattel* (Case 06-989).

In *Hall Street*, the Supreme Court had offered several possible readings of the manifest disregard doctrine as grounds to modify or vacate an arbitration award, including the reasoning utilized by the Ninth Circuit. As *Hall Street* did not directly conflict with the Ninth Circuit's prior analysis, the court reaffirmed its conclusion that manifest disregard of the law is an appropriate ground to vacate an arbitration award.

Utilizing the manifest disregard standard, the Ninth Circuit reiterated that the licensing agreement's broad covenant not to compete violated California law because prohibiting

Comedy Club from operating comedy venues in the United States for 14 years stifled competition in a “substantial share of the affected line of commerce”. In addition, the court reaffirmed that in binding Comedy Club’s affiliates (broadly defined to include non-party relatives and former spouses) to the licensing agreement and covenant not to compete, the arbitrator exceeded his authority under California law, which typically does not bind non-parties to arbitration agreements in the absence of an agency relationship.

The Ninth Circuit thus affirmed its prior holding in its entirety and adjusted the arbitration award to:

- prohibit Comedy Club from opening non-Improv venues only in counties where Comedy Club currently operates Improv clubs; and
- limit the definition of 'affiliates' to those persons with agency relationships to the signatories of the trademark agreement.

Elisabeth Malis, McDermott Will & Emery LLP, Los Angeles

© Copyright 2003-2009 Globe Business Publishing Ltd