MANIFEST DISREGARD OF THE LAW

AS A BASIS TO VACATE ARBITRATION AWARDS

AFTER *HALL STREET ASSOCIATES*

By

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I. Introduction

There are a limited number of bases to vacate reinsurance, and other, arbitration awards. In 1953, the United States Supreme Court discussed the concept of "manifest disregard of the law" in a manner that suggested to some that it is a non-statutory basis for vacating an arbitration award. After that decision, a number of courts attempted to articulate standards for manifest disregard, one set of standards being that vacatur is appropriate in the exceedingly rare instances in which: (a) the law was clear and explicitly applicable to the matter at hand; (b) the law was improperly applied by the arbitrators leading to an erroneous result; and (c) the arbitrators were aware of the law and its applicability and chose not to apply it.[1]

In 2008, the Supreme Court revisited this issue and debunked the use of manifest disregard of the law as a non-statutory basis to vacate arbitration awards. The purpose of this article is to examine the reaction of federal courts to the latter decision.

II. *Wilko v. Swan*, 74 S. Ct. 182 (1953)

A securities margin agreement contained an arbitration clause and the issue before the court was whether or not this violated the Securities Act of 1933, 15 U.S.C. §§ 77a et seq. The court found that the arbitration clause did violate the act as it limited the buyer's ability to seek redress in the courts. In *dicta*, the court commented the power to vacate arbitration awards:

> Power to vacate an award is limited (citation to the four statutory bases in § 10 (a) of the Federal Arbitration Act to vacate awards). While it may be true, as the Court of Appeals thought, that a failure of the arbitrators to decided in accordance with the provisions of the Securities Act would "constitute grounds for vacating the award

> pursuant to section 10 of the Federal Arbitration Act," that failure would need to be made clearly to appear. In unrestricted submissions, such as the present margin agreements envisage, the interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation. The United States Arbitration Act contains no provision for judicial exercise of legal issues such as that found in the English law.[2]

Read in context, the "manifest disregard" language seems to require that such a concept must fall within one of the four bases for vacation contained in § 10 (a) of the FAA[3] to be effective. Nonetheless, a considerable body of case law developed subsequently which treated manifest disregard as a separate, judge-made basis to vacate arbitration awards.[4]

III. *Hall Street Associates v. Mattel, Inc.*, 128 S. Ct. 1396 (2008)

This case involved an arbitration clause which granted the courts the power to vacate an award "where the arbitrator's conclusions of law are erroneous."[5] The district court vacated an award on this basis and later modified a revised award under § 11 of the FAA. The Supreme Court granted certiorari to decide "whether the grounds for vacatur and modification provided for by §§ 10 and 11 of the FAA are exclusive."[6] The Court held that "§§ 10 and 11 respectively provide the FAA's exclusive grounds for expedited vacatur and modification."[7]

Hall Street pressed the manifest disregard language from *Wilko* as an expansion on the statutory bases to vacate arbitration awards. The Court responded:

> But this is too much for *Wilko* to bear. Quite apart from its leap from a supposed judicial expansion by interpretation of a private expansion by contract, Hall Street overlooks the fact that the statement it relies on expressly rejects just what Hall Street asks for here, general review for an arbitrator's legal errors. Then there is the vagueness of *Wilko*'s phrasing. Maybe the term "manifest disregard" was meant to name a new ground for review, but maybe it merely referred to the § 10 grounds collectively. Or, as some courts have thought, "manifest disregard" may have been shorthand for § 10(a) (3) or §10 (a) (4), the subsections authorizing vacatur when arbitrators were "guilty of misconduct" or "exceeded their powers." We, when speaking as a Court, have merely taken the *Wilko* language as we found it without embellishment, and now that its meaning is implicated, we see no reason to accord it the significance Hall Street urges.[8]

The Court also observed that "[u]nder the terms of § 9 [of the FAA], a court 'must' confirm an arbitration award 'unless' it is vacated, modified, or corrected 'as prescribed' in §§ 10 and 11."[9] Thus, the *Hall Street* court rejected the argument that the manifest disregard language from *Wilko* created any extra-statutory, judge-made basis for vacating arbitration awards.

IV. Reaction to *Hall Street Associates* in the Circuit Courts

To date, five federal circuit courts have issued opinions indicating their view of the impact of *Hall Street Associates* on the issue of manifest disregard of the law as a separate basis for vacatur of arbitration awards.

A. First Circuit

In a non-FAA case, the court in *Horving Ramos-Santiago v. United Parcel Service*, 524 F.3d 120 (1st Cir. 2008), interpreted *Hall Street Associates* as ruling that manifest disregard is no longer a valid basis for vacating arbitration awards:

> We acknowledge the Supreme Court's recent holding in *Hall Street Associates* . . . that manifest disregard of the law is not a valid ground for vacating or modifying an arbitral award in cases brought under the Federal Arbitration Act ("FAA"). Because the case at hand is not an FAA case – neither party has invoked the FAA's expedited review provisions, and the original complaint was filed in Puerto Rico state court under a mechanism provided by state law – we decline to reach the question of whether *Hall Street* precludes a manifest disregard inquiry in this setting.[10]

B. Second Circuit

The court dealt with the impact of *Hall Street Associates* on manifest disregard in *Stolt-Nielsen SA v. Amimalfeeds Int'l*, 548 F.3d 85 (2nd Cir. 2008) *cert. granted* 129 S. Ct. 2793 (2009). Rather than abandon it as a concept, the court characterized it as a "judicial gloss" on the statutory bases for vacatur:

> In the short time since *Hall Street* was decided, courts have begun to grapple with its implications for the "manifest disregard" doctrine. Some have concluded or suggested that the doctrine simply does not survive. Others think that "manifest disregard" reconceptualized as a judicial gloss on the specific grounds for vacatur enumerated in section 10 of the FAA remains a valid ground for vacating arbitration awards.
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> We agree with those courts which take the latter approach. . . .
>
> Like the Seventh Circuit,[11] we view the "manifest disregard" doctrine, and the FAA itself, as a mechanism to enforce the parties' agreements to arbitrate rather than as a judicial review of the arbitrators' decision. We must therefore continue to bear the responsibility to vacate arbitration awards in the rare instances in which "the arbitrator knew of the relevant [legal] principle, appreciated that this principle controlled the outcome of the disputed issue, and nonetheless willfully flouted the governing law by refusing to apply it." At that point the arbitrators have "failed to interpret the contract

> at all," for the parties do not agree in advance to submit to arbitration that is carried out in manifest disregard of the law. Put another way, the arbitrators have thereby "exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.[12]

See also, *Macromex Sri v. Globex Int'l*, 2009 U.S. Lexis 11069 (2nd Cir.).

C. Fifth Circuit

In *Citigroup Global Markets Inc. v. Bacon,* 562 F.3d 349 (5th Cir. 2009) the court articulated the *Hall Street Associates* holding as a clear statement that § 10 of the FAA is the exclusive basis upon which arbitration awards can be vacated. After reviewing decisions from other circuits to the effect that the manifest disregard principle survives in some fashion, the court stated:

> In light of the Supreme Court's clear language that, under the FAA, the statutory provisions are the exclusive grounds for vacatur, manifest disregard of the law as an independent, nonstatutory ground for setting aside an award must be abandoned and rejected. Indeed, the term itself, as a term of art, is no longer useful in actions to vacate arbitration awards.[13]

See also, Saipem America v. Wellington Underwriting Agencies, 2009 U.S. App. Lexis 12673 (5th Cir.).

D. Sixth Circuit

To date, the sixth circuit has dealt with the relevant issue in three decisions, the first two of which are unpublished. The first in time was *Coffee Beanery, Ltd. v. WW, L.L.C.,* 2008 U.S. App. Lexis 23645 (6th Cir.). In that case, the court seemed to recognize some reduction in the scope of the manifest disregard of law principle as a result of *Hall Street Associates* but declined to read that decision as eliminating it as a separate, non-statutory basis for vacating arbitration awards:

> [T]he Supreme Court significantly reduced the ability of federal courts to vacate arbitration awards for reasons other than those specified in 9 U.S.C. §10, but did not foreclose federal courts' review for an arbitrator's manifest disregard of the law. . . . However, with respect to the judicially-invoked narrow exception for an arbitrator's manifest disregard of the law, the Court acknowledged that "[m]aybe the term 'manifest disregard' [in *Wilko*] was meant to name a new ground for review," though it also suggested that narrower interpretations of *Wilko* were equally plausible. The Court did not come to a conclusion regarding the precise meaning of *Wilko*, holding only that *Wilko* could not be read to allow the parties to expand the scope of judicial review by their own agreement.
>
> It is worth noting that since *Wilko*, every federal appellate court has allowed for the vacatur of an award based on an arbitrator's manifest disregard of the law. In light of

> the Supreme Court's hesitation to reject the "manifest disregard" doctrine in all circumstances, we believe it would be imprudent to cease employing such a universally recognized principle. Accordingly, this Court will follow its well-established precedent here and continue to employ the "manifest disregard" standard.[14]

Coffee Beanery was followed closely by another unpublished opinion, *Martin Marietta Materials, Inc. v. Bank of Oklahoma*, 2008 U.S. App. Lexis 25681 (6th Cir.). In this case, the parties assumed that manifest disregard of the law survives *Hall Street Associates* as a valid basis for vacating arbitration awards and the court agreed to proceed on this basis.

Martin Marietta was followed less than a month later by the published decision of *Grain v. Trinity Health*, 551 F.3d 374 (6th Cir. 2008) which involved an attempt to modify rather than vacate an award. In rejecting the argument that manifest disregard applies to modification of awards in addition to vacatur, the court stated:

> It is true that we have said that "manifest disregard for the law" may supply a basis for *vacating* an award, at times suggesting that such review is a "judicially created" supplement to the enumerated forms of FAA relief. *Hall Street's* reference to the "exclusive" statutory grounds for obtaining relief casts some doubt on the continuing vitality of that theory.[15]

E. Ninth Circuit

Comedy Club, Inc. v. Improv West Assoc., 553 F.3d 1277 (9th Cir. 2009) was a remand from the Supreme Court to consider the prior ruling in light of *Hall Street Associates.* In the circuit's prior decision, it ruled that an arbitration award should be vacated due to manifest disregard of the law. The court confirmed its prior ruling as consistent with *Hall Street Associates* as manifest disregard of the law fits within the ambit of § 10 (a) (4) of the FAA concerning arbitrators exceeding their powers:

> [T]he manifest disregard ground for vacatur is shorthand for a statutory ground under the FAA, specifically 9 U.S.C. § 10 (a) (4) which states that the court may vacate "where the arbitrators exceeded their powers." The Supreme Court did not reach this question of whether the manifest disregard of the law doctrine fits within §§ 10 or 11 of the FAA. Instead, it listed several possible readings of the doctrine, including our own. We cannot say that *Hall Street* is "clearly irreconcilable" with *Kyocera* (the ninth circuit precedent) and thus we are bound by our prior precedent. Therefore, we conclude that, after *Hall Street Associates*, manifest disregard of the law remains a valid ground for vacatur because it is part of § 10 (a) (4).[16]

See also, Cockerham v. Sound Ford, Inc., 2009 U.S. App. 12855 (9th Cir.).

V. Selected District Court Decisions in Other Circuits

A. Third Circuit

In *Danieli Corus, Inc. v. ATSI, Inc.*, 2009 U.S. Dist. Lexis 45458 (W.D.Pa.) the party opposing confirmation of the arbitration award argued various non-statutory bases to vacate the award. The court declined to do so on the basis that this would contravene the clear holding of *Hall Street Associates.*

B. Fourth Circuit

The court observed the it is required to confirm an arbitration award unless it is vacated, modified or corrected under the terms of §§ 10 and 11 of the FAA pursuant to *Hall Street Associates* in *MCI Constructors, Inc. v. Hazen and Sawyer,* 2009 U.S. Dist. Lexis 37148.

C. Seventh Circuit

In *CUNA Mutual Ins. Society v. O.M. Financial Assoc.*, 2008 U.S. Dist. Lexis 25601 (W.D. Wis.) the court observed that pursuant to *Hall Street Associates,* §§ 10 and 11 of the FAA are the exclusive grounds for vacatur and modification of arbitration awards.

D. Eight Circuit

Pursuant to *Hall Street Associates*, § 10 of the FAA is the exclusive method by which arbitration awards may be vacated. *Medicine Shoppe Int'l v. Simmonds,* 2009 U.S. Dist. Lexis 10022 (E.D.Mo.); *Prime Therapeutics LLC v. Omnicare, Inc.,* 555 F.Supp.2d 993 (D.Minn. 2008).

E. Tenth Circuit

DMA Int'l v. Qwest Communications Int'l , 2008 U.S. Dist. Lexis 76164 (D. Col.) was a case of first impression in the tenth circuit after *Hall Street Associates* was handed down. As such, the court observed that there remains some question after this decision as to whether or not it eliminates all judicially-created grounds for vacatur. Nonetheless, the court found no basis to vacate for manifest disregard under prior case law.

F. Eleventh Circuit

The party opposing the confirmation of an arbitration award argued a non-statutory basis for vacatur, namely violation of public policy in *Carey Rodriquez v. Arminak*, 583 F.Supp. 2d 1288 (S.D. Fla. 2008). The court noted that *Hall Street Associates* did leave open the possibility of vacatur under state statute or common law but determined that this was not the case for such a vacatur since it was filed pursuant to the FAA.

G. DC Circuit

In *Regency Publishing, Inc. v. Miniter,* 601 F.Supp. 2d 192 (D.D.C 2009) the party opposing confirmation of the arbitration award sought to have it vacated on the basis of manifest disregard of the law. The court did not reach the issue of the exclusivity of the statutory basis for vacatur pursuant to *Hall Street Associates* since the allegations of the respondent did not rise to the level of manifest disregard under prior law.

VI. Commentary

Manifest disregard of the law is certainly an unusual and persistent principle. It arose out of dicta that was unclear as to its meaning and has served as a judge-made supplement to the statutory bases to vacate arbitration awards. Notwithstanding the Supreme Court's ruling in *Hall Street Associates* rejecting it as a basis to vacate arbitration awards, the reaction in the circuit courts to date has been highly varied. Some courts would read manifest disregard out of the legal lexicon (the fifth and, possibly, the first circuit), others would give *Hall Street Associates* short shrift and follow prior precedent (sixth circuit), and yet others would treat manifest disregard as a gloss on the statutory bases for vacatur (second and ninth circuits).

Perhaps the Supreme Court's view on manifest disregard will be further clarified when it hears the appeal of *Stolt-Nielsen SA v. Animalfeeds Int'l,* 548 F.3d 85 (2nd Cir. 2008). However, it may be more likely that the Court will focus on the class arbitration issue which was the central feature of the second circuit opinion and let the lower courts further digest the import of *Hall Street Associates.*

ENDNOTES

1 *Duferco Int'l Steel Trading v. T. Llaveness Shipping A/S,* 33 F.3d 383, 389-90 (2nd Cir. 2003).

2 74 S. Ct. 182 at 187-8.

3 "(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 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."

4 *See e.g. Stolt-Nielson v. Animalfeeds Int'l; 548 F.3d 85 at 92 n. 7 ((2nd Cir. 2008); Dufero Int'l Steel Trading v. T. Klaveness Shipping A/S,* 333 F.3d 383 at 389 (2nd Cir. 2003).

5 128 S. Ct. 1396 at 1401.

6 *Id.*

7 *Id.* at 1403.

[8] *Id.* at 1404 (internal citations omitted).
[9] *Id.* at 1402.
[10] 524 F.3d 120 at 124 n. 3.
[11] Referring to *Wise v. Wachovia Sec., LLC,* 450 F.3d 265, 269 (7th Cir. 2006) *cert. denied* 549 U.S. 1047 (2006).
[12] 548 F.3d 85 at 94-5 (internal citations omitted).
[13] 562 F.3d 349 at 358.
[14] 2008 U.S. App. 23645 *10-12 (internal citations omitted).
[15] 551 F.3d 374 at 380 (internal citation omitted).
[16] 553 F.3d 1277 at 1291.