IADC Committee Newsletter

BUSINESS LITIGATION

November 2009

IN THIS ISSUE

The Supreme Court's decision in Hall Street Associates, L.L.C. v. Mattel, Inc. *brings into question the continuing validity of manifest disregard of the law as a grounds for seeking vacatur of arbitration awards. Unfortunately, the decision raises more questions that it resolves. This article surveys the case law that has emerged in the wake of* Hall Street. *In particular, it addresses two issues courts are grappling with: (1) whether to continue to consider manifest disregard in deciding whether to vacate or confirm an award, and (2) whether parties may contractually, or otherwise, seek a more searching review of an arbitral award under state law.*

Are You Able to Disregard "Manifest Disregard" After *Hall Street*: A Continuing and Twisted Tale

ABOUT THE AUTHORS

Keith A. Dotseth is one of the founding partners of Larson • King. Throughout his career he has devoted his practice to complex civil litigation and strategic counseling. Keith has practiced and has been admitted pro hac vice in numerous jurisdictions around the country and has appeared before national and international arbitration tribunals. He received his undergraduate degree, summa cum laude, from the University of Northern Iowa and his law degree, with high distinction and Order of the Coif, from the University of Iowa.

Hilary J. Loynes is an attorney with Larson • King. She focuses her practice on business litigation, reinsurance litigation, and mortgage lending and servicing litigation. Hilary received her law degree magna cum laude from Hamline University School of Law.

ABOUT THE COMMITTEE

The Business Litigation Committee consists of members involved in business and commercial litigation including business torts, contract and other commercial disputes, e-commerce, antitrust and other distribution issues, trade secrets and intellectual property, unfair competition and business defamation and disparagement. The Business Litigation Committee helps connect members involved in these areas around the world through networking and referral opportunities; developing and keeping current in the substantive, strategic and procedural aspects of business litigation; and affords members an international forum for sharing current developments and strategies with colleagues. Among the Committee's planned activities are newsletters, publications, sponsorship of additional programs at conferences and the execution of membership initiatives.

Learn more about the Committee at www.iadclaw.org. To contribute a newsletter article, contact:

Jonathan A. Berkelhammer
Vice Chair of Publications
Smith Moore Leatherwood LLP
(336) 378-5251
jon.berkelhammer@smithmoorelaw.com

The Supreme Court's decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.* 552 U.S. 2, 128 S.Ct. 1396 (2008) expressly called into question the continuing validity of manifest disregard of the law as a grounds for vacatur. Unfortunately, the Court did not resolve the issue with unquestionable clarity. Rather, following *Hall Street* the fate of manifest disregard seems even more uncertain.

In the wake of *Hall Street*, lower courts are split on the continuing role, if any, of manifest disregard. Some courts suggest that the Supreme Court avoided the issue completely, while others view that the Court's decision that the Federal Arbitration Act (FAA) provided exclusive means for vacating an award, eliminates manifest disregard as a valid ground for vacatur.

The uncertainty created by *Hall Street* has been caused, in part, by the Court's decision to leave at least two significant issues unresolved. First, the Court's dicta concerning *Wilko v. Swan* left unresolved the issue of whether federal common law still provides valid grounds for vacatur in the form of manifest disregard of the law. Second, the Court recognized that the FAA is not the exclusive way into court for parties seeking review of an arbitration award. This recognition raises the issue of whether parties seeking review under state arbitration law will be able to obtain a more searching review under manifest disregard.

I. The Supreme Court's Decision in *Hall Street*

In *Hall Street*, the Supreme Court addressed whether statutory grounds for vacatur and modification may be supplemented by contract. 128 S.Ct. at 1400. The Court concluded that the statutory grounds expressly provided by the FAA are exclusive. *Id.*

In doing so, the Court rejected the assertion that *Wilko v. Swan*, 436 U.S. 427 (1953), added manifest disregard of the law as an additional ground to vacate an arbitration award under § 10 of the FAA. *Id.* at 1403-4. Rather, it stated that the *Wilko* Court's reference to manifest disregard was vague. *Id.* It stated, "[m]aybe the term 'manifest disregard' was meant to name a new ground for review, but maybe it merely referred to the § 10 grounds collectively, rather than adding to them." *Id.* The Court concluded §§ 10 and 11 of the FAA provided the exclusive grounds for vacating an arbitration award under federal law.

However, in holding that parties may not contractually expand judicial review for legal error, the Court explicitly preserved the rights of parties to pursue review of an arbitration award under state law alternatives to the FAA schematic, stating "we do not purport to say that they exclude more searching review based on authority outside the statute as well." *Id*. at 1406. Accordingly, enforcement of arbitration awards may be sought under state statutory or common law. *Id*.

The Supreme Court's decision in *Hall Street*, with all of its equivocations, left many courts unequivocally confused about the ongoing viability of "manifest disregard" as a basis for vacatur. Adding to the uncertainty, *Hall Street* appeared to clearly indicate that the answer to whether "manifest disregard" was available might turn on whether one were reviewing an arbitration award under federal common law or state law.

II. Post-*Hall Street* Interpretations of Manifest Disregard of the Law as a Valid Grounds for Vacatur: The Status of "Manifest Disregard" in Federal Common Law after *Hall Street*

Federal courts have applied manifest disregard of the law to provide substantive judicial review to arbitration awards that depart from well-established law. Despite the Supreme Court's ruling in *Hall Street*, the majority of courts have continued to consider 'manifest disregard' as a valid ground for vacatur of an arbitration award. Arthur D. Felsenfeld and Antonette Ruocco. '*Manifest Disregard' After 'Hall Street': The Early Returns.* N.Y.L. J. 24 (2008).

The Second Circuit decided that *Hall Street* did not abrogate the "manifest disregard" doctrine. *Stolt-Nielsen v. Animalfeeds Int'l Corp.*, 548 F.3d 85, 95 (2d Cir. 2009). Rather, the court found manifest disregard remains a valid ground for vacating arbitration awards. It determined the doctrine is merely "reconceptualized as a judicial gloss on the specific grounds for vacatur enumerated in section 10 of the FAA." *Id.* at 94 (internal citations omitted). The court viewed manifest disregard doctrine—and the FAA itself—as a mechanism to enforce the parties' agreement to arbitrate rather than a judicial review of the arbitrator's decision. Consequently, the court will vacate an award for manifest disregard of the law when 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.'" The court determined in such instances "the arbitrators will have failed to interpret the contract at all, for parties do not agree in advance to submit to arbitration that is carried out in manifest disregard of the law." *Id.* at 95 (internal citations omitted). Or in other words, "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." *Id.* (quoting U.S.C. § 10(a)(4)). The Second Circuit's ruling therefore attempts to balance the goal of enforcing the parties' agreement to arbitrate with the narrow grounds for vacatur under the FAA. It therefore, read § 10(a)(4) expansively to include manifest disregard of the law. In so doing the court has suggested that the agreement of the parties controls in that an award may be vacated when the panel failed to adhere to the agreement and instead decided the dispute against the weight of the authority. *See also Vitarroz Corp v. G. Willi Food Int'l*, No. 05-5363, 2009 WL 1844293 (D. N. J. June 26, 2009) (finding that while the Third Circuit has yet to confront manifest disregard after *Hall Street* it will continue to apply the manifest disregard standard as a means to enforce § 10).

In *Coffee Beanery, Ltd. v. WW L.L.C.*, the Sixth Circuit applied manifest disregard of the law to vacate the arbitrator's award. No. 07-1830, 2008 WL 4899478 (6th Cir. Nov. 14, 2008). The court concluded the 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 it did not foreclose federal courts' review for an arbitrator's manifest disregard of the law." *Id.* at **4. Rather, the court interpreted *Hall Street* as precluding *private parties* from supplementing by contract the FAA's statutory grounds for vacatur of an arbitration award. *Id.* (emphasis in original). The court also noted that the Supreme Court did not overturn *Wilko*, holding only that *Wilko* could not be read to allow parties to expand the scope of judicial review by their

own agreement. As a result, the court determined that "[i]n 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." *Id*. *See also Xtria v. Int'l Ins. Alliance Inc.*, 286 S.W.3d 583, 594 (Tex. Ct. App. 2009) (without making a legal determination on whether the common-law grounds for vacatur still exist after *Hall Street* it addressed the argument that the arbitrator manifestly disregarded the law "in the attitude of cautiously donning both a belt and suspenders.") In so holding, the court made a distinction between parties' ability to contractually agree to expand the grounds for vacatur enumerated in the FAA, and the courts ability to continue to apply federal common law to vacate an award for a panel's manifest disregard of the law.

The Ninth Circuit likewise found *Hall Street* did not eliminate manifest disregard as a valid ground for vacatur. *Comedy Club, Inc. v. Improv West Assocs.*, 553 F.3d 1277 (9th Cir. 2009). It held that "*Hall Street Associates* d[id] not undermine [its] prior precedent, *Kyocera Corp. v. Prudential-Bache T. Servs.*, 341 F.3d 987 (9th Cir. 2003)." *Id.* at 1281. The court stated that in *Kyocera* it had decided manifest disregard was "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.'" *Id.* at 1290. As a result, in the Ninth Circuit an arbitrator's manifest disregard of the law remains a valid ground for vacatur of an arbitration award under § 10(a)(4) of the FAA in the Ninth Circuit. *Id.* at 1281. *See also Cockerham v. Sound Ford, Inc.*, No. 08-35567, 2009 WL 1975426 (9th Cir. June 16, 2009) (applying *Comedy Club* to find manifest disregard is a valid form of vacatur).

Similarly, the Eastern District of Pennsylvania recently ruled an arbitration award was completely irrational, and therefore in manifest disregard of the law. *PMA Capital Ins. Co. v. Platinum Underwriters Bermuda, Ltd.*, No. 09-84, 2009 WL 2989804 (E.D.Pa. Sept. 17, 2009). In reaching its conclusion, the court determined that an award is not subject to judicial review unless it is 'completely irrational.' *Id.* at *7. Therefore, it found an "arbitration award based on the interpretation of a contract is irrational if the award does not draw its essence therefrom and . . . is in manifest disregard thereof." *Id.* Because the court found the panel's decision did not draw its essence from the agreement, it vacated the award for manifest disregard of the law. *Id.* at *8. Notably, the court did not consider *Hall Street* in its analysis of whether to vacate the arbitral award.

In contrast the Fifth Circuit recently held that it would no longer apply the manifest disregard doctrine as a basis for vacating awards under the FAA. *CitiGroup Global Markets Inc., v. Bacon*, 562 F.3d 349 (5th Cir. 2009). The court decided that *Hall Street* "unequivocally held that the statutory grounds are the exclusive means for vacatur under the FAA. . . . Thus to the extent that manifest disregard of the law constitutes a nonstatutory ground for vacatur it is no longer a basis for vacating awards under the FAA." *Id.* at 355.

In so holding the Fifth Circuit rejected the Sixth Circuit's contention that the Supreme Court's discussion of *Wilko* demonstrated "hesitation to reject the 'manifest disregard' doctrine." *Id.* at 356. Instead, the court found the Supreme Court's discussion demonstrated an "unwillingness to give any significant meaning to *Wilko's* vague language." *Id.* The court also rejected the Second and Ninth Circuit Court analysis that manifest disregard

survived *Hall Street* as a shorthand for § 10(a)(4) by holding that "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 legal art, is no longer useful in actions to vacate arbitration awards." *Id*. at 358.

Similar to the Fifth Circuit, the First Circuit in dicta recognized that *Hall Street* rejected manifest disregard as valid grounds for vacatur. In a footnote the court stated, "we acknowledge the Supreme Court's recent holding in [*Hall Street*], that manifest disregard of the law is not a valid ground for vacating or modifying an arbitral award in cases brought under the [FAA]." *Ramos-Santiago v. United Parcel Service,* 524 F.3d 120, n. 3 (1st Cir. 2008). However, the court concededly did not reach the question of whether *Hall Street* precluded a manifest disregard inquiry in *Ramos-Santiago* because neither party invoked the FAA, and the case was brought under state law. *Id.*

A subsequent determination by the Massachusetts District Court reinforces the First Circuits rejection of manifest disregard as a valid grounds for vacatur after *Hall Street.* In *ALS & Associates, Inc. v. AGM Marine Constructors, Inc.* the court rejected the argument that the award should be vacated because the arbitrator manifestly disregarded the law. 557 F.Supp.2d 180 (D. Mass 2008). Citing *Ramos-Santiago,* it held manifest disregard of the law is not a ground for vacating an award in cases brought under the FAA. *Id.* at 185. However, the *ALS* court also briefly noted that even if manifest disregard of the law remained a valid basis for vacatur, the moving party had failed to show that the arbitrator in question had manifestly disregarded the applicable law. *Id. See also Wachovia Securities, Inc., v. Bonebrake,* No. Doc. 1084 No. 455, 2009 WL 1916059 (Neb. Dist. Ct. June 19, 2009) (while the Eighth Circuit has not directly addressed the issue this court found manifest disregard is no longer an extra-statutory grounds for vacatur; rather, if it survived *Hall Street* at all, it must be viewed as encompassed by the statutory grounds in § 10).

The *Hall Street* decision, in attempting to resolve one split in authority, succeeded in creating another. Prior to the Supreme Court's ruling, courts uniformly considered manifest disregard of the law to be a valid grounds for vacatur. Now, courts are sharply divided. The majority of courts who have addressed this issue post *Hall Street* have found manifest disregard has survived in one form or another as a valid basis on which to review a panel's decision. Moreover, of those courts who have found *Hall Street* eliminated this federal common law standard most address the issue in the alternative, often finding "even if" manifest disregard remained the party seeking to vacate the award failed to prove the arbitrator's conduct violated this standard.

III. Availability of Expanded Review under State Arbitration Statutes or State Common Law

Hall Street's explicit recognition that parties may seek judicial review of an arbitration award under state common and statutory law provides parties who wish to obtain an expanded judicial review an avenue through which they may achieve such a result, even in those federal court jurisdictions that have concluded that such a review does not exist in federal common law. Arbitration agreements which contain clearly worded choice-of-law provisions may enable parties to contractually obtain judicial review for manifest disregard

of the law if the chosen state law supports such review. In addition, even if parties fail to include a choice of law provision, recent decisions suggest a party may obtain expanded review by simply seeking to confirm the award in state court in a state that recognizes the availability of expanded review.

After *Hall Street*, parties have successfully sought and received expanded judicial review under state law. For example, the California Supreme Court found the California Arbitration Act ("CAA") permitted parties to contractually expand judicial review of an arbitration award. *Cable Connection Inc. v. DirecTV, Inc.*, 190 P.3d 586, 599 (Cal. 2008). Under the CAA, courts are authorized to vacate an arbitration award if it was in excess of the arbitrator's powers. *Id.* at 592. In this case, the court focused on the policy of enforcing the contractual agreement of the parties. It stated the general rule is that an arbitrator's decision is not reviewable for error. *Id.* at 599. However, if the parties "constrain the arbitrators' authority by requiring a dispute to be decide according to the rule of law, *and* make plain their intention that the award is reviewable for legal error, the general rule of limited review has been displaced by the parties' agreement." *Id.* (emphasis in original).

A recent 2009 case applied the California Supreme Court's ruling in *DirecTV*. *See Bekken v. Fisher & Phillips, LLP*, 2009 WL 1112796 (Cal. App. 4th Dist. 2009). In this case, the court highlighted the distinction between the applicability of §§ 2 and 4 of the FAA to state court proceedings. *Id.* at *3. It determined the broad language of § 2 preempts state law by creating a body of federal substantive law applicable to any arbitration agreement within the coverage of the Act. On the other hand, it concluded the procedural rules of the FAA do not apply to state court proceedings. *Id.* The court concluded the provisions for judicial review of arbitration awards are directed to "the United States court in and for the district wherein the award was made." *Id.* Accordingly, the court found this language demonstrated Congress's intent to limit the application of this provision to federal courts. Consequently, the court found the decision in *Hall Street* was restricted to proceedings under the FAA, and does not require state law to conform to its limitation. *Id.* at *5. The court therefore rejected the argument that the FAA preempted the parties' agreement for judicial review of legal error by an arbitrator. It further rejected the argument that the parties intended federal law to be controlling based on the language in the arbitration clause which stated it "shall be enforced under the FAA." It determined that by seeking to confirm the arbitration award in state court the parties availed themselves to the CAA and its procedural provisions. *Id.**6. Consequently, this decision provides an additional avenue by which parties may seek an expanded review despite the absence of a choice-of-law provision.[1]

[1] It should be noted that recent jurisprudence has made motions to confirm an arbitration award in federal court arguably more difficult. Federal courts have plainly held that the FAA does not confer subject matter jurisdiction in federal court. In order to establish an independent basis for jurisdiction, therefore, the party seeking confirmation must establish both diversity of citizenship and amount in controversy. Courts have reached different conclusions on whether the amount in controversy has been satisfied depending on the facts of the case. Therefore, a party seeking a more searching judicial review of an arbitration award may attempt to confirm the award in state court arguing that the amount in controversy has not been satisfied. *See e.g. Hansen Beverage Co v. DSD Distributors, Inc.*, No. 08cv0619-LAB, 2008 WL 5233180 (S.D. Cal. Dec. 12, 2008) (finding an arbitration decision that awarded zero dollars did not satisfy the amount in controversy requirement).

The Seventh Circuit reached a similar conclusion in *Edstrom Industries, Inc. v. Companion Life Insurance Company*. 516 F.3d 546 (7th Cir. 2008). The court vacated the arbitration award for the arbitrator's disregard of the applicable law. *Id.* at 552-53. The court concluded that parties may opt out of the FAA, provided the state arbitration statute does not contain provisions that would undermine the FAA's aim of facilitating the resolution of disputes involving interstate commerce. *Id.* 549. In this insurance coverage dispute, the arbitration agreement directed the arbitrator to "strictly abide by the terms of this policy and shall strictly apply the rules of law applicable thereto," namely the laws of Wisconsin. *Id.* On a motion to vacate, one of the parties claimed the arbitrator improperly ignored a critical Wisconsin statute despite the fact that the statute was raised to the arbitrator. The court agreed, noting that "because arbitration is a creature of contract, the arbitrator cannot disregard lawful directions the parties have given them." *Id.* at 552. Consequently, the court applied an expanded judicial review of the arbitration award for an arbitrator's disregard of the applicable state law. *Id.* at 553. *See also Sands v. Menard, Inc.*, No. 2008AP1703, 2009 WL 983034 (Wis. Ct. App. April 14, 2009) (finding manifest disregard of the law remains a basis for vacating arbitration awards in Wisconsin).

IV. Conclusion: Where *Hall Street* Leaves Us

In the wake of *Hall Street* federal courts have already struggled to interpret the issue of whether the Supreme Court's decision abrogates manifest disregard as a valid federal common-law ground for vacatur. The majority of jurisdictions which have addressed this issue suggest manifest disregard has survived.

In addition, *Hall Street* left a significant avenue for parties to obtain expanded judicial review under state arbitration statutory and common law. "Given the ability of states, interpreting their own arbitration laws, to deviate from the *Hall Street* reasoning, it remains possible for parties to obtain heightened judicial scrutiny." Aluyah I. Imoisili, *Life After Hall Street: States Remain Torn on Contractually Expanded Judicial Review of Arbitration Awards.* p. 16, *ARIAS Quarterly* (4th ed. 2008). Therefore, one way parties may ensure more searching scrutiny, is to designate a state arbitration law and venue that permits such review, and carefully provide for expanded judicial review in their arbitration agreement. *Id.* However, even if parties fail to contractually agree to a choice of law which would provide for expanded review, a party may seek to vacate the award in state court and argue the limited grounds for vacatur under the FAA are not controlling.

PAST COMMITTEE NEWSLETTERS

Visit the Committee's newsletter archive online at www.iadclaw.org to read other articles published by the Committee. Prior articles include:

OCTOBER 2009
Standard of Review and Discovery after *Glenn*: The Effect of the *Glenn* Standard of Review on the Role of Discovery in Cases Involving Conflicts of Interest
Elizabeth J. Bondurant

MARCH 2009
Plausibility Pleadings: How the United Supreme Court with *Bell Atlantic Corporation v. Twombly* and *Erickson v. Pardus*, Energized Rule 12(b)(6) and Changed the Playbook in all Civil Cases
Pat Long Weaver

JANUARY 2009
The Lawyer as Counselor
Michael Sullivan

OCTOBER 2008
Eroding the Economic Loss Doctrine: Are Exceptions Consuming the Rule?
Val H. Stieglitz and Molly H. Cherry

SEPTEMBER 2008
The Erosion of Consumer Arbitration – and Why It May Not Be as Bad as It Seems
Jonathan A. Berkelhammer, C. Bailey King, Jr. and Patrick M. Kane

AUGUST 2008
Production of Information Contained in Litigation Reserves
R. Bruce Barze, Gregory C. Cook and Marcus R. Chatterton

JUNE 2008
Deciding Where to Arbitrate Creates Significant Jurisdictional Issues with Respect to the Enforcement or Attack of the Arbitration Award
William C. Cleveland

MAY 2008
Proving Irreparable Harm in Franchise Termination and Non-Renewal Cases: A Primer for Both Franchisors and Franchisees
David A. Reif and James F. DeDonato