

Stolt-Nielsen's Comfort for the 'Average Arbitrator': An Analysis of The Post-Hall Street 'Manifest Disregard' Award Review Standard

BY CHRISTOPHER WALSH

For decades, federal district courts nationwide have vacated arbitration awards upon a showing that the arbitration award reflected a "manifest disregard" of the applicable law.

Last year, the U.S. Supreme Court decided *Hall Street Assocs. LLC v. Mattel Inc.*, 128 S. Ct. 1396 (2008), which many analysts view as the death knell for the manifest disregard standard of review of arbitration awards.

Since *Hall Street*, however, a number of district and circuit courts have found life in the manifest disregard review standard. Others, indeed, have pronounced it dead. This article briefly surveys the post-*Hall Street* federal court cases addressing the continued viability of the manifest disregard doctrine standard of review, and criticizes the approach taken in a prominent recent case by the Second U.S. Circuit Court of Appeals, *Stolt-Nielsen SA v. Animalfeeds Int'l Corp.*

VACATUR ORIGINS

Federal Arbitration Act Section 10 lists four specific grounds for vacating an arbitration award, all of which, generally speaking, go to the process by which the arbitration was conducted. Section 10 permits a district court to vacate an arbitration award if: (1) the

award "was procured by corruption, fraud, or undue means," (2) "there was evident partiality or corruption in the arbitrators," (3) the arbitrators engaged in misbehavior by refusing to consider material evidence, refusing without cause to postpone a hearing, or other acts which prejudiced one of the liti-

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gants, or (4) 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." 9 U.S.C. § 10.

In addition to these four statutory grounds, it has been recognized since at least the 1950s that arbitration awards may be vacated if the award displays a "manifest disregard of the law." While the exact standards for finding a manifest disregard of the law have been phrased differently over the years in the federal circuit courts, the fundamental idea is that an arbitration award may be vacated if it can be shown that the arbitrator was aware of a controlling and well-defined legal principle but did not heed that principle when rendering the award. See, e.g., *Duferco Int'l Steel Trading v. T. Klaveness Shipping A/S*, 333 F.3d 383, 389 (2d Cir. 2003) ("A party seeking vacatur bears the burden of proving that the arbitrators were fully aware of the existence of a clearly defined governing legal principle, but refused to apply it, in effect, ignoring it").

While some circuits, such as the Seventh Circuit, claim to find the doctrine's jurisprudential basis in the Section 10 language—see, e.g., *Wise v. Wachovia Sec. LLC*, 450 F.3d 265, 268 (7th Cir. 2006) ("we have defined 'manifest disregard of the law' so narrowly that it fits comfortably under the first clause of the fourth

statutory ground")—virtually all of the circuits have recognized the doctrine as an extra-statutory, common-law ground for vacatur. See, e.g., *Three S Delaware Inc. v. Dataquick Info. Sys. Inc.*, 492 F.3d 520, 527 (4th Cir. 2007); *B.L. Harbert Int'l, LLC v. Hercules Steel Co.*, 441 F.3d 905, 910 (11th Cir. 2006); *Black Box Corp. v. Markham*, 127 Fed. Appx. 22, 25 (3d Cir. 2005); *Dominion Video Satellite Inc. v. Echostar Satellite L.L.C.*, 430 F.3d 1269, 1275 (10th Cir. 2005); *Brabham v. A.G. Edwards & Sons Inc.*, 376 F.3d 377, 381 (5th Cir. 2004); *Duferco*, supra; *Hoffman v. Cargill Inc.*, 236 F.3d 458, 461 (8th Cir. 2001), *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Jaros*, 70 F.3d 418, 421 (6th Cir. 1995); *Advest Inc. v. McCarthy*, 914 F.2d 6, 8-9 (1st Cir. 1990).

Thus, most of the circuits recognizing the manifest disregard standard of review do so on the often-tacit assumption that the FAA's four vacatur grounds are not the exclusive grounds on which to vacate an arbitration award.

NEW SERIOUS DOUBT

The U.S. Supreme Court's *Hall Street* opinion casts that assumption into serious doubt.

In *Hall Street*, the Court was called on to decide whether the parties to an arbitration agreement could agree to expand by contract the grounds for vacating an arbitration award beyond the four listed in Section 10.

The Court held unequivocally that such an agreement could not be enforced by a district court acting under the FAA because Section 10 provides the "exclusive grounds for expedited vacatur." 128 S. Ct. at 1403.

In reaching this conclusion, the Court was forced to deal with its earlier opinion in *Wilko v. Swan*, 346 U.S. 427 (1953), overruled by *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 109 S. Ct. 1917 (1989), which was seen by many lower courts as giving tacit approval to the nonstatutory manifest disregard standard of review.

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Cartoon by John Chase



Arbitrator Comfort

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In *Wilko*, the Court considered whether an arbitration provision in a margin agreement requiring arbitration of securities fraud claims was void as a result of Section 14 of the Securities Act of 1933.

In holding that such a provision was void—a holding which has since been overruled—the *Wilko* Court made the point that an arbitrator's erroneous Securities Act interpretation would not be subject to judicial review. But the Court also suggested in passing that an arbitrator's "manifest disregard" of the Securities Act—as opposed to a mere erroneous interpretation—could be subject to judicial review:

While it may be true, as the Court of Appeals thought, that a failure of the arbitrators to decide 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.

Wilko, 346 U.S. at 436, 74 S. Ct. at 187 (emphasis supplied).

The *Hall Street* petitioner argued that this *Wilko* language showed that the Court already had acknowledged that the Section 10 grounds are not exclusive, and that parties to an arbitration therefore should be permitted to agree to additional grounds for vacating an award.

The *Hall Street* Court rejected that argument and distanced itself from the *Wilko* language in a few ways. First, the Court noted that the manifest disregard standard was not at issue in *Wilko* which, as mentioned, involved a since-overturned interpretation of a 1933 Securities Act provision in limiting the arbitrability of securities fraud claims.

Second, the Court argued that, due to the "vagueness of *Wilko*'s phrasing," it was unclear exactly what the Court was saying about the manifest disregard standard of review:

Maybe the term "manifest disregard" was meant to name a new ground for review, but may be it merely referred to the § 10 grounds collectively, rather than adding to them. [Citations omitted.] 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 the arbitrators were "guilty of misconduct" or "exceeded their powers."

Hall Street, 128 S. Ct. at 1404. Ultimately, the Court stated that it saw "no reason to accord [*Wilko*] the significance that [petitioner] urges." Id.

This statement—along with the Court's unequivocal and often-stated holding that

peals, relying on *Hall Street*, has clearly renounced the doctrine, albeit in dicta. *Ramos-Santiago v. United Parcel Serv.*, 524 F.3d 120, 124 n.3 (1st Cir. 2008) ("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]").

In addition, some district courts similarly have concluded that manifest disregard is no longer a basis for vacating an arbitration award under the FAA. See, e.g., *The Householder Group v. Caughran*, 576 F. Supp. 2d 796, 800 (E.D. Tex. 2008); *ALS & Assocs. Inc. v. AGM Marine Constructors Inc.*, 557 F. Supp. 2d 180, 185 (D. Mass. 2008) (applying *Ramos-Santiago*), *Prime Therapeutics LLC v. Omnicare Inc.*, 555 F. Supp. 2d 993, 999 (D. Minn. 2008).

Courts in other circuits—even in circuits where the manifest disregard doctrine was expressly recognized as an extra-statutory basis for vacatur—have continued to apply the doctrine. Most notably, the Second Circuit in *Stolt-Nielsen SA v. Animalfeeds Int'l Corp.*, 548 F.3d 85 (2d Cir. Nov. 4 2008), expressly held that the manifest disregard doctrine continued to survive after *Hall Street*.

While the *Stolt-Nielsen* court readily acknowledged that *Hall Street* was "undeniably inconsistent" with earlier Second Circuit opinions that characterized "the 'manifest disregard' standard as a ground for vacatur entirely separate from those enumerated in the FAA" (Id. at 94), the court, relying on the Seventh Circuit's *Wise* decision, supra, recast the very nature of the doctrine as one which springs from the FAA's express statutory vacatur grounds, rather than a judicially created complement to those grounds. Id. at 94-95.

With the review standard so re-conceived, the Second Circuit went on to conclude that the manifest disregard standard was not abrogated entirely by *Hall Street*'s holding that FAA § 10 represents the exclusive vacatur grounds in cases governed by the FAA. Id.

District courts in the Second Circuit have taken the same approach. *Mastec N. Am. Inc. v. MSE Power Sys. Inc.*, 2008 U.S. Dist. LEXIS 52205 at *9 (N.D.N.Y. July 8, 2008) ("this Court will view 'manifest disregard of law' as judicial interpretation of the Section 10 requirements, rather than as a separate standard of review, and will

A Persistent Standard

The issue: The U.S. Supreme Court's dismissal of 'manifest disregard of the law' as a reason to overturn arbitration awards in Federal Arbitration Act matters.

The problem: The Court's 'dismissal' was soft. The standard persists.

The analysis: The Second Circuit's recent *Stolt-Nielsen* opinion, backing the manifest disregard standard and linking it to FAA § 10, is troubling.

FAA Section 10 provides the "exclusive" grounds for vacating an arbitration award, Id. 128 S. Ct. at 1400, 1403, 1406, and 1408—seems to be a clear Court view that the manifest disregard standard is no longer a viable review standard for district courts reviewing arbitration awards.

LOWER COURTS STRUGGLE

Despite *Hall Street*'s apparent clarity, lower courts have disagreed concerning the continued viability of the manifest disregard standard of review.

The First U.S. Circuit Court of Ap-

resort to existing case law to determine its contours”).

The Sixth Circuit, in an unpublished decision, also continued to apply the manifest disregard standard of review, notwithstanding the *Hall Street* decision. *Coffee Beanery Ltd. v. WW L.L.C.*, 2008 U.S. App. LEXIS 23645 (6th Cir. Nov. 14, 2008)(amended opinion available at www.ca6.uscourts.gov/opinions.pdf/08a0696n-06.pdf). Rather than trying to shoehorn the doctrine into the FAA’s statutory grounds for vacatur like the Second Circuit did, the Sixth Circuit read *Hall Street*’s discussion of *Wilko* and the manifest disregard standard of review as not “foreclos[ing] federal court’s review for an arbitrator’s manifest disregard of the law.”

As a result, because the doctrine had been “universally recognized” prior to *Hall Street*, the Sixth Circuit found that it would be “imprudent” to stop applying the doctrine. It continues to do so.

A similar rationale was used by Texas’s Southern U.S. District Court in concluding that the manifest disregard doctrine survived *Hall Street*. *Halliburton Energy Servs. Inc. v. N.L. Indus.*, 553 F. Supp. 2d 733, 753 (S.D. Tex. 2008). Like the Sixth Circuit, the *Halliburton* court read *Hall Street* as “not expressly decid[ing] whether the manifest disregard standard remains a separate basis for federal court review of arbitration decisions in at least some circumstances.” *Id.*

Thus, “out of an abundance of caution,” the *Halliburton* court continued to apply the manifest disregard doctrine. Curiously, though, the court stated that it was applying the doctrine “as both a summary of some of the statutory grounds and as an additional ground for vacatur.” *Id.*

CRITICIZING STOLT-NIELSEN

The *Stolt-Nielsen* court’s notion that the manifest disregard standard of review is somehow contained within the four FAA Section 10 factors is troubling.

Stop the Shooting

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pute with a profoundly different focus. Again, commercial mediators spend a great deal of time and effort in reframing the issues involved in the dispute.

The CeaseFire experience demonstrates

To be sure, none of the four statutory factors make any reference to errors in the legal underpinnings of the arbitrator’s decision. Section 10(a)(4), which speaks to instances where the arbitrators have “exceeded their powers,” could serve as a possible justification for vacating an award when an arbitrator intentionally ignores controlling law. But that should happen only when the parties have expressly agreed on the legal principles that would become the “rules of decision” during the arbitration process and, therefore, would limit the arbitrator’s power to consider other rules of decision.

Indeed, it is telling that the Seventh Circuit—which the *Stolt-Nielsen* court looked to in concluding that the manifest disregard standard of review can be found in Section 10(a)(4)—has so severely restricted the scope of the standard of review that it applies only in instances where the arbitrator orders the parties to violate the law or does not apply the legal rules of decision to which the parties expressly agreed. *Wise*, 450 F.3d at 269 (doctrine confined “to cases in which arbitrators direct parties to violate the law”); *George Watts & Son Inc. v. Tiffany & Co.*, 248 F.3d 577, 581 (7th Cir. 2001) (“the ‘manifest disregard’ principle is limited to two possibilities: an arbitral order requiring the parties to violate the law (as by employing unlicensed truck drivers), and an arbitral order that does not adhere to the legal principles specified by contract, and hence unenforceable under §10(a)(4)”).

It is only because it has construed and applied the manifest disregard standard of review so narrowly that the Seventh Circuit has found that it fits within Section 10(a)(4). *Wise*, 450 F.3d at 268-69.

The Second Circuit, however, has not similarly restricted the manifest disregard standard. Instead the Second Circuit continues to apply the doctrine as it was developed before *Hall Street* when it was considered by the Second Circuit to be an

that highly interactive street mediators have many additional insights to give the mediation world, some of which might not be readily apparent.

Among the insights are:

- **THE NECESSITY OF THINKING OUTSIDE THE BOX IN EVALUATING MEDIATOR CREDENTIALS.** While conventional wisdom might suggest that a clergyman, school official or

extra-statutory basis for vacatur. While that version of the standard of review presents a formidable challenge to the unsuccessful litigant—applying, as it does, only where the arbitrator is aware of, but disregards, clearly applicable law—the Second Circuit has made it clear that to prevail the unsuccessful litigant does not need an express acknowledgment by the arbitrator that he or she intentionally disregarded applicable law. *Stolt-Nielsen*, 548 F.3d at 92.

To the contrary, the Second Circuit allows knowledge and intentionality on the part of the arbitrator to be inferred from the arbitrator’s decision. It permits vacatur if the reviewing court finds “an error that is so obvious that it would be instantly perceived as such by the average person qualified to serve as an arbitrator.” *Id.* at 93.

Unlike the much-narrower Seventh Circuit articulation of the standard, an “average arbitrator” standard seems to be sufficiently open-ended to allow unsuccessful litigants to tie up an adverse arbitration award in the courts for what may be years before a final judgment is issued.

But such a “cumbersome and time-consuming judicial review process” was exactly what the *Hall Street* Court was seeking to avoid. *Hall Street*, 128 S. Ct. at 1405.

Thus, if a manifest disregard standard of review is to survive *Hall Street*, it should be so narrowly circumscribed that it can plausibly find a basis in the Section 10 language, and continue to promote the “national policy favoring arbitration with just the limited review needed to maintain arbitration’s essential virtue of resolving disputes straightaway.” *Id.*

While the Seventh Circuit’s version of the standard arguably fits this bill, the Second Circuit’s standard is overbroad, and should be narrowed if it is to continue to be recognized after *Hall Street*. ■

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public safety officer would be the optimal mediator in a street confrontation, CeaseFire has determined that it is essential that the mediator be “culturally appropriate,” and acceptable to all parties.

Thus, some of the most effective CeaseFire street mediators describe themselves as having been previously incarcerated and as
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