Manifest disregard of the law after Hall Street Associates: considerations in the enforcement of international arbitration awards rendered in the United States

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In March 2008, the United States Supreme Court handed down its decision in *Hall Street Associates, LLC v Mattel, Inc*,[1] holding that a provision in an arbitration agreement providing for judicial review of the arbitration award for error of law was not enforceable in a proceeding to vacate the award under the Federal Arbitration Act (FAA).[2] The court held that sections 10 and 11 of the FAA, which list specific grounds for vacating or modifying an arbitration award, provide the exclusive grounds for judicial review of arbitration awards in such a proceeding.

The decision immediately vitiated provisions in arbitration agreements providing for judicial review of errors of law by arbitrators where confirmation or vacatur is sought under the FAA.[3] More broadly, it also threw into question the continued existence of the doctrine of 'manifest disregard of the law', under which United States courts may vacate an arbitration award in the limited circumstance where the arbitrator knowingly and actually ignores the law.[4] The issue raised – but not resolved – by *Hall Street* is whether 'manifest disregard' of the law is a judicially created grounds for vacatur (and thus invalid), or whether it is a shorthand expression for application of a statutory ground (and thus still available to US courts).

Arbitrators will be found to have manifestly disregarded the law when: (i) they ignore clear and plainly applicable law; (ii) they improperly apply the law, leading to an erroneous outcome; and (iii) the governing law was made known to the arbitrators by the parties within the arbitration.[5] Although parties often invoke the claim of manifest disregard, the burden on the party asserting it is very high, and manifest disregard only very rarely forms the basis for vacatur of an award. In the Second Circuit Court of Appeals, for example, the claim succeeds less than ten per cent of the time it is raised.[6] Since the decision in *Hall Street*, a number of federal circuit courts of appeal have addressed the question of whether the manifest disregard doctrine still exists, with differing answers.

A brief overview of the FAA and international arbitration

Because the FAA provides an efficient mechanism for enforcement of international arbitration awards rendered in the United States, the decision in *Hall Street* is of importance to the international practitioner. Chapter 2 of the FAA (9 U S C §§ 201-208) is the mechanism by which the United States enforces the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958 (New York Convention).[7] Chapter 2 of the FAA provides a gateway to the United States federal court system for the recognition and enforcement of foreign and domestic awards arising out of a commercial relationship that is either (i) not entirely between United States citizens or (ii) between United States citizens but 'involves property located abroad, envisages performance or enforcement abroad, or has some other reasonable relation with one or more foreign states.'[8] Where its prerequisites are met, Chapter 2 grants federal courts jurisdiction over proceedings to compel arbitration, to appoint arbitrators, and to confirm awards within three years of issuance.[9]

The court in which a motion is brought to confirm[10] an award under Chapter 2 of the FAA 'shall' confirm the award unless one of the grounds specified in Article V of the New York Convention applies.[11] Under Article V § 1(e) of the New York Convention, awards issued in the United States (unlike foreign awards) are subject to vacatur, modification or correction on the same grounds as other domestic awards.[12] An award may be vacated under section 10(a) of the FAA:

- (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 of 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 was not made.[13]

The manifest disregard doctrine and *Hall Street*

None of these provisions directly addresses the problem of arbitrators making a ruling that is entirely contrary to clear law applying to the dispute. Under United States law, the doctrine of manifest disregard covers this circumstance.

In *Hall Street*, the parties to litigation in a federal court agreed to arbitration of part of the case. The parties' agreement to arbitrate included a provision that the arbitrator's award would be subject to vacatur, modification or correction 'where the arbitrator's conclusions of law are erroneous'.[14] The arbitrator issued an initial award in favour of defendant Mattel. Plaintiff Hall Street successfully contended in the district court that the arbitrator had committed legal error (but not that the arbitrator had manifestly disregarded the law). The district court vacated the award, and the arbitrator issued a new award in favour of Hall Street. The district court upheld the new award, and Mattel appealed to the Ninth Circuit. That court held that the provision for expanded judicial review for error of law was unenforceable, and reversed the district court, ordering that the original (and legally erroneous) arbitration award be confirmed, unless grounds existed under sections 10 or 11 of the FAA for vacatur or correction.[15] Hall Street ultimately appealed to the United States Supreme Court.

The Supreme Court, in a majority opinion by Justice Souter, emphasised that, under section 9 of the FAA, a court 'must' confirm an arbitration award 'unless' it is vacated, modified or corrected 'as prescribed' in §§ 10 and 11.[16] Based on that imperative and restrictive language, the court held that sections 10 and 11 provide the FAA's exclusive grounds for expedited vacatur and modification.[17] Thus, under the FAA, a judge's power to vacate, modify or correct an award cannot be expanded by agreement of the parties or by judicially-created standards.

Hall Street had argued that sections 10 and 11 are not exclusive, and that an earlier Supreme Court decision, *Wilko v Swan*,[18] had recognised manifest disregard of the law as an additional ground for vacatur. In *Wilko*, the Supreme Court had noted that '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'.[19] Hall Street argued that *Wilko* had recognised an extra-statutory ground for vacatur, so that sections 10 and 11 of the FAA were not exclusive. Hall Street argued that if manifest disregard constituted additional grounds for vacatur, then agreement of the parties to review of the arbitrators' interpretation of the law could also constitute grounds for vacatur.

The Supreme Court rejected that contention. First finding that the above-quoted language from *Wilko* itself excluded review for error of law, the Court in *Hall Street* described the *Wilko* court's statement as 'vague', and continued:

> 'Maybe 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. 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 power".'[20]

The ambiguity left unresolved by the Supreme Court in *Wilko* and *Hall*, then, is whether arbitrators' manifest disregard of the law – ignoring known, clear and plainly applicable law – constitutes a violation of the FAA itself, or whether it is an extra-statutory (and now unavailable) grounds for vacatur.

The ambiguity in the Supreme Court's analysis has left subsequent courts room to consider and analyse the issue, resulting in a a split among the circuit courts that have addressed the issue. The Second, Sixth and Ninth Circuits have continued to recognise the doctrine of manifest disregard. Those courts have taken up the Supreme Court's musing that manifest disregard may be a shorthand for section 10(a)(3) or (4) – that the arbitrators committed misconduct or exceeded their power in the course of the arbitration.[21] Under this analysis, parties to an arbitration agreement 'do not agree in advance to submit to arbitration that is carried out in manifest disregard of the law'.[22] Arbitrators therefore exceed or imperfectly execute their powers in the narrow circumstance where they reject or ignore controlling law.[23]

The First and Fifth Circuits have invalidated the doctrine of manifest disregard altogether.[24] The Fifth Circuit, reviewing

the history of that Circuit's adoption of the manifest disregard doctrine, determined that it had been defined in that circuit 'as a *nonstatutory* ground for vacatur, [and] it is no longer a basis for vacating awards under the FAA.'[25]

Post-*Hall Street* considerations for the international practitioner

As noted above, Chapter 2 of the FAA provides an effective mechanism for parties to international arbitrations seeking confirmation of their award in the United States. For parties seeking confirmation of such an award, the decision in *Hall Street* may affect the choice of venue for a confirmation proceeding. When seeking confirmation of an award rendered in the United States, the practitioner may prefer to seek confirmation in a region where the doctrine of manifest disregard is not available, currently being those courts within the First and Fifth Circuits.[26]

Parties negotiating arbitration agreements who wish to obtain review for errors of law by the tribunal have limited choices. One option is to allow appeal to an arbitration appeal panel, a separate arbitration set up solely for review. To obtain judicial review, however, the parties might seek to opt out of the FAA entirely and choose a governing law and/or seat of arbitration (not just for the agreement but also for its enforcement)[27] that permits judicial review of arbitration awards for errors of law. The Supreme Court in *Hall Street* made it clear that its holding applied only to enforcement of arbitration awards under the FAA. Where the parties 'may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable', agreements for expanded judicial review may be enforced.[28] The California Supreme Court, for example, post-*Hall Street*, held that the arbitration agreements providing for judicial review of the merits are enforceable under the California Arbitration Act.[29] It remains to be seen how other courts in the US will address the issues raised by *Hall Street*, and how they will resolve the difficult issues raised when arbitrators rule in contravention of established law.

Notes

1 128 S Ct 1396 (2008).

2 Title 9 of the United States Code.

3 In contrast, English law, for example, permits appeals from arbitration awards on questions of law in certain circumstances. Arbitration Act 1996 § 69.

4 See, eg, *Telenor Mobile Communications, AS v Storm LLC*, 584 F.3d 396, 407-08 (2d Cir 2009); *Stolt-Nielsen SA v Animalfeeds Int'l Corp*, 548 F.3d 85, 93 (2d Cir 2008), *cert granted*, 129 S Ct 2793 (2009).

5 *Duferco Int'l Steel Trading v T. Klaveness Shipping A/S*, 333 F.3d 383, 389-90 (2d Cir 2003); see, eg, *DMA Int'l, Inc v Qwest Communications Int'l, Inc*, 585 F.3d 1341, 1344 (10th Cir 2009) (manifest disregard is 'willful inattentiveness to governing law'); *Comedy Club, Inc v Improv West Assocs*, 553 F.3d 1277, 1290 (9th Cir 2009) (arbitrator must recognise applicable law and proceed to ignore it for the doctrine to apply).

6 *Stolt-Nielsen SA*, 548 F.3d at 92.

7 9 U S C § 201.

8 9 U S C §§ 202, 203. Chapter 1 of the FAA does not itself grant original jurisdiction to the federal courts; a party seeking to enforce or vacate a domestic award must find independent grounds for jurisdiction. *Hall Street*, 128 S Ct at 1402. State courts apply Chapter 1 of the FAA where its statutory prerequisites are met.

9 Chapter 2 does not provide jurisdiction, however, over proceedings to stay arbitration or vacate an award. The party against whom a proceeding to confirm an award made in the United States is brought may seek to vacate the award.

10 See 9 U S C §§ 6, 208.

11 9 U S C § 207. In addition, at the time it brings the motion, the moving party must also supply the authenticated award or a certified copy, and the original or a certified copy of the agreement to arbitrate, and translations as needed. New York Convention Article IV.

12 *Yusuf Ahmed Alghanim & Sons, W L L v Toys 'R' Us, Inc*, 126 F.3d 15, 21 (2d Cir 1997).

13 9 U S C § 10(a). The grounds for modification are 'evident material miscalculation,' 'evident material mistake in the description of any person, thing or property' in the award, where the arbitrators make an award on a matter not submitted to them, or '[w]here the award is imperfect in a matter of form not affecting the controversy.' 9 U S C § 11.

14 *Hall Street*, 128 S Ct at 1400-01.

15 The Ninth Circuit had not long before reversed its position on the enforceability of contractual provisions for expanded judicial review. *Kyocera Corp v Prudential-Bache Trade Servs, Inc*, 341 F.3d 987, 1000 (9th Cir 2003).

16 *Hall Street*, 128 S Ct at 1402.

17 *Ibid*, at 1403.

18 346 U S 427 (1953).

19 *Ibid*, at 436-37.

20 *Hall Street*, 128 S Ct at 1404.

21 *Comedy Club, Inc*, 553 F.3d at 1290 ('We have already determined that the manifest disregard ground for vacatur is shorthand for a statutory ground under the FAA, specifically 9 U S C § 10(a)(4).'); *Coffee Beanery, Ltd v WW, L L C*, 300 Fed Appx 415, 419 (6th Cir 2008) ('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.'); *Stolt-Nielsen*, 548 F.3d at 95. Sixth Circuit cases subsequent to *Coffee Beanery* express doubt concerning the continued existence of the doctrine in dicta, but come to no conclusion. *Martin Marietta Materials, Inc v Bank of Oklahoma*, 304 Fed Appx 360, 362 (6th Cir 2008); *Dealer Computer Servs., Inc v Dub Herring Ford*, 547 F.3d 558, 561 n 2 (6th Cir 2008).

22 *Stolt-Nielsen*, 548 F.3d at 94-95 & n 8 (citing earlier cases considering manifest disregard as within sections 10 and 11 of the FAA).

23 *Ibid*, at 95.

24 *Citigroup Global Markets Inc v Bacon*, 562 F.3d 349 (5th Cir 2009); *Ramos-Santiago v United Parcel Serv*, 524 F.3d 120 (1st Cir 2008) (after *Hall Street*, manifest disregard 'is not a valid ground for vacating or modifying an arbitral award in cases brought under the FAA').

25 *Citigroup*, 562 F.3d at 355.

26 The First Circuit includes the United States District Courts for Maine, Massachusetts, New Hampshire, Rhode Island and Puerto Rico. The Fifth Circuit includes the United States District Courts in Texas, Louisiana and Mississippi.

27 *Mastrobuono v Shearson Lehman Hutton, Inc*, 514 U S 52 (1995).

28 *Hall Street*, 128 S Ct at 1406.

29 *Cable Connection, Inc v DIRECTV, Inc*, 44 Cal 4th 1334, 1364 (2008).