

Manifest Disregard of the Law after *Hall Street*: A Continued Role for an Extra-Statutory Doctrine?

By Sherman Kahn with assistance from Jordan Nodel

In the inaugural issue of this publication, Carroll Neesemann¹ posed the question of whether the judicially created doctrine of manifest disregard for the law as a ground for vacating an arbitration award made under the Federal Arbitration Act (“FAA”) would survive the Supreme Court’s decision in *Hall Street Assocs. v. Mattel, Inc.*² Courts have begun to grapple with the question, and the initial answer appears to be a qualified “Yes”—but only as a gloss on FAA Section 10(a)(4). This article discusses the developing law on this issue.

A. What Is Manifest Disregard of the Law, and What Did *Hall Street* Do to It?

In *Hall Street*, the Supreme Court held that FAA § 9 limits review of arbitration awards to the specific grounds set forth in FAA §§ 10 (*vacatur*) and 11 (modification). The Supreme Court held that parties may not, through contract, agree to expanded or alternative standards of review of an FAA arbitration award.³

The parties in *Hall Street* had entered into an arbitration agreement to resolve a disputed issue raised in a lease dispute the parties were litigating in federal district court. The parties’ agreement, which the district court had entered as an order, stated that the district court could review the arbitration award for findings of fact not supported by substantial evidence or erroneous conclusions of law.⁴ Thus, the arbitration agreement at issue in *Hall Street* provided for review substantially less deferential than that authorized specifically under FAA §§ 10 and 11. Section 10 allows for *vacatur* only where:

- (1) the award was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption in the arbitrators; (3) where the arbitrators were guilty in 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 submitted was not made.⁵

Section 11, in turn, provides for modification of an award only where:

- (a) there was an evident miscalculation of figures or an evident material mistake in the description of any person, thing or

property referred to in the award; (b) the arbitrators have awarded on a matter not submitted to them, unless it is a matter not affecting the merits of the decision on the matter submitted; or (c) the award is imperfect in a matter of form not affecting the merits of the controversy.⁶

Before the Supreme Court’s decision in *Hall Street*, the courts of appeal had supplemented the statutory grounds set forth in FAA Sections 10 and 11 with the judicially created doctrine of “manifest disregard for the law.” While each circuit had a slightly different formulation of this doctrine, generally it provided that an arbitration award could be overturned where the arbitrators had been aware of a clear principle of law but had deliberately disregarded it. For example, in the Second Circuit, manifest disregard of the law can be demonstrated where “the arbitrator knew of the relevant principle, appreciated that this principle controlled the outcome of the disputed issue, and nonetheless willfully flouted the governing law by refusing to apply it.”⁷

In *Hall Street*, Hall Street argued that expanded review should be allowed, taking the position that the judicially created manifest disregard standard supported the proposition that the FAA statutory factors were not the only grounds upon which an arbitration award could be vacated.⁸ Hall Street pointed to the Supreme Court’s decision in *Wilko v. Swan*,⁹ which is generally credited with creating the manifest disregard standard, in support of its position. The Supreme Court disagreed, stating that *Wilko* could not bear the weight Hall Street sought to put on it.¹⁰ While recognizing that some Circuits have treated manifest disregard as a further ground for *vacatur* in addition to those listed in § 10, the Supreme Court said:

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 then 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.”¹¹

Hall Street did not overrule, or even explicitly construe *Wilko*, but rather set forth conflicting interpretations and stated that the case did not support the position urged by Hall Street. So, while *Hall Street* held that §§ 10 and 11 were the sole grounds for overturning an arbitration

award, it left open the question of whether the “manifest disregard” doctrine would continue to be viable.

Since *Hall Street* was decided, a number of courts have addressed the continued viability of the manifest disregard standard. We discuss their findings below.

B. Courts Finding Continued Viability for Manifest Disregard

It did not take long for the courts to begin to confront the issues raised by the Supreme Court’s decision in *Hall Street*. As of the time of submission of this article, the Second and the Ninth Circuits have found a continued role for the doctrine of manifest disregard.¹² The Sixth Circuit has done the same, albeit in an unpublished opinion.¹³

The Second Circuit’s analysis in *Stolt-Nielsen SA v. Animalfeeds, Int’l.*, (“*Stolt-Nielsen*”) is quite detailed. The Second Circuit first sets out that under its pre-*Hall Street* jurisprudence, manifest disregard provided for *vacatur* of an arbitration award only in very limited circumstances—i.e., a federal court cannot vacate an award if there is a barely colorable justification for the outcome reached by the arbitrators.¹⁴ The Second Circuit then set out a three-part test that must be met before an arbitration award can be vacated for manifest disregard of the law: (1) the law alleged to have been ignored must be clear and explicitly applicable to the matter at issue; (2) the law must have, in fact, been improperly applied, leading to an erroneous outcome; and (3) the arbitrators must have actually known of the law’s existence and its applicability.¹⁵

The *Stolt-Nielsen* court then considered the effect of *Hall Street* on the scope and vitality of the use of “manifest disregard of the law” as a ground to vacate an arbitration award. The Second Circuit acknowledged that *Hall Street*’s holding that the enumerated grounds in the FAA are the exclusive grounds for vacating an arbitration award is inconsistent with *dicta* in some Second Circuit cases to the effect that “manifest disregard” is a ground for *vacatur* separate from those enumerated in the FAA.¹⁶ However, the *Stolt-Nielsen* court observed that, in *Hall Street*, the U.S. Supreme Court had also speculated that “manifest disregard” might have referred to the § 10 grounds collectively rather than adding to them or might have been used as a shorthand for § 10(a)(3) or § 10(a)(4).¹⁷ The Second Circuit thus concluded that the U.S. Supreme Court had not abrogated the manifest disregard doctrine entirely.

Following a footnote stating that the Second Circuit will adhere to its precedent where the U.S. Supreme Court has “cryptically cast doubt” on prior holdings,¹⁸ the *Stolt-Nielsen* Court referred with approval to the law of the Seventh Circuit and, in particular, to *Wise v. Wachovia*,¹⁹ in which the Seventh Circuit held that the doctrine of manifest disregard of the law was a species of situation in which the arbitrators had exceeded their powers, putting the doctrine squarely within 9 U.S.C. § 10(a)(4).²⁰ While we do not yet have the benefit of a post-*Hall Street*

ruling from the Seventh Circuit itself on this issue, the Northern District of Illinois has decided, in accord with *Stolt-Nielsen*, that the manifest disregard doctrine survives in the Seventh Circuit because it is a species of 9 U.S.C. § 10(a)(4).²¹

Stolt-Nielsen, therefore, raises the question of whether the doctrine of manifest disregard of the law has been narrowed in the Second Circuit. The rationale of the decision does not inexorably lead to that conclusion, but it is possible that courts in the Second Circuit will circumscribe the doctrine more tightly to ensure it remains consistent with Section 10(a)(4). The Second Circuit’s footnote regarding adhering to precedent suggests that it will follow existing Second Circuit precedent, but its discussion of the Seventh Circuit’s rule suggests the Second Circuit might look at the issue more narrowly going forward. We will have to wait to see how the law develops.

The Ninth Circuit has joined the Second Circuit in reaffirming the continued viability of manifest disregard. Before *Hall Street* was decided, in a case entitled *Comedy Club, Inc. v. Improv West Associates*, the Ninth Circuit had vacated an arbitration award in part for manifest disregard of California’s ban on covenants not to compete (California Business & Professions Code § 16600).²² The U.S. Supreme Court vacated and remanded the case to the Ninth Circuit for further review in light of *Hall Street*. Upon reconsideration, the Ninth Circuit reaffirmed its finding of manifest disregard. The Ninth Circuit characterized its previous standard, as articulated in *Kyocera v. Prudential Bache T. Services*,²³ to be that manifest disregard was a species of violation of 9 U.S.C. § 10(a)(4) (i.e., the arbitrators exceeded their powers).²⁴ Accordingly, the Ninth Circuit held in *Comedy Club* that manifest disregard survives, stating, “We cannot say that *Hall Street Associates* is clearly irreconcilable with *Kyocera* and thus we are bound by our prior precedent.”²⁵

The only other Circuit to directly hold that manifest disregard of the law continues to be a viable independent ground for challenge of an arbitration award following *Hall Street* is the Sixth Circuit—although it addressed the issue in an unpublished opinion. In *Coffee Beanery, Ltd. v. W.W., L.L.C.*,²⁶ the Sixth Circuit discussed manifest disregard as an extra-statutory ground for *vacatur*, citing *Wilko*, and held 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.”²⁷ The Sixth Circuit resolved to continue employing the doctrine.²⁸

C. Courts Finding that Manifest Disregard Is No Longer Good Law

The Fifth Circuit has squarely held that “manifest disregard” of the law is no longer viable as an extra-statutory ground for *vacatur*.²⁹ In *Citigroup Global Markets Inc. v. Bacon*, the Fifth Circuit concluded that manifest

disregard of the law could not survive, at least in the Fifth Circuit’s formulation, as an independent ground to vacate an arbitration award.³⁰ The court first looked at the history of the manifest disregard doctrine, pointing out that the Fifth Circuit had been one of the last Circuit Courts of Appeal to adopt the doctrine.³¹ It then examined the post-*Hall Street* authority on the issue, finding a continued role for the doctrine. The Fifth Circuit flatly rejected the Sixth Circuit’s *Coffee Beanery* decision, finding that it failed to address the Supreme Court’s express holding that the grounds for *vacatur* in § 10 are exclusive and misread the Supreme Court’s discussion of *Wilko v. Swan*.³² The Fifth Circuit was far less dismissive, however, of the Second Circuit’s decision in *Stolt-Nielsen* and the Ninth Circuit’s in *Comedy Club*, as those decisions cast manifest disregard as a gloss on FAA § 10(a)(4)—a description of manifest disregard the Fifth Circuit described as “very narrow.”³³ Thus, while the Fifth Circuit, in *Citigroup Global Markets* clearly rejects manifest disregard “as an independent, nonstatutory ground for setting aside an award” the decision leaves open the possibility of a future in the Fifth Circuit for manifest disregard as a gloss on FAA Section 10(a)(4).

The First Circuit has also said that it now rejects manifest disregard, but suggested such only as an aside, in a case that did not involve the Federal Arbitration Act.³⁴ Interestingly, the first direct statement that manifest disregard of the law is no longer viable came not from a federal court at all, but from the Supreme Court of Alabama. In *Hereford v. Horton*, the Supreme Court of Alabama initially held that “manifest disregard” standard was no longer viable.³⁵ However, the Supreme Court of Alabama recently revised its ruling to include a new footnote suggesting that the issue of “whether manifest disregard of the law remains as a judicial gloss on the grounds specified in § 10(a) of the Federal Arbitration Act or is merely shorthand for § 10(a)(3) or § 10(a)(4)” was still to be decided.³⁶ Nonetheless, the *Hereford* decision’s result remained the same—rejecting the appellant’s claim because she “raised manifest disregard of the law as the only ground on which she seeks to have the arbitrator’s award vacated.”³⁷ The Alabama Supreme Court thus appears to have hedged its bets but, nonetheless, stuck with its ruling that manifest disregard cannot be raised as an independent ground for *vacatur*.

Scattered district courts have also held that manifest disregard cannot survive *Hall Street*. For example, at least one decision of the Southern District of New York rejected the doctrine—although that decision has now been overruled by the Second Circuit’s decision in *Stolt-Nielsen*.³⁸

The District of Minnesota has also rejected manifest disregard in light of *Hall Street*.³⁹ In rejecting the doctrine, the District of Minnesota reasoned “[i]t would be somewhat inconsistent to say that the parties cannot contractually alter the FAA’s exclusive ground for vacating or

modifying an arbitration award, but then allow the courts to alter the exclusive grounds by creating extra-statutory bases for vacating or modifying an award.”⁴⁰

D. Courts Declining to Decide the Issue

A variety of courts have deferred ruling on *Hall Street*’s effect on the manifest disregard doctrine. The Fifth Circuit initially took this approach, addressing the issue but deciding that, because it was affirming the challenged arbitration award, there was no need to determine whether manifest disregard remains good law after *Hall Street*.⁴¹ A variety of district courts similarly deferred the issue.⁴²

E. Conclusion

It is still too early to tell whether a consensus will emerge regarding the continued viability of manifest disregard of the law. However, it appears that there is a trend toward continued viability of the manifest disregard doctrine under the rubric of an act beyond the arbitrator’s powers under 9 U.S.C. § 10(a)(4). No doubt, in the coming months there will be more decisions on this evolving issue—perhaps those decisions will provide clear direction regarding the issue.

Endnotes

1. *New York Dispute Resolution Lawyer*, Vol. 1, No. 1, p. 13.
2. 128 S. Ct. 1396 (March 25, 2008).
3. *Id.*
4. 128 S. Ct. at 1400-01.
5. Title 9 U.S.C. § 10(a).
6. Title 9 U.S.C. § 11.
7. *Westerbeke Corp. v. Daihatsu Motor Co., Ltd.*, 304 F.3d 200, 217 (2d Cir. 2002).
8. 128 S. Ct. at 1403.
9. 346 U.S. 427 (1953).
10. 128 S. Ct. at 1404.
11. *Id.*
12. *Stolt-Nielsen SA v. Animalfeeds Int’l Corp.*, 548 F.3d 85, 94 (2nd Cir. 2008) (*Hall Street* “did not, we think, abrogate the ‘manifest disregard’ doctrine altogether”); *Comedy Club, Inc. v. Improv West Associates*, 553 F.3d 1277, 2009 US App. LEXIS 1634, *29 (9th Cir. 2009). See also, *Americredit Financial Services, Inc. v. Oxford Management Services*, 2008 U.S. Dist. LEXIS 76720, at *18-19 (E.D.N.Y. 2008) (decided before *Stolt-Nielsen*; discussing manifest disregard standard under *Hall Street* and applying pre-*Hall Street* Second Circuit rule); *Mastec North America, Inc. v. MSE Power Systems, Inc.*, 581 F. Supp. 2d 321 (N.D.N.Y. 2008) (also decided before *Stolt-Nielsen*, interpreting *Hall Street* to treat manifest disregard as a gloss on the § 10 requirements and analyzing it under Second Circuit case law).
13. *Coffee Beanery, Ltd. v. W.W. LLC, et al*, 2008 U.S. App. LEXIS 23645, at *12 (6th Cir. 2008).
14. 548 F.3d at 92.
15. *Id.* at 92-93.
16. *Id.* at *94 (citing *Hoeft v. MDL Group, Inc.*, 343 F.3d 57, 64 (2d Cir. 2003) (describing manifest disregard as an additional ground not prescribed in the FAA); *Duferco Int’l Steel Trading v. T. Klaveness Shipping A/S*, 333 F.3d 389 (2d Cir. 2003) (observing

- that the doctrine's use is limited to instances "where none of the provisions of the FAA apply"; *DiRussa v. Dean Witter Reynolds, Inc.*, 121 F.3d 818, 821 (2d Cir. 1997) (referring to the doctrine as "judicially created"), *cert. denied*, 522 U.S. 1049 (1998); and *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 933 (2d Cir. 1986) (same).
17. 2008 U.S. App. Lexis 22838 at *24.
 18. *Id.* at *25, fn. 9, citing *State Employees Bargaining Agent Coal. v. Rowland*, 494 F.3d 71, 84, 86 (2d Cir. 2007).
 19. *Wise v. Wachovia Sec. LLC*, 450 F.3d 265, 269 (7th Cir. 2006), *cert. denied*, 127 S. Ct. 582 (2006).
 20. *Joseph Stevens v. Cikanek*, 2008 U.S. Dist. LEXIS 52611 at *11-12 (noting that the Seventh Circuit "has specified that the 'manifest disregard of the law' standard is cabined entirely within 9 U.S.C. § 10(a)(4)").
 21. *Id.*, at *11-12 (N.D. Ill. 2008). One pre-*Hall Street* case from the Seventh Circuit presents an interesting issue. In *Edstrom Industries, Inc. v. Companion Life Ins. Co.*, 516 F.2d 546 (7th Cir. 2008), Judge Posner interpreted an arbitration clause requiring that the parties "strictly abide" by the terms of an insurance policy and "strictly apply" the substantive law of Wisconsin to, in effect, restrict scope of the arbitrator's discretion in interpreting the substantive law. *Id.* at 549. Judge Posner said that the question before the court in *Edstrom Industries* was different from that posed in *Hall Street* (which, at the time, was pending before the Supreme Court)—"whether the arbitrator can be directed to apply specific substantive norms and be held to the application." *Id.* The Seventh Circuit went on to rule that the arbitrator had ignored applicable Wisconsin law contrary to his instruction under the arbitration agreement. It is an open question whether the reasoning of *Edstrom Industries* remains sound after *Hall Street*, unless the case is viewed as an application of the "manifest disregard of the law" standard.
 22. *Comedy Club, Inc. v. Improv West Associates*, 502 F.3d 1100 (9th Cir. 2007), *vacated and remanded*, 129 S. Ct. 45 (2008).
 23. 341 F.3d 987, 997 (9th Cir. 2003) (*en banc*).
 24. 553 F.3d 1277, 2009 U.S. App. LEXIS 1634, at *29 (9th Cir. 2009).
 25. *Id.*, at *29. It remains to be seen how whether the Supreme Court will be asked to review the *Comedy Club* decision again now that the Ninth Circuit has announced its application of *Hall Street*.
 26. 2008 U.S. App. LEXIS 23645 at *9-12.
 27. *Id.* at *12; *cf. Martin Marietta Materials, Inc. v. Bank of Oklahoma*, 2008 U.S. App. LEXIS 25681, at *6 (6th Cir. Dec. 17, 2008) (unpublished decision decided after *Coffee Beanery* stating that *Hall Street* calls manifest disregard into question but applying the standard nonetheless "in order to allow future panels and litigants to choose for themselves whether to challenge these premises or to continue to walk down the same calf-path as we have").
 28. *Id.* The Supreme Court of New York, New York County, reached a similar conclusion in *Chase Bank USA, N.A. v. Hale*, 859 N.Y.S.2d 342, 348-49 (N.Y. Sup. 2008) (reasoning that "the Supreme Court appears to have done nothing to jettison the 'manifest disregard' standard of *Wilko*").
 29. *Citigroup Global Markets Inc. v. Bacon*, Fifth Circuit Court of Appeals Docket No. 07-20670, at 15 (slip opinion). Before *Citigroup Global Markets* resolved the issue in the Fifth Circuit, one decision from the Eastern District of Texas had at least implicitly held that manifest disregard of the law is no longer good law. *The Householder Group v. Caughran*, 576 F. Supp. 2d 796, 800 (E.D. Tex. 2008) ("[i]n light of the Supreme Court's holding in *Hall Street*, the court will limit its analysis to the statutory grounds enumerated in the FAA"). However, another division of the same court found this issue unclear and analyzed a challenge to an FAA arbitration award under both the statutory factors and manifest disregard. *Acuna v. Aerofreeze, Inc.*, 2008 U.S. Dist. LEXIS 87346, at *5-6 (E.D. Tex. 2008) ("this Court will analyze the parties' arguments under both the Fifth Circuit's judicially-created 'manifest disregard' standard as well as the statutory bases under the FAA that the Supreme Court has declared as exclusive grounds for a vacatur").
 30. *Id.*
 31. *Id.*, at 8-11.
 32. *Citigroup Global Markets Inc.*, slip opinion at 12-13.
 33. *Id.*, at 13-15.
 34. In *Stolt-Nielsen*, the Second Circuit appears to have interpreted the First Circuit's decision in *Ramos-Santiago v. UPS*, 524 F.3d 120 (1st Cir. 2008) as concluding that the doctrine does not survive. 548 F.3d at 94. The Ninth Circuit also appears to interpret *Ramos-Santiago* in this way. *Comedy Club*, 553 F.3d 1277, 2009 U.S. App. LEXIS at *30. However, it is not clear that *Ramos-Santiago* supports this interpretation. In *Ramos-Santiago*, which involved a non-FAA arbitration, the First Circuit observed that *Hall Street* had held "that manifest disregard of the law is not a valid ground for vacating or modifying an arbitral award" in FAA cases. 524 F.3d at 124. However, the First Circuit declined to reach the question of whether *Hall Street* precluded the application of manifest disregard to the case before it because, regardless of whether it applied, the court held that the challenge to the award failed. *Id.* See also *ALS & Associates, Inc. v. AGM Marine Constructors, Inc.*, 557 F. Supp. 2d 180, 185 (D. Mass. 2008) (interpreting *Ramos-Santiago* to reject manifest disregard as a ground to vacate an arbitration award).
 35. *Hereford v. Horton*, 2008 Ala. LEXIS 186 (Ala. 2008), *revised*, *Hereford v. Horton*, 2009 Ala. LEXIS 1 (Ala. Jan. 9, 2009)
 36. 2009 Ala. LEXIS 1, at *13 fn. 1.
 37. *Id.* at *14.
 38. *Robert Lewis Rosen Assocs., Ltd. v. Webb*, 566 F. Supp. 2d 228, 233 (S.D.N.Y. 2008).
 39. *Prime Therapeutics LLC v. Omnicare, Inc.*, 555 F. Supp. 2d 993, 998-999 (D. Minn. 2008) .
 40. *Id.* at 999.
 41. *Rogers v. KBR Technical Services, Inc.*, 2008 U.S. App. LEXIS 12320, at *5-6 (5th Cir. 2008) (decided before *Citigroup Global Markets*); *Ramos-Santiago v. UPS*, 524 F.3d 120 (1st Cir. 2008); see also *Sole Resort v. Allure Resort Management LLC*, 2008 U.S. App. LEXIS 22507 (2nd Cir. 2008) (decided before *Stolt-Nielsen*).
 42. See, e.g., *O'Leary v. Salomon Smith Barney, Inc.*, 2008 U.S. Dist. LEXIS 98483, at *8 (D.N.J. 2008) (holding that the court need not reach the issue because the challenge to award failed on both manifest disregard and statutory grounds); *Acuna*, 2008 U.S. Dist. LEXIS 87346 at *5-6 (analyzing challenge to arbitration award under both standards); *DMA Int'l, Inc. v. Qwest Communications Int'l*, 2008 U.S. Dist. LEXIS 76164, at *13 (D. Colo. 2008) (holding it need not reach this issue as challenge to award failed on both manifest disregard and statutory grounds); *Millmaker v. Brusco*, 2008 U.S. Dist. LEXIS 79480 (S.D. Tex. 2008) (considering manifest disregard because Fifth Circuit had not yet ruled on effect of *Hall Street*) (decided before *Citigroup Global Markets*); *Halliburton Energy Services, Inc. v. VS NL Industries*, 553 F. Supp. 2d 733 (S.D. Tex. 2008) (same); *Fitzgerald v. H&R Block Financial Advisors, Inc.*, 2008 U.S. Dist. LEXIS 45472, at *8 (E.D. Mich. 2008) (citing *Hall Street* for statutory standard but analyzing manifest disregard without comment); *Jimmy John's Franchise, LLC v. Kelsey*, 549 F. Supp. 2d 1034 (C.D. Ill. 2008) (same).

Messrs. Kahn and Nodel are attorneys with the New York office of Morrison & Foerster LLP. Mr. Kahn is co-chair of the Arbitration Committee of the Dispute Resolution Section of the New York State Bar Association. They can be reached at skahn@mofocom and jnodel@mofocom. Morrison & Foerster's Washington D.C. and Los Angeles offices represent Mattel in the *Hall Street* litigation. The views expressed in this article are the authors' own.