Second Circuit Reaffirms Manifest Disregard Standard of Review for Arbitral Awards

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On August 21, 2008, we issued a Client Alert reporting that the U.S. District Court for the Southern District of New York had held, based on the U.S. Supreme Court’s ruling in *Hall Street Associates, L.L.C. v. Mattel*,¹ that the “manifest disregard” standard of review of arbitration awards under the Federal Arbitration Act (“FAA”)² was no longer good law. The U.S. Court of Appeals for the Second Circuit has now had occasion to rule on the continued validity of manifest disregard review, and expressly held that manifest disregard of the law continues to constitute a valid ground for non-recognition of an arbitral award, despite the Supreme Court’s ruling in *Hall Street*.

*Hall Street and Robert T. Rosen*

*Hall Street* was a watershed ruling concerning the scope of judicial review of arbitral awards under the FAA. The issue in that case was whether parties could agree to more rigorous judicial review of an arbitral award than would be permitted under Sections 10 and 11 of the FAA, which sets forth the grounds upon which a court may refuse to recognize or modify an award.³ The Supreme Court, in a six-to-three decision, held that because the grounds for annulment and non-recognition set forth in Sections 10 and 11 of the FAA are fixed and exclusive,⁴ parties may not contract for judicial review that would permit invalidation of an arbitral award on any grounds not set forth in Sections 10 or 11.⁵

While the Supreme Court held in *Hall Street* that the statutory grounds for annulment were exclusive and could not be expanded (by agreement or otherwise), it did not reach the question of whether the manifest disregard doctrine – which is not expressly set forth in Section 10 the FAA, but was developed by federal courts following the Supreme Court’s 1953 decision in *Wilko v. Swan*⁶ – still constituted a valid basis to refuse to recognize an arbitral award. As a result, lower courts have struggled to determine whether the doctrine remains valid.⁷ In July 2008, the U.S. District Court for the Southern District of New York joined those courts that had concluded that *Hall Street* had abrogated the manifest disregard doctrine. Specifically, in *Robert T. Rosen Associates, Ltd. v. Webb*,⁸ Judge Richard J. Holwell held as follows:

Necessary to *Hall Street’s* holding are two related propositions: first, that the FAA’s statutory grounds [for vacatur and/or modification] are exclusive, and second, that the Supreme Court has never endorsed manifest disregard as an independent basis for vacatur. Together, these propositions undercut the rationale for the Second Circuit’s prior adherence to the manifest disregard standard.
[Citation omitted.] As the Second Circuit’s traditional understanding of Wilko and § 10 – that Wilko endorsed manifest disregard and that § 10’s grounds are not exclusive – is inconsistent with the basis for the holding in Hall Street, the Court finds that the manifest disregard of the law standard is no longer good law.9

Stolt-Nielsen

The Second Circuit heard argument in Stolt-Nielsen SA v. Animal Feeds International10 on August 8, 2008, one month after Rosen Associates was decided. Stolt-Nielsen concerned whether the arbitration panel hearing a maritime dispute under the American Arbitration Association Rules correctly held that the arbitration could proceed on a class basis. The panel issued a clause construction award permitting the arbitration to proceed on a class basis; Stolt-Nielsen, the respondent in the arbitration, sought to annul this award on the ground that it was made in manifest disregard of the law. The district court granted the petition, finding that the arbitrators had “failed to make any meaningful choice-of-law analysis,” and thus failed to recognize that the dispute was governed by federal maritime law.11

At the outset of its decision, the Second Circuit noted the uncertainty surrounding the manifest disregard doctrine, observing that

[i]n the 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. [Citations]. 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.12

Noting the developing conflict in authority, the Second Circuit expressly adopted the latter view. While observing that Hall Street’s core ruling is “undeniably inconsistent with some dicta by this Court treating the ‘manifest disregard’ standard as a ground for vacatur entirely separate from those enumerated in the FAA,” the Second Circuit, relying heavily on a prior ruling of the Seventh Circuit, considered the essential nature of judicial review under the FAA and found that courts retained the authority to annul arbitral awards that reflect a manifest disregard of the law. Quoting the Seventh Circuit’s decision in Wise v. Wachovia Securities, the court stated that

It is tempting to think that courts are engaged in judicial review of arbitration awards under the Federal Arbitration Act, but they are not. When parties agree to arbitrate their disputes they opt out of the court system, and when one of them challenges the resulting arbitration award he perforce does so not on the ground that the arbitrators made a mistake but that they violated the agreement to arbitrate, as by corruption, evident partiality, exceeding their powers, etc. – conduct to which the parties did not consent when they included an arbitration agreement in their contract. That is why in the typical arbitration … the issue for the court is not whether the contract interpretation is incorrect or even wacky but whether the arbitrators had failed to interpret the contract at all, for only then were they exceeding the authority granted to them by the contract’s arbitration clause.13

The court continued:

Like the Seventh Circuit, we view the “manifest disregard” doctrine, and the FAA itself, as a mechanism to enforce the parties’ agreements to arbitrate rather than as judicial review of the arbitrators’ decision. We must therefore continue to
bear the responsibility to vacate arbitration awards in 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.” [Citation omitted.] At that point the arbitrators have “failed to interpret the contract at all,” [citation omitted], 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.” [Citation omitted.]¹⁴

By ruling as it did, the Second Circuit, like the Seventh Circuit before it, characterized manifest disregard of the law as an error within the meaning of Section 10(a)(4) of the FAA, rather than as an independent ground for non-recognition. This analysis permits the manifest disregard doctrine to comfortably coexist with the Supreme Court’s analysis in *Hall Street*, and appears to solidify the doctrine’s vitality in the Second Circuit. Of course, the Second Circuit’s analysis has not been uniformly embraced, and the developing split of authority among federal and state courts concerning the manifest disregard doctrine’s consistency with *Hall Street* makes it likely that the Supreme Court will ultimately need to resolve the issue. Because so many agreements fix New York as an arbitral venue, however, the Second Circuit’s ruling in *Stolt-Nielsen* constitutes an important clarification in the law of judicial review that will permit parties considering arbitration to fully understand the likely scope of any post-arbitral litigation in Second Circuit courts.

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2 9 U.S.C. § 1 et seq.

3 The parties in *Hall Street* had agreed that the district court could annul the arbitrator’s award for mere legal error, a ground that is not set forth as a ground for annulment or nonrecognition in Section 10 or 11 of the FAA.

4 Section 10 of the FAA permits a court to refuse to recognize an award where it was procured by corruption, fraud, or undue means, where there was evident partiality or corruption on the part of the arbitrator(s), where the arbitrator(s) were guilty of misconduct in refusing to postpone the hearing, in refusing to hear pertinent evidence, or any other misbehavior which prejudices the rights of any party, and/or where the arbitrator(s) exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter was not made. See 9 U.S.C. § 10. In addition, Section 11 of the FAA permits a court to modify or correct an award where there was an evident miscalculation of figures or in describing the subject matter (such as property, persons, etc.) of the award, where the arbitrator(s) have awarded upon a matter not submitted to them, and/or where the award is imperfect as to form, but not in a manner affecting the merits. See id. § 11.

5 *Hall Street*, 128 S. Ct. at 1403-04.

6 The manifest disregard standard has been recognized by every federal judicial circuit; while the particulars of the doctrine vary slightly by circuit, the doctrine generally permits a court to refuse to recognize an arbitral award where the arbitrator knew of a legal principle that is well-defined, explicit, and clearly applicable to the dispute before him, but either refuses to apply it or ignores it altogether. See, e.g., *Hoeft v. MVL Grp., Inc.*, 343 F.3d 57, 64 (2d Cir. 2003).


8 566 F. Supp.2d 228 (S.D.N.Y. 2008).

9 Id. at 233.


11 Id. at *11.

12 Id. at *23 (citations omitted).

13 Id. at *25-6 (quoting *Wise v. Wachovia Sec., LLC*, 450 F.3d 265, 269 (7th Cir.), cert. denied, 127 S. Ct. 582 (2006)).

14 Id. at *27.