Kluwer Arbitration Blog

Manifest Disregard is Dead – Long Live § 10(a)(4) FAA?

Jan Kleinheisterkamp (The London School of Economics and Political Science) · Monday, April 27th, 2009 · YIAG

The relevance of the Supreme Court's Hall decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 128 S. Ct. 1369 (2008) for the question of whether "manifest disregard of the law" can constitute a ground for vacatur of an arbitral award by a U.S. court has already been addressed in an earlier post to this blog, which was prompted by the Fifth Circuit decision in *Citigroup Global Markets, Inc. v. Bacon*, 2009 WL 542780, 2009 U.S. App. LEXIS 4543. In this decision, the Fifth Circuit stressed its understanding that "*Hall Street* rejected manifest disregard as an independent ground for vacatur" and declared – much to the joy of most critics of the "manifest disregard" doctrine – that "manifest disregard of the law is no longer an independent ground for vacating arbitral awards." Is this yet another coffin nail for the controversial doctrine? A closer look rather suggests the contrary.
Interestingly, the *Citigroup* decision discusses three recent decisions of the Sixth, Second, and Ninth Circuit, which all held that *Hall Street* would not affect their powers to vacate awards made by arbitrators in manifest disregard of the law. The Fifth Circuit felt obliged to declare only the first of the three as flawed.

The decisions of the Second and Ninth Circuit apparently did not trouble the Fifth Circuit, since it merely summarized them without any criticism. In fact, the Second and Ninth Circuit had folded their understanding of "manifest disregard" into the ground of § 10(a)(4) FAA, the "excess of powers" exception (which had already been the pragmatic position of the Ninth Circuit prior to *Hall Street*), and thus saw no conflict with the *Hall Street* finding about the exclusivity of the ground for vacatur under the FAA.

The Sixth Circuit's decision, in contrast, clearly upset the Fifth Circuit, albeit probably not for the decisive reasons. The Sixth Circuit, dwelling on the passage in *Hall Street* that "[m]aybe the term 'manifest disregard' [in *Wilko*] was meant to name a new ground for review…", had concluded that "[i]n light of the Supreme Court's hesitation to reject the 'manifest disregard' doctrine in all circumstance, … it would be imprudent to cease employing such a universally recognized principle"; *Coffee Beanery, Ltd. v. WW, L.L.C.*, 2008 U.S. App. LEXIS 23645 (6th Cir. 2008), at **12. This, according to the Fifth Circuit, would be – and probably is – incompatible with the Supreme Court's holding "that the statutory grounds [for vacatur found in § 10 FAA] are exclusive."

What the Fifth Circuit, however, ignored is that the Sixth Circuit's opinion was also – and much more so – flawed in another respect. The Sixth Circuit's *Coffee Beanery* decision concerned the

application of the Maryland Franchise Act (for the consequences of this decision see another earlier post). The court didn't actually care that the award had confirmed a franchise agreement which the franchisees had been lured into by material misrepresentations. It cared, however, about the arbitrator's interpretation of the Act that the franchisor was not required to disclose his representative's conviction for larceny in the offering prospectus. The Sixth Circuit concluded that because the franchisees were "deprived of a mandatory, statutorily required notice, prior into entering into the franchise agreement, and did not have an opportunity to avoid being subjected to the consequences of having entered into the contract (including the requirement to arbitrate such claims), [the franchisees] should not be bound by the arbitration provisions of the agreement which it was fraudulently induced into signing in violation of the Franchise Act."

This exemplifies one of the fundamental problems of the "manifest disregard" doctrine as a stand-alone ground for vacatur: courts are tempted to use it as a *factotum* instead of soundly applying the law. The Sixth Circuit thought it needed to rely on the "manifest disregard" doctrine when it actually did not. The review was not one of the merits but of the arbitrator's finding concerning her own jurisdiction. The court in fact applied – unconsciously – the Supreme Court's normal standard of full review of the validity and scope of the arbitration agreement as deriving from *First Options v. Kaplan*, 514 U.S. 938, 943 (1995). *Coffee Beanery* simply was not a "manifest disregard" case.

All in all, the Fifth Circuit's opinion shows that there is probably no reason to expect a post-*Hall Street* split of the Circuits on the issue of "manifest disregard". The Fifth Circuit acknowledged, without any objection, the integration of the "manifest disregard" doctrine into the § 10(a)(4) FAA by the Second and Ninth Circuit. Had the Sixth Circuit not insisted imprudently on the possibility of "manifest disregard" being an independent ground of vacatur, but had it dwelled upon the Supreme Court's passage acknowledging that, "as some courts have thought, 'manifest disregard' may have been shorthand for § 10(a)(3) or § 10(a)(4)," the Fifth Court would probably not have had much objections at all. Indeed, it vacated the district court's judgement which had vacated the award on the ground of manifest disregard of the law, but noted explicitly that "[t]he court, however, did not consider whether the grounds asserted for vacating the award might support vacatur under any of the statutory grounds" and remanded "for further consideration not inconsistent with its opinion." This could well be understood as an encouragement for the district court to follow the track of redefining "manifest disregard" as a form of "excess of powers".

No doubt, this solution is unsatisfactory because it puts unnecessary strain on the interpretation of § 10(a)(4) FAA, which being an exception should be interpreted restrictively. It has to be admitted, though, that the courts' worries underlying their dependency on the "manifest disregard" corrective are frequently legitimate. These worries could certainly be accommodated in a doctrinally much sounder way (unfortunately, there is not the space to elaborate this here). In the meanwhile, giving "manifest disregard" a provisional home under the roof of § 10(a)(4) FAA seems to be a solution that everybody – at least all U.S. courts, which have unanimously embraced the "manifest disregard" doctrine in the past – can live with, at least if restricted to "those exceedingly rare instances where some egregious impropriety on the part of the arbitrators is apparent", as reaffirmed by the Second Circuit in *Stolt-Nielsen SA v. AnimalFeeds Int'l Corp.*, 548 F.3d 85, 91-92 (2d Cir. 2008).

To make sure you do not miss out on regular updates from the Kluwer Arbitration Blog, please subscribe here. To submit a proposal for a blog post, please consult our Editorial Guidelines.

This entry was posted on Monday, April 27th, 2009 at 9:28 am and is filed under Domestic Courts, National Arbitration Laws, North America
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.