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Is Manifest Disregard Alive and Well in the Second Circuit?: A Remand to Find Out

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Introduction

In domestic award enforcement proceedings, the U.S. federal Court of Appeals for the Second Circuit ("Second Circuit") in New York recently reversed a lower federal trial court's decision to vacate that award on grounds that the arbitrator manifestly disregarded the law. *See Weiss v. Sallie Mae, Inc.*, Dkt. No. 18-2362, Slip Op. (2d Cir. Sept. 12, 2019). While *Weiss* appears at first blush to be a pro-arbitration decision, closer examination reveals it is less so for two reasons.

First, while the Second Circuit refused to vacate the award on manifest disregard grounds, the Second Circuit nevertheless reaffirmed the controversial doctrine's continued viability.

Second, after refusing to vacate the award, the Second Circuit remanded it back to the arbitrator with instructions to revisit his merits conclusions. While the Second Circuit ostensibly did so to encourage the arbitrator to reach the legally correct outcome, the court's actions undermined the *functus officio* doctrine and the doctrine of finality.

Weiss is therefore problematic on several levels.

Background

Weiss was a domestic arbitration that concerned consumer rights in a debt-collection matter.

Weiss was an individual who had defaulted on student loans. After Weiss defaulted on her loans, the lender began calling her mobile telephone several times a day to collect her outstanding debt. After receiving several hundred automated phone calls over an extended period, Weiss sued the lender in federal court. The dispute was subsequently referred to arbitration.

By the time Weiss' arbitration started, a class action lawsuit against the same lender

for the same conduct settled on terms that precluded class members from recovering any damages from the lender. Weiss was generally bound by that settlement under U.S. law if she was given notice of it, which would have precluded her arbitration claims.

Despite that fact, the arbitrator awarded Weiss $108,500 in damages against the lender, even though the arbitrator also concluded that Weiss was a member of the class that had previously settled its claims.

After receiving that seemingly inconsistent award, Sallie Mae moved in a federal trial court under domestic chapter of the U.S. Federal Arbitration Act ("FAA") to vacate it. Weiss responded by cross-moving to confirm the award.

The federal trial court accepted the lender's arguments and vacated the award on grounds that the arbitrator had manifestly disregarded the law by acknowledging that Weiss was a member of a class that was barred from recovering damages from Sallie Mae, but nevertheless awarding Weiss such damages. Weiss subsequently appealed that ruling to the Second Circuit.

Manifest Disregard After *Hall Street*

Manifest disregard of the law is a controversial doctrine, because it is not an expressly stated ground for vacating arbitral awards under the FAA. The FAA and case law construing it also preclude courts from reviewing the underlying merits of a dispute in enforcement proceedings, and manifest disregard challenges inherently require courts to revisit merits determinations and to replace their judgment for that of the arbitrator's.

In 2008, the U.S. Supreme Court called the manifest disregard doctrine into question in *Hall Street Assocs., LLC v. Mattel, Inc.*, 552 U.S. 576 (2008). In *Hall Street*, the Supreme Court ruled that the only bases for vacating an arbitral award are the ones expressly stated in the FAA, which does not include manifest disregard, but declined to rule that manifest disregard was dead. Moreover, subsequent Supreme Court decisions refused to decide whether manifest disregard survived *Hall Street*. *See Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 670 (2010).

U.S. federal appeals courts have reached conflicting conclusions as to whether manifest disregard continues to be a viable basis for challenging arbitral awards after *Hall Street*. The Fifth, Eighth, and Eleventh Circuits have held that manifest disregard did not survive *Hall Street*. Conversely, the Second, Fourth, Seventh, Ninth and Tenth Circuits have all upheld manifest disregard challenges. The First and Third Circuits have not yet ruled on the issue, but trial courts in those circuits have continued to allow manifest disregard challenges.

The Second Circuit Reiterates Manifest Disregard's Viability in Weiss

In *Weiss*, the Second Circuit began its analysis by accepting that manifest disregard continues to provide a valid basis for challenging awards. The court reiterated, however, that "[a] litigant seeking to vacate an arbitration award based on alleged manifest disregard of the law bears a heavy burden." Slip Op. at 9. Accordingly, the Second Circuit reiterated the high bar that manifest disregard challenges face to succeed.

While it is positive that the Second Circuit reinforced such high standards for manifest disregard challenges, the court continues to ignore the fact that the mere act of raising manifest disregard challenges can force the party that prevailed in the arbitration to relitigate in the enforcement court issues that it already won in the arbitration. Consequently, if the Second Circuit wishes to truly signal to parties the limited circumstances in which manifest disregard challenges are warranted, it should consider reinforcing that sanctions can be awarded for frivolous enforcement challenges, which the Eleventh Circuit and trial courts in the Second Circuit have done. *See, e.g., Inversiones y Procesadora Tropical Inprotsa SA v. Del Monte International GmbH,* No. 18-14807, 2019 WL 4200011 (11th Cir. Sept. 5, 2019); *New York Hotel & Motel Trades Council v. CF 43 Hotel, LLC*, No. 16 CIV. 5997 (RMB), 2017 WL 2984168, at *6 (S.D.N.Y. June 14, 2017); *DigiTelCom, Ltd. v. Tele2 Sverige AB*, No. 12 CIV. 3082 RJS, 2012 WL 3065345, at *1, *7 (S.D.N.Y. July 25, 2012).

The Second Circuit Remands the Award Back to the Arbitrator to Revisit the Merits of His Conclusions

After refusing to vacate the award, the Second Circuit remanded it back to the arbitrator to revisit his prior merits determinations "to clarify whether the [settlement] notice was sufficient, to construe the general release in the [s]ettlement [agreement] in the first instance and, if necessary, to vacate or modify the arbitral award." *Weiss*, Slip Op. at 15. While the Second Circuit's decision to remand the award to the arbitrator was undoubtedly driven by the laudable desire to have the arbitrator reach the right conclusion, the Second Circuit's actions called the *functus officio* doctrine into question.

Under the *functus officio* doctrine, arbitrators generally lose their mandates once a final award is issued. Limited exceptions to the doctrine exist under both the FAA and the arbitral rules of most institutions for correcting non-substantive errors, and the Second Circuit has joined several other U.S. federal circuits in recognizing that arbitrators may revisit awards to clarify ambiguities that do not substantively modify the award. *See General Re Life Corp. v. Lincoln Nat'l Life Ins Co.*, 909 F.3d 544 (2d Cir. 2018).

The Second Circuit's remand instructions in *Weiss*, however, went well beyond those limited exceptions and expressly directed the arbitrator to revisit the merits and reach a different outcome after doing so. That directive would seem to call the *functus officio* doctrine into serious question and to severely undermine finality as well.

Conclusion

The *Weiss* decision contains pro-arbitration outcome-driven rulings, but also contains conclusions that are arguably hostile to fundamental arbitration doctrines. Ultimately, *Weiss* may therefore represent a decision that was motivated by good intentions, but that may produce unintended consequences. Particularly, the decision may (1) discourage courts from vacating awards in the rare instances where manifest disregard grounds do in fact exist; (2) while simultaneously signaling to parties that manifest disregard challenges can continue in all cases without consequence; and (3) encourage courts to remand awards back to arbitrators with instructions to "correct" the merits instead of just upholding or vacating them, which undermines finality and the *functus officio* doctrine.

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