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NY Courts Should Revisit Criteria For Vacating Arbitral Awards

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Based on dicta in a 1953 U.S. Supreme Court opinion in Wilko v. Swan, federal courts have held that an arbitrator's manifest disregard of the law is a basis to vacate an arbitral award under Section 10 of the Federal Arbitration Act.

Although the U.S. Supreme Court appeared to call into question the manifest-disregard doctrine in Hall Street Associates LLC v. Mattel Inc., [1] the U.S. Court of Appeals for the Second Circuit subsequently held that it remains a narrow basis to vacate awards as a judicial gloss on the express annulment grounds found in Section 10. For the time being, therefore, manifest disregard of the law is a potential ground to vacate in New York federal courts. But what about in New York state courts?

New York state courts have considered manifest disregard of the law in dozens of cases. Most recently, in a decision dated Oct. 24, 2019, the New York State Appellate Division, First Department, considered whether an award should be vacated for manifest disregard of the law because it was undisputed that the FAA applied in the case.

The other New York state cases appear similarly to assume that FAA Section 10 applied because the cases involved interstate commerce. But that assumption seems unsound. The U.S. Supreme Court has held that Section 2 of the FAA — which governs the enforcement of arbitration agreements — creates federal substantive law that applies in both federal and state courts, but it has never held that the grounds to vacate arbitral awards under Section 10 of the FAA do as well.

And there is good reason to think that Section 10 only governs applications in federal court. Section 10(a) says that "the United States court in and for the district wherein the award was made" may vacate an award on specified grounds, which would suggest that Congress did not intend Section 10 to govern enforcement of arbitral awards in state courts. Courts in other states have reached that conclusion, as have prominent commentators.

This article discusses these issues and suggests that the New York courts should reexamine whether manifest disregard of the law is a basis to vacate arbitral awards before them.

Background on Manifest Disregard of the Law

Section 10 of the FAA[2] sets out four grounds to vacate arbitral awards. Manifest disregard of the law is not among them. In a 1953 decision, however, the U.S. Supreme Court stated that arbitrators' legal interpretations are not subject to judicial review, "in contrast to manifest disregard."[3]

Lower federal courts have taken that dictum as requiring them to vacate arbitral awards if they were issued in manifest disregard of the law. The U.S. Supreme Court has not itself affirmed that view. In Hall Street, the court described Wilko's dictum as vague:

> Maybe the term "manifest disregard" [in Wilko] was meant to name a new ground for review, but maybe it merely referred to the § 10 grounds collectively, rather than adding to them.[4]

Hall Street raised questions as to whether manifest disregard was a basis to vacate awards under the FAA. The Second Circuit has concluded, however, that Hall Street did not eliminate manifest disregard as a basis for annulment but that the doctrine continued as a judicial gloss on the express bases to vacate awards under Section 10.

The Second Circuit also noted that "[a] litigant seeking to vacate an arbitration award based on alleged manifest disregard of the law bears a heavy burden, as awards are vacated on grounds of manifest disregard only in those exceedingly rare instances where some egregious impropriety on the part of the arbitrator is apparent."[5]

To constitute manifest disregard of the law in the Second Circuit, an arbitrator must have knowingly failed to apply a clear and applicable governing legal principle, leading to an erroneous result.[6]

New York State Decisions on Manifest Disregard

New York Civil Practice Law & Rules Section 7511 contains its own grounds for vacating arbitral awards, the first four of which are nearly identical to those in FAA Section 10. Manifest disregard of the law is also not listed in Section 7511. As stated above, however, New York courts have considered whether an arbitrator manifestly disregarded the law in dozens of cases.

The New York Court of Appeals has discussed the doctrine only once. In Wien & Malkin LLP v. Helmsley-Spear Inc.,[7] the Court of Appeals appeared to assume that the FAA governed the bases to vacate the arbitral award before it, applied the Second Circuit case law on manifest disregard of the law, and reversed the First Department's decision vacating the award.[8]

The court did not address why FAA Section 10 applied in state court, nor did it suggest that manifest disregard of the law was also a ground to vacate awards under the CPLR.

To the extent that there is any discussion of the issue in the case law, the lower New York state courts have applied manifest disregard of the law because they have believed that the FAA in general applied to the cases before them, not because they found manifest disregard to be a basis to vacate awards under the CPLR.

For example, in Nexia Health Technologies Inc. v. Miratech Inc.,[9] the First Department stated: "It is undisputed that the Federal Arbitration Act (FAA) applies to this dispute."[10] It then considered and rejected a challenge to an award based on manifest disregard of the law.[11]

Because most decisions reject challenges to awards based on manifest disregard, whether the doctrine applies in state court might be considered of minor importance. But not all manifest-disregard arguments have failed. In one notable decision, for example, the First Department affirmed annulment of an $11 million award for manifest disregard of the law without any discussion of why the doctrine applied or even its elements.[12]

These decisions appear to assume that the FAA in its entirety governs arbitration issues in state court where the arbitration affects or involves interstate commerce. As discussed in the next section, that assumption appears to be wrong.

The Scope of the FAA

The FAA does not preempt the entire field of arbitration, and thus leaves room for state arbitration statutes.[13] Section 2 of the FAA, which makes written arbitration agreements enforceable, establishes substantive federal law that applies in federal and state courts.[14]

But while Section 2 of the FAA concerning the enforcement of arbitration agreements undisputedly applies in state court, the U.S. Supreme Court has never held that Section 10 of the FAA concerning annulment of arbitral awards similarly does. The plain language of Section 10 suggests that it does not.

FAA Section 10(a) states: "In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration."[15] The statute therefore speaks only of federal courts vacating awards.

In contrast, Section 2 of the FAA provides that a written agreement to arbitrate in a contract involving commerce "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[16]

Courts in other jurisdictions and commentators have concluded that Section 10, unlike Section 2, has no application in state courts. For example, the California Supreme Court has held that language referring to the district courts in Section 10 and other sections of the FAA "reflects Congress's intent to limit the application of those provisions to federal courts."[17]

The drafters of the Restatement of the U.S. Law of International Commercial and Investor-State Arbitration also concluded that FAA Sections 9 (modification of awards) and 10 "apply in federal court, not state court," based on their plain language.[18]

There might be a reason that the FAA preempts state-law grounds to vacate awards, but that preemption would occur through Section 2, not Section 10. Section 2 preempts state law that "interferes with fundamental attributes of arbitration."[19] Thus, Section 2 might preempt state laws that permit annulment of awards for errors of law or fact, because a fundamental attribute of arbitration is that it is final and not subject to judicial appeal.

Or Section 2 might preempt state laws that allow annulment because the arbitrators did not employ state discovery or evidence rules when the parties did not agree to use those rules, because party autonomy and procedural flexibility are fundamental attributes of arbitration. But state courts' rejection of the federal manifest-disregard doctrine would not fit in that category. The doctrine invites greater judicial intrusion into arbitration, not less.

With one notable exception, the New York state courts do not appear to have grappled with these issues. In Banc of America Securities v. Knight,[20] Judge Harlan Stone thoroughly analyzed the New York state case law on manifest disregard of the law and held that it was not an independent ground to vacate awards under the CPLR. He also held that FAA Section 10, by its plain terms, did not apply in state court.[21]

Unfortunately, the First Department instructed that Judge Stone's decision was wrong and should not be followed "to the extent it suggests that the applicability of the FAA depends on the citizenship of the parties to the subject arbitration agreement."[22]

The First Department did not explain why Banc of America was wrongly decided, and it appears to have misinterpreted Banc of America's reasoning — Judge Stone did mention that the FAA applies to interstate disputes, but his holding that Section 10 only applied in federal court was based on statutory language not citizenship of the parties.

Considerations for Future Cases

Parties in New York state courts should consider arguing that manifest disregard of the law is only a ground to vacate awards in federal, not state, court. To date, litigants appear to have overlooked this issue, and the courts have failed to distinguish between the FAA's provisions on enforcement of arbitration agreements and enforcement of arbitral awards, effectively extending the FAA beyond what its language requires.

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[1] Hall Street Associates, L.L.C. v. Mattel, Inc., 552 U.S. 576 (2008).

[2] 9 U.S.C. § 10(a).

[3] Wilko v. Swan, 346 U.S. 427, 436 (1953).

[4] Hall St., 552 U.S. at 585.

[5] T.Co Metals, LLC v. Dempsey Pipe & Supply, Inc., 592 F.3d 329, 339-40 (2d Cir. 2010).

[6] See id. at 339.

[7] Wien & Malkin LLP v. Helmsley-Spear, Inc., 6 N.Y.3d 471 (2006).

[8] See id. at 479-86.

[9] Nexia Health Technologies, Inc. v. Miratech, Inc., 176 A.D.3d 589 (1st Dep't 2019).

[10] Id. at 590.

[11] See id. at 590-91; see also Cantor Fitzgerald Sec. v. Refco Sec., LLC, 83 A.D.3d 592, 593 (1st Dep't 2011) (applying manifest-disregard doctrine because "[j]udicial review of the award in this matter is governed by the Federal Arbitration Act"); Morgan Stanley DW Inc. v. Afridi, 13 A.D.3d 248, 249 (1st Dep't 2004) (same).

[12] See Citigroup Global Mkts. v. Fiorilla, 127 A.D.3d 491, 491-92 (1st Dep't), leave to appeal denied, 26 N.Y.3d 908 (2015).

[13] Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 477 (1989).

[14] Southland Corp. v. Keating, 465 U.S. 1, 12 (1984).

[15] 9 U.S.C. § 10(a).

[16] Id. § 2.

[17] Cable Connection, Inc. v. DIRECTV, Inc., 190 P.3d 586, 597 (Cal. 2008); see also Finn v. Ballentine Partners, LLC, 143 A.3d 859, 866 (N.H. 2016) ("[W]e conclude that §§ 9–11 of the FAA apply only to arbitration review proceedings commenced in federal courts."); Nafta Traders, Inc. v. Quinn, 339 S.W.3d 84, 99-100 (Tex. 2011) (noting Section 10's language and holding that "the FAA does not preempt all state-law impediments to arbitration; it preempts state-law impediments to arbitration agreements"); Raymond James Fin. Servs., Inc. v. Honea, 55 So.3d 1161, 1168-69 (Ala. 2010) (stating that Section 10 "represents procedural as opposed to substantive law," allowing state courts to choose whether to apply it).

[18] Restatement (Third) U.S. Law of Int'l Comm. Arb. § 1.9, reporters' notes (b)(i) (proposed final draft) (2019).

[19] AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 344 (2011).

[20] Banc of America Securities v. Knight, 781 N.Y.S.2d 829 (Sup. Ct. N.Y. Cty. 2004).

[21] See id. at 831-36.

[22] Morgan Stanley, 13 A.D.3d at 250 n.1.