NY Appellate Court Weakens ‘Manifest Disregard’ Exception to Arbitration Enforcement

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A closely followed New York trial court decision in favor of the “manifest disregard” standard for vacating arbitral awards was recently reversed by the New York Supreme Court Appellate Division in In re Daesang Corp. v. The NutraSweet Co. With this decision, arbitral awards in New York courts have regained their sense of finality, judicial interference has become less likely, and nonprevailing parties have fewer grounds on which to challenge enforcement of awards.

Arbitration’s finality is both its primary virtue and curse. Absent procedural irregularity, arbitration awards should always be enforced by courts. But for decades, courts had diffi-
culty with this principle and questioned how low an arbitrator could go on a “wrong” deci-
sion. To address these concerns, courts created the “manifest disregard” doctrine, which
operated as a judicial exception, beyond the Federal Arbitration Act’s (FAA’s) statutory
grounds, to the rule against reversing arbitration on the merits. In jurisdictions adopting
the “manifest disregard” doctrine, courts could choose not to confirm the arbitration award
if the arbitrator wholly ignored the law, as opposed to just getting it wrong.

But the line between ignoring the law and misapplying it was difficult to distinguish, and
some courts struggled with defining “manifest disregard.” The U.S. Supreme Court had
an opportunity to clarify the issue in its decision in *Hall Street Associates LLC v. Mattel,
Inc.*, 552 U.S. 576 (2008), but instead left the question open, and the term as ambiguous
as ever.

Into this void stepped a New York trial judge in 2017, with a decision that seemed to give
“manifest disregard” significant force in a state where domestic and international awards
frequently go to get confirmed. The arbitration bar was concerned about how the decision
would affect New York’s future as an arbitration destination, and the New York City Bar
Association filed an amicus brief in favor of reversal. With the Appellate Division’s rever-
sal on September 27, 2018, “manifest disregard” returns to its ambiguous shadows.

**Background**

The *In re Daesang Corp.* case concerned an international commercial dispute between
two artificial sweetener producers — Daesang and NutraSweet. In 2002, the companies
began to discuss an acquisition by NutraSweet of Daesang’s aspartame business. The
companies entered into an asset purchase agreement whereby NutraSweet would pay a
sum at closing, followed by five annual installments.

NutraSweet paid the initial amount and the first two installments, but did not pay the third
installment. The company informed Daesang that it was rescinding the contract because
of antitrust class action suits that had commenced against Daesang.

Daesang invoked the arbitration provisions in its agreements with NutraSweet in June
2008. After a lengthy process, the arbitral tribunal issued a final award in 2016, awarding
Daesang $100 million in damages, which Daesang sought to enforce in New York.

NutraSweet countered the enforcement action, claiming that the tribunal had shown
“manifest disregard” for New York state and federal law, that Daesang was an admitted
antitrust violator engaged in rigging the market, and that the agreements between the
companies were induced by fraud and misrepresentation. NutraSweet’s arguments found
favor with the trial court, which ordered the award to be vacated.
The trial court stated, “the Tribunal chose to disregard the well-established principle [in-
voked by NutraSweet during the arbitration] that a fraud claim can be based on a breach
of contractual warranties where the misrepresentations are of present facts (in contrast to
future performance) and cause the actual losses claimed.”

The trial court’s ruling again raised the question of whether “manifest disregard” is a
proper basis for denying enforcement of arbitration awards, and, if it is, what “manifest
disregard” means.

In its 2008 Hall Street decision, the U.S. Supreme Court held that section 10(a) of the
FAA provides the “exclusive grounds” for vacating arbitration awards. The Supreme Court
analyzed the statute and concluded that “‘Fraud’ and a mistake of law are not cut from
the same cloth.” Therefore, a court’s decision to vacate an award based only on a mistaken
application of law cannot be upheld. The Supreme Court, however, did little to clear
the ambiguity surrounding the definition of “manifest disregard.”

In the case, Hall Street Associates, arguing against the exclusivity of section 10(a), cited
the decision in Wilko v. Swan, 346 U.S. 427, where the Supreme Court observed that
“interpretations of the law by . . . arbitrators in contrast to manifest disregard [of the law]
are not subject, in the federal courts, to judicial review for error in interpretation.”

In Hall Street, rather than clarifying the term “manifest disregard,” the Court added to its
nebulousness. The Court stated:

Maybe the term “manifest disregard” [as employed 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. . . . Or, as some courts have thought, “manifest disre-
gard” may have been shorthand for §10(a)(3) or §10(a)(4), the subsections autho-
rizing vacatur when the arbitrators were “guilty of misconduct” or “exceeded their
powers.”

This ambiguity has caused a circuit split on whether “manifest disregard” survives as an
independent ground for vacating an arbitration award. The Second, Fourth and Ninth Cir-
cuits have held that it is valid as a “judicial gloss” on the grounds stated in FAA sections
10(a)(3) and (4). The Fifth, Eighth and Eleventh Circuits have ruled against applying the
“manifest disregard” standard at all. State courts, meanwhile, have their own views, as
shown by the decision in In re Daesang Corp.

The New York Appellate Decision

The Appellate Division held that the trial court erred in finding that the tribunal “manifestly
disregarded the law and . . . misconstrued the procedural record.” The appellate court
held that the trial court’s decision was contrary to the “emphatic federal policy in favor of
arbitral dispute resolution’ embodied in the FAA, a policy that ‘applies with special force in the field of international commerce.’” Although the court recognized the “manifest disregard” doctrine, it held that the standard was not met in this case, where, “at most, the tribunal stated an intention to apply a law, and then misapplied it.”

The Appellate Division supported the belief that “manifest disregard” means ignoring the law, not just getting it wrong. According to the court, the doctrine requires “more than a simple error in law” and not a mere mistake by the arbitrator. “Errors, mistakes, departures from strict legal rules, are all included in the arbitration risk,” the court noted. The court held that the standard requires intentional, blithe disregard for the law — “a showing that ‘the arbitrators 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.’”

Holding that the scope of judicial review for arbitration awards is “extremely limited,” the Appellate Division quoted Wien & Malkin LLP v. Helmsley-Spear, Inc., 6 NY 3d, 471, 479-480 (2006), which stated:

> An arbitration award must be upheld when the arbitrator offers even a barely colorable justification for the outcome reached. Indeed, we have stated time and again that an arbitrator’s award should not be vacated for errors of law and fact committed by the arbitrator and the courts should not assume the role of overseers to mold the award to conform to their sense of justice.

**Takeaway**

One can continue to debate the propriety of the manifest disregard doctrine; there is something concerning about affirming either a remarkably wrong award or an award that ignored the law. That said, even in jurisdictions where “manifest disregard” survives, it has been curtailed. Parties with arbitrations seated in New York can now have additional certainty that the awards will be affirmed, even if they are wrong.

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