MANIFEST DISREGARD OF LAW OR FACTS OR BOTH?

By

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I. Introduction

In addition to the statutory bases listed in the Federal Arbitration Act for vacation of an order of an arbitration panel, there exists a judicially created basis commonly known as manifest disregard of the law. This exception was created by *dicta* in Wilko v. Swan, 346 U.S. 427 (1953) in which the court held that an arbitration clause in a margin agreement violated the Securities Act of 1933. In enumerating the benefits of litigation over arbitration, the court commented: "In unrestricted submissions, such as the present margin agreements envisage, the interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review of error in interpretation."[ii]

The progeny of Wilko v. Swan are described in a very helpful article published by ARIAS - US entitled *Manifest Disregard, Vacating Arbitration Awards: A Circuit by Circuit Review* authored by John H. Binning and Robert L. Nefsky.[iii] The authors explain that nine of twelve circuits have adopted essentially the same standards for manifest disregard of the law: (a) the court may not set aside a panel order simply because it might have interpreted the agreement differently or some errors were made in interpreting the facts or law; and (b) the governing law alleged to have been ignored must be well defined, explicit and clearly applicable.

Messrs. Binning and Nefsky note one second circuit case which expands the manifest disregard doctrine to fact as well as law. The purpose of this article is to review case law (admittedly a minority of cases) which embody such an expansion, to analyze whether these cases represent a new doctrine and to comment on means to avoid a court finding of manifest disregard.

II. Cases Applying Manifest Disregard to a Panel's Findings of Fact

A. Acknowledged Application to Facts

The leading case in this category is Halligan v. Piper Jaffray, 148 F.3d 197 (2nd Cir.1998) *cert. denied* 529 U.S. 1034 (1999). An arbitration panel rejected Halligan's allegations of age discrimination without a rationale. The court reviewed the evidence placed before the panel and ruled:

In view of the strong evidence that Halligan was fired because of his age and the agreement of the parties that the arbitrators were correctly advised of the applicable legal principles, we are inclined to hold that they ignored the law or the evidence or both. . . . . At least in the circumstances here, we believe that when a reviewing court is inclined to hold that an arbitration panel manifestly disregarded the law, the failure of the arbitrators to explain the award can be taken into account. Having done so, we are left with the firm belief that the arbitrators here manifestly disregarded the law or the evidence or both.[iii]

In Pacific Reins. Mgt. Corp. v. Ohio Reins. Corp, 935 F.2d 1019 (9th Cir. 1991) an arbitration panel issued an interim final order ("IFO") requiring participants of a reinsurance pool to place funds in escrow for the pool manager. The pool members argued to the court that the panel issued the IFO in manifest disregard of the facts since it was contrary to the weight of evidence. The court rejected these arguments:

We hold that the IFO did not exceed the arbitrator's powers, was not tainted by the alleged misbehavior, and was not issued in manifest disregard of the law or fact. Therefore, we affirm the district court's confirmation of the IFO.[iv]

The court conducted an extensive review of the panel's findings of fact and conclusions of law in Space Systems/Loral, Inc. v. Yuzhnoye Design Office, 164 F.Supp.2d 397 (S.D.N.Y.2001). The court ruled:

The panel stated that it had "considered and rejected" the respondents' $14.5 million counterclaim. There is no indication that the arbitrators manifestly disregarded the law or the evidence in reaching that conclusion. The decision was in fact a reasonable interpretation of the facts and the law.[v]

In Green v. Progressive Asset Management, Inc., 2000 U.S. Dist. Lexis 12428 (S.D.N.Y. 2000) the petitioner sought to vacate the award of an arbitration panel but neglected to append the record below. The court rejected the petition stating: "Here, Green's failure to supply a full record makes it impossible for the court to determine whether the Panel's decision was based on a manifest disregard for the law or the evidence."[vi]

B. Unacknowledged Application to Facts

There are a number of cases which purport to apply the manifest disregard rule to law but actually apply it to fact or mixed issues of fact and law. One such case involved a cancellation by a broker of a client's short sale of

stock. Merrill Lynch Pierce Fenner & Smith v. Bobker, 636 F.Supp. 444 (S.D.N.Y. 1986). The district court vacated the panel's ruling after an extensive review of the panel's factual conclusions and its application of SEC rules. On appeal, the court disagreed with the lower court's reading of the facts and law and reversed. Merrill Lynch, Pierce, Fenner & Smith v. Bobker, 808 F.2d 930 (2nd Cir.1986). The concurring opinion in the court of appeals notes the incongruity ruling on the facts under the aegis of manifest disregard of the law:

Whether the majority disagrees with [the district court's] decision on the merits is entirely beside the point. The standard of manifest disregard was adopted to insulate arbitration decisions from precisely this kind of inquiry. (citations omitted) The majority opinion in this case perpetuates the district court's error by reversing the district court on the merits of the arbitrators' decision and by engaging in unnecessary speculation over the validity of Rule 10b-4. We need not express any view on the correctness of the arbitrators' or district court's decision. All that is needed here is a recognition of the arbitrators' efforts to apply an unclear rule of law to a complex factual situation. When the appropriate legal principles are applied, it is clear that the arbitration panel did not act in manifest disregard of the law.[viii]

Another example is American Postal Workers Union v. United States Postal Service, 682 F.2d 1280 (9th Cir.1982). A key factual determination for the arbitrator was whether a worker participated in a strike since a striker could not be employed by the postal service. The arbitrator waffled on the issue, apparently because of the consequences of such a decision on the worker's employment status. The court upheld vacation of the arbitrator's award, characterizing its ruling on the factual issue as manifest disregard of the law.

A court may have to make considerable inquiry into the factual findings of a panel in order to determine what law is applicable and whether or not it has been manifestly disregarded. In Colonial Penn Ins. Co v. American Centennial Ins. Co., 1997 U.S. Dist. Lexis 133 (S.D.N.Y.1997) Colonial Penn issued facultative certificates and ceded 90% to Dominion. Dominion arrange for common account excess of loss from American Centennial. The common account was for Colonial Penn and Dominion, as their interests may appear. Dominion later became insolvent and assigned its rights under the common account to Colonial Penn. Dominion owed money to American Centennial and as a result, American Centennial declined to pay more than 10% of recoverables under the common account to Colonial Penn. To pay Dominion's share to Colonial Penn, American Centennial argued, would be in violation of New York law on assignment and setoff. However, the panel ordered that American Centennial pay such sums without a rationale.

When American Centennial filed a motion to vacate, the court searched for a factual basis for the panel's ruling. The court determined that the panel might

have concluded that the language of the common account excess required American Centennial to reimburse Colonial Penn for the amounts it actually paid on the relevant claims. Therefore, Colonial Penn's right to recovery flowed through the common account excess and not the assignment. On this basis, the law of assignment was irrelevant and setoff did not apply due to lack of privity.

III. Cases Squarely Rejecting Court Review of a Panel's Findings of Fact

Hoffman v. Cargill Incorporated, 236 F.3d 458 (8th Cir.2001) involved the arbitration of a dispute over a contract to deliver corn. The district court reviewed the testimony and evidence submitted to the arbitration panel and concluded that the panel's decision was irrational, fundamentally unfair and in manifest disregard for the law. The court of appeal reversed the lower court decision noting:

In vacating the arbitration award, the district court essentially re-tried the already-arbitrated matter. The district court accepted evidence on matters and arguments that either were or could have been submitted to the arbitration panel. The district court simply disagreed with the arbitrators' analysis of the facts.[viii]

A late notice defense provided the factual backdrop for Transit Casualty Co. v. Trenwick Reinsurance Co., 659 F.Supp. 1346 (S.D.N.Y.1987). The arbitration panel found for the reinsurer, Trenwick, and Transit sought to vacate the order. The court rejected Transit's motion finding:

That the arbitrators erroneously decided the facts or erroneously applied the law does not suffice. (citation omitted)
. . . . At base, Transit simply disagrees with the legal and factual conclusions reached by the panel. By no means, however, does Transit's disagreement establish any of the statutory grounds for vacating an award or that the panel manifestly disregarded the law.[ix]

Many other cases reject the application of the manifest disregard doctrine to a panel's factual determinations, albeit, somewhat less explicitly. *See, Manifest Disregard, Vacating Arbitration Awards: A Circuit by Circuit Review, supra.*

IV. ANALYSIS AND COMMENTARY

It can be argued that any "manifest disregard" standard is a slippery slope inviting judicial intervention whenever there is strong disagreement with an arbitration order. It can argued equally that the manifest disregard of the facts cases cited above represent improper judicial activism, second-guessing the determinations of the arbitrators chosen by the parties and judicial wariness with the unstructured nature of the arbitration process.

However, an effort at reconciliation of these two lines of cases may involve a consideration of the difficulties inherent in applying a manifest disregard standard to arbitration awards which are usually very brief and may be completely devoid of any findings of facts or conclusions of law. Perhaps it is no accident that in four of the cases cites in Section II, *supra*, the panel provided no rationale for its award.[x] In one of these cases, the court made it clear that a questionable panel order would not benefit by the lack of a rationale:

We want to make clear that we are not holding that arbitrators should write opinions in every case or even in most cases. We merely observe that where a reviewing court is inclined to find that arbitrators manifestly disregarded the law or the evidence and that an explanation, if given, would have strained credulity, the absence of explanation may reinforce the reviewing court's confidence that the arbitrators engaged in manifest disregard.[xi]

Case law recognizes the need of a court to look into the facts of the case to determine whether the award is in manifest disregard of the law:

"The problem is how a court is to be made aware of the erring conduct of the arbitrators." When arbitrators decline to provide an explanation for their decision, a reviewing court can only infer from the facts of the case whether "the arbitrators appreciated the existence of a clearly governing legal principle but decided to ignore or pay no attention to it. (citations omitted)[xii]

Another court has commented in similar fashion:

Our evaluation of these opposing contentions is not helped by the form of the award. The arbitrators have produced no clue as to how they reached the precise result of $13,877,263 – a number apparently arrived at by a series of calculations. Although we have stated that "arbitrators may render a lump sum award without disclosing their rationale for it," we suggested at the same time that a court has the power to "inquire into the basis" of an award if it believes that the award was rendered "in manifest disregard" of the law or if "the facts of the case fail to support it."(citations omitted)[xiii]

Thus, it is clear that a reviewing court may look at the facts of the case to determine whether there has been a manifest disregard of the law by the panel. The lack of rationale by a panel may make this process doubly difficult since findings of fact by the panel may determine which legal issues are in play. *See* Colonial Penn Ins. Co. v. American Centennial Ins. Co., *supra*. In addition, a number of panel ruling (*e.g.* material misrepresentations) are a mixture of findings of fact and conclusions of law.

V. CONCLUSION

A relatively small number of cases would allow courts to vacate the order of an arbitration panel based on manifest disregard of the facts as well as the law. Some of these cases represent blatant second guessing of the factual findings of arbitrators. However, the heart of the issue may be more of a semantical difference than a true change in the law.

To rule on a claim of manifest disregard of the law, a court must look at the facts of the case to determine what legal issues are in play and whether there is any evidence that would tend to prove the elements of a particular cause of action or defense. Courts are forced to delve more deeply into the factual background when arbitral orders lack findings which support the conclusions of law. This may result in a somewhat different characterization of manifest disregard examination when the process is essentially the same.

Some reinsurance arbitrators are concerned that "reasoned orders" *i.e.* those with findings of fact and conclusions of law, will encourage motions to vacate. The case law in Section II above may suggest that reasoned orders will make motions to vacate less likely to succeed.

ENDNOTES

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[i]. 346 U.S. at 436 - 7.

[ii]. This article may be accessed at www.arias-us.org. It appears in the ARIAS US Quarterly for the second quarter of 2002.

[iii]. 148 F.3d at 204.

[iv]. 935 F.2d at 1019.

[v]. 164 F.Supp. at 406.

[vi]. 2000 U.S. 12428*6.

[vii]. 808 F.2d at 938.

[viii]. 236 F.3d 458 at 462.

[ix]. 659 F.Supp. 1346 at 1355.

[x]. Halligan v. Piper Jaffray, 148 F.3d 197 at 200; Merrill Lynch, Pierce, Fenner & Smith, 808 F.2d 930 at 933; Colonial Penn Ins. Co. v. American

Centennial Ins. Co., 1997 U.S. Dist. Lexis 133*11; Green v. Progressive Asset Management, Inc., 2000 U.S. Dist. Lexis 12428*2.

[xi]. Halligan v. Piper Jaffray, 148 F. 3d 197 at 204.

[xii]. Houdstermaatschappi v. Standard Microsystems Corp., 103 F.3d 9 at 12 - 13 (2nd Cir.1997)

[xiii]. Siegel v. Titan Industrial Corp., 779 F.2d 891 at 893 - 4 (2nd Cir. 1985).