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Courts Drastically Limit Review of Arbitration Awards

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In an earlier article, we detailed the heavy burden faced by counsel seeking to overturn or vacate an arbitration award under New York law.[1] To summarize, the New York courts drastically limit their review of arbitration awards, serving the goals of efficiency and judicial economy.[2] The limited grounds for vacatur or modification under the New Civil Practice Law and Rules are: "(1) corruption, fraud, or misconduct in procuring the award; (2) partiality of the arbitrator; (3) the arbitrator exceeded his power or imperfectly executed it; (4) failure to follow the procedures of Article 75 of the CPLR."[3]

As with New York law, the Federal Arbitration Act (FAA) gives arbitrators tremendous deference in federal courts, and grounds for vacatur or modification of arbitral awards are just as limited. Indeed, the burden placed upon parties seeking vacatur often proves too difficult to overcome. This article discusses the pitfalls of arbitration, focusing on the treatment of arbitration awards under the FAA, as compared to relevant New York law.

FAA and New York's Analog

The FAA, 9 U.S.C. §§1-14, sets forth federal arbitration standards. Formally enacted in 1925, the FAA mandates the enforcement of privately negotiated arbitration agreements.[4] Indeed, the FAA establishes that "as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration."[5] The FAA even extends federal substantive law on arbitrability not only to federal courts, but state courts as well.[6] Thus, the FAA clearly codifies a national preference for arbitration, where parties have agreed to alternative dispute resolution.

Operating as an instrument that enforces arbitration agreements, the FAA closely mimics New York's Civil Practice Law and Rules (the CPLR).[7] Like Article 75 of the CPLR, the FAA serves the twin aims of efficiency and judicial economy by promoting arbitration awards as valid and enforceable judgments.[8] Accordingly, both the CPLR and the FAA reflect liberal public policies toward arbitration.

Closely tracing CPLR 7511, the FAA enumerates four narrow grounds for vacating an arbitral award, including: "(1) where the award was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption…; (3) where the arbitrators were guilty of misconduct…or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers…."[9] As is demonstrated by extensive case law, these grounds are limited in their application.

Federal Judicial Review

Judicial review of arbitral awards is constrained by the FAA. As noted by one circuit court, judicial power to review awards is "among the narrowest known to the law."[10] This deference is only further emphasized by the fact that arbitrators are not bound by the rules of evidence

or, in large part, substantive law.[11] Nor do arbitrators need to disclose the facts or reasoning relied upon in determining awards.[12] Where awards are supported by the arbitrator's reasoning, courts hold no duty to examine the decision for accuracy or merit.

Obtaining vacatur in federal courts is just as difficult as in New York courts under the CPLR. Arbitration awards are not set aside for errors, whether in law or fact.[13] In at least one circuit, vacatur has been denied where the arbitrator's decision was deemed arbitrary and capricious by the district court.[14] Because arbitrators are not bound by substantive law or the rules of evidence, they need not follow "the niceties observed by the federal courts," and they may, for example, refer to evidence not included in the record.[15] Such discrepancies in the arbitration process do not provide valid grounds for vacatur or modification. Arbitration proceedings may be imprecise, so long as each party is afforded fair process.

Misinterpretations of fact are equally no grounds for vacatur. For example, courts have no authority vacating an award based upon an arbitrator's misinterpretation of a contract.[16] So long as a court can determine that factual interpretations are, at the least, plausible, vacatur is not permitted. This comports with the well-established principle that arbitrators are not required to disclose the basis upon which their awards are made.

Where improprieties in the arbitration process exist, as in a situation where an arbitrator fails to investigate conflicts of interest, courts are still reluctant to vacate or modify awards.[17] In *Applied Indus. Material Corp. v. Ovalar*, the court noted that the "failure to investigate is not, by itself, sufficient to vacate an arbitration award" and held that the arbitrator did not have a duty to investigate, so long as he informed the parties of his intent not to investigate.[18] Even when a pre-existing business relationship exists between arbitrators on a panel, a federal court is unlikely to meddle with the arbitration process.[19] In *Lucent Techs. v. Tatung*, two panel arbitrators did not disclose that they had co-owned an airplane 10 years earlier. This failure, however, did not mandate vacatur under the FAA. The U.S. Court of Appeals for the Second Circuit reasoned that the failure to disclose co-ownership of the plane was "simply too insubstantial to require vacatur."[20]

Despite imperfections in the arbitral process, federal courts presume that awards are rational and valid. For a party to overcome this presumption, the record must clearly demonstrate ample grounds for vacatur or modification. In *A.G. Edwards v. McCollough*, one party contended that opposing counsel offered defenses "so facially meritless that to offer them was to engage in 'undue means,'" contrary to Section 10(a) of the FAA.[21] The U.S. Court of Appeals for the Ninth Circuit readily rejected this argument, holding that courts must presume "arbitrators took a permissible route to the award where one exists."[22] Without sufficient evidence showing that the alleged undue means actually caused the award to be given, neither vacatur nor modification is appropriate.

Likewise, where a party claims corruption on the part of the arbitrator, the record must demonstrate that the alleged undue influence actually caused a prejudicial award. In *Kolel Beth v. YLL Irrevocable Trust*, the arbitrator was overheard in conversation (allegedly) revealing that one party would receive a favorable judgment.[23] The Second Circuit found no grounds for vacatur, even assuming the conversation actually occurred. Specifically, the conversation was "not direct or definite evidence of bias" required to justify vacatur.[24] Rather, in order to vacate judgment on the grounds of corruption, a reasonable person would have to conclude that the arbitrator was biased against one party. Thus, despite possible imperfections, federal circuits uphold the arbitral decisions.

Manifest Disregard Exception

In a prior article, the author noted that New York courts permit vacatur where an award is contrary to public policy.[25] This exception permits courts to overturn or stay arbitration where "there is any statutory, constitutional or public policy prohibition against arbitration of the grievance[26] or where a court can conclude "that the granting of any relief would violate public policy."[27] In very limited instances, federal courts allow vacatur where a party demonstrates that the arbitrator "manifestly disregarded" the law.[28]

The "manifest disregard doctrine" originated in the U.S. Supreme Court case, *Wilko v. Swan*, where the court found that "interpretations of the law by…arbitrators in *contrast to manifest disregard* are not subject…to judicial review for error in interpretation."[29] In following *Wilko*, federal courts have allowed for vacatur outside of the FAA where a party demonstrates that: "(1) the arbitrator knew of a governing legal principle yet refused to apply it or ignored it all together, and (2) the law ignored by the arbitrators was well defined, explicit and clearly applicable to the case."[30]

Of course, as with the provisions of the FAA, this is a markedly narrow exception. Vacatur remains a difficult judgment to obtain under the doctrine. The Supreme Court itself has questioned the scope of the manifest disregard doctrine,[31] prompting some circuits to reject the doctrine as a ground for vacating arbitration awards altogether.[32] Meanwhile, other circuits continue to apply the manifest disregard doctrine, finding that the Supreme Court only sought to limit the application of the doctrine.[33] This area of the law bears watching.

Conclusion

While there are some differences between the FAA and New York laws pertaining to arbitration, the two closely follow one another. The main departures between the two bodies of law—the federal manifest disregard doctrine, and New York's public policy exception—do not lead to entirely different results. In many ways, the grounds for vacatur in either jurisdiction is an incredibly difficult standard to meet. Accordingly, the unpredictability of the arbitration process, coupled with the difficulty of overturning unfavorable awards, signals the need to exercise caution when agreeing to arbitrate and selecting arbitration panels.

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Endnotes

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[1]http://www.newyorklawjournal.com/home/id=1202735156954/Selecting-Arbitrators-Is-Critical-Given-Courts-Deference-to-Awards.

[2]*Tullett Prebon v. BGC Fin.*, 975 N.Y.S.2d 18, 21 (1st Dept. 2013) ("awards are subject to very limited review in order to avoid undermining the twin goals of arbitration, namely, settling disputes efficiently and avoiding long and expensive litigation").

[3]See N.Y. C.P.L.R. 7511; see also *Bernstein Family Ltd. P'ship v. Sovereign Partners*, 66 A.D.3d 1, 7-8 (1st Dept. 2009) (confirmation is mandatory in the absence of grounds for vacatur).

[4]See *Dean Witter Reynolds v. Byrd*, 470 U.S. 213, 218 (1985) ("the Act leaves no place for the exercise of discretion by a district court, but instead mandates that district courts shall direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed").

[5]*Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 74 (1983).

[6]See *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984) ("In creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements.").

[7]See N.Y. C.P.L.R. §7511.

[8]See *Scherk v. Alberto-Culver Co.*, 417 US 506 (1974) ("designed to allow parties to avoid costliness and delays of litigation and to place arbitration agreements upon same footing as other contracts").

[9]9 U.S.C. §10(a).

[10]*Denver & Rio Grande W. R.R. v. Union Pac. R.R.*, 119 F.3d 847, 849 (10th Cir. 1997) (citation omitted).

[11]See *LJL 33rd St. Associates v. Pitcairn Properties*, 725 F.3d 184 (2d Cir. 2013), cert. denied, 134 S. Ct. 2289 (2014) ("it is indisputably correct that arbitrators are not bound by the rules of evidence").

[12]See *Bernhardt v. Polygraphic Co. of America*, 350 US 198, 203 (1956) ("they need not give their reasons for their results").

[13]See *Wallace v. Buttar*, 378 F.3d 182 (2d Cir. 2004) ("A federal court cannot vacate an arbitral award merely because it is convinced that the arbitration panel made the wrong call on the law.").

[14]*Brabham v. A.G. Edwards & Sons*, 376 F.3d 377, 382 (5th Cir. 2004) (Unlike manifest disregard, arbitrariness and capriciousness is not an accepted nonstatutory ground for vacatur in FAA cases in this Circuit.").

[15]*Bell Aerospace Co. Div. of Textron v. Inter. Union, United Auto.*, 500 F.2d 921, 923 (2d Cir. 1974).

[16]See *Anheuser-Busch v. Local Union 744, IBT*, 280 F.3d 1133, 1137 (7th Cir. 2002) ("The question is not whether the arbitrator misinterpreted the agreement, but only whether the arbitrator's inquiry disregarded the very language of the agreement itself.").

[17]See *Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi*, 492 F.3d 132 (2d Cir. 2007).

[18]Id. at 138.

[19]See *Lucent Techs. v. Tatung Co.*, 379 F.3d 24 (2d Cir. 2004).

[20]Id. at 31.

[21]*A.G. Edwards & Sons v. McCollough*, 967 F.2d 1401, 1402 (9th Cir. 1992).

[22]Id. at 1403.

[23]*Kolel Beth Yechiel Mechil of Tartikov v. YLL Irrevocable Trust*, 729 F.3d 99, 105 (2d Cir. 2013).

[24]Id. at 106.

[25]http://www.newyorklawjournal.com/home/id=1202735156954/Selecting-Arbitrators-Is-Critical-Given-Courts-Deference-to-Awards?mcode=1202615326010&curindex=1

[26]*Matter of City of Johnstown*, 99 N.Y.2d 273, 278 (2002).

[27]*Matter of New York City Tr. Auth. v. Amalgamated Tr. Union Local*, 1056, 801 N.Y.S.2d 237, 284 (Sup. Ct. 2005).

[28]See *Buttar*, 378 F.3d at 190 ("Our cases demonstrate that we have used the manifest disregard of law doctrine to vacate arbitral awards only in the most egregious instances of misapplication of legal principles.").

[29]*Wilko v. Swan*, 346 U.S. 427, 436-437 (1953) (emphasis added).

[30]*British Ins. Co. of Cayman v. Water St. Ins. Co. Ltd.*, 93 F.Supp.2d 506, 515 (S.D.N.Y. 2000).

[31]See *Hall St. Associates v. Mattel*, 552 U.S. 576, 585 (2008) ("Maybe the term "manifest disregard" was meant to name a new ground for review, but maybe it merely referred to the §10 grounds collectively, rather than adding to them.").

[32]See *Citigroup Global Markets v. Bacon*, 562 F.3d 349, 350 (5th Cir. 2009) ("We conclude that *Hall Street* restricts the grounds for vacatur to those set forth in §10 of the Federal Arbitration Act (FAA or Act), 9 U.S.C. §1 et seq., and consequently, manifest disregard of the law is no longer an independent ground for vacating arbitration awards under the FAA.").

[33]See *T.Co Metals v. Dempsey Pipe & Supply*, 592 F.3d 329, 340 (2d Cir. 2010) ("We agree with the district court that [e]ven if 'manifest disregard of the law' [is] still a viable theory, it would be inapplicable here.").