The Arbitration Newsletter

(Published by Whitaker Chalk Swindle & Schwartz PLLC)
(John Allen Chalk, Sr., Editor)

February, 2014

****

The Arbitration Newsletter is published periodically by Whitaker Chalk Swindle & Schwartz PLLC, Fort Worth, Texas, to explore the rapidly developing law and practice of commercial arbitration both in the U.S. and other countries.[1]

****

ARBITRATOR'S LEGAL ERROR IS NOT "MANIFEST DISREGARD"
Schafer v Multiband, 2014 U.S. App. LEXIS 288, 2014 WL 30713 (6th Cir. Jan. 6, 2014)

Schafer v. Multiband is a recent unpublished opinion by the United States Court of Appeals for the Sixth Circuit.[2] In *Schafer,* trustees of employee stock ownership plan settled claims of breach of fiduciary duty and sought indemnification from the parent companies who had agreed to indemnify the trustees pursuant to contractual indemnification provisions.[3] The arbitrator, however, found the indemnification agreements invalid because a provision of the Employment Retirement Income Act (ERISA) makes exculpatory agreements unenforceable.[4] The trustees filed suit seeking to have the arbitrator's decision vacated based on the arbitrator's manifest disregard of the law.[5] The district court agreed with the trustees and vacated the arbitrator's decision.[6] The district court reasoned that the arbitrator acted in manifest disregard of the law because the arbitrator committed more than a mere error of law when he was aware of clearly established legal precedent that was contrary to his conclusions, but he chose to ignore it.[7]

On appeal, the Sixth Circuit noted that the arbitrator's decision would have been reversed if it were a court decision subject to Sixth Circuit precedent.[8] Yet, the Court reversed the district court's judgment.[9] The Court held that the arbitrator's decision did not fall under any of the

---

[1] Nothing in *The Arbitration Newsletter* is presented as or should be relied on as legal advice to clients or prospective clients. The sole purpose of *The Arbitration Newsletter* is to inform generally. The application of the comments in *The Arbitration Newsletter* to specific questions and cases should be discussed with the reader's independent legal counsel.

[2] The Sixth Circuit, along with the Second, Fourth, and Ninth Circuits, continue to recognize "manifest disregard" as a common law vacatur ground. *See* the January 2014 *Arbitration Newsletter* for a decision of the recent *Dewan v. Walia*, 2013 WL 5781207 (4th Cir.2013), and the excellent Amici Curiae Brief filed in support of a Petition for Writ of Certiorari to the U.S. Supreme Court on the continuing viability of "manifest disregard" as an independent common law ground for vacatur.

[3] *Schafer v. Multiband Corp.*, 2014 U.S. App. LEXIS 288 at *1, 2014 WL 30713, *1 (6th Cir. Jan. 6, 2014).

[4] *Id.*

[5] *Id.* at *9.

[6] *Id.*

[7] *Id.*

[8] *Id.* at *1.

[9] *Id.* at *17.

statutory vacatur grounds provided by the Federal Arbitration Act (FAA)[10] nor did the arbitrator's decision fall under the common law vacatur ground - manifest disregard of the law.[11]

The Sixth Circuit explained that a court's review of an arbitrator's decision is one of the narrowest standards of judicial review.[12] Absent extraordinary circumstances, arbitration is supposed to resolve with finality, legal as well as factual disputes.[13] Thus, legal error by the arbitrator—even clear legal error or "apparent error of law"—is not sufficient, by itself, for vacatur of an arbitrator's decision.[14] One of the advantages of arbitration is the avoidance of the expense of appeals, and the avoidance of such costs would be undermined by permitting appeals based on clear error of law.[15]

Manifest disregard of the law is not just manifest error of law.[16] Under a manifest disregard of the law standard, a general review for an arbitrator's legal errors is not permitted.[17] If the arbitrator expressed disagreement with the law, rather than interpretation of the law, that might suggest "disregard."[18]

The Sixth Circuit reasoned that the narrow review of arbitral decisions "leads to the conclusion that the arbitrator is not necessarily bound by court precedent."[19] Court precedent is "binding in courts and on agencies whose decisions are appealable to the courts."[20] The court held that an arbitrator cannot reject the law, but can disagree with nonbinding precedent, as to the arbitrator, without disregarding the law. Because the arbitrator's decision reasoned from statute and the contract,[21] and not in clear disregard of them, he did not reject the law but disagreed with what to the arbitrator was nonbinding court precedent.[22] Thus, notwithstanding an apparent or clear error of the law, the Sixth Circuit held that the arbitrator did not manifestly disregard the law by interpreting rather than rejecting the law.

The court explained that the arbitrator "relied on a very broad 'plain' reading of the ERISA provision" in question, "relied on a narrow and formal meaning of the insurance

---

[10] Under the FAA, a court must confirm an arbitration award unless it is vacated, modified, or corrected as prescribed in §§ 10 and 11. Section 10 lists grounds for vacating an award. These are: (1) where the award was procured by corruption, fraud, or undue means; (2) where there is evident partiality or corruption in the arbitrators, or either of them; (3) where the arbitrators were guilty of misconduct in refusing to hear evidence pertinent and material to the controversy, or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their power, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made. *Id.* at * 10–11.

[11] *Id.* at *11.

[12] *Id.* at *10.

[13] *Id.* at *2.

[14] *Id.* at *16.

[15] *Id.*

[16] *Id.*

[17] *Id.* at *12.

[18] *Id.* at *16.

[19] *Id.* at *17.

[20] *Id.*

[21] Here, the arbitrator relied on (1) a very broad reading of the ERISA provision invalidating contractual provisions that relieve a fiduciary of liability; (2) a narrow meaning of the insurance exception to that provision; and (3) precedent the court believed was distinguishable from this case. *Id.* at *16–17.

[22] *Id.* at *17.

exception [to the ERISA provision]," and "relied on precedents that we can distinguish."[23] This means, according to the Sixth Circuit, that the arbitrator's award is "possible" disregard of the law or "even likely" disregard of the law, but it is now "manifest disregard."[24] In other words, this "questionable reading" of the law in which the arbitrator disagreed "with nonbinding precedent" is not rejection of the law that would implicate "manifest disregard."[25]

On this reasoning, the Sixth Circuit expressly declined to "decide whether a manifest disregard of the law legitimately forms a basis for vacatur in the **first place**, either as an interpretation of the **fourth** statutory basis for vacatur, or as a **fifth, inferred**, basis for vacatur."[26] But whether manifest disregard is or is not permitted as a vacatur ground, the court explained that what this arbitrator did (in his reading and interpretation of the law) was not manifest disregard of the law. [27]

OBSERVATIONS

1. It does appear that the Sixth Circuit, with *Schafer*, has narrowed its review of arbitration decisions based on "manifest disregard."[28]

2. There is no manifest disregard common law vacatur in the Fifth Circuit.[29]

3. FAA jurisprudence, including *Schafer*, stresses finality of arbitration awards even in the face of clear, apparent legal and factual error.[30]

4. In an arbitration award the arbitrator should strive to ground the award in both the applicable law and the relevant facts, unless the parties have expressly agreed (in writing) that the arbitrator may decide the dispute *ex aequo et bono*.

5. As long as the arbitrator considers or interprets but does not disagree with the applicable law, the Sixth Circuit according to *Shafer*, will find no "manifest disregard of the law."

---

[23] 2014 WL 30713, *5.
[24] *Id.*
[25] *Id.*
[26] 2014 WL 30713, *4 (emphasis added).
[27] *Id.*
[28] "2014 WL 30713, *4 ("Because the arbitrator, notwithstanding his apparent error of law, did not manifestly disregard the law so as to warrant vacatur of the award, we need not decide whether a manifest disregard of the law legitimately forms a basis for vacatur in the **first place**, either as an interpretation of the fourth statutory basis for vacatur, **or** as a fifth, **inferred**, basis for vacatur.") (emphasis added). In either approach, "manifest disregard" for the Sixth Circuit appears to be tied to 9 U.S.C. §10(a).
[29] *Citigroup Global Markets, Inc. v. Bacon*, 562 F.3d 349, 350 (5th Cir. 2009).
[30] *See Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219-220, 105 S.Ct. 1238, 84 L.Ed.2d 158 (1985).