Courts Call for Good FAA Stewardship

Spare the Rod and Spoil the Arbitration

By Edward M. Slaughter, Kenneth Sisco and Jason Gregory

With narrowed grounds for challenging arbitration awards, courts are aggressively sanctioning litigants who frustrate the purpose of the Federal Arbitration Act.

The Federal Arbitration Act envisions arbitration as an alternative to litigation rather than as a precursor. Arbitration serves the dual purposes of unburdening courts that are clogged with business disputes and providing potential litigants with a way to resolve disputes that is less protracted than litigation. The aspirations of the Federal Arbitration Act (FAA) vanish when abusive parties treat arbitration as nothing more than a first step toward the courthouse. Meritless appeals of arbitration compound the expense and delay of litigation rather than avoid it. To ensure that the aspirations of the Federal Arbitration Act are achieved, our courts have narrowed the basis for appealing arbitration awards and made it plain that they will mete out sanctions for frivolous appeals that frustrate the purpose of the act. *Hall Street Associates, LLC v. Mattel*, 128 S. Ct. 1396 (2008); *B.L. Harbert Intern., LLC v. Hercules Steel Co.*, 441 F.3d 905 (11th Cir. 2006).

In 2008, the United States Supreme Court held that a court could only vacate an arbitration award based on the statutory grounds listed in 9 U.S.C. §10(a). *Hall Street Associates, LLC v. Mattel*, 128 S. Ct. 1396 (2008). This decision eliminated the non-statutory grounds that had been enunciated by prior courts vacating arbitration awards, and thereby narrowed the grounds for appealing an arbitration award. By eliminating redundant and vague non-statutory grounds, the Supreme Court made it clear that vacating arbitration awards was a remedy rarely available and narrowly reviewed. The Supreme Court also raised a question that is the subject of some debate. Namely, what exactly constitutes a non-statutory ground for vacating an arbitration award?

Historically, four statutory grounds and three non-statutory grounds had existed for vacating an arbitration award. The four statutory grounds are specifically addressed by the Federal Arbitration Act in 9 U.S.C. §10(a)(1–4). However, the non-statutory grounds were judicially created to vacate arbitration awards and had been adopted

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by the circuit courts of appeals. They included the following: (1) the award was arbitrary and capricious, (2) enforcement of the award was contrary to public policy; and (3) the award was made in manifest disregard for the law. The Supreme Court's decision eliminated these non-statutory grounds.

The debate over the meaning of these non-statutory grounds continues. In reference to one of the historical non-statutory grounds, the Supreme Court stated that "manifest disregard may mean a new ground of review, but maybe it merely referred to §10 grounds collectively." 128 S. Ct. 1396, 1404 (2008). The possibility that the non-statutory grounds survive between the lines of the statutory grounds has led a number of circuit courts to address the question of just what the phrase "manifest disregard" means. Unfortunately, the answer has been anything but uniform or clear.

Arbitration's allure is dependent upon the arbitrator being the last decision maker in all but the most unusual cases.

The courts have not clearly defined manifest disregard. For instance, the Ninth Circuit Court of Appeals clearly stated, "manifest disregard ground for vacatur is shorthand for a statutory ground under the FAA, specifically 9 U.S.C. §10(a)(4)." *Comedy Club Inv. v. Improv West Assocs.*, 553 F.3d 1277, 1290 (9th Cir. 2008); *see also Williams v. RI/WFI Acquisition Corporation*, 2009 U.S. Dist. Lexis 11115, 5, 2009 WL 383420, 2 (N.D. Ill. 2009) ("In the Seventh Circuit, a corollary to §10(a)(4) is vacatur for 'manifest disregard of the law.'"). In contrast, the Fifth Circuit has stated, "to the extent manifest disregard of the law constitutes a non-statutory ground for vacatur it is no longer a basis for vacating awards under the FAA." *Citigroup Global Markets Inc. v. Debra M. Bacon*, 562 F.3d 349, 355 (5th Cir. 2009). It is possible that the Fifth Circuit will allow counsel to allege manifest disregard as a grounds for vacating an arbitration award. However, based on this language, it is equally plausible that the Fifth Circuit will state that under the Supreme Court's holding in *Hall Street* this is a non-statutory ground for vacatur and is improper—thereby exposing the party who alleged manifest disregard to sanctions.

Thus, while *Hall Street* limits the grounds for vacating arbitration awards and makes it easier to spot frivolous appeals, the various courts of appeal may interpret differently whether, and to what extent, the statutory basis for appeal contain remnants of the historical non-statutory grounds. This debate will no doubt play out in the courts of appeal in the context of an increasing willingness to issue sanctions to curtail frivolous appeals of arbitration awards.

Given the willingness of courts to impose sanctions for frivolous appeals of arbitration awards and the inconsistent application of manifest disregard by courts as a statutory ground of vacatur, counsel will best serve a client by simply refraining from using this phrase during appeal. Instead, counsel should specifically allege a statutory ground for vacatur as listed in the Federal Arbitration Act. Whether you seek to appeal or enforce an arbitration award, you should remember the growing tendency of courts of appeal to issue sanctions for frivolous appeals.

In *B.L. Harbert Intern., LLC v. Hercules Steel Co.*, 441 F.3d 905 (11th Cir. 2006), the Eleventh Circuit Court of Appeals recognized the existence of what it called a "poor loser problem" that threatened to frustrate the purposes of the Federal Arbitration Act. The court suggested that the way to retard this trend was to award sanctions when the losing party moved to vacate an arbitration award without "any real legal basis for doing so." *Id.* at 913.

The *Harbert* case arose from a contract dispute on a construction project. B.L. Harbert International, LLC, was the general contractor for a federal construction project and had awarded Hercules Steel Company the subcontract to supply and erect the project's structural steel. During the course of construction, a dispute arose between Harbert and Hercules. Harbert was dissatisfied with Hercules' performance and withheld payment. Hercules responded by filing an arbitration demand seeking to recover the unpaid contract balance and other damages. Harbert responded by filing a counterclaim seeking delay damages, accelerated costs and other damages. The case proceeded to arbitration.

After the arbitration hearing, the arbitrator found in favor of Hercules and ultimately awarded Hercules the unpaid contract balance and denied all of Harbert's claims. Unhappy with the result, Harbert filed a motion to vacate with the district court, and Hercules countered with a motion to confirm. The district court denied Harbert's motion to vacate and granted Hercules' motion to confirm. Harbert appealed to the Eleventh Circuit.

On appeal, Harbert's sole argument for vacating the arbitration award was that the arbitrator acted in manifest disregard of the law. After analyzing the manifest disregard of the law standard and applying it to the facts of the case, the court found that Harbert's argument did "not come within shouting distance of the (manifest disregard) exception." The court found that Harbert had litigated the case without a good basis through the district court and appellate court, depriving Hercules and the judicial system of the principal benefits of arbitration, which the court discussed in its opinion:

> Instead of costing less, the resolution of this dispute has cost more than it would have had there been no arbitration agreement. Instead of being decided sooner, it has taken longer than it would have to decide the matter without arbitration. Instead of being resolved outside the courts, this dispute has required the time and effort of the district court and this Court.

Id. at 913.

The court proceeded to explain that the *Harbert* case was not an isolated instance of the growing "poor loser" problem, which it described this way:

> When a party who loses an arbitration award assumes a never-say-die attitude and drags the dispute through the court system without an objectively reasonable belief it will prevail, the promise of arbitration is broken. Arbitration's allure is dependent upon the arbitrator being the last decision maker in all but the most unusual cases. The more cases

there are, like this one, in which the arbitrator is only the first stop along the way, the less arbitration there will be. If arbitration is to be a meaningful alternative to litigation, the parties must be able to trust that the arbitrator's decision will be honored sooner instead of later.

Id. at 913.

After recognizing and describing the poor loser problem, the court's solution was to impose sanctions on a party that attacked an arbitration award without a real legal basis. *Id.* at 913. The court posited that the threat of sanctions may discourage baseless litigation over arbitration awards and help fulfill the purposes of the pro-arbitration policy contained in the FAA.

The court's rational and reasoning in *Harbert* was clear, and even though it did not impose sanctions, subsequent cases decided in courts under the jurisdiction of the Eleventh Circuit have awarded sanctions based on the precedent. In *Rueter v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 440 F. Supp. 2d 1256, 1265–67 (N.D. Ala. 2006), the District Court for the Northern District of Alabama found that the facts in that matter presented precisely the type of behavior that the Eleventh Circuit admonished in *Harbert*. However, unlike the plaintiff in *Harbert*, these plaintiffs had received both notice and warning of the possibility of sanctions. The court noted that the *Harbert* case did not propose a specific rule, statute or standard that would assist the court in determining sanctions. The court then examined the case through the substantive lens of Federal Rule of Civil Procedure 11, even though the procedural requirements of the rule had not been met.

The court applied Fed. R. Civ. P. 11 substantive standards to determine that in accordance with the authority of *Harbert* a court could levy sanctions sua sponte against a party. *Id.* at 1266. The court then concluded that the plaintiff's motion to vacate was based on a legal theory that had no reasonable chance of success and could not be considered as a reasonable argument to change existing law. Since the plaintiff had needlessly increased the cost of litigation, the court imposed sanctions. Other cases heard by courts in the Eleventh Circuit have likewise recognized *Harbert* and a court's ability to award sanctions for meritless motions to vacate arbitration awards. *See SII Investments, Inc. v. Jenks*, 2006 WL 2092639 (M.D. Fla., 2006) (unreported opinion where the court awarded sanctions); *Deitchman v. Bear Stearns Securities Corp.*, 2007 WL 4592238 (S.D. Fla.2007) (unreported opinion where the court recognized ability to award sanctions but found that the facts did not warrant sanctions).

Though they have not necessarily referred specifically to *Harbert*, courts in the Second, Seventh, Ninth and Tenth Circuits (as well as one decision from the First Circuit) appear more than willing to impose sanctions if it has been clear that an appeal has been frivolous and detrimental to the arbitration process.

Second Circuit

A survey of cases by the authors suggests that the Second Circuit would impose sanctions if it found a motion to vacate frivolous. In several Second Circuit cases the court considered imposing sanctions for filing a motion to vacate, but the court did not find that the facts of the cases warranted them. *See International Telepassport Corp. v. USFI, Inc.*, 89 F.3d 82, 86 (2d Cir. 1996) (finding that viewed charitably, a losing party to arbitration's motion to vacate was barely a non-frivolous argument and affirming the district court's denial of a motion for Fed. R. Civ. P. 11 sanctions); *W.K. Webster & Co. v. American President Lines, Ltd.*, 32 F.3d 665, 670 (2d Cir. 1994) (Fed. R. Civ. P. 11 sanctions were not warranted where the court found that a motion to vacate had not been filed for improper purposes, presented colorable claims and made plausible arguments in support of its positions); *York Research Corp. v. Landgarten*, 927 F.2d 119, 123 (2d Cir. 1991) (upholding a trial court's refusal to award sanctions against a losing party to arbitration for petitioning to the vacate award because the motion was "colorable"); *see also Fort Hill Builders, Inc. v. National Grange Mut. Ins. Co.*, 866 F.2d 11, 16 (1st Cir. 1989) (finding that a party's motion to vacate an arbitration award was not frivolous and overturning sanctions under Fed. R. Civ. P. 56).

Seventh Circuit

In *Cuna Mutual Insurance Society v. Office and Professional Employees International Union, Local 39*, 443 F.3d 556 (7th Cir. 2006), a local union filed a grievance against Cuna regarding the potential outsourcing of a number of jobs. CUNA lost the arbitration and subsequently sought to vacate the award in Wisconsin federal district court. Cuna's appeal to the district court failed, and the court imposed Fed. R. Civ. P. 11 sanctions because the suit was not well grounded in fact, warranted by existing law and failed to present a good faith argument for the extension, modification or reversal of existing law. *Id.* at 560.

On appeal, the Seventh Circuit determined that a long line of Seventh Circuit cases has established a precedent. That discouraged parties from challenging arbitration awards by imposing Fed. R. Civ. P. 11 sanctions. *Id.* at 561. In this case, the Seventh Circuit found that the arbitrator's determination was clear and easy to follow and that Cuna's attempts to "sidestep" the deferential standard afforded arbitration awards warranted sanctions. *Id.* at 562.

Ninth Circuit

In *G.C. and K.B. Investments, Inc. v. Wilson*, 326 F.3d 1096 (9th Cir. 2003), the Ninth Circuit held that sanctions had been properly imposed by the district court because the party that sued had filed improper motions specifically to delay the arbitration process. This case involved the Wilsons, operators of a SpeeDee franchise in Hawaii. The Wilsons sought to vacate a Louisiana arbitration award that favored of G.C. and K.B., which held franchisor rights to SpeeDee. *Id.* G.C. and K.B. filed an application to confirm the arbitration award in California federal district court under the arbitration agreement and the FAA. *Id.* at 1101. G.C. and K.B. also sought an order in Hawaii state court to enforce the federal court judgment against the Wilsons in Hawaii. *Id.* The Wilsons then sought a "motion for limited remand" to have the court consider its Fed. R. Civ. P. 60(b) motion. *Id.* At that time, G.C. and K.B. sought an injunction to prevent the Wilson's from further interfering with its ability to obtain the judgment. *Id.* The Hawaii district court vacated the arbitration award, holding that the federal district court did not have subject matter jurisdiction. *Id.* at 1102. The California federal district court, where G.C. and K.B. had sought to enforce the arbitration

Statutory Grounds for Vacating Arbitration Awards

Where the award was procured by corruption, fraud, or undue means.	9 U.S.C. §10(a)(1)
Where there was evident partiality or corruption in the arbitrators, or either of them.	9 U.S.C. §10(a)(2)
Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or 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.	9 U.S.C. §10(a)(3)
Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.	9 U.S.C. §10(a)(4)

award, imposed FED. R. CIV. P. 11 sanctions against the Wilsons. *Id.*

In reviewing the case, the Ninth Circuit determined that the Wilsons had misconstrued the nature of a proceeding to confirm an arbitration award and that the only way to vacate or correct an arbitration award was through the statutory grounds delineated by 9 U.S.C. §10 and §11. *Id.* The FAA applied to this case, and the California district court had been bound to grant a confirmation award unless one of the grounds in 9. U.S.C. §10 and §11 vacated or modified the award. *Id.* The Ninth Circuit also found that because the Wilsons had failed to allege anything other than arguments rejected by the California district court, such as proper statutory grounds to vacate, the FED. R. CIV. P. 11 sanctions had been proper. *Id.* at 1110–11.

Tenth Circuit

In *Dominion Video Satellite, Inc. v. Echostar Satellite L.L.C.*, the parties sought arbitration to resolve a dispute regarding whether a lease agreement had been breached. 430 F.3d 1269 (10th Cir. 2005). When arbitration favored Dominion, Echostar "vigorously opposed… the arbitration panel's decision by filing numerous motions and supporting memoranda." *Id.* at 1272. The district court found that Echostar "had unreasonably and vexatiously extended the arbitration hearings and court proceedings" and imposed sanctions, awarding Dominion "its costs, expenses and attorney's fees incurred in responding to Echostar frivolous motions." *Id.* The Tenth Circuit stated that all the arguments raised by Echostar on appeal, including manifest disregard, had been raised and rejected three times. *Id.* at 1275–76. On reviewing Echostar's claims, the Tenth Circuit found that "none of the arguments advanced by Echostar were grounds for vacating an arbitration award," and Echostar's appeal of the confirmation award was frivolous. *Id.* at 1278. The court then instructed Dominion to file a separate brief within 10 days that apprised the court of its necessary attorney's fees and costs so that it could impose FED. R. APP. P. 38 sanctions, and the Tenth Circuit upheld the district court's imposition of attorney's fees and costs under 28 U.S.C. §1927.

In *DMA International, Inc. v. Qwest Communications*, the Tenth Circuit decided that sanctions were warranted to compensate Qwest for the unnecessary legal fees it had been forced to spend defending the arbitration award on appeal. 585 F.3d 1341 (10th Cir. 2009). The Tenth Circuit specifically cited *B.L. Harbert International LLC v. Hercules Steel Co.*, and stated that sanctions were the only way in which to "give breath to the national policy favoring arbitration." *Id.* at 1346.

Conclusion

The United States Supreme Court has narrowed the grounds for challenging arbitration awards. *Hall Street Associates, LLC. v. Mattel*, 128 S. Ct. 1396 (2008). Both before and after the *Hall Street* decision, federal courts have aggressively meted out sanctions against litigants if they have frustrated the purpose of the Federal Arbitration Act through meritless challenges to arbitration awards. *See, e.g.*, *B.L. Harbert Intern., LLC, v. Hercules Steel Co.*, 441 F.3d 905 (11th Cir. 2006); *DMA International, Inc. v. Qwest Communications*, 585 F.3d 1341 (10th Cir. 2009). The courts have called on practitioners to serve as good stewards of the Federal Arbitration Act so that its aspirations will be fulfilled. Arbitration award challenges that fail to meet statutory criteria are not just bad form, the courts will impose sanctions against them. FD