North America

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CITIGROUP GLOBAL MARKETS INC v DEBRA BACON

Awards; Commercial arbitration; Striking out; United States

Enforcement; vacatur; manifest disregard for the law; Hall Street Associates LLC v Mattel Inc; ss.10 and 11 of the Federal Arbitration Act

Citigroup Global Markets Inc v Debra Bacon: manifest disregard for the law is no longer a valid ground for vacatur of an arbitral award in the Fifth Circuit

562 F.3d 349, 2009 WL 542780 (5th Cir. March 5, 2009)

Summary

The United States Court of Appeals for the Fifth Circuit held that, in light of the Supreme Court's recent decision in *Hall Street Associates LLC v Mattel Inc* 128 Sup. Ct. 1396 (2008), manifest disregard of the law is no longer a valid ground for vacatur of an arbitration award.

Facts and background

This litigation began as a dispute between Debra Bacon, her husband (Randall Bacon), and their bank (Citigroup Global Markets Inc, which was formerly known as Salomon Smith Barney, referred to here as Citigroup throughout). In 1996, the Bacons opened several individual and joint retirement accounts with Citigroup. Shortly thereafter, they decided to open a restaurant and withdrew money from their retirement accounts to fund this project. The Bacons opened a second restaurant in 2000. By 2001, the restaurants were struggling and Randall began withdrawing money from Debra's account without her permission in an attempt to save the failing businesses.

When Debra became aware of these unauthorised transactions, she promptly called the bank to freeze her accounts and filed for divorce. As part of the property division, Randall agreed to pay Debra more than US $360,000, but failed to do so. In late 2003, Debra initiated arbitration against the bank, claiming that it had assisted Randall in these unauthorised transactions and caused her loss of money. The arbitration panel found in favour of Debra and ordered Citigroup to pay US $218,000 in damages, plus attorneys' fees.

Citigroup then filed an action in the US District Court for the Southern District of Texas, seeking to vacate the award. The bank argued that the arbitral panel "manifestly disregarded" the law: (a) on causation for damages; (b) on customers' duty to report unauthorised withdrawals promptly; (c) on proportionate responsibility; and (d) on attorneys' fees. The court agreed with the bank and vacated the award, finding that the "arbitrators wholly chose to disregard" the law. *Citigroup Global Markets Inc v Debra Bacon* Civ. A. No. H-05-3849, 2007 WL 2255114, at 4 (S.D. Tex. August 3, 2007).

Debra Bacon appealed to the US Circuit Court of Appeals for the Fifth Circuit on the basis that a recent Supreme Court decision, *Hall Street Associates*

LLC v Mattel Inc, invalidated manifest disregard of the law as a ground for vacatur of an arbitration award.

Holding

The Fifth Circuit held that in enacting the Federal Arbitration Act (FAA), Congress embraced the notion that arbitration awards should generally be upheld absent some sort of procedural injustice. In particular, FAA ss.10 and 11 enumerate the specific grounds on which an arbitral award can be vacated, modified, or corrected, and largely reflect the grounds that may be invoked under the New York Convention.

Section 10 provides that, upon application by a party to the arbitration, a federal court may vacate the arbitral award for any of the following reasons:

"(1) where the award was procured by corruption, fraud, or undue means;
(2) where there was evident partiality or corruption in the arbitrators, or either of them;
(3) 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; or
(4) 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."

Section 11 of the FAA provides that, upon application by a party to the arbitration, a federal court may issue an order modifying or correcting the arbitral award upon the application:

"(1) where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award;
(2) where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted; or
(3) where the award is imperfect in matter of form not affecting the merits of the controversy."

In considering the issue presented, the Fifth Circuit relied extensively on the Supreme Court's recent decision in *Hall Street*. In that case, the Supreme Court examined the FAA's plain language and the legislative history, and held that the FAA's grounds for vacatur and modification are exclusive and cannot be expanded.

Prior to *Hall Street*, most appellate courts, including the Fifth Circuit, had recognised manifest disregard of the law as a valid basis for vacating arbitration awards in addition to those specific grounds listed in the FAA. The Fifth Circuit's definition, which was similar to that embraced by other appellate courts, was:

> "Manifest disregard of the law means more than error or misunderstanding with respect to the law. The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator. Moreover the term 'disregard' implies that the arbitrator appreciates the existence of a clearly governing principle but decides to ignore or pay no attention to it."

2009 WL 542780, at 4 (citing *Prestige Ford v Ford Dealer Computer Services Inc* 324 F.3d 391 (5th Cir. 2003)). But, in light of *Hall Street*, the Fifth Circuit concluded that manifest disregard is no longer a valid basis for vacating

awards under the FAA, because it had previously been defined as a *non-statutory* ground for vacatur. In so holding, the Court specifically overruled its previous precedent.

Comment

Other appellate courts have also considered this issue since the Supreme Court's judgment in *Hall Street*. The First Circuit, in *Ramos-Santiago v United Parcel Services* 524 F.3d 120, 124 (1st Cir. 2008), concluded that *Hall Street* abolished manifest disregard of the law as a ground for vacatur. In *Coffee Beanery Ltd v WW LLC* 300 Fed. Appx. 415, 418–19 (6th Cir. 2008), the Sixth Circuit came to different conclusion by adopting a narrow construction of *Hall Street,* holding that it applies only to *contractual* expansions of the grounds for review. The Second Circuit also held that manifest disregard survives *Hall Street* and remains a valid basis for vacatur. *Stolt-Nielsen SA v Animal Feeds International Corp* 548 F.3d 85, 93-95 (2d Cir. 2008). The Second Circuit harmonised its prior holdings with *Hall Street* by recasting "manifest disregard" as a shorthand for the grounds set forth in s.10 of the FAA—e.g., that the arbitrators "exceeded their powers". Using similar reasoning, the Ninth Circuit reached the same result. *Comedy Club Inc v Improv West Associates* 553 F.3d 1277, 1290 (9th Cir. 2009).

This decision heralds a narrowing within the Fifth Circuit of the scope of judicial review of arbitration awards that are subject to the FAA. Although this case did not involve an international arbitration award subject to either the New York or Washington Conventions, this judgment is suggestive of a trend toward less searching judicial review of arbitration awards in general. This is particularly so given the influential role played by the Fifth Circuit in the review and enforcement of international arbitration awards. Outside of the Fifth Circuit, recent judgments suggest that federal courts may be willing to adopt a view of the FAA in light of *Hall Street* that allows them to retain the ability to scrutinise the merits of arbitration awards, even though they generally use such authority sparingly.

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In the context of international commercial arbitration, these judgments indicate that even after the influential judgment by the Supreme Court in *Hall Street,* some element of doubt still subsists as to the willingness of US federal courts in some circuits to go beyond the narrow grounds for review that are enumerated in the New York Convention.