Journal of Dispute Resolution

Volume 2004 | Issue 1 Article 17

2004

Securities Arbitration Awards of Punitive Damages: Protective or Expansive Steps for Review - Sawtelle v. Waddell & (and) Reed, Inc.

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Securities Arbitration Awards of Punitive Damages: Protective or Expansive Steps for Review?

Sawtelle v. Waddell & Reed, Inc.[1]

I. INTRODUCTION

An award of punitive damages is often the most significant and detrimental part of an award arising from a judicial or arbitral proceeding. In 1995, the United States Supreme Court resolved a circuit split upholding an arbitral panel's authority to award punitive damages under a securities arbitration agreement.[2] This decision was monumental in establishing arbitral power. However, it left several questions unanswered. For example, which, if any, standards should be applied to such awards?

This casenote addresses the reviewability of punitive damages awards arising out of a securities arbitration hearing.

II. FACTS AND HOLDING

For seventeen years Stephen B. Sawtelle (Sawtelle) was the registered representative of Waddell & Reed, Inc. (Waddell), a member of the National Association of Securities Dealers, Inc. (NASD).[3] Waddell terminated Sawtelle's employment on February 9, 1997, citing personal differences and suspicions about his security practices.[4] Sawtelle claimed his termination was in retaliation for his testimony against a fellow Waddell broker, David Stevenson, before the Securities and Exchange Commission (SEC).[5]

In July 1997, Sawtelle filed a statement of claim with the NASD against Waddell and certain officers and representatives, alleging tortious interference with business expectancy and violation of the Connecticut Unfair Trade Practices Act (CUTPA).[6] On November 14, 1999, Waddell countered by filing a statement of claim against Hackett Associates, Inc. (Hackett), Waddell's competitor and Sawtelle's new employer as of February 10, 1997. The claim was based on Sawtelle's actions following his termination.[7]

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1. 754 N.Y.S.2d 264 (N.Y. App. Div. 2003).

2. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52 (1995). *See* Carroll E. Neesemann & Maren E. Nelson, *Securities Arbitration Damages*, *in* SECURITIES ARBITRATION 1999, at 683, 707-15 (PLI Corp. Law & Practice Course, Handbook Series No. B0-0092, 1999) [hereinafter Neesemann & Nelson, *Securities Arbitration Damages*].

3. *Sawtelle*, 754 N.Y.S.2d at 267.

4. *Id.*

5. *Id.* The SEC subsequently convicted Stevenson for embezzling millions of dollars from his clients. *Id.*

6. *Id.* at 268; CONN. GEN. STAT. §§ 42-110a, et seq. (1995).

7. *Sawtelle*, 754 N.Y.S.2d at 267-68.

The day after Sawtelle's termination, Waddell sent letters to all 2,800 customers previously represented by Sawtelle informing them that Sawtelle was no longer employed by the company and explaining potential tax liabilities and other fees which they would incur if their investments were transferred from Waddell to Hackett.[8] On February 26, 1997, Sawtelle mailed letters to the same customers informing them of his transfer to Hackett, and soliciting their business.[9] As a result, Sawtelle retained a large portion of his prior customers.[10]

Throughout the subsequent months, Sawtelle's customers who attempted to contact him at his old employment were informed by Waddell that Sawtelle's whereabouts were unknown and suggested that Sawtelle may have engaged in past criminal conduct similar to David Stevenson.[11] Waddell also re-routed mail and phone calls from Sawtelle's Connecticut office to Waddell's office.[12]

Following NASD rules, Waddell prepared a Form U-5, Uniform Notice of Termination, citing "personality differences" as their reason behind Sawtelle's discharge from the firm.[13] Waddell checked "yes" to questions fourteen and fifteen on the form, stating Sawtelle was under investigation by a governmental body or self-regulatory organization, and he was under internal review for fraud or wrongful taking of property.[14] The Form U-5 filed by Waddell also cited a customer complaint about the inadequacy of Sawtelle's services. A subsequent investigation led the NASD to issue a "no action" letter in regard to this complaint.[15] Waddell later filed amendments to Sawtelle's Form U-5, reporting dozens of new complaints to Sawtelle's work. The NASD also issued "no action" letters for these additional customer complaints.[16]

On September 11, 2000, a three-member arbitration panel consolidated all of the claims between the parties and granted Hackett's motion to dismiss Waddell's claims.[17] The panel held fifty days of hearings over the following two and a half years.[18] The panel granted an award in favor of Sawtelle for joint and several liability against all parties for $1,827,499 in compensatory damages and $747,000 in attorneys' fees.[19] The panel further found joint and several liability for punitive damages against Waddell and its president Robert L. Helchler for their reprehensible conduct in deception of Sawtelle's clients in the amount of $25 million.[20]

Following the arbitration panel's award, Sawtelle commenced proceedings in the New York Supreme Court to confirm his award.[21] Waddell and its fellow defendants cross-petitioned the court to vacate or modify the damages award, claiming that it was erroneous to include attorney's fees within the compensatory damages, since they were already awarded separately, and claiming the punitive

8. *Id.* at 267.
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.*
13. *Id.* at 268.
14. *Id.*
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.* at 269.

damage award was irrational and in manifest disregard of the law.[22] Waddell argued that judicial review of punitive damage awards, even in arbitration awards, is governed by the standards set forth in *BMW of North America v. Gore*.[23] The court declined to modify or vacate the punitive damages award.[24] However, the court did modify the compensatory damages award, reducing the award to $1,080,499 because attorney's fees had already been separately awarded.[25] In its decision, the court noted that the Federal Arbitration Act (FAA)[26] limits the scope of review for arbitral awards and stated even if the *Gore* standard was applied, the punitive damage award was not illegal, irrational, or in violation of public policy.[27]

The New York Supreme Court, Appellate Division, affirmed the lower court's modification of compensatory damages, holding that modification of compensatory damages is allowed under the FAA "where there was an evident material miscalculation of figures."[28] The court vacated the punitive damage award and remanded that issue for further consideration,[29] holding that the *Gore* standards should be applied to determine whether a punitive damage award in arbitration is excessive under the FAA.[30] Applying this standard, the court held the punitive damages award was in manifest disregard of applicable law, and the degree of reprehensibility did not support a punitive damages award of $25 million.[31]

III. LEGAL BACKGROUND

The United States Supreme Court recognizes that the FAA exemplifies "a strong 'liberal federal policy favoring arbitration agreements,' providing only for extremely limited judicial review of an arbitration award."[32] The limited review of arbitration awards has been attributed to the need to promote the two basic goals of arbitration, namely, "settling disputes efficiently and avoiding long and expensive litigation."[33]

In the last two decades it has become increasingly common for parties to request judicial review of arbitration awards. It is well-established that an arbitration award subject to review under the FAA can only be vacated in one of two sets of circumstances: those set forth in the FAA, or those based on non-statutory

22. *Id.*

23. *Id.* (citing BMW of N. Am. v. Gore, 517 U.S. 559, 574-75 (1996) (setting forth three guidelines for determining when an award is grossly excessive: (1) the degree of reprehensibility of conduct; (2) the disparity between the award and the harm or potential harm suffered; and (3) the difference between the remedy and the civil penalties authorized or imposed in comparable cases)).

24. *Id.*

25. *Id.*

26. 9 U.S.C. §§ 1-16 (2000).

27. *Sawtelle*, 754 N.Y.S.2d at 269.

28. *Id.* at 275 (citing 9 U.S.C. § 11(a)).

29. *Id.*

30. *Id.* at 271.

31. *Id.* at 271-73.

32. *Id.* at 269 (citing Green Tree Fin. Corp.-Ala. v. Randolph, 531 U.S. 79, 91 (2000) (quoting Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983))).

33. Porush v. Lemire, 6 F. Supp. 2d 178, 181 (E.D.N.Y. 1998) (quoting Willemijn Houdstermaatschappij, BV v. Standard Microsystems Corp., 103 F.3d 9, 12 (2d Cir. 1997)).

grounds, such as manifest disregard of the law or evidence, contravention of public policy, or irrationality.[34] Section 10 of the FAA states that a court may:

> [M]ake an order vacating [an arbitration award] upon the application of any party to the arbitration—(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 refusing to hear evidence pertinent and material to the controversy; or 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.[35]

Additionally, a court can vacate an award under the "manifest disregard of the law" standard only if the law was "obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator," and "the arbitrator knew the existence of a clear governing principle but decided to ignore it or pay no attention to it."[36]

The FAA also provides a more limited standard of review to be applied in modification of an arbitration award.[37] A court may modify an arbitration award only upon a finding of one of the following:

> [T]here 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 [or] [w]here the arbitrators have awarded upon a matter not submitted to them . . . [or] [w]here the award is imperfect in matter of form not affecting the merits of the controversy.[38]

If a court makes one of the previous findings then it is authorized to modify and correct the award as to "promote justice between the parties."[39]

A. Manifest Disregard of the Law

The United States Court of Appeals for the Second Circuit has been asked to review arbitration awards for manifest disregard of the law on several occasions.[40] One such case is *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*.[41] On March 11, 1985, Bobker informed his broker, Merrill Lynch, that he wished to

34. *Sawtelle*, 754 N.Y.S.2d at 269. *See Porush*, 6 F. Supp. 2d at 181; McDaniel v. Bear Stearns & Co., 196 F. Supp. 2d 343, 350 (S.D.N.Y. 2002) (citations omitted).

35. 9 U.S.C. § 10(a) (2000).

36. *Porush*, 6 F. Supp. 2d at 182 (quoting Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, 808 F.2d 930, 933-34 (2d Cir. 1986)).

37. 9 U.S.C. § 11 (2000).

38. *Id.*

39. *Id.*

40. *See id.*; *see also* Halligan v. Piper Jaffray, Inc., 148 F.3d 197 (2d Cir. 1998); DiRussa v. Dean-Witter Reyonlds Inc., 121 F.3d 818 (2d Cir. 1997).

41. 808 F.2d 930 (2d Cir. 1986).

short sell 2,000 shares in Phillips Petroleum Company. However, Merrill Lynch cancelled the transaction before carrying out Bobker's request because it believed the transaction would violate Section 10(b-4) of the Securities Exchange Act and SEC regulations.[42] Subsequent to the cancellation, Bobker submitted a claim to the New York Stock Exchange claiming Merrill Lynch's actions prohibited him from receiving a $23,000 profit upon the exercise of the short sale.[43]

Pursuant to the rules of the New York Stock Exchange an arbitration panel was appointed and returned a decision granting $12,500 in favor of Bobker.[44] Following this award, Merrill Lynch filed a petition to vacate the award in the United States District Court for the Southern District of New York, claiming such award was in manifest disregard of the law.[45] The district court agreed with Merrill Lynch and vacated the award, finding the arbitration panel was aware of the SEC regulations, and that Bobker's transaction "would have resulted in the kind of disparate treatment of tendering shareholders [the SEC regulation] was intended to prevent."[46]

The United States Court of Appeals for the Second Circuit reversed the district court's decision to vacate the arbitration award.[47] The appellate court, following the reasoning of the SEC amicus brief, interpreted Section 10(b-4) of the Securities Exchange Act and the SEC regulation as designed to prevent a "shareholder from double-tendering stock in response to a partial offer and thus increase the percentage of the violator's stock accepted for purchase and dilute that of other tendering stockholders."[48] The appellate court rejected Merrill Lynch's claim that the transaction would have violated Section 10(b-4) of the Securities Exchange Act and SEC regulations, because the transactions Bobker had proposed (withdrawing the tender of 2,000 of the 4,000 shares or covering the short sale with the purchase of 2,000 additional shares) were legal.[49] The court concluded the short sale proposed by Bobker was not manipulative or deceptive, and would not have violated the purpose of the statutes and regulations asserted by Merrill Lynch.[50] Therefore, because Bobker's requested transaction met these pre-

42. *Id.* at 931-32. *See* 15 U.S.C. § 78j (2000); 17 C.F.R. § 240.10(b-4) (1984). This section was adopted by the SEC in 1968 with the intent of prohibiting "short tendering," i.e., "tendering more shares than a person owns in order to avoid or reduce the risk of *pro rata* acceptance in tender offers for less than all the outstanding securities of a class or series." Short Tendering Rule, 49 Fed. Reg. 13867 (Apr. 9, 1984) (codified in 17 C.F.R. § 240.10(b-4) (1984)). On April 9, 1984, the SEC announced the adoption of amendments to Rule 10(b-4), which did not substantially alter the rule however, included a prohibition of the practice of hedged tendering, i.e., "tendering and then selling a portion of the tendered shares in the market." *Id.* Additionally, Rule 10(b-4) was again amended by the SEC in order to further prohibit hedged tendering through the use of call options. Short Tendering, 50 Fed. Reg. 8100 (Feb. 28, 1985) (codified in 17 C.F.R. § 240.10(b-4) (1985)). In 1990, the SEC redesignated Rule 10(b-4) as Rule 14(e-4), which still prohibited both short tendering and hedged tendering however eliminated the "prohibition of multiple tendering to competing partial offers." Prohibited Transactions in Connection with Partial Tender Offers, 55 Fed. Reg. 50316 (Dec. 6, 1990) (codified in 17 C.F.R. § 240.014(e-4)).

43. *Merrill Lynch*, 808 F.2d at 931.

44. *Id.* at 932-33.

45. *Id.* at 933.

46. *Id.*

47. *Id.* at 937.

48. *Id.* at 935.

49. *Id.*

50. *Id.* at 936.

requisites, the arbitration panel's decision was not in manifest disregard of the law.[51]

More recently, in the case *Halligan v. Piper Jaffray, Inc.*, the Second Circuit was again asked to review an arbitration award under the "manifest disregard of the law" standard.[52] In *Halligan*, an equity investments salesperson claimed that he had been terminated in violation of the Age Discrimination in Employment Act (ADEA).[53] The claim was heard before a panel of NASD arbitrators, but before the conclusion of the hearing, the plaintiff, Theodore Halligan, passed away.[54] His widow, Mrs. Irene Halligan, took up the claim and continued the arbitration.[55] Both sides produced testimony as to whether Halligan was terminated because of his age.[56] In March 1996, the arbitrators denied relief to Halligan in a written opinion.[57]

Mrs. Halligan petitioned the court to vacate the arbitrator's decision.[58] She claimed that "given the very strong evidence of discrimination and the clear description of the applicable law presented to the arbitrators, the award reflected manifest disregard of the law."[59] In response to Mrs. Halligan's petition, the defendant agreed that the governing law was not disputed by the parties but argued that it was not the court's place to review the merits of the decision since it was supported by ample evidence.[60] The court declined to grant Mrs. Halligan's petition stating, "Crediting one witness over another does not constitute manifest disregard of the law [and] this court's role is not to second-guess the fact-finding done by the panel."[61]

The United States Court of Appeals for the Second Circuit reversed the order, stating Halligan had presented overwhelming evidence to the arbitration panel that he had been terminated and the termination was motivated by age discrimination.[62] The court further stated the record indicated agreement on the legal standards for burden of proof and an adequate understanding of the law by the arbitrators.[63] The court concluded that given the strong evidence that Halligan was terminated because of his age as well as the panel's apparent knowledge of the applicable standards, the court was inclined to hold that the panel ignored the law or evidence or both.[64]

51. *Id.*
52. 148 F.3d 197 (2d Cir. 1998).
53. *Id.* at 198. *See* 29 U.S.C. § 621, et seq. (2000).
54. *Halligan*, 148 F.3d at 198.
55. *Id.*
56. *Id.* at 199.
57. *Id.* at 200.
58. *Id.*
59. *Id.*
60. *Id.*
61. *Id.* (citations omitted).
62. *Id.* at 203.
63. *Id.* at 204.
64. *Id.*

B. Punitive Damages

The United States Supreme Court set forth the standards for determining whether a punitive damages award in a civil case is "grossly excessive" and thereby in violation of the Due Process Clause of the Fourteenth Amendment in *BMW of North America, Inc. v. Ira Gore, Jr.*[65] BMW sold Gore a new sports sedan but failed to disclose that it had been repainted after pre-delivery damage.[66] The jury returned a verdict in favor of Gore in the amount of $4,000 for compensatory damages and $4 million in punitive damages, finding the "non-disclosure policy constituted 'gross, oppressive or malicious' fraud" under Alabama law.[67] On appeal, the Alabama Supreme Court ordered remittitur with instructions that constitutionally reasonable punitive damages would be $2 million in this case.[68]

On further appeal, the U.S. Supreme Court in a five-to-four decision found the Alabama Supreme Court's remittitur order "grossly excessive" and inconsistent with BMW's right to due process because BMW did not receive notice of the large sanction the state might impose on such conduct.[69] The Court established three factors in determining whether a punitive damage award violates the Due Process Clause of the Fourteenth Amendment: (1) the degree of reprehensibility of the party's conduct; (2) the ratio of punitive damages to the actual harm inflicted on a party; and (3) the civil or criminal penalties that could be imposed for comparable misconduct.[70]

The Court reversed the award of $2 million in punitive damages because it violated the Due Process Clause of the Fourteenth Amendment.[71] Applying the three-factor analysis, the Court found the harm BMW inflicted was purely economic, and not one that would give rise to a $2 million punitive damages award.[72] The Court went on to state the punitive damage award granted by the Alabama Supreme Court amounted to 500 times the amount of actual harm inflicted, well over the four-to-one ratio generally held as constitutional in past cases.[73] The Court further stated the award was "grossly excessive" in that "the maximum civil penalty authorized by the Alabama Legislature for violation of its Deceptive Trade Practices Act is $2,000," and other state statutes authorized penalties only up to $10,000.[74]

65. 517 U.S. 559 (1996).
66. *Id.* at 563-64.
67. *Id.* at 565 (citing ALA. CODE §§ 6-11-20, 6-11-21 (1993)).
68. *Id.* at 567.
69. *Id.* at 574-75.
70. *Id.* at 575-76.
71. *Id.* at 586.
72. *Id.* at 576, 580.
73. *Id.* at 581-82.
74. *Id.* at 584.

IV. INSTANT DECISION

A. Three-Part Gore Test

In the instant case, the New York Supreme Court, Appellate Division, held that despite the strong federal policy limiting arbitration award review, punitive damage awards in securities arbitrations under the FAA are subject to the limitations set forth by the United States Supreme Court in *BMW of North America, Inc. v. IRA Gore, Jr.*[75] The court noted that *Gore* "established the constitutional limits on the imposition of punitive damages," and that it applies to situations in which plaintiff's sole challenge is that the damage award is "grossly excessive," without asserting a due process claim.[76] The court further stated the *Gore* test is "not only applicable to due process analysis of a punitive damage award but also provides a guide for determining whether such an award is irrational."[77]

The court ruled the $25 million punitive damages award excessive and running afoul of the *Gore* three-part test.[78] First, the court ruled that the third step of *Gore*—the degree of reprehensibility of a party's misconduct—was the most important for determining the irrationality of a punitive damages award.[79] Because Waddell's actions were a one-time occurrence and had little or no impact on Sawtelle's earnings, the court held that this was not a case that would support such a large damage award.[80] Second, the ratio of punitive damages to compensatory damages was approximately twenty-three-to-one, well above the common four-to-one ratio mentioned in *Gore*.[81] In fact, the court noted that punitive damages awarded under the Connecticut Unfair Trade Practices Act (CUTPA) have typically followed the standard laid out in *Bailey Employment System v. Hahn*,[82] merely "doubling the amount of actual or compensatory damages."[83] Third, the award was "vastly out of proportion to the civil or criminal penalties that could be imposed for comparable misconduct."[84] Most CUTPA awards have ranged from $250 to $450,000, and no CUTPA case heard in federal court has ever exceeded $1 million.[85] The court distinguished the two largest CUTPA awards from the instant decision on the grounds of severe misconduct.[86]

75. *Sawtelle*, 754 N.Y.S.2d at 270.
76. *Id.* at 270.
77. *Id.* at 271.
78. *Id.* at 271-73.
79. *Id.* at 271.
80. *Id.*
81. *Id.* at 272.
82. 545 F. Supp. 62, 73 (D. Conn. 1982), *aff'd*, 723 F.2d 895 (2d Cir. 1983).
83. *Sawtelle*, 754 N.Y.S.2d at 272.
84. *Id.*
85. *Id.* at 272-73.
86. *Id.* at 273 (describing one of the cases as involving hundreds of millions of dollars in a "bait and switch" scheme, and the other involving a decade-long nationwide plot intentionally stalling the processing of large insurance claims).

B. Manifest Disregard of Law

The court also found a second ground for reversal in that the arbitrators completely ignored applicable law.[87] During the arbitration, Sawtelle's counsel informed the arbitrators that "'proportionality' of punitive damages was 'a very big constitutional issue,'" and courts have typically granted punitive damages under CUTPA at a two-to-one ratio.[88] Sawtelle's counsel also specifically informed the arbitration panel that neither CUTPA nor Connecticut case law would support a treble damage award.[89] The court recognized that "both parties generally agreed on the applicable law . . . and explained it to the arbitrators," but the arbitrators failed to adhere to it.[90] The court concluded that since both sides agreed on the well-established proportionality rule and the panel was specifically informed of the rule, the "$25 million punitive damages award . . . was made in manifest disregard of law."[91]

C. Public Policy

The court rejected Waddell's argument that the arbitration award violated a "well accepted and deep rooted public policy."[92] Waddell argued that the award violated public policy because it punished the company for following the NASD rules requiring the reporting of all customer complaints, which would result in sanctions if not followed.[93] The court acknowledged Waddell's claim, but emphasized that "not a single complaint resulted in any action by the NASD," and the arbitration panel did not refer to the amended Form U-5 by Waddell in the imposition of the punitive damages award.[94] In light of these facts, the court refused to find the punitive damages award violated a strong public policy.[95]

D. Award Modification

The court ruled the modification of the compensatory damages award by the lower court did not violate the FAA.[96] The court interpreted the provision under the FAA providing for modification of an award "where there was an evident material miscalculation of figures . . ."[97] as authorizing a modification "when an arbitration award orders a party to pay damages that have already been paid or which are included elsewhere in the award."[98] Sawtelle claimed the lower court erred in reducing the compensatory damages because the amount reduced was meant to be compensation for emotional distress and/or general damages associ-

87. *Id.*
88. *Id.* at 273-74.
89. *Id.* at 274.
90. *Id.* (quoting *Halligan*, 148 F.3d at 204).
91. *Id.*
92. *Id.*
93. *Id.* at 274-75 (citations omitted).
94. *Id.* at 275.
95. *Id.*
96. *Id.* at 276; *see* 9 U.S.C. § 11 (2000).
97. *Sawtelle*, 754 N.Y.S.2d at 275 (citing 9 U.S.C. § 11(a)).
98. *Id.*

ated with a negative effect on his reputation.[99] The court, however, found no evidence in the record to support any such claim and thus concluded it was not a "legitimate basis for disputing [the] allegation of double recovery" for attorney's fees.[100]

IV. COMMENT

Resolving disputes through arbitration is beneficial for individuals who want to settle their disputes more efficiently and inexpensively than through litigation.[101] Central to accomplishing these goals is the generally established principle that an arbitrator's decision is *final* or extremely limited on review.[102] This concept of finality arises from the strong presumption in favor of enforcing arbitration awards.[103]

A. Should Arbitration Be Subject To Due Process Challenges?

In line with this presumption of finality, several courts have ruled that arbitral punitive damage awards are not subject to due process challenges because they do not arise from a state action.[104] This rationale stems from the well established principle that constitutional due process protections "do not extend to 'private conduct abridging individual rights,'" but only to state action.[105] Thus, several courts have ruled that arbitration hearings, invoked by voluntary private action, lack the state action element of a due process claim, and therefore punitive damages awarded by arbitrators do not warrant the scrutiny of the Due Process Clause.[106] This holding seems to further the underlying goals of arbitration in that it follows the FAA's goal of enforcing arbitrator's awards by severely limiting the means by which an arbitral award may be challenged. However, this prohibition may also create disincentives to engaging in arbitration by preventing review of large punitive damages awards, and in turn, undermine the vital role of arbitration as a means of alternative dispute resolution.[107]

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99. *Id.* at 276.

100. *Id.*

101. *Porush v. Lemire*, 6 F. Supp. 2d 178, 181 (E.D.N.Y. 1998); *see* Carroll E. Neesemann & Maren E. Nelson, *The Law of Securities Arbitration*, *in* SECURITIES ARBITRATION 2000, at 829, 898 (PLI Corp. Law & Practice Course, Handbook Series No. B0-00KP, 2000) [hereinafter Neesemann & Nelson, *The Law of Securities Arbitration*].

102. *Porush*, 6 F. Supp. 2d at 181; Neesemann & Nelson, *The Law of Securities Arbitration*, *supra* note 101, at 898.

103. *Porush*, 6 F. Supp. 2d at 181. *See* Wall Street Assocs., L.P. v. Becker Paribas Inc., 27 F.3d 845, 849 (2d Cir. 1994) (citing Moses H. Cone Mem'l Hosp. v. Mercury Const. Corp., 460 U.S. 1, 24-25 (1983)).

104. Glennon v. Dean Witter Reynolds, Inc., 83 F.3d 132, 138 (6th Cir. 1996); Davis v. Prudential Sec., Inc., 59 F.3d 1186, 1190-91 (11th Cir. 1995); Austern v. Chicago Bd. Options Exch., Inc. 716 F. Supp 121, 125 (S.D.N.Y. 1989) (stating that CBOE arbitration is not state action), *aff'd on other grounds*, 898 F.2d 882 (2d Cir. 1990).

105. *Davis*, 59 F.3d at 1190 (quoting Nat'l Collegiate Athletic Ass'n v. Tarkanian, 488 U.S. 179, 191 (1998) (citing Burton v. Wilmington Parking Auth., 365 U.S. 715, 722 (1961))).

106. *Id.* at 1191-95. *See Glennon*, 83 F.3d at 138.

107. *See* Edward Wood Dunham, *Are There Due Process Limits on Arbitral Punitive Damage Awards?*, 23 FRANCHISE L.J. 3 (Summer 2003).

Despite the strong presumption to enforce arbitration awards, the *Sawtelle* court seems determined to undermine the underlying principles of arbitration by expanding the reviewability of arbitration awards through judicially-created grounds—allowing a court to overturn an arbitration award of punitive damages because it is "grossly excessive."[108] The *Sawtelle* court sidestepped the established position that private arbitration agreements are not subject to due process scrutiny by characterizing the Supreme Court's *Gore* standard as based not only on due process grounds, but on the concept of irrationality as well.[109] The *Sawtelle* court fails to provide any substantial rationale as to how it arrived at this conclusion; it merely cites a few cases where the Second Circuit applied the *Gore* test.[110] The court adopted the *Mathie v. Fries* ruling, which stated that "[t]he Supreme Court's guideposts in *Gore*, though marking outer constitutional limits, counsel restraint with respect to the size of punitive awards even as to the nonconstitutional standard of excessiveness."[111] The court also referenced the decision in *Sanders v. Gardner*, where the Second Circuit held a $10 million punitive damages award was not a violation of the individual's due process rights and that such an award was "constitutionally sound and supported by the evidence" under an independent *Gore* analysis.[112] Nevertheless, even if the test can be construed to provide guidelines in reviewing punitive damage awards, both the Second Circuit and the *Sawtelle* court fail to acknowledge any possible ramifications that such adoption may have in jeopardizing the simplicity and efficiency arbitration was designed to create.

B. Gore Test v. FAA's Policy to Enforce Arbitration Awards

By allowing additional review because an award is "grossly excessive," *Sawtelle* creates another crack in the strong policy favoring the enforcement of an arbitrator's award. *Sawtelle* attempted to justify the inclusion of a "grossly excessive" standard with the FAA's strong pro-arbitration policy by focusing on the rationale behind the development of the *Gore* test.[113] The three-part *Gore* test was designed to allow a jury some degree of latitude in protecting and furthering state legitimate interests by "punishing unlawful conduct and deterring its repetition."[114] However, it was also created to limit damages awards to only those amounts which are reasonably necessary to vindicate such interests.[115] In light of the underlying theory of the *Gore* test, the *Sawtelle* court inferred that because the test incorporates wide latitude to the fact-finders in their determination of the size of an award, its application to punitive damages awards in an arbitration setting

108. *Id.* at 5. *See also* Halligan v. Piper Jaffray, Inc., 148 F.3d 197, 204 (2d. Cir. 1998) (establishing the "manifest disregard of law" standard of review for arbitration awards).
109. Sawtelle v. Waddell & Reed, Inc., 754 N.Y.S.2d 264, 271 (N.Y. App. Div. 2003).
110. *Id. See* Mathie v. Fries, 121 F.3d 808, 816-17 (2d Cir. 1997); Lee v. Edwards, 101 F.3d 805, 809-12 (2d Cir. 1996); Sanders v. Gardner, 7 F. Supp. 2d 151, 176-79 (E.D.N.Y. 1998).
111. *Sawtelle*, 754 N.Y.S.2d at 271 (quoting *Mathie*, 121 F.3d at 817).
112. *Sanders*, 7 F. Supp. 2d at 179.
113. *Sawtelle*, 754 N.Y.S.2d at 270.
114. BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 568 (1996).
115. *Id.*

would not disrupt the FAA's presumption to enforce the original arbitration award.[116]

Even if one agrees with this rationale, that the *Gore* test does not go against the FAA's policy, there are still several broad reasons for not allowing expansion of such review. One of the strongest is the importance of arbitration as an efficient alternative to litigation. If a court is allowed to broadly question an arbitrator's final determination, then arbitration could become just another expensive and time consuming layer within the complex litigation process.[117] In the instant situation, given that no set ratio of compensatory to punitive damages has been declared *per se* constitutional, the application of the *Gore* test could cause courts to review each situation on a case-by-case basis in order to determine the upper limit of what is "grossly excessive." This would allow a party to delay, by motions or appeals, any proceeding where a large punitive damage award is granted.[118]

A further argument against expanded review arises from the currently accepted practice of creating stricter judicial review of arbitration awards in predispute contracts. The Court of Appeals for the Tenth Circuit stated that by "agreeing to arbitrate, a party 'trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.'"[119] Although not all courts follow this view, the Tenth Circuit refuses to allow contractual expansions on the grounds that such expanded review undermines the independence of the arbitration process and finality of arbitration awards.[120] The same argument could be made against a court reviewing an award under the *Gore* test, in that both parties voluntarily chose to give up their right to judicial review by choosing arbitration in favor of an efficient and cost-effective means of dispute resolution and should therefore be barred from later arguing against an unfavorable ruling.

C. Is the Gore Test Even Necessary?

The *Sawtelle* court reaches its holding under an expanded notion of the *Gore* standard (that the award is irrational), but it later declares under the same rationale that the award is in manifest disregard of the law.[121] The court concluded the arbitrators were explicitly informed on the issue of proportionality of punitive damages under Connecticut law by agreement of both parties prior to their decision. Thus, "their failure to adhere to the relevant standards constitutes 'manifest disregard [of the law].'"[122] Given this analysis, the issue turns to whether the *Gore* test is even a necessary additional form of review in the dispute resolution field, when protection from the same error is found in an already well-established principle of review. The *Sawtelle* court simply fails to provide any solid justifica-

116. *Sawtelle*, 754 N.Y.S.2d at 270.
117. *See* Albert G. Besser, *The Arbitrator Blew It! Now What?*, VT. B.J. Summer 2003, at 39.
118. *See* Neesemann & Nelson, *Securities Arbitration Damages*, *supra* note 2, at 733.
119. Bowen v. Amoco Pipeline Co., 254 F.3d 925, 935 (10th Cir. 2001) (quoting Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 31 (1991)).
120. *Id.*
121. *Sawtelle*, 754 N.Y.S.2d at 271, 273.
122. Id. at 274 (quoting Halligan v. Piper Jaffray, Inc., 148 F.3d 197, 204 (2d Cir. 1998)).

tion as to the necessity of such an expansion, which directly contradicts the strong federal policy of extremely limited judicial review of arbitral awards.[123]

V. CONCLUSION

The United States Supreme Court only recently established the power to review punitive damage awards on due process grounds, and many jurisdictions have simply not faced the issue. However, it may arise quite frequently in the future. The decision in *Sawtelle*, adopting a separate ground for review of punitive damages awards, is one that signals a significant change in the field of arbitration. The court's adoption of the *Gore* test could be interpret as an attempt by courts to promote dispute resolution through arbitration by protecting a party from a decision by an incompetent arbitrator, thus eliminating any disincentive to arbitration which may arise from the fear of being held liable for extremely large punitive damage awards. On the other hand, the adoption of the *Gore* standard indicates a breakdown of the independence associated with arbitration hearings and is another attempt by courts to expand their power to regulate fields of dispute resolution. The lack of clear policy justification, along with the generalizations made in arriving at this decision, leaves this case open to interpretation as to which interest is actually being furthered.

At this point it is too soon to determine the lasting effect this decision will have in the field of dispute resolution. This case may have a negative effect on the simplicity associated with the arbitral process or it may provide a positive regulatory effect over abusive actions by arbitrators. For the sake of individuals desiring a quick and cost-effective means of resolving a dispute, let's hope it is the latter.

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123. Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).