Courts Have the Final Say: Does the Doctrine of Manifest Disregard Promote Lawful Arbitral Awards or Disguise Unlawful Judicial Review

Lindsay Biesterfeld

Follow this and additional works at: https://scholarship.law.missouri.edu/jdr

Part of the Dispute Resolution and Arbitration Commons

Recommended Citation
Lindsay Biesterfeld, Courts Have the Final Say: Does the Doctrine of Manifest Disregard Promote Lawful Arbitral Awards or Disguise Unlawful Judicial Review, 2006 J. Disp. Resol. (2006)
Available at: https://scholarship.law.missouri.edu/jdr/vol2006/iss2/12

This Note is brought to you for free and open access by the Law Journals at University of Missouri School of Law Scholarship Repository. It has been accepted for inclusion in Journal of Dispute Resolution by an authorized editor of University of Missouri School of Law Scholarship Repository.
Courts Have the Final Say: Does the Doctrine of “Manifest Disregard” Promote Lawful Arbitral Awards or Disguise Unlawful Judicial Review?

Sawtelle v. Waddell & Reed, Inc.¹

I. INTRODUCTION

In exchange for a speedy, economical dispute resolution process, parties that submit to binding arbitration assume the risk that an arbitrator might misapply the law.² United States Supreme Court precedent and federal law favor agreements to arbitrate by limiting judicial review of arbitral awards and requiring courts to “rigorously enforce arbitration agreements.”³ These judicial constraints support the arbitral goals of efficiency and finality by reducing the risk that arbitral awards will be vacated on appeal. To balance the risk that arbitrators may abuse this standard of review, courts have supplemented restricted judicial review with a doctrine that allows an arbitral award to be vacated in circumstances where the arbitrator manifestly disregarded the law.⁴ Sawtelle v. Waddell & Reed⁵ reaches the outer limits of this doctrine by demonstrating how the courts can use the doctrine to engage in a heightened form of judicial review of arbitral awards.

II. FACTS AND HOLDING

Waddell & Reed, Inc. (Waddell & Reed), a Kansas-based securities broker-dealer and member of the National Association of Securities Dealers, Inc. (NASD),⁶ employed Stephen Sawtelle (Sawtelle) as its Connecticut representative for seventeen years.⁷ Even though Sawtelle had approximately 2,800 customers and received the “number one broker of 1996” award, Waddell & Reed fired Sawtelle on February 10, 1997.⁸

Sawtelle and Waddell & Reed disputed the reason for the termination. Sawtelle alleged that he was terminated in retaliation for testifying before the Securi-

⁷. Id.
⁸. Id. The trial court found that “until his termination, Sawtelle had been one of Waddell’s most successful salesmen, with approximately 2,800 customers, none of whom had ever made a complaint against him. In fact, as late as February 3, 1997, Sawtelle had received accolades from Waddell for his work and status as the ‘number one broker’ in 1996.” Id.
ties and Exchange Commission (SEC) against another Waddell & Reed broker. However, on a form that Waddell & Reed prepared for the NASD, the U-5 Uniform Notice of Termination form, Waddell & Reed cited "personality differences" as the reason for Sawtelle's termination. Other portions of the form referenced customer complaints and suggested that Sawtelle was under investigation for fraud. Specifically, Waddell & Reed answered in the affirmative two questions on the NASD U-5 Uniform Notice of Termination form asking whether Sawtelle was under internal and external investigation for investment related business.

On February 11, 1997, one day after Sawtelle's termination, Sawtelle began working for a Waddell & Reed competitor, Hackett Associates (Hackett). In response, Waddell & Reed wrote letters to Sawtelle's customers, warning them that there could be financial repercussions if they moved their accounts to a new firm. Waddell & Reed then obscured customers' attempts to communicate with Sawtelle by misdirecting Sawtelle's mail and telephone calls. Waddell & Reed also encouraged customers to complain about Sawtelle and suggested to customers that Sawtelle had engaged in criminal behavior. Waddell & Reed's efforts to retain Sawtelle's customer base largely failed, however, as the vast majority of the customers followed Sawtelle to Hackett.

In July 1997, Sawtelle filed a claim with the NASD against Waddell and certain officers and representatives alleging tortuous interference with business expectancy and a violation of the Connecticut Unfair Trade Practices Act (CUTPA). After holding over fifty days of hearings spanning two and a half
Courts Have the Final Say

years, a three member arbitration panel found against Waddell & Reed, and awarded Sawtelle $1,827,499 in compensatory damages and $747,000 in attorneys’ fees. The arbitration panel also held Waddell & Reed and its president jointly and severally liable under CUTPA for punitive damages in the sum of $25 million for “their reprehensible conduct in orchestrating a campaign of deception.”

Following the arbitral award, Sawtelle petitioned the New York State Supreme Court of New York County to confirm the arbitration panel’s award. Waddell and its fellow defendants cross-petitioned to vacate or modify the award, claiming that the punitive damages award was irrational and in manifest disregard of the law, and that the compensatory damages erroneously included Sawtelle’s attorneys’ fees because the fees were separately awarded. The New York Supreme Court agreed with Waddell & Reed that the panel had awarded the attorneys’ fees twice, and accordingly modified the compensatory damage award to $1,080,499. As for the punitive damages, the trial court rejected Waddell & Reed’s argument that the large award violated the standard set forth by the Supreme Court in BMW of North America, Inc. v. Gore, by reasoning that Gore dealt with due process concerns not applicable to arbitration. After acknowledging the limited role of judicial review of arbitral awards, the court affirmed the $25 million award, finding that the punitive damage award was not made irrationally or in manifest disregard of the law.

Waddell & Reed appealed the award of punitive damages and Sawtelle appealed the reduction of compensatory damages to the New York Supreme Court, Appellate Division. The court affirmed the trial court’s modification of the compensatory damages award, but vacated the punitive damages award. The

20. Id. at 106-07. In 1999, Waddell responded to Sawtelle’s claim by filing a claim against Sawtelle’s new employer, Hackett. Id. at 107. The three member arbitration panel consolidated the two proceedings and dismissed the claims against Hackett on September 11, 2000. Id.

21. Id. In awarding the punitive damages, the arbitration panel found that the campaign of deception “included giving the impression that Sawtelle had mishandled his clients’ investments, was untrustworthy, was not authorized to do business and, in some way, had been involved in the embezzlement of clients’ funds.” Id. The panel further ordered the expungement of certain entries on the U-5 form. Id.

22. Id.

23. Id.

24. Id. The trial court found that Sawtelle asked the arbitrators to award the amount of income he would have received from Waddell in 1997 if he had not been fired because Sawtelle introduced evidence showing that in 1997 he would have received an annualized commission income of $766,861, an investment bonus of $263,648, and an additional $300,000 in “trails.” Id. at 116. While Sawtelle conceded that Waddell had paid him $250,000 prior to his termination, the net total of the amounts, after subtracting the 250,000 credit, is $1,080,499. Id. The court recognized that the compensatory damage award was $1,827,499, approximately $747,000 more than Sawtelle had asked for, which was also the amount of Sawtelle’s attorneys fees. Id. The trial court concluded that because the panel had separately awarded Sawtelle $747,000 in attorneys fees, the compensatory damages award must have erroneously included a double award of attorneys fees. Id. The court accordingly reduced the compensatory damages award to $1,080,499. Id. at 115-16.

25. Id. at 107 (citing BMW of North America, Inc. v. Gore, 517 US 559 (1996)).

26. Sawtelle, 304 A.D.2d at 103, 107. The New York State Supreme Court held that the award was not “otherwise illegal or irrational as grossly excessive since CUTPA, which authorizes an award of punitive damages, does not by its terms, place limits on such an award.” Id.

27. Id. at 104.

28. Id. at 117-18.
appellate court reasoned that the *Gore* standards did govern judicial review of arbitral awards, and that the punitive damages award was excessive under *Gore* and also made in 'manifest disregard' of the law, remanding for further consideration. 29

Upon remand, the original three-member arbitration panel held a one day hearing and issued a second award. 30 The panel did not modify the amount of the punitive damage award, but changed only the description of Waddell & Reed's conduct in its findings from a "campaign of deception" to a "horrible campaign of deception, defamation and persecution." 31

Sawtelle again petitioned the New York State Supreme Court in the county of New York to confirm the punitive damages award and Waddell & Reed moved to vacate. 32 This time, the trial court applied the *Gore* standards as mandated by the Appellate division, found the punitive damages award excessive under such standards, and vacated the award and remanded to a new arbitration panel. 33 Sawtelle responded to the vacatur by motioning the trial court to modify its order vacating and remanding to a new panel and to instead issue a conditional remittitur. 34 The trial court recognized several reasons why Sawtelle's request for a conditional remittitur was reasonable: first, the several appeals and expensive legal fees had already costs the parties much time and money; second, there was no guarantee that the new arbitration panel's award would be confirmed by the instant court or that the appeals would end; and finally, the new arbitration panel was "likely to be as expensive and time consuming as the first." 35 However, the court was bound by the FAA and thus without the authority to issue a conditional remitter. 36 Therefore, the trial court denied this motion. 37

To avoid arbitrating in front of a new and unpredictable panel, Sawtelle appealed both decisions. 38 The New York Supreme Court, Appellate Division, affirmed both of the trial court's orders, denying the conditional remitter and granting the motion to vacate and remand. 39 The appellate court agreed that the issue should be remanded to a new arbitralional panel, holding that when a court vacates an arbitral award on the ground that it is in manifest disregard of the law, and where the original arbitrators issue an identical award on remand, the court

29. *Id.* at 109-15.
32. *Sawtelle*, 789 N.Y.S.2d at 858.
33. *Id.* at 858. The trial court stated: "the panel acted illegally, arbitrarily and beyond the scope of its authority when it awarded punitive damages so disproportionate to the compensatory damages awarded. All too aware that the same arbitration panel might not be expected to impartially apply the Appellate Division's mandate and the Gore standard, this Court remanded with a direction that a different panel hear the new (i.e., third) arbitration." *Id.* at 859.
34. *Id.* at 858. Instead of remanding the issue to a new arbitration panel, Sawtelle asked the court for an order that would remand the matter only if the parties could not stipulate to an amount to be awarded. *Id.*
35. *Id.* at 859. The trial court stated: "The history of this arbitration undermines the very purpose of arbitration: to provide a manner of dispute resolution more swift and economical than litigation in court. Petitioner's suggestion seems to make sense." *Id.*
36. *Id.* at 860.
37. *Id.*
39. *Id.* at 821-22.

https://scholarship.law.missouri.edu/jdr/vol2006/iss2/12
Courts Have the Final Say

III. LEGAL BACKGROUND

A. Governing Law

Even though the instant dispute occurred in New York state court, it was decided under federal law because the Federal Arbitration Act (FAA) governs the arbitration of employment disputes in the securities industry. The substance and procedure of the FAA apply in both state and federal courts. State courts must apply the FAA consistently with the United States Supreme Court's interpretation of the federal law. When a state court confronts an issue regarding the FAA that has not been addressed by the Supreme Court, unanimous lower federal courts decisions are binding on the state court. When lower federal courts have divided on the FAA issue, the decisions of the federal circuit in which the state court sits are persuasive authority.

The FAA, enacted in 1925, established a "liberal federal policy favoring arbitration agreements." As part of this policy, the FAA limits judicial review of arbitration awards in order to preserve the goals of arbitration: speed, economy, and finality. Theoretically, courts have justified the limited judicial review of arbitral awards by inferring from the decision to arbitrate a belief, on behalf of the parties, that the speed and economy of arbitration outweighs the risk that an arbitrator will misapply the law.

Under the FAA, a reviewing court may vacate an award where: (1) the award was procured by corruption, fraud, or undue means; (2) there was evident partiality;
ity or corruption in the arbitrators; (3) the arbitrators were guilty of misconduct; or (4) the arbitrators exceeded their powers. In addition to these four statutory grounds, each federal circuit has recognized a judicially created, non-statutory ground for vacating arbitration awards, and manifest disregard of the law is the most common non-statutory ground for vacatur.

B. Manifest Disregard of the Law

The doctrine of manifest disregard stems from Justice Reed’s statement in a 1953 Supreme Court case, Wilko v. Swan, that “the interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation.” Although the Supreme Court overruled Wilko in 1989, Justice Reed’s manifest disregard statement has survived. In 1995, the Supreme Court cited to Justice Reed’s manifest disregard statement with approval, acknowledging that arbitral awards made in manifest disregard of the law may be vacated.

Although the Supreme Court and each federal circuit recognize the doctrine of manifest disregard, the precise definition of the doctrine of manifest disregard varies slightly by the circuit. The prevailing definition, used by at least ten of

50. Rubins, supra note 2, at 369.

Although the courts usually articulate the non-statutory ground as "manifest disregard of the law," some courts have applied other labels to it, either in combination with or as a substitute for the manifest disregard standard. Thus, courts have held that an arbitration award may be vacated if it violates public policy, is completely irrational, is arbitrary and capricious, is fundamentally unfair, is an abuse of discretion, or does not "draw its essence" from the agreement to arbitrate.

Id.

55. Cole v. Burns Int’l Sec. Servs., 105 F.3d 1465, 1486 (D.C. Cir. 1997). “The Supreme Court has also indicated that arbitration awards can be vacated if they are in ‘manifest disregard of the law.’” Id.
56. First Circuit: The test for a challenge to an arbitration award for manifest disregard of the law is set out in Advest, Inc. v. McCarthy: a successful challenge... depends upon the challenger’s ability to show that the award is “(1) unfounded in reason and fact; (2) based on reasoning so palpably faulty that no judge, or group of judges, ever could conceivably have made such a ruling; or (3) mistakenly based on a crucial assumption that is concededly a non-fact.”
57. Prudential-Bache Secs. v. Tanner, 72 F.3d 234, 238 (1st Cir. 1995) (citing Advest, Inc., v. McCarthy, 914 F.2d 6, 8-9). Third Circuit: In order to vacate under doctrine of manifest disregard ‘there must be absolutely no support at all in the record justifying the arbitrator’s determinations for a court to deny enforcement of an award.’ United Transp. Union Local 1589 v. Suburban Transit Corp., 51 F.3d 376, 379 (3d Cir. 1995).
58. Fourth Circuit: “Appellant is required to show that the arbitrators were aware of the law, understood it correctly, found it applicable to the case before them, and yet chose to ignore it in propounding their decision.” Remmey v. PaineWebber, Inc., 32 F.3d 143, 149-50 (4th Cir. 1994).
59. Fifth Circuit: “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

https://scholarship.law.missouri.edu/jdr/vol2006/iss2/12
the twelve circuits, requires the court to find both that (1) the arbitrator knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrator was "well-defined, explicit and clearly applicable to the case."\(^{57}\)

The Second Circuit has adopted this definition for the doctrine of manifest disregard.\(^{58}\) Second Circuit case law explains that this standard requires the arbitrator’s mistake to be so obvious that the average arbitrator would "readily and instantly" recognize the mistake.\(^{59}\) Even if the mistake is blatantly apparent, the court cannot vacate the arbitral award under the manifest disregard standard if the arbitrator offers "even a barely colorable justification for the outcome reached."\(^{60}\)

Further, the court must find subjective knowledge of the well-defined law on behalf of the arbitrators before vacatur under manifest disregard is appropriate.\(^{61}\)

While the precise definition of manifest disregard differs by circuit, the federal courts are unanimous in strictly limiting the doctrine.\(^{62}\) If the doctrine were not so curtailed, it would threaten the very premise of arbitration—finality—by increasing the risk that parties losing in arbitration would successfully seek vacatur under manifest disregard grounds.\(^{63}\) The circuits have thus limited the doctrine attention to it." Prestige Ford v. Ford Dealer Computer Servs., 324 F.3d 391, 395 (5th Cir. 2003) (citing Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, 808 F.2d 930, 933-34 (2d Cir. 1986)).

Sixth Circuit: "An arbitration panel does not act in manifest disregard of the law unless (1) the applicable legal principle is clearly defined and not subject to reasonable debate; and (2) the arbitrators refused to heed that legal principle." Merrill Lynch, Pierce, Fenner & Smith v. Jaros, 70 F.3d 418, 421 (6th Cir. 1995).

Seventh Circuit: In any event, to vacate an arbitration award for manifest disregard of the law, there must be something beyond and different from mere error in law or failure on the part of the arbitrators to understand or apply the law; it must be demonstrated that the majority of arbitrators deliberately disregarded what they knew to be the law in order to reach the result they did.

Health Services Management Corp. v. Hughes, 975 F.2d 1253, 1267 (7th Cir. 1992) (citing Second Circuit case law, Venice v. Holt Industries, Inc., 515 F. Supp. 1302 (D.N.Y. 1981)). Eighth Circuit: Manifest disregard of the law exists when the arbitrator commits an error that was "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 legal principle but decides to ignore or pay no attention to it.


57. Rubins, supra note 2, at 369. See supra, note 56, circuits 1, 2, 3, 4, 5, 6, 7, 8, 9, and 10.
59. Id. at 933.
61. Bobker, 808 F.2d at 933.
63. United Steelworkers of America v. Enter. Wheel & Car Corp., 363 U.S. 593, 599 (1960). "The Supreme Court has explained that heightened judicial review by a court of the merits would make meaningless the provisions that the arbitrator's decision is final, for in reality it would almost never be...
in order to comply with the liberal federal policy favoring arbitration, and to preserve the efficient nature of arbitration.64

C. Punitive Damages

Federal appellate courts can overturn a trial court's punitive damage award on the ground of excessiveness. When courts award punitive damages, the amount of the award cannot be so unexpected or irrationally high that it violates the offending party's constitutional right to due process.65 In BMW of North America, Inc. v. Gore,66 the United States Supreme Court explained that a punitive damages award, grossly excessive in relation to the State's legitimate interests in punishment and deterrence, enters "the zone of arbitrariness that violates the Due Process Clause of the Fourteenth Amendment."67 The proper inquiry for determining excessiveness, according to Gore, is whether the punitive damages have a rational relationship to the actual and potential harm caused by the defendant's conduct.68 The Court emphasized that the question of unconstitutionally excessive punitive awards cannot be determined by reference to a set ratio between actual and punitive damages or a "simple mathematical formula."69 Rather, Gore requires courts to analyze the question of unconstitutionally excessive in light of three relevant factors: (1) "the degree of reprehensibility of the defendant's conduct;"70 (2) how the punitive damages compare to "actual harm inflicted on the plaintiff;"71 and (3) how the punitive damages compare to "civil or criminal penalties that could be imposed for comparable misconduct."72 Almost every federal circuit has not only applied the Gore factors, but also cited the Supreme Court's rejection of a "simple mathematical formula" with approval.73

64. Prestige Ford v. Ford Dealer Computer Servs., 324 F.3d 391, 395 (5th Cir. 2003) (citing Merrill Lynch, Piere, Fenner & Smith, Inc. v. Bobker, 808 F.2d 930, 933-34 (2d Cir. 1986). "A less strict standard of judicial review would be to undermine our well established deference to arbitration as a favored method of settling disputes when agreed to by the parties." Id.
65. BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 574 (1996). "Elementary notions of fairness enshrined in our constitutional jurisprudence dictate that a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that a State may impose." Id.
67. Id. at 568.
68. Id. at 581.
69. Id. at 582.
70. Id. at 575.
71. Id. at 580.
72. Id. at 583.
73. The first circuit has noted "that the Supreme Court has 'dismissed any simple, mathematical formula in favor of general inquiry into reasonableness.'" Davis v. Rennie, 264 F.3d 86, 117 (1st Cir. 2001) (quoting Romano v. U-Haul Int'l, 223 F.3d 655, 673 (1st Cir. 2000)). Third: The constitutionally acceptable range is not reducible to a 'simple mathematical formula,' . . . Rather, the ratio of punitive damages to the harm caused by the defendant is a tool to ensure that the two bear a reasonable relationship to each other. Gore, 517 U.S. at 580; State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 426 (2003). Fourth: "Indeed, the Supreme Court clarifies in BMW that it has "consistently rejected the notion that the constitutional line is marked by a simple mathematical formula, even one that compares actual and potential damages to the punitive award."" Jordan v. Shaw Indus., 1997 U.S. App. LEXIS 33589 (4th Cir. 1997) (quoting Gore, 517 U.S. at 582). Fifth: "The principle that
Even if the constitutionality of the punitive damage award is not questioned, it can be overturned as excessive. The non-constitutional standard for excessiveness in most circuits, including the Second Circuit, is whether the award is "so high as to shock the judicial conscience and constitute a denial of justice." 74

exemplary damages must bear a 'reasonable relationship' to compensatory damages has a long pedigree." Gore, 517 U.S. at 580 (citations omitted). But, the Court has 'consistently rejected the notion that the constitutional line is marked by a simple mathematical formula'. Id. at 582. 'We need not, and indeed we cannot, draw a mathematical bright line between the constitutionally acceptable and the constitutionally unacceptable that would fit every case.' Pacific Mut. Life Ins. Co. v. Haslip, 499 U.S. 1, 18, 113 L. Ed. 2d 1, 111 S. Ct. 1032 (1991)." Deffenbaugh-Williams v. Wal-Mart Stores, 156 F.3d 581, 597 (5th Cir. 1998). The Sixth Circuit has recognized that the Court "declined again to impose a bright-line ratio which a punitive damages award cannot exceed," Clark v. Chrysler Corp., 436 F.3d 594, 606 (6th Cir. 2006) (quoting Campbell, 538 U.S. at 425). Courts in the Seventh circuit have quoted the Gore language with approval: "We have consistently rejected the notion that the constitutional line is marked by a simple mathematical formula, even one that compares actual and potential damages to the punitive award." Alexander v. City of Milwaukee, 2006 U.S. Dist. LEXIS 7454 (D. Wis. 2006). Eighth: "As the Supreme Court noted in Gore, there is no "simple mathematical formula" that marks the constitutional line." Boerner v. Brown & Williamson Tobacco Co., 394 F.3d 594, 603 (8th Cir. 2005) (citing Gore, 517 U.S. at 582). Ninth: the court "rejected the notion that the constitutional line is marked by a simple mathematical formula, even one that compares actual and potential damages to the punitive award," Planned Parenthood of the Columbia/Willamette, Inc. v. Am. Coalition of Life Activists, 422 F.3d 949, 954 (9th Cir. 2005) (quoting Gore, 517 U.S. at 582). Tenth: "Of course, we have consistently rejected the notion that the constitutional line is marked by a simple mathematical formula, even one that compares actual and potential damages to the punitive award." Progressive Motors v. Frazier, 220 B.R. 476, 479 (D. Utah 1998). Eleventh: "The Supreme Court has not delineated "a simple mathematical formula, even one that compares actual and potential damages to the punitive award." U.S. EEOC v. W&O, Inc., 213 F.3d 600, 615 (11th Cir. 2000) (quoting Gore, 517 U.S. at 582).

74. Lee v. Edwards, 101 F.3d 805, 808 (2d Cir. 1996) (quoting Hughes v. Patroilmen's Benevolent Ass'n of New York, Inc., 850 F.2d 876, 883 (2d Cir. 1989)). First Circuit: "We have expressed the extent of distortion that warrants intervention by requiring such awards to be so large as to 'shock the judicial conscience.'" Nydav v. Lennerton, 948 F.2d 808, 811 (1st Cir. 1991) (quoting Caldarera v. E. Airlines, Inc., 705 F.2d 778, 784 (5th Cir. 1983)). Third Circuit: "We may disturb the district court's determination with respect to a remittitur only for abuse of discretion, and reverse and grant a new trial 'only if the verdict is so grossly excessive as to shock the judicial conscience.'" Gumbs v. Pueblo Int'l, Inc., 823 F.2d 768, 771 (3d Cir. 1987) (quoting Edynak v. Atl. Shipping, Inc. 562 F.2d 215, 225-226 (3rd Cir. 1977)). Fourth Circuit: "Our review of the punitive damage awards here is limited to whether the verdict is so grossly excessive so as to shock the judicial conscience." Thorne v. Wise, 1995 U.S. App. LEXIS 2844 (4th Cir. 1995) (quoting Gumbs, 823 F.2d at 771). Fifth Circuit: "Unless an award is so 'inadequate as to shock the judicial conscience and to raise an insurmountable inference that passion, prejudice, corruption or other improper cause invaded the trial, the jury's determination of the fact is considered inviolate.'" Taylor v. Green, 868 F.2d 162, 164 (5th Cir. 1989) (quoting Garrick v. City & County of Denver, 652 F.2d 969, 972 (10th Cir. 1981). Sixth Circuit: "the standard is '[w]hether the award is so high as to shock the judicial conscience and constitute a denial of justice.'" Mitchell v. Associated Bldg. Contractors, Inc., 884 F.2d 1392 (6th Cir. 1989) (quoting Rodgers v. Fisher Body Div., Gen. Motors Corp., 739 F.2d 1102, 1109 (6th Cir. 1984). Eighth Circuit: "[W]e review the size of the compensatory award 'with a keen sense of respect for the latitude given tojuries,' and will order remittitur only if the verdict is so grossly excessive as to shock the conscience." Rowe v. Hussman Corp., 381 F.3d 775, 783 (8th Cir. 2004) (quoting Kucia v. Se. Ark. Cnty. Action Corp., 284 F.3d 944, 947 (8th Cir. 2002). Tenth Circuit: "This court has said many times that absent an award so excessive or inadequate as to shock the judicial conscience and raise an insurmountable inference that passion, prejudice or another improper cause invaded the trial, the jury's determination of the amount of damages is inadvisable." Lane v. Gorman, 347 F.2d 332, 335 (10th Cir. 1965). Eleventh Circuit: "Unless an award is so inadequate "as to shock the judicial conscience and to raise an insurmountable inference that passion, prejudice, corruption or other improper cause invaded the trial, the jury's determination of fact is considered inadvisable." Murphy v. Flagler Beach, 846 F.2d 1306, 1310 (11th Cir. 1988) (quoting Garrick v. City & County of Denver, 652 F.2d 969, 972 (10th Cir. 1981).
spite the due process focus of *Gore*, courts in the Second Circuit have used the three *Gore* factors to guide this non-constitutional inquiry.\textsuperscript{75} 

Although *Gore* dealt with constitutional limits on punitive damage awards, the federal courts agree that constitutional due process protections do not extend to private arbitration.\textsuperscript{76} The federal courts have recognized that the state action required to trigger due process protection is absent in judicial confirmation of punitive damage awards.\textsuperscript{77} 

Although arbitration does not implicate the due process concerns at issue in *Gore*, courts in the Second Circuit have used the *Gore* factors to review arbitral punitive damages award.\textsuperscript{78} In *Sanders v. Gardner*, the United States District Court for the Eastern District of New York analyzed an arbitral punitive damage award of $10,000,000.\textsuperscript{79} In applying the three *Gore* factors, the court focused on the legitimate state interest in punishing and deterring federal security regulation violations and the Supreme Court’s rejection of a categorical approach to the actual/punitive damages ratio.\textsuperscript{80} Since the court found that the offending party had acted with “greed, avarice, and fraud,” the court used the *Gore* factors to uphold a punitive damage award that was fifty times as large as the compensatory damages.\textsuperscript{81} 

Similarly, in *Acciardo v. Millennium Securities Corporation*,\textsuperscript{82} the United States District Court for the Southern District of New York decided whether an arbitral punitive damages award was excessive by applying the *Gore* factors. The court, like the *Sanders* court, highlighted the Supreme Court’s refusal to draw a “mathematical bright line” for acceptable and non-acceptable actual/punitive damage ratios.\textsuperscript{83} The court then held that since the arbitration panel had made a specific finding of malice, it was within the arbitrator’s authority to issue a punitive damage award that was twenty times the amount of actual damages.\textsuperscript{84} 

\begin{thebibliography}{99}
\bibitem{75} Lee, 101 F.3d at 809.
\bibitem{76} Second Circuit: *Sanders v. Gardner*, 7 F. Supp. 2d 151, 174 (E.D.N.Y., 1998). Seventh Circuit: “Private arbitration, however, really is private; and since constitutional rights are in general rights against government officials and agencies rather than against private individuals and organizations, the fact that a private arbitrator denies the procedural safeguards that are encompassed by the term ‘due process of law’ cannot give rise to a constitutional complaint.” Elmore v. Chi. & Ill. Midland R.R. Co., 782 F.2d 94, 96 (7th Cir. 1986). Eighth Circuit: “In the arbitration setting we have almost none of the protections that fundamental fairness and due process require for the imposition of this form of punishment.” Stark v. Sandberg, Phoenix & von Gontard, P.C., 381 F.3d 793, 802-03 (8th Cir. 2004) (en banc). Ninth Circuit: “This court recently held that ‘neither private arbitration nor the judicial act of enforcing it under the FAA constitutes state action.’” VisionQuest Nat'l v. Marined Found., 1998 U.S. App. LEXIS 15340 (9th Cir. 1998) (citing Duffield v. Robertson Stephens & Co., 144 F.3d 1182 (9th Cir. 1998)). Eleventh Circuit: “We agree with the numerous courts that have held that the state action element of a due process claim is absent in private arbitration cases.” Davis v. Prudential Sec., Inc., 59 F.3d 1186, 1191 (11th Cir 1995).
\bibitem{78} *Sanders*, 7 F. Supp. 2d at 177-78; *Acciardo v. Millenium Secs. Corp.*, 83 F. Supp. 2d 413, 422 (S.D.N.Y 2000).
\bibitem{79} *Sanders*, 7 F.Supp. 2d at 156-57.
\bibitem{80} Id. at 176-77
\bibitem{81} Id. at 177-79.
\bibitem{82} 83 F. Supp. 2d at 422.
\bibitem{83} *Id.*
\bibitem{84} *Id.*
\end{thebibliography}
IV. INSTANT DECISION

In Sawtelle v. Waddell & Reed, the Appellate Division of the New York Supreme Court revisited a dispute over an arbitral award of punitive damages. The court’s opinion began by noting that although the instant court had vacated the punitive damage award on a prior appeal, the arbitration panel had awarded Sawtelle the same amount of punitive damages on remand. The court identified only one difference between the two awards: the description of Waddell & Reed’s conduct changed from a “campaign of deception” to a “horrible campaign of deception, defamation and persecution.” The court reasoned that this change did not provide adequate justification for the panel’s decision to award $25 million in punitive damages. Although the court noted that arbitrators are not required to explain their initial awards on remand, the court clarified that, in the instant case, neither the presence nor the absence of such an explanation could have eliminated the possibility of modification or vacatur on appeal.

The court explained that it previously vacated the initial punitive damages award of $25 million because the arbitrators had manifestly disregarded the law by awarding punitive damages that were grossly disproportionate to the actual harm Sawtelle suffered. It follows, the court reasoned, that when an arbitral award is vacated on manifest disregard grounds, arbitrators cannot simply ignore the court’s holding on remand and reissue the same award. After discussing the limited amount of actual harm to Sawtelle by pointing out that he did not lose many clients or income, the court declared that when punitive damages are twenty-three times actual damages, the punitive award necessarily conflicts with established law and is per se arbitrary.

As for Sawtelle’s motion for an order remitting the matter to a new panel unless the parties stipulated to the amount to be awarded, the court agreed with the trial court that a reviewing court would impermissibly exceed their limited role if it issued such an order. After explaining that reviewing courts can only confirm, modify, or vacate arbitral awards, the court affirmed the trial court’s order denying the conditional remitter, vacating the second award of punitive damages, and remanding to a new arbitration panel.

---

86. Id. at 820.
87. Id. at 821.
88. Id.
89. Id. “The addition of four words by way of explanation amounts to no more than cosmetic, pretextual gloss.” Id.
90. Id.
91. Id.
92. Id.
93. Id.
94. Id. at 821-22.
95. Id. at 820. The court rejected Sawtelle’s argument that the remand to a new panel would unnecessarily increase the length of the proceedings because the new arbitration panel could review the same submissions considered by the initial panel. Id. at 821-22.
V. COMMENT

In *Sawtelle v. Waddell & Reed*, the New York Supreme Court Appellate Division expanded the doctrine of manifest disregard by holding that an arbitral award of punitive damages can be vacated under the manifest disregard doctrine when the amount of punitive damages is grossly disproportionate to actual harm. This decision was governed by the FAA, and so the court interpreted and applied a federal law that is substantively and procedurally applicable in both state and federal courts. The instant court's decision relied on precedent set forth by the United States Supreme Court and the circuit in which it sits—the Second Circuit.

While the doctrine of manifest disregard is a well-established ground for vacatur under federal law, the courts have limited its impact by construing this doctrine of judicial review narrowly. If the doctrine were construed broadly to expand judicial review of arbitral awards, the increased risk of lengthy and expensive appeals of arbitral awards would threaten the arbitral goals of efficiency and finality. Recognizing these concerns, and in light of the strong federal policy in favor of arbitration, courts have restricted the doctrine of manifest disregard through difficult burdens of proof. The *Sawtelle* court cited to Second Circuit case law to support its use of the manifest disregard doctrine in its application of federal law. This standard, which is the most common formulation of manifest disregard, strictly limits vacatur under the manifest disregard grounds to arbitral awards clearly governed by a well-established legal principle. Therefore, by holding that certain punitive awards can be vacated on manifest disregard

96. *Id.* at 821.
97. *See supra* notes 41-42.
98. The Supreme Court's interpretation of the FAA is binding on the state court, and although Second Circuit authority is only binding on the state court's application of federal law when the Supreme Court has not addressed the issue and all the federal circuits are in agreement, the state court is located within the geographical borders of the Second Circuit and so it is not surprising that the state court would rely more heavily on Second Circuit case law than other circuits. *See supra* notes 42-46.
100. *See supra* note 56. For example, the Second Circuit will only vacate awards under the manifest disregard standard that lack "even a barely colorable justification." *Andros Compania Maritima, S.A. v. Marc Rich & Co., A.G.* 579 F.2d 691, 704 (2d Cir. 1978).
101. *Sawtelle*, 21 A.D.3d at 821. Immediately after stating that the basis for vacatur was the manifest disregard ground, the instant court cited to the 1998 Second Circuit case, *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197 (2d Cir. 1998). This case repeats the above quoted standard for vacating an arbitral award made in manifest disregard of the law:

[[the reach of the doctrine [manifest disregard of the law] is "severely limited." Indeed, we have cautioned that manifest disregard "clearly means more than error or misunderstanding with respect to the law." We have further noted that to modify or vacate an award on this ground, a court must find both that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrators was well defined, explicit, and clearly applicable to the case. *Halligan*, 148 F.3d 197, 202 (quoting Government of India v. Cargill, Inc., 867 F.2d 130, 133 (2d Cir. 1989); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, 808 F.2d 930, 933 (2d Cir. 1986); DiRussa v. Dean Witter Reynolds Inc., 121 F.3d 818, 821 (2d Cir. 1997)). Because the federal circuits are unanimous in strictly limiting this doctrine, the state court is bound by these limitations. *See also supra* notes 44, 62.
102. *Id.* *See also supra* note 57.
Courts Have the Final Say

Courts Have the Final Say

No. 2

Biesterfeld: Biesterfeld: Courts Have the Final Say

Published by University of Missouri School of Law Scholarship Repository, 2006

639

Courts Have the Final Say

grounds, the Sawtelle court implied that the law governing excessive damages was "well defined, explicit, and clearly applicable."103

The Sawtelle court identified two types of arbitral punitive awards that could be vacated under the doctrine of manifest disregard.104 First, an arbitral award of punitive damages can be vacated on manifest disregard grounds when the punitive damages are "grossly disproportionate to the actual harm sustained by petitioner."105 Second, the court stated a twenty-three to one ratio between punitive and actual damages "can only be construed as arbitrary."106 If the twenty-three to one ratio between punitive and actual damages is necessarily arbitrary, the award must lack the "barely colorable justification" required to survive vacatur under the manifest disregard doctrine.107 In order for the court to have held that these types of punitive awards are appropriate grounds for manifest disregard, the court's logic must have been to find that both the law against punitive arbitral awards that are grossly disproportionate to the actual harm sustained, and the legal principle barring punitive awards that are twenty-three times actual damages, are "well defined, explicit, and clearly applicable."108

Although the standard used mandates a finding of clearly established, applicable law to support the court's holding, no clear cut formula for determining when punitive awards are impermissibly excessive exists.109 The United States Supreme Court has "consistently rejected the notion" that "a simple mathematical formula, even one that compares actual and potential damages to the punitive award," can determine when a punitive award is impermissibly excessive.110 While the Gore court noted that a ratio between punitive and actual damages of 500 to 1 would "surely raise a suspicious judicial eyebrow,"111 the Supreme Court refused to adopt a bright line rule that even a 500 to 1 ratio would automatically make the award excessive.112 Almost federal circuit, including the Second Circuit, has explicitly cited the Supreme Court's rejection of a "simple mathematical formula" for determining excessiveness of punitive awards.113 Accordingly, the Second Circuit "refused" to rely exclusively on the ratio between punitive and actual damages to determine whether a punitive award was excessive.114 Even New York state law is in accord: the New York state courts have held that "there is no rigid formula by which the amount of punitive damages are fixed."115 New York state courts also agree that while the ratio between punitive and actual damages should be reasonable, the question of excessiveness cannot be decided by a simple mathematical limit on the ratio.116

103. Sawtelle, 21 A.D.3d 820 at 821.
104. Id.
105. Id.
106. Id.
108. Id. at 158. See also supra note 104.
110. Id. at 582.
111. Id. at 583 (citing TXO Prod. Corp. v. Alliance Res. Corp., 509 U.S. 443, 481 (1993)).
112. Supra note 73; Disorbo v. Hoy, 343 F.3d 172, 187 (2d Cir. 2003).
While the courts have uniformly declined to adopt a bright line approach to determine the reasonableness of punitive awards, the United States Supreme Court has identified three factors that should be examined when deciding if a punitive damages award is excessive. Some courts have held that *Gore* does not apply to a court’s review of arbitral awards because *Gore* dealt with a claim that the punitive damages award was so excessive that it violated the defendant’s due process rights, and it is well-settled that judicial review of arbitral awards does not involve the requisite state action to trigger due process protections. However, several courts in the Second Circuit have used the *Gore* factors to examine whether an arbitral award is excessive, even when the constitutionality of the award is not challenged. While courts in the Second Circuit have used the *Gore* factors to examine arbitral punitive awards, the *Gore* factors have been used to confirm, never vacate, the arbitral award. Moreover, such courts have used the *Gore* factors to confirm arbitral punitive damages awards that are twenty and fifty times actual damages.

Despite the uniform rejection of a bright line approach, the Sawtelle court declared that when an arbitration panel awards punitive damages twenty-three times the amount of actual damages, that panel has acted in manifest disregard of the law. The court states that such an award “can only be construed as arbitrary” even though the United States Supreme Court, the Second Circuit Court of Appeals, and New York state courts have consistently rejected the idea that the ratio between punitive and actual damages are per se determinative of when a punitive damages award is excessive. The Sawtelle court also states that a punitive damages award twenty-three times greater than actual damages is “irreconcilable with prevailing authority” even though Second Circuit courts have confirmed arbitral punitive awards that are twenty and fifty times actual damages. Finally, while binding federal case law recognizes three factors as relevant to the inquiry of excessive punitive awards, Sawtelle ignores the factor that the Supreme Court has emphasized as most important: the reprehensibility of the defendant’s conduct. Rather, the court identifies one of the three relevant factors—the relationship between punitive damages and the amount of actual harm inflicted on the plaintiff—as independently sufficient to vacate an arbitral punitive damages award as excessive under the manifest disregard doctrine.

The instant decision presents a radical departure from the previously undisputed treatment of the bright line approach to punitive awards. The fact that the

---

116. *Gore*, 517 U.S. at 574-75. The three factors are: (1) degree of reprehensibility of defendant’s conduct; (2) ratio of punitive damages to actual or potential harm suffered by the plaintiff; and (3) civil or criminal penalties that the state could impose for comparable misconduct. *Id.*


119. *Sanders*, 7 F. Supp. 2d at 177-79; *Acciardo*, 83 F. Supp. 2d at 422.

120. *Id.*


122. Supra notes 11-15.

123. *Sanders*, 7 F. Supp. 2d at 177-79; *Acciardo*, 83 F. Supp. 2d at 422.

124. See Sawtelle 21 A.D.3d at 821.

125. *Id.*
bright line rule was used to justify vacatur under the manifest disregard doctrine is significant because the underlying premise of the doctrine is that the scope of review is considerably narrower than the scope of review that an appellate court applies to the judgment of a trial court.126 If the Sawtelle court found a twenty-three to one ratio excessive under a limited form of judicial review, and judicial review of trial court awards is more rigorous than judicial review of arbitral awards, then courts would have even greater authority to reverse a trial court's punitive award if it exceeded the twenty-three to one ratio.127

The instant case illustrates why the doctrine of manifest disregard is limited to issues governed by clearly defined legal principles. When a court vacates an award under the manifest disregard doctrine and remands it to arbitrators, there is a risk that the court will not confirm the new arbitral award, and will force the parties to arbitrate for a third time with the possibility of further appeals. The doctrine of manifest disregard addresses and attempts to limit this problem by allowing awards to be vacated on such grounds only when the governing law is clear and well-defined. When the governing legal principle is well-settled, there is less room for the arbitrators and the courts to disagree on its application and thus the appropriate result.

In the instant case, for example, the definition of excessive punitive awards was not well-settled prior to the instant decision. The only clearly defined law at the time of remand was the Supreme Court's holding that three factors should guide the inquiry, with special emphasis on one factor—the reprehensibility of the defendant's conduct—as the most important of the three.128 As such, an argument could be made that punitive damages were awarded in conformity with the law on remand. The panel's single change on remand in the description of the defendant's conduct—a "campaign of deception" to a "horrible campaign of deception, defamation, and persecution"129—addressed "the reprehensibility of the defendant's conduct."130 The argument follows that instead of "obdurately issu[ing] an identical determination," as the court claimed,131 the panel appears to have changed the description of Waddell & Reed's conduct to reflect their appreciation of the legal significance of this factor. In order to accept the instant court's holding as logically sound, however, this interpretation must fail to provide "an even barely colorable justification."132

Ironically, the instant dispute would likely have been resolved quicker and less expensively through litigation.133 As noted by the New York State Supreme

126. See Posner, supra note 47, at 503.
127. In order for arbitration to maintain its goals of speed and economy, arbitral awards must be final. Judicial review of arbitral awards is strictly limited to minimize the risk that arbitral awards will be vacated and thus preserve the element of finality attributed to arbitral awards. See supra notes 62-64. It necessarily follows that a court's ordinary judicial review, of trial court awards, is not so strictly limited.
129. Sawtelle, 21 A.D.3d 820, 821.
130. Gore, 517 U.S. at 575.
133. Sawtelle v. Waddell & Reed, Inc. 789 N.Y.S.2d 857, 859 (N.Y. Sup. Ct. 2004). The Trial Court stated: "The history of this arbitration undermines the very purpose of arbitration: to provide a manner of dispute resolution more swift and economical than litigation in court." Id.
Court, the courts would have been able to issue a conditional remittitur\textsuperscript{134} if a trial court, rather than an arbitration panel, had awarded the punitive damages.\textsuperscript{135} Had the court issued conditional remittitur, the parties could have avoided going to arbitration again by stipulating to the amount of punitive damages to be awarded.\textsuperscript{136} However, judicial review of arbitral awards is strictly limited to prevent courts from issuing orders, like a conditional remittitur, that would “fundamentally affect the merits.”\textsuperscript{137} Such limitations were implemented to foster the speed and finality of arbitral awards, but here, the limitations prevented the courts from issuing an order—conditional remittitur—that could have reduced the delay and expense of the instant dispute.\textsuperscript{138}

VI. CONCLUSION

In the instant case, the court inappropriately used the doctrine of manifest disregard. The law governing when punitive damages awards are excessive is not settled. Although the doctrine of manifest disregard allows remand only in circumstances of well-settled law, the court used this doctrine to overturn the arbitrator’s award as excessive. This case illustrates why limitations of judicial review of arbitral award should remain limited. Although the parties contractually assumed the risk of misapplied law in exchange for economy and finality by agreeing to arbitrate, the parties did not receive the benefit of their bargain.\textsuperscript{139} Instead of receiving a speedy alternative to litigation, the parties’ agreement to arbitrate resulted in a dispute between arbitrators and judges over a legal principle, spanning over eight years, five appeals, and two remands to arbitration panels.\textsuperscript{140}

LINDSAY BIESTERFELD

134. Conditional Remittitur is “the process by which a court requires either that the case be retried, or that the damages awarded by the jury be reduced.” BLACK’S LAW DICTIONARY 1321 (8th ed. 2004); the Supreme Court explains conditional remittitur as:

When an excessive verdict is given, it is usual for the judge to suggest to counsel to agree on a sum, to prevent the necessity of a new trial. In the absence of agreement the Court has no power to reduce the damages to a reasonable sum instead of ordering a new trial.


135. Sawtelle, 789 N.Y.S.2d at 859.

Petitioner's suggestion seems to make sense. If New York law now permits a court to vacate an arbitration award of punitive damages solely on the ground of excessiveness, because it is disproportionate under Gore, then a court should be able to modify that award in the same way that the court would modify a legally excessive jury verdict.

\textit{Id.}

136. Sawtelle, 21 A.D. 3d at 821.

137. \textit{Id.} at 822.

138. The trial court explained, following remand, that:

Petitioner's suggestion seems to make sense. If New York law now permits a court to vacate an arbitration award of punitive damages solely on the ground of excessiveness, because it is disproportionate under Gore, then a court should be able to modify that award in the same way that the court would modify a legally excessive jury verdict.

\textit{Sawtelle}, 789 N.Y.S.2d at 859. However, “A court's power to modify an award issued in an arbitration conducted pursuant to the FAA is governed, and strictly limited by, [the FAA].” \textit{Id.} at 860.

139. See Rubins, supra note 2 at 367.

140. The trial court stated, in the opinion directly preceeding the instant decision, “The history of this arbitration undermines the very purpose of arbitration: to provide a manner of dispute resolution more swift and economical than litigation in court.” \textit{Sawtelle}, 789 N.Y.S.2d at 859.