Judicial Review of Arbitration Awards Under Federal and Michigan Law

| Similar But Different

By Phillip J. DeRosier

It is well established that judicial review of arbitration awards under the Federal Arbitration Act (FAA)[1] is very narrow, requiring "egregious departures from the parties' agreed-upon arbitration…."[2] While federal courts have traditionally applied the "manifest disregard of the law" standard in reviewing arbitration awards, the Michigan Supreme Court charted a different course for judicial review in *Detroit Automobile Inter-Insurance Exchange v Gavin*[3] by rejecting the manifest disregard standard in favor of one allowing for a "broader role for the judiciary in statutory arbitration cases than is generally assumed in other jurisdictions…."[4] Although there is room for disagreement as to whether the standards are all that different as a practical matter, the fact remains that they *are* different.

FAST FACTS

Under the Federal Arbitration Act, review of an arbitration award is limited to "egregious departures from the parties' agreed-upon arbitration."

While many federal courts, including the Sixth Circuit, review arbitration awards solely to determine whether there was a "manifest disregard of the law," Michigan courts apply a slightly different test.

Under Michigan law, an arbitration award may be set aside if, through an error of law, the arbitrator was led to a wrong conclusion, and, but for that error, a substantially different award would have been made.

Review of an Arbitration Award Under the Federal Arbitration Act

Under Section 9 of the FAA, a court must confirm an arbitration award unless it is vacated, modified, or corrected as prescribed in Sections 10 and 11.[5] Section 10 of the FAA allows for the vacatur of an arbitration award where:

(1) the award was procured by corruption, fraud, or undue means;

(2) there was evident partiality or corruption by the arbitrators;

(3) the arbitrator is guilty of misconduct; or

(4) *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.[6]

Section 11 allows for modification or correction of an award where:

(1) there was an evident material miscalculation or mistake in the award;

(2) the arbitrators decided something outside of the scope of the agreement; or

(3) the award is imperfect in form, but does not impact its merits.[7]

If none of these grounds are met, the court *must* confirm the arbitration award—even if the parties have agreed to expand the scope of judicial review. In *Hall Street Associates, LLC v Mattel, Inc,*[8] the parties' arbitration agreement attempted to grant a reviewing court the power to vacate, modify, or correct any award if the arbitrator's findings of facts were not supported by substantial evidence or if the arbitrator's conclusions of law were erroneous. The United States Supreme Court, however, rejected this attempted expansion of the availability of judicial review, concluding that "the text [of the FAA] compels a reading of the §§ 10 and 11 categories as exclusive."[9] Such exclusivity, the Court explained, "substantiat[es] a national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straightaway."[10]

Despite the Court's decision in *Hall Street,* some circuits continue to recognize a common-law doctrine allowing vacatur of an arbitrator's award if it exhibits a manifest disregard of the law.[11] Under the manifest disregard standard, a court may only vacate an arbitrator's award if it clearly evinces more than a mere "erroneous interpretation of the law."[12] For example, manifest disregard of the law has been found where the arbitrator was presented with controlling law but refused to apply it.[13] On the other hand, several circuits have read *Hall Street* as precluding use of the manifest disregard standard.[14]

Two years ago, the Supreme Court had the opportunity to address whether the manifest disregard standard survived *Hall Street,* but ended up punting on the issue. In *Stolt-Nielsen SA v AnimalFeeds International Corporation,*[15] the Court reaffirmed that parties seeking to vacate an arbitration award have a "high hurdle,"[16] stressing "[i]t is not enough for petitioners to show that the panel committed an error—or even a serious error."[17] Rather, "[i]t is only when [an] arbitrator strays from interpretation and application of the agreement and effectively 'dispense[s] his own brand of industrial justice' that his decision may be unenforceable."[18] In such a situation, the Court explained that "an arbitration decision may be vacated under § 10(a)(4) of the FAA on the ground that the arbitrator 'exceeded [his] powers,' for the task of an arbitrator is to interpret and enforce a contract, not to make public policy."[19]

> A court may set aside the arbitrator's decision only if "after applying 'clearly established legal precedent, . . . no judge or group of judges could conceivably come to the same determination.'"

Applying that standard in *Stolt-Nielsen,* the Supreme Court found that the arbitration panel exceeded its powers in imposing class arbitration on the parties because they had expressly stipulated that there was no agreement to authorize class arbitration.[20] However, the Court specifically declined to base its decision on the manifest disregard standard:

> We do not decide whether "manifest disregard" survives our decision in [*Hall Street*] as an independent ground for review or as a judicial gloss on the enumerated grounds for vacatur set forth at 9 U.S.C. § 10. . . . Assuming, *arguendo,* that such a standard applies, we find it satisfied. . . .[21]

Regardless whether the manifest disregard standard survived *Hall Street,* there appears to be no question that it remains "'severely limited,' 'highly deferential,' and confined to 'those exceedingly rare instances of egregious impropriety on the part of the arbitrators.'"[22] In the Sixth Circuit, the manifest disregard standard allows for vacatur only if the applicable legal principle is clearly defined and not subject to reasonable debate, and the arbitrators refused to heed that legal principle.[23] Or put another way, a court may set aside the arbitrator's decision only if "after applying 'clearly established legal precedent, . . . no judge or group

of judges could conceivably come to the same determination.'"[24] Moreover, the manifest disregard standard cannot be used as a basis for modifying (as opposed to vacating) an award.[25]

Review of an Arbitration Award Under the Michigan Court Rules

While limiting review of arbitration awards in federal court to the statutory grounds for vacatur, *Hall Street* also recognized the potential for broader review under state law. As the Court explained in *Hall Street,* the FAA is "not the only way into court for parties wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable."[26] It is, of course, well established that the FAA's reach is expansive, applying to all contracts involving interstate commerce, and that state courts are bound to enforce the FAA's substantive provisions under the Supremacy Clause.[27] But at least two state high courts since *Hall Street* have taken the position that the FAA does not control judicial review of an arbitration award in state court, even if the FAA is otherwise implicated.[28]

This is significant because while federal courts continue to struggle with whether the manifest disregard standard may be used to *expand* judicial review of arbitration awards, the Michigan Supreme Court long ago rejected the manifest disregard standard as being *too limited,* despite the fact that the Michigan court rules ostensibly mirror the FAA.[29] In *Gavin, supra,* the Court characterized the manifest disregard standard as a rule of "virtual nonreviewability" that was based on the notion that the goal of private arbitration is the "expeditious, inexpensive, and unreviewable resolution of private disputes…."[30] The *Gavin* Court, however, concluded that those are not the goals or purpose of arbitration.[31]

The *Gavin* Court instead found the "process of dispute resolution and the procedural advantages of arbitration" to be "the servants of the law governing the issues in dispute, not the reverse."[32] In wrestling with the proper balance to be struck in reviewing errors of law by arbitrators, the *Gavin* Court observed that on one end of the spectrum are errors that so plainly disregard principles fundamental to a fair resolution of the dispute, or generate a legally unsustainable result, that they cannot be within the parties' agreement to arbitrate or the arbitrator's authority.[33] Yet, on the other end, there are errors committed by the arbitrators that are so minimal and inconsequential to the outcome of the arbitration as to be immaterial.[34]

The *Gavin* Court concluded that justice and common sense required drawing

> a line between the two and that it be drawn sufficiently close to the center of the spectrum that it cannot in fairness be said that the line is a fiction and that errors of substantive law, no matter how egregious, are never reviewable because they are the price paid for the procedural advantages of the dispute resolution.[35]

The Court decided to adopt a review standard recognizing that arbitrators exceed their power when they act beyond the terms of the contract or in contravention of controlling principles of law.[36] Thus, under *Gavin,* a court must set aside an arbitration award whenever it

> appears on the face of the award or the reasons for the decision as stated, being substantially a part of the award, that the arbitrators through an error in law have been led to a wrong conclusion, and that, but for such error, a substantially different award must have been made….[37]

In adopting this framework, the *Gavin* Court was careful to point out that the primary role of arbitrators is fact-finding. It emphasized that these findings of fact are unreviewable, given the informal nature of arbitration hearings and the subsequent lack of meaningful review.[38] However, "just as a judge exceeds his power when he decides a case contrary to controlling principle of law, so does an arbitrator."[39] The Court felt that its approach would "secure to litigants who come to the courts for judicial confirmation and enforcement of arbitration results, that which we believe they agreed to: an arbitration award rendered according to the law which governs their dispute."[40]

As a practical matter, it is not clear how different the *Gavin* standard really is from the federal manifest disregard standard. Applying the manifest disregard standard, lower federal courts have vacated awards that ignored the plain language of the parties' contract.[41] Compare that to *Gavin,* in which the Michigan Supreme Court observed that "by ignoring express and unambiguous contract terms, arbitrators run an especially high risk of being found to have 'exceeded their powers.'"[42] Similarly, an arbitrator's fact-finding is essentially unreviewable under either approach.[43]

It seems clear that Michigan courts have more of a role in reviewing arbitration awards than do their federal counterparts.

At the same time, however, the *Gavin* Court specifically rejected what it viewed as the essence of the manifest disregard standard, explaining that "[r]eviewing courts should focus upon the materiality of the legal error to test whether judicial disapproval is warranted, and not upon the question whether the rule of law was so well settled, widely known, or easily understood that the arbitrators should have known of it."[44] Thus, if an "error in law" is sufficiently material that its correction would lead to a "substantially different award," vacatur is permissible, whereas a court operating under the FAA would presumably not have this same freedom.

Conclusion

While the differences between the federal manifest disregard standard and the review framework adopted in *Gavin* may be subtle, it seems clear that Michigan courts have more of a role in reviewing arbitration awards than do their federal counterparts. Practitioners should keep this in mind when drafting arbitration agreements or seeking judicial review of an arbitration award in a Michigan court. ■

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FOOTNOTES

1. 9 USC 1 *et seq.*
2. *Hall Street Associates, LLC v Mattel, Inc,* 552 US 576, 586; 128 S Ct 1396; 170 L Ed 2d 254 (2008).
3. *Detroit Auto Inter-Ins Exch v Gavin,* 416 Mich 407; 331 NW2d 418 (1982).
4. 9 USC 9.
5. *Hall Street,* 552 US at 582.
6. 9 USC 10(a).
7. 9 USC 11.
8. *Hall Street,* 552 US at 578.
9. *Id.* at 586.
10. *Id.* at 588.
11. See *Stolt-Nielsen SA v AnimalFeeds Int'l Corp,* 548 F3d 85, 95–96 (CA 6, 2008), rev'd on other grounds, 130 S Ct 1758 (2010); *Wachovia Securities, LLC v Brand,* 671 F3d 472, 483 (CA 4, 2012); *Coffee Beanery, Ltd v WW, LLC,* 300 Fed Appx 415, 419 (CA 6, 2008); *Comedy Club, Inc v Improv W Assoc,* 553 F3d 1277, 1290 (CA 9, 2009).
12. *Local 863 Int'l Bhd of Teamsters v Jersey Coast Egg Prod, Inc,* 773 F2d 530, 533 (CA 3, 1985).
13. See *Goldman v Architectural Iron Co,* 306 F3d 1214, 1216 (CA 2, 2002).
14. See *Ramos-Santiago v United Parcel Serv,* 524 F3d 120, 124 n 3 (CA 1, 2008); *Citigroup Global Markets, Inc v Bacon,* 562 F3d 349, 355 (CA 5, 2009); *Medicine Shoppe Int'l, Inc v Turner Investments, Inc,* 614 F3d 485, 489 (CA 8, 2010); *Frazier v CitiFinancial Corp, LLC,* 604 F3d 1313, 1324 (CA 11, 2010).
15. *Stolt-Nielsen SA v AnimalFeeds Int'l Corp,* ___ US ___; 130 S Ct 1758; 176 L Ed 2d 605 (2010).
16. *Id.,* 130 S Ct 1767.
17. *Id.*
18. *Id.* (citation omitted).
19. *Id.*
20. *Id.,* 130 S Ct 1776.
21. *Id.,* 130 S Ct 1768 n 3.
22. *Stolt-Nielsen,* 548 F3d at 95 (citation omitted).
23. *Coffee Beanery,* 300 Fed Appx at 418 (citation omitted).
24. *Ozormoor v T-Mobile USA, Inc,* 459 Fed Appx 502, 505 (CA 6, 2012) (citation omitted).
25. See *Grain v Trinity Health,* 551 F3d 374, 380 (CA 6, 2008).
26. *Hall Street,* 552 US at 590.
27. *Amtower v William C Roney & Co (On Remand),* 232 Mich App 226, 232; 590 NW2d 580 (1999).
28. See *Nafta Traders v Quinn,* 339 SW3d 84, 99–101 (Tex, 2011); *Cable Connection, Inc v DIRECTV, Inc,* 44 Cal 4th 1334, 1354 (Cal, 2008).
29. Similar to the FAA, MCR 3.602(J)(2) allows for vacatur of an arbitration award if:
    (a) the award was procured by corruption, fraud, or other undue means;
    (b) there was evident partiality by an arbitrator appointed as a neutral, corruption of an arbitrator, or misconduct prejudicing a party's rights;
    (c) the arbitrator exceeded his or her powers; or
    (d) the arbitrator refused to postpone the hearing upon a showing of sufficient cause, refused to hear evidence material to the controversy, or otherwise conducted the hearing to prejudice substantially a party's rights.
30. *Gavin,* 416 Mich at 426.
31. *Id.* at 427.
32. *Id.*
33. *Id.* at 430.
34. *Id.*
35. *Id.*
36. *Id.* at 434.
37. *Id.* at 443 (citation and internal quotation marks omitted).
38. *Id.* at 429.
39. *Id.* at 444.
40. *Id.* at 445.
41. See *Sonic Automotive, Inc v Price,* unpublished opinion of the US District Court for the Western District of North Carolina, issued August 12, 2011 (Docket No. 10-CV-382), pp *15–16.
42. *Gavin,* 416 Mich at 434.
43. *Id.* at 429; see also *Scinto v Life Ins Co of N America,* 20 Fed Appx 45, 47 (CA 2, 2011) ("An arbitrator's error in fact finding does not provide a grounds for reversal.").
44. *Gavin,* 416 Mich at 443–44.