

## Outside Counsel

## Expert Analysis

# New York Vacates Arbitral Award With Manifest Disregard Doctrine

In *Daesang v. The NutraSweet Co.* (May 2017), the New York State Supreme Court partially vacated a \$100 million International Chamber of Commerce (ICC) arbitral award on the grounds of manifest disregard of the law. Justice Charles E. Ramos, who is designated to hear all international arbitration disputes before the Commercial Division of New York County, granted NutraSweet's motion to vacate an arbitral award in favor of the South Korean food group Daesang. Justice Ramos found that the arbitral tribunal had manifestly disregarded the law when it dismissed some of NutraSweet's counterclaims, calling the tribunal's failure to consider the merits of one counterclaim an "egregious dereliction of duty." The decision has strategic implications for how parties will invoke the doctrine of manifest disregard of the law when contesting future arbitral awards.

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The decision could also potentially affect New York's reputation as a seat for the reliable enforcement of international arbitral awards, and as a venue with courts that respect and support this alternative dispute resolution process.

**Background: A rotten deal or a breached contract?** In 2003, amid a rise in global demand for sugar substitutes, NutraSweet agreed to buy Daesang's aspartame business for \$79 million. Under a provision of the parties' Joint Defense and Confidentiality Agreement (JDA), NutraSweet retained the right to rescind the transaction within five years of the agreement if any customer with annual global purchases in excess of one million pounds of aspartame filed an

antitrust action in connection with NutraSweet's newly acquired business. NutraSweet made an initial \$5 million payment at the time of closing and was to follow up with installment payments over five years. After completing the first two installments, NutraSweet defaulted on its payments to Daesang. In March 2007, upon learning of an antitrust action initiated in federal court in Pennsylvania, NutraSweet exercised its contractual right to rescind the transaction.

Daesang commenced arbitration in 2008, seeking NutraSweet's

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outstanding payments with interest as well as damages for NutraSweet's alleged breach. In response, NutraSweet claimed that it properly rescinded the transaction because

of the Pennsylvania antitrust action, and that this rescission was a total defense to Daesang's claims. In addition, NutraSweet counterclaimed for breach of contract and fraudulent inducement. To support its breach of contract counterclaim, NutraSweet presented evidence showing that Daesang's aspartame fell short of the contractual standards. NutraSweet's fraudulent inducement counterclaim asserted that Daesang misrepresented its compliance with relevant law. NutraSweet supported this theory with an affidavit containing admissions by Daesang's president that for at least 10 years prior to the agreement with NutraSweet, Daesang had engaged in a large-scale conspiracy with other aspartame producers to coordinate market behavior.

In December 2012, a tribunal of U.S. arbitrators (Louis Kimmelman, Arnold Schickler, and Jonathan Schiller) dismissed all of NutraSweet's defenses and counterclaims in a partial award. In June 2016, the tribunal issued its final award, which included findings that NutraSweet had waived its breach of contract counterclaim and had breached its payment obligations under the agreement. The tribunal awarded Daesang more than \$100 million in damages. When Daesang commenced an action to confirm the award in New York state court in September 2016, NutraSweet moved to vacate the award on the grounds that the tribunal had manifestly disregarded the law

when it dismissed NutraSweet's counterclaims and defenses.

With respect to NutraSweet's defenses, the court rejected NutraSweet's argument that the tribunal had manifestly disregarded the law in concluding that the antitrust action did not constitute grounds for rescission. Justice Ramos described contract interpretation as "within the province of the arbitrator" and found no indication that the tribunal had ignored governing law. However, with respect to NutraSweet's counterclaims for breach of contract and fraudulent inducement, which included a request for the remedy of equitable rescission, Justice Ramos concluded that the tribunal had manifestly disregarded the law. The court found that, contrary to the tribunal's conclusion, the pleadings and transcript showed that NutraSweet had not waived its breach of contract counterclaim. With regard to fraudulent inducement, Justice Ramos observed that the tribunal had disregarded an applicable and established principle NutraSweet "repeatedly" presented that supported NutraSweet's counterclaim. Justice Ramos partly granted NutraSweet's motion to vacate the partial and final awards and remanded the case to the tribunal for redetermination of the counterclaims for breach of contract and fraudulent inducement. On June 14, 2017, however, Daesang filed a Notice of Appeal.

**Manifest Disregard: Sweet or sour, depending on the court.** Manifest disregard of the law is a controversial doctrine that courts across the country have not considered uniformly. The doctrine applies if arbitrators knew of and ignored (or refused to apply) relevant governing law, and the refusal resulted in an erroneous outcome and derives from §10 of the Federal Arbitration Act (FAA), which, according to most circuits, applies to enforcement proceedings on an international arbitral award that was issued by a tribunal seated in the United States.

In the 2008 case *Hall Street Associates v. Mattel*, the U.S. Supreme Court held that the FAA provided the exclusive grounds for vacating an award. However, the Supreme Court held that the FAA provided the exclusive grounds for vacating an award, and noted that the "manifest disregard" standard is not expressly articulated by the FAA's text. In response to this language from *Hall Street*, some circuits have eliminated manifest disregard of law as a basis for vacatur. Other circuits, including the Second Circuit, which covers New York, have concluded that *Hall Street* left open the continuing viability of the manifest disregard of law standard, which can function as a "shorthand" for the vacatur grounds enumerated in FAA §10(a)(4).

The Second Circuit applies the doctrine narrowly. In *Dufuerco Intern. Steel Trading v. T. Klaveness Shipping A/S*, the Second Circuit

held that to succeed on manifest disregard grounds, a party must show that:

- The allegedly ignored law was clear and applicable to the matter; and
- The law was in fact improperly applied, leading to an erroneous outcome; and
- The arbitrator was aware of the law and its applicability to the problem but either refused to apply or ignored it.

But if a tribunal's manifest disregard of the law amounts to a harmless error because the factual findings would lead to the same outcome under any legal standard, the award may be insulated from vacatur.

A 2012 report by the New York City Bar's Committee on International Commercial Disputes found that federal and state courts in New York applied a highly deferential standard of review to arbitral awards and upheld manifest disregard challenges only in rare instances.

**The aftertaste of New York's decision.** The success of the manifest disregard challenge in *NutraSweet* has raised the prospect that New York courts may be increasingly willing to vacate arbitral awards. Although sweeping conclusions cannot be drawn from a case that remains subject to appeal, the decision offers lessons for parties contemplating New York as their seat of arbitration or whose contracts provide for it.

A party challenging an international arbitral award in the United States may bring that challenge in state or federal court, but parties in state court are entitled to remove their cases to federal court if they have independent grounds to assert federal jurisdiction. While Justice Ramos is the primary justice overseeing international arbitration disputes in New York County, the

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federal district courts in New York do not have specialized judges for international arbitration matters. Although federal courts see a high volume of international arbitration-related cases, parties seeking to challenge an award on manifest disregard grounds cannot predict how strictly a particular judge will apply the test. Any party seeking to have an award vacated or modified will have the benefit of Justice Ramos' interpretation of manifest disregard. By contrast, a party seeking to confirm or enforce an award in state court may run greater risks of vacatur in New York state court than in federal court. On the other hand, the outcome of the appeal in this

case could undercut Justice Ramos' interpretation.

**New York: The recipe is still good.** Parties select New York as an arbitral seat because of its reputation for having pro-arbitration courts, a wealth of international arbitration practitioners, and a well-developed infrastructure to facilitate proceedings. Traditionally, New York courts' approach to manifest disregard—acknowledging its existence, but generally applying the test so stringently that it only rarely affects arbitral awards—has been consistent with this pro-arbitration reputation. Although the *NutraSweet* decision calls into question whether judges and experienced arbitrators' legitimate differences of opinion about New York law can provide grounds for a successful manifest disregard challenge, this decision should not shake parties' confidence in New York as a seat that respects the arbitration process. In the immediate term, and at least until the resolution of Daesang's appeal, it remains uncertain whether or not the *NutraSweet* decision represents a lasting change to the state courts' approach to the manifest disregard doctrine.