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The "Manifest Disregard of the Law" Doctrine to Set Aside Arbitral Awards — Still Good Law After *Hall Street*?

In *Hall Street Associates LLC v. Mattel Inc.*, 128 S. Ct. 1396 (2008), the U.S. Supreme Court recently decided that parties to an arbitration agreement may not expand the grounds for judicial review of an arbitral award beyond those provided in the Federal Arbitration Act (9 U.S.C. § 1 et seq.). The court relied, among other considerations, on its interpretation of the holding in *Wilko v. Swan*, 346 U.S. 427 (1953). *Wilko* had been the basis on which U.S. courts developed the so-called Manifest Disregard of the Law ("MDL") doctrine as an unwritten ground to set aside arbitral awards. While the Supreme Court did not give a definite answer as to whether or not MDL continues to be good law,[1] lower courts that are left with interpreting and applying *Hall Street* are coming to different conclusions.

Summary of *Hall Street*

In *Hall Street*, the Supreme Court addressed whether the parties to an arbitration agreement may expand the grounds for vacating an award beyond those set forth in §§ 10 and 11 of the FAA. Writing for the Court, Justice Souter held that the answer / *continued page 2*

[1] The Supreme Court had previously declined to address whether MDL falls under Sections 9 and 10 of the FAA. *See*, for example, *Bernhardt v. Polygraphic Co. of America*, 350 US 198, 203 n. 4 (1956).

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is "no," at least as far as out-of-court agreements are concerned.[2]

The FAA, 9 U. S. C. §§ 9-11, provides expedited judicial review to confirm, vacate, or modify arbitration awards. Pursuant to § 9, a court must confirm an award unless it is vacated, modified, or corrected as prescribed in §§ 10 and 11. Section 10 identifies the circumstances under which an award may be vacated, including where the award was procured by corruption, fraud, or undue means, and where the arbitrators are guilty of misconduct or exceeded their powers. Section 11 identifies additional grounds for modifying or correcting an award, which include evident material miscalculation, evident material mistake, and imperfections in a matter of form not affecting the merits.

Factual Background of Hall Street

This case began as a lease dispute between a landlord, Hall Street Associates, L.L.C. ("Hall Street"), and its tenant, Mattel, Inc. ("Mattel"), regarding who was responsible for clean-up costs resulting from environmental contamination. The lease agreement did not contain an arbitration clause, and the case had been pending for several years in state and later federal court. After attempts at mediation failed, the parties sought the District Court's permission to subject the dispute to arbitration. The District Court agreed and entered the arbitration agreement as an order. The agreement provided, in pertinent part:

> "[T]he United States District Court for the District of Oregon may enter judgment upon any award, either by confirming the award or by vacating, modifying, or correcting the award. The Court shall vacate, modify, or correct any award: (i) where the arbitrator's findings of facts are not supported by substantial evidence, or (ii) where the arbitrator's conclusions of law are erroneous."

The arbitrator found for Mattel, and Hall Street then filed a motion with the District Court to vacate the award due to legal error. The District Court, reviewing the award under the expanded review clause, agreed, vacated the award and remanded the case to the arbitrator. Specifically, the District Court found that the arbitrator had committed legal error by failing to properly apply the Oregon Drinking Water Quality Act to environmental contamination. On remand, the arbitrator followed the District Court's legal ruling and consequently found for Hall Street. Following the decision, both parties petitioned for review. The District Court, aside from correcting the arbitrator's interest calculation, upheld the award. Mattel appealed to the Court of Appeals for the Ninth Circuit.

On appeal, the Ninth Circuit reversed the District Court's order that had confirmed the arbitration award, and held that because the FAA specifies that arbitration awards can be vacated only in limited cases such as fraud, corruption, partiality, or where the arbitrators exceed their powers, an award has to be upheld even though it contains errors of law. The Ninth Circuit also held "the terms of the arbitration agreement controlling the mode of judicial review are unenforceable and severable" and instructed the District Court on remand to confirm the original arbitration award, unless the award should be vacated on the grounds allowed under § 10, or modified or corrected under the grounds allowable under § 11 of the FAA. After the District Court again held for Hall Street on the ground that it rested on an implausible interpretation of the lease, the Ninth Circuit again reversed on the basis that implausibility is not a valid ground under the FAA. The Supreme Court then granted certiorari to decide whether the grounds for vacatur and modification provided by §§ 10 and 11 of the FAA are exclusive.

The Hall Street *Decision*

The Supreme Court agreed with the Ninth Circuit that the grounds promulgated under §§ 10 and 11 of the FAA are exclusive, resolving a long-standing circuit court split.[3] The Court based its decision on two grounds.

First, the Court rejected Hall Street's argument that the Supreme Court's prior decision in *Wilko* established the rule that "expandable judicial review authority has been accepted as the law." The Court noted *Wilko*'s holding that

[2] Justices Roberts, Thomas, Ginsburg, and Alito joined; Justice Scalia joined as to all but one footnote. Justice Stevens filed a dissenting opinion, in which Justice Kennedy joined; Justice Breyer filed a separate dissenting opinion.

[3] The Ninth and Tenth Circuits had found that parties may not contract for expanded judicial review (the Eighth Circuit, in dicta, appeared to agree), while the First, Third, Fourth, Fifth, and Sixth Circuits had held that parties may do so.

"the interpretations of the law by arbitrators in contrast to manifest disregard [of the law] are not subject, in the federal courts, to judicial review for error in interpretation." The Court also noted that *Wilko*'s "manifest disregard" language may have referred to the § 10 grounds collectively or the § 10(a)(3) or 10(a)(4) grounds specifically, which authorize vacatur where arbitrators are guilty of "misconduct" or "exceeded their powers." The Court found, however, that the *Wilko* Court's "manifest disregard" phrasing was "vague" and refused to "accord it the significance that Hall Street urges," *i.e.*, that parties may provide additional grounds for federal judicial review beyond those promulgated under §§ 10 and 11 of the FAA.

Second, the Court rejected Hall Street's additional argument that an expansion of §§ 10 and 11 of the FAA to include review for legal error should prevail because "arbitration is a creature of contract, and the FAA is motivated, first and foremost, by a congressional desire to enforce agreements into which parties have entered." Again, the Court noted that the FAA allows parties to tailor many features of arbitration by contract, including, *inter alia*, the manner in which arbitrators are chosen, procedural rules, and substantive law. But the Court noted that this argument misses the point. The issue is not whether private parties may draft and later modify arbitration agreements, but whether statutory grounds for prompt vacatur and modification provided by the FAA preclude private parties from drafting and later modifying arbitration agreements to provide grounds for judicial review beyond those promulgated under §§ 10 and 11 of the FAA. The Court relied upon a strict construction of the text of the FAA, holding "that the text compels a reading of the §§ 10 and 11 categories as exclusive." Coupled with the § 9 language that district courts must grant an order confirming an arbitration award "unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title," this language "unequivocally tells courts to grant confirmation in all cases," except when the specific grounds of §§ 10 and 11 apply.[4]

The Implications For MDL – Post *Hall Street* Decisions

As *Hall Street* leaves room for interpretation as to whether or not MDL remains a proper basis to overturn an arbitration award despite that it is not one of the enumerated grounds of the FAA, it is not surprising that lower courts have come up with differing views.

Some courts seem to think that *Hall Street* has no impact on MDL. Without even mentioning *Hall Street*, the First Circuit stated that courts retain "inherent powers outside" the FAA to vacate arbitral awards, including where the arbitrator acts in disregard of law. *UMass Memorial Medical Center, Inc. v. United Food and Commercial Worker's Union*, No. 07-2527 (1st Cir. May 15, 2008). The First Circuit also—again without any discussion of *Hall Street*—reversed the confirmation of an arbitration award (rendered pursuant to the rules of the NASD) on the basis that the award was in manifest disregard of the law. *Kashner Davidson Securities Corp. v. Mscisz*, No. 07-1231 (1st Cir. June 27, 2008).[5]

Various district courts throughout the country have confirmed arbitration awards, in part rejecting MDL challenges, without any discussion of *Hall Street*. *See*, for example, *Grigsby & Associates, Inc. v. M Securities Investment, Inc.*, Case No. 06-23-35 (S.D. Fla. July 30, 2008); *Hicks v. The Cadle Co.*, Case No. 04-2616 (D. Col. July 23, 2008); *Remote Solution Co. v. FGH Liquidating Corp.*, Case No. 06-4 (D. Del. July 31, 2008). A New Jersey appellate court, while holding that vacatur of an award based on MDL may not be sought under the New Jersey Arbitration Act, noted that a MDL challenge is available under the FAA (without mentioning *Hall Street*). *Maguire v. Freehold Subaru,* / continued page 4

4 Although the Court agreed with the Ninth Circuit that the FAA "confines its expedited judicial review to the grounds listed in 9 U.S.C. §§ 10 and 11," the Court vacated the judgment and remanded the case. The Court posed the question whether the District Court's authority to manage its cases under Rule 16 of the Federal Rules of Civil Procedure "independently warranted that court's order on the mode of resolving the indemnification issues remaining in this case." The Court also noted that although §§ 10 and 11 provide exclusive regimes for review under the FAA, "we do not purport to say that [§§ 10 and 11] exclude more searching review based on authority outside the statute as well."

5 Which is remarkable, given that a previous panel of the First Circuit stated in dicta that "manifest disregard of the law is not a valid ground for vacating or modifying an arbitral award in cases brought under the [FAA]." *Ramos-Santiago v. UPS*, No. 07-1024, n. 3 (1st Cir. April 24, 2008). (Since the case was governed by Puerto Rico state law, the court ultimately declined to "reach the question of whether Hall Street precludes a manifest disregard inquiry in this setting. Whether or not Hall Street applies, Ramos's claim fails." *See id.*) — Faced with the apparent contradiction between *Ramos-Santiago* and *UMass Memorial Medical Center*, one district court in the First Circuit chose to do the analysis under both. *ALS & Associates, Inc. v. AGM Marine Constructors, Inc.*, Case No. 06-10088 (D. Mass. June 2, 2008)("Even if manifest disregard remained a valid basis for vacatur, however, Southeast has failed to show that the arbitrator manifestly disregarded the applicable law.)

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L.L.C., No. A-1258-07T2, 2008 WL 2796393 (N.J. Super. Ct. App. Div. July 22, 2008).

Some courts are cautious not to draw too far-reaching conclusions from *Hall Street*. According to the first reported post-*Hall Street* case in New York, the U.S. Supreme Court found the MDL doctrine to be "ambiguous," but concluded that it did nothing to "jettison the 'manifest disregard' standard of *Wilko*." *Chase Bank USA, N.A. v. Hale*, 2008 WL 1746984, *4-5 (Sup. Ct. N.Y. Co. Mar. 31, 2008). On the same day, a federal district court in Texas used the same approach, holding that *Hall Street* did not expressly decide whether MDL is a ground for vacatur separate from the statutory grounds under the FAA or a way of summarizing multiple statutory grounds. Consequently, the court analyzed the award both ways (and upheld it). *Halliburton Energy Services, Inc. v. NL Industries*, Nos. H-05-4160 & H-06-3504, 2008 WL 906037 (S.D. Tex. Mar. 31, 2008). Similarly, the Fifth Circuit in *Rogers v KBR Tech Servs*, 2008 US App LEXIS 12320 at *5-6 (5th Cir. June 9, 2008) recognized that *Hall Street* may have called into doubt the non-statutory grounds for vacating an arbitration award under Fifth Circuit precedent, but declined to reach the question because the award would be confirmed in any case.

Other courts are willing to go a step further. A federal district court in Minnesota found that MDL is no longer a viable basis for vacating an arbitration award under the FAA and as such did not even entertain a MDL challenge to an arbitration award. In Prime Therapeutics LLC v. Omnicare Inc, 2008 US Dist LEXIS 41306 at *15 (D. Minn. May 21, 2008), the court held that Hall Street ended MDL review: "[i]t would be somewhat inconsistent to say that the parties cannot contractually alter the act's exclusive grounds for vacating or modifying an arbitration award but then to allow the courts to alter the exclusive grounds by creating extra-statutory bases for vacating or modifying an award"). District Judge Richard J. Holwell (S.D.N.Y.) in *Robert Lewis Rosen Associates Ltd. v. Webb*, 07 Civ. 11403, came to the same conclusion. Because "the Second Circuit's traditional understanding of *Wilko* and § 10 — that *Wilko* endorsed manifest disregard and that § 10's grounds are not exclusive — is inconsistent with the basis for the holding in *Hall Street*," he found that "manifest disregard of the law standard is no longer good law."[6] His colleague, District Judge Crotty of the Southern District of New York, agreed: "'Manifest disregard', therefore, is no longer an independent basis on which to upset an arbitration award." *T. Co Metals LLC v. Dempsey Pipe & Supply Inc.*, Court Order, 07 Civ 7747 (PAC)(S.D.N.Y. July 8, 2007).

Conclusion

Hall Street has finally decided the question whether parties may expand the scope of judicial review of arbitral awards (they may not),[7] but left open the issue whether the MDL doctrine remains as an independent basis for vacatur of arbitral awards. As the post-*Hall Street* decisions outlined above show, there is continuing uncertainty in that regard. While some courts are hesitant to equate *Hall Street* with the death knell of MDL,[8] others, including the SDNY, have concluded that the era of MDL has come to an end. Either way, parties to arbitration clauses may want to review their agreements to ensure they are in compliance with Hall Street. ◎

[6] In *Supreme Oil Co. v. Abondolo*, Case No. 07-6479 (S.D.N.Y. July 31, 2008), an arbitration relating to claims under the Labor-Management Relations Act, 29 U.S.C. § 185(a) ("LMRA"), Judge Holwell confirmed his decision that MDL was no longer a basis to vacate an award, but at the same time noted that "*Hall Street*'s effect (if any) on review of arbitration awards under the LMRA is unclear." He ultimately declined to reach that question as he did not find any manifest disregard of the law.

[7] Note that *Hall Street* does not restrict parties from contracting for expanded *arbitral* review of awards. *See Redish v. Yellow Transp., Inc.*, No. 3-07-CV-1065-O, 2008 WL 2572658 (N.D. Tex. June 24, 2008).

[8] *See* the commentary by Lucy Reed and Phillip Riblett, *Hall Street: The Death Knell Of Manifest Disregard Of The Law*, Mealey's Int'l Arb Report, Vol. 23, #5 (May 2008), pp. 29-31.

Second Circuit Extends Reach of Class Action Fairness Act

In an apparent case of first impression, the Second Circuit decided in *Estate of Pew* v. *Cardarelli*, 527 F.3d 25, No. 06-5703 (2d Cir. May 13, 2008) that a class action suit concerning a company's failure to disclose its insolvency should be heard in federal court, despite being filed under New York's consumer fraud law and not involving nationally traded securities. The Class Action Fairness Act of 2005 ("CAFA") expands federal jurisdiction for certain class action cases where there is no complete diversity. 28 U.S.C. § 1332(d). An exception to CAFA's grant of federal jurisdiction is provided for a claim "that relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security." 28 U.S.C. § 1332(d)(9)(C); 28 U.S.C. § 1453(d)(3). (Section 1332(d)(9)(C) is an exception to CAFA's grant of original and appellate jurisdiction. Section 1453(d)(3) is an exception to the rule allowing removal of class actions to federal court.) In a split 2-1 decision, the majority interpreted CAFA broadly in finding that this case did not qualify for the exception.

Agway, Inc. was an agricultural supply and marketing cooperative that sought to raise capital by issuing money market certificates. Agway later suspended the sale of these certificates and ended a practice of re-buying the certificates prior to maturity. In September 2002, Agway filed for bankruptcy. Plaintiffs, a putative class of individuals who purchased money market certificates from Agway, Inc., filed suit in New York Supreme Court under the State Consumer Fraud Act, N.Y. Gen. Bus. Law § 349. Plaintiffs alleged that misrepresentations in Agway's financial statements fraudulently concealed that the company was insolvent and could only discharge its debt through the issuance of new debt instruments. Defendants, the officers and auditor of Agway, removed the action to federal court under CAFA. Plaintiffs moved to remand the action back to state court, arguing that the claim fell under the security exception to CAFA. The federal District Court for the Northern District of New York agreed and remanded the case back to state court. Defendants then challenged the District Court's decision in the Second Circuit.

In addressing the exception, the majority first noted that the plain language of the statute was ambiguous and thus interpretation required consideration of the statutory context of the legislative history. The court found that the purpose of the exception for certain securities-related class actions was to "keep purely local matters and issues of particular state concern in the state courts." Slip op. at 14 (quoting *Lowery* v. *Alabama Power Co*., 483 F.3d 1184, 1194 (11th Cir. 2007)). The court found that claims "'related[] to the rights and obligations' 'created by or pursuant to' a security must be claims grounded in the terms of the security itself." Slip op. at 19. The claim under the consumer fraud statute "that a debt security was fraudulently marketed by an insolvent enterprise . . . does not enforce the rights of the certificate-holders as holders, and therefore it does not fall within" the exception to federal jurisdiction. *Id*. Although this interpretation "arguably renders the words 'relating to' superfluous," the court deemed this interpretation was necessary because a broader interpretation of those words would render superfluous a separate exception for claims "concerning a covered security" because "all 'covered securities' are (of course) securities." *Id*. at 18-19; 28 U.S.C. § 1332(d)(9)(A); 28 U.S.C. § 1453(d)(1). The court preferred "an interpretation that preserves the meaning of an entire subsection." *Id*. at 19.

In dissent, Judge Pooler disagreed with the majority's view that the statute is ambiguous on its face. *Id*. at 25. She further asserted that the claim "in fact relates to the rights and obligations created by, or at least relating to" the securities at issue. *Id*. at 28. Judge Pooler contended that Agway's issuance of the certificates created an obligation to make interest and principal payments, and thus a corresponding right in the certificate-holders to receive said payments. The suit concerns Agway's failure to fulfill its obligations and thus arises out of the "consequent deprivation" of the certificate-holders' rights. *Id*. at 31.

This broad interpretation of CAFA's grant of federal jurisdiction should be generally viewed as a good sign by corporate clients. In enacting CAFA, Congress sought in part to reduce forum-shopping by class action plaintiffs. In narrowly construing the exception to federal jurisdiction of §§ 1332(d)(9)(C) and 1453(d)(3), the Second Circuit has strengthened the ability to remove state court class actions.

Appellate Division Allows Breach of Fiduciary Duty Claim to Go Forward Based on Alleged Failure to Provide Complete Financial Projections

In *Littman* v. *Magee*, __ N.Y.S.2d __, 2008 WL 2345152 (1st Dep't June 10, 2008), the First Department reversed the decision of the Supreme Court, New York County, 14 Misc.3d 1228(A), 836 N.Y.S.2d 493 (table), 2007 WL 419373 (Sup. Ct. N.Y. Co. Feb. 7, 2007) and determined that the Supreme Court had improperly dismissed a fraudulent buyout action initiated by a former partner. The plaintiff, Steven Littman, owned an 18.7% interest in Rockwood Realty Associates LLC, ("Rockwood") a closely held real estate investment firm. Littman and the two owners with a majority interest had experienced tension due to Rockwood's "phantom profits," which saddled Littman with significant personal income tax obligations that the company refused to pay. Negotiations on a sale of Littman's interest soon followed. Littman, represented by legal counsel and assisted by an accountant, requested financial information to assist in the evaluation of his interest in Rockwood. He received a balance sheet and income statement of Rockwood for nine months ending in 2004, the tax returns and actual full-year results of Rockwood for 2002 and 2003, the prospects (EBTIDA targets) for 2002 and 2003, and the revenue figures. Littman also requested further information pertaining to Rockwood's projected value and was told by Rockwood's CFO that "no other information was or would be made available."

On April 15, 2005, Littman sold his interest to Rockwood for $2.125 million. As part of the sale, Littman represented and warranted that he had "such knowledge and experience in financial and business matters such that [he] is capable of evaluating the terms and provisions of this Agreement and the other Transaction Documents." All of the parties executed a broad general release of all claims between them. In May of 2006 – more than a year later – DTZ Holdings PLC purchased a 50% interest in Rockwood for $45 million dollars. In his complaint, Littman alleged, based on the price paid by DTZ, that his interest would have been worth between $16 million and $47 million in May of 2006. He also alleged that the Rockwood defendants concealed the true value and prospects of Rockwood.

The Decision Below

Littman brought suit against DTZ Rockwood, LLC (formerly known as Rockwood Realty Associates, LLC), Rockwood Realty Associates Inc. (the managing member of Rockwood LLC), three individual investors in Rockwood LLC, and Herick Feinstein, LLP and Irwin Kishner (legal counsel to the Rockwood defendants). 2007 WL 419373 at *1. The complaint set forth claims for breach of fiduciary duty and aiding breach of fiduciary duty; unjust enrichment, constructive trust, and an accounting; and sought a declaratory judgment rescinding and declaring the general release void against all defendants. *Id*. at *2. The defendants moved pursuant to CPLR 3211(a)(1), (5), and (7) for an order dismissing the complaint. *Id*. at *1.

The Supreme Court granted the defendants' motions to dismiss, determining that "[e]ven giving the complaint every favorable inference, no reasonable reading of the release permits the construction proposed by the plaintiff Littman." *Id*. at *3. Although the court acknowledged that "a fiduciary cannot by contract relieve itself of the fiduciary obligation of full disclosure by withholding the very information the beneficiary needs in order to make a reasoned judgment," the court determined that "in the instant case the release refers to the specific subject matter as to which the representations are alleged, with precise specificity to put the plaintiff Littman on notice as the clause's intended effect." *Id*.

The Appellate Division's Reversal

The Appellate Division determined that the Supreme Court "erred in concluding that as a matter of law plaintiff's claims are barred by the terms of the release he signed." 2008 WL 2345152 at *1. The court noted that "a release may be set aside on the traditional bases of fraudulent inducement, fraudulent concealment, misrepresentation, mutual mistake or duress." Nevertheless, the plaintiff, even in the context of a fiduciary relationship, "must establish justifiable reliance on the misrepresentations or omissions at issue." *Id*. at *3 (citation omitted). Thus, "if [the plaintiff] was aware of information that rendered his reliance unrea-

sonable, or if he had enough information to create a duty to investigate further, the requisite reliance cannot be established." *Id*. That being said, the court still determined, weighing the statement "no other information was or would be available" in the light most favorable to the plaintiff, "at this juncture, it was erroneous to conclude as a matter of law that plaintiff could not establish the requisite justifiable reliance to set aside the release." *Id*. at *3-5.

The court's analysis was largely based upon the reasoning in *Blue Chip Emerald LLC* v. *Allied Partners Inc*., 299 A.D.2d 278 (1st Dep't 2002) and *Global Mins.& Metals Corp*. v. *Holme*, 35 A.D.3d 93 (1st Dep't 2006). Specifically, the court determined that "allegations here have much in common with those in *Blue Chip*" where this court reinstated a complaint for fraud and breach of fiduciary duty, and determined that "[t]he present matter is distinguishable from *Global Minerals*" where the court upheld the dismissal of the claim despite the fiduciary duty owed to the plaintiff because the plaintiff had sufficient knowledge of the questionable dealings of the defendant to put the plaintiff on notice. *Id*. at *3-4. Thus, the court reinstated the complaint and left "[t]he question of whether plaintiff can establish reasonable reliance . . . for determination at a later point in this litigation." *Id*. at *5.

A party owes its fiduciary a "duty of undivided and undiluted loyalty" and is thus obligated "to make full disclosure of all material facts."

Implications of the Decision

The *Littman* facts were dissimilar to those in *Blue Chip* in many ways. Specifically, in *Blue Chip* the plaintiff sold its 50% interest in a joint venture based upon an $80 million dollar valuation of the property. 299 A.D.2d 278 at 278. A mere *two weeks* later the defendants sold the property to a third party for $200 million. *Id*. By contrast, in *Littman* the subsequent sale occurred *more than one year* after Littman sold his 18% interest. Even more striking, in *Blue Chip*, as of the date of sale by the plaintiff, the defendants had already received offers and entered into an oral agreement with the third party to sell the property. *Id*. As the Court in *Blue Chip* stated, "in negotiating the buy-out agreement, the . . . defendants had no right to keep to themselves or misrepresent material facts concerning their efforts to sell or lease the . . . [p]roperty, such as, for example, the prices prospective purchasers were offering to pay." *Id*. at 280. In contrast, in *Littman*, it is alleged that the defendants merely failed to provide complete financial projections and targets of the company. Moreover, the offending sale occurred more than a year later.

A party owes its fiduciary a "duty of undivided and undiluted loyalty" and is thus obligated "to make full disclosure of all material facts." *Blue Chip*, 299 A.D.2d at 279 (internal quotation marks omitted). In *Blue Chip*, this duty was held to prevent a fiduciary from concealing and misrepresenting that a third-party was willing to pay a much higher price than the value agreed upon in a buy-out agreement. In *Littman*, the Appellate Division extended this duty to apply even when the offending party merely failed to provide complete financial projections and subsequently entered into a lucrative sale to a third party that may not even have been contemplated at the time of the initial buy-out. *See* 2008 WL 2345152 at *4-5. Fiduciaries must be prepared for New York courts to give teeth to the duty of complete disclosure and take care to comport with the requirements of said duty. ◎

Second Circuit Limits Authority of Federal Securities Receivers

In *Eberhard v. Marcu*, 530 F.3d 122 (2d Cir. 2008), the Second Circuit considered the extent of a federal securities receiver's authority to set aside prior fraudulent conveyances of assets that otherwise would fall within the receivership. Although acknowledging that receivers have "a variety of tools to preserve the status quo," the Second Circuit cautioned that "the power of a securities receiver is not without limits." And, one such limit is found in N.Y. Debtor & Creditor Law § 276, which the Second Circuit held does not grant a receiver standing to set aside a fraudulent conveyance if that receiver was appointed to represent only the transferor, and not his creditors.

On September 14, 2004, Todd Eberhard pled guilty to a variety of criminal charges arising from a wide-ranging securities fraud he admitted to perpetrating between 1998 and 2003. In a parallel SEC civil enforcement action, the district court issued a restraining order freezing Mr. Eberhard's personal assets, and created a receivership over those assets. The case on appeal in the Second Circuit was a dispute over the ownership of one of those assets; a corporation named Borderline Development NS, Inc. ("Borderline"), which Mr. Eberhard caused to play a role in his aforementioned securities fraud. Initially, Mr. Eberhard submitted an affidavit in which he represented that he was the "sole owner" of Borderline. Mr. Eberhard later disavowed that representation, and produced an agreement purporting to convey his interest in Borderline to Sandi Eberhard, his mother, supposedly executed before criminal charges were brought against Mr. Eberhard.

Ms. Eberhard intervened in the civil action pursuant to Fed. R. Civ. P. 24. Although Ms. Eberhard admitted that the agreement produced by her son was a fraud, she claimed that Borderline was nonetheless conveyed to her in documents she was unable to find. On April 18, 2003, the district court authorized the Receiver for Mr. Eberhard's personal assets to "if necessary, bring appropriate proceedings in this Court" to determine ownership of those assets. On September 9, 2005, the Receiver applied to the district court seeking a determination that Borderline was among Mr. Eberhard's personal assets because the purported conveyance of Borderline to Ms. Eberhard was fraudulent. The district court conducted a bench trial to determine ownership of Borderline, despite Ms. Eberhard's objection that the Receiver lacked standing to set aside the conveyance. At the conclusion of that trial, the district court entered judgment against Ms. Eberhard, holding that even if there had been a conveyance it was fraudulent and voidable pursuant to N.Y. Debtor & Creditor Law § 276, and therefore she had "no ownership or other interest" with respect to Borderline.

Ms. Eberhard appealed the district court's decision, in part on the ground that the Receiver lacked standing to set aside a fraudulent conveyance under N.Y. Debtor & Creditor Law § 276. On appeal, the Second Circuit began its discussion of the Receiver's standing by tracing the history of sec-

A receiver (does not have) standing to set aside a fraudulent conveyance if that receiver was appointed to represent only the transferor, and not his creditors.

tion 276 from an act of the English Parliament in 1570 to the present day. The Second Circuit concluded that there was "no doubt" that the only parties with standing to set aside a fraudulent conveyance under section 276 are the creditors of the transferor. The transferor has no such standing. Thus, Mr. Eberhard, as transferor, would have been without standing to challenge his own conveyance of Borderline to Ms. Eberhard. The Second Circuit considered this rule not only well settled, but also reasonable. To hold otherwise would permit transferors to "rescind transactions by virtue of their own fraudulent or deceptive designs," thereby harming innocent transferees.

Next, the Second Circuit applied the basic rule that section 276 standing is only available to creditors of the transferor to the specific context of federal securities receivers. In doing so, the Second Circuit discussed the reasoning (and colorful language) of a pair of Seventh Circuit opinions written by Judge Posner. In *Scholes v. Lehmann*, the court held that a receiver appointed to represent both Michael Douglas and the three corporations he had created had standing to attempt to recover assets of those corporations that had been fraudulently conveyed to third parties by Douglas. 56 F.3d 750, 755 (7th Cir. 1995). Once the corporations were under the control of a receiver, they were no longer Douglas's "evil zombies," and thus the receiver could seek the return of the assets on the corporations' behalf. *Id*. at 754-55. Judge Posner noted that the court "need not consider" whether the receiver would still have had standing if "Douglas had operated as a sole proprietorship rather than through corporations." *Id*. at 755.

The Seventh Circuit was presented with just that situation in *Troelstrup v. Index Futures Group, Inc*., and came to a different conclusion regarding the receiver's standing. 130 F.3d 1274 (7th Cir. 1997). In *Troelstrup*, the court held that a receiver appointed to represent John Tobin did not have standing to sue to recover the funds of Tobin's defrauded investors from a third party. *Id*. at 1277. The receiver was appointed to represent Tobin alone, and therefore could not sue "a third party on behalf of Tobin's creditors to enforce a right of theirs, not a right of Tobin's." *Id*.

The Second Circuit adopted Judge Posner's analysis and concluded that "a receiver's standing to bring a fraudulent conveyance claim will turn on whether he represents the transferor only or also represents a creditor of the transferor." Thus, the instant case turned on whether the Receiver represented Mr. Eberhard alone, and therefore lacked standing to challenge the conveyance of Borderline to Ms. Eberhard under section 276, or the Receiver also represented any of Mr. Eberhard's creditors, and thus had such standing. The court held that the receiver did not have standing to set aside the conveyance under section 276 because the receiver represented Mr. Eberhard alone. "As in *Troelstrup*, the Receiver here stands only in the shoes of Todd Eberhard" and "can press only those claims that Eberhard himself could assert." Because Mr. Eberhard is the transferor of Borderline, and transferors can never set aside their own fraudulent conveyances, the Receiver representing Mr. Eberhard is also without standing to set aside the Borderline conveyance. Accordingly, the Second Circuit vacated the district court's judgment. ◎

City Bar Committee on International Commercial Dispute Resolution Endorses Use of 28 U.S.C. § 1782 as Means of Obtaining Discovery in Aid of International Commercial Arbitration

In a recent report, the Committee on International Commercial Dispute Resolution of the Association of the Bar of the City of New York considered the long-standing controversy over whether 28 U.S.C. § 1782 should be used in connection with international commercial arbitrations. The Committee concluded that § 1782 *should* be available for use in connection with foreign or international arbitrations. The Committee also recommended that, once an arbitral tribunal is constituted, § 1782 discovery should be allowed only if the request for the same comes from the arbitral tribunal or with the consent of the tribunal.

Section 1782 of 28 U.S.C. permits the requesting party to take discovery in support of proceedings pending in foreign

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Use of § 1782

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or international tribunals. More specifically:

> "(a) the district court of the district in which a person resides or is found may order him to give his testimony or statement or to produce a document or other thing for use in a proceeding in a foreign or international tribunal, including criminal investigations conducted before formal accusation."

As the Report noted, there has long been uncertainty as to whether the "foreign or international tribunal" referenced in the statute includes foreign or international arbitral panels. The Committee analyzed the statute's long history, and, in particular, recent judicial consideration of the statute and its applicability to international arbitration. The Report noted the Second and Fifth Circuit cases, *NBC* v. *Bear Stearns & Co.*, 165 F. 3d 184 (2d Cir. 1999) and *Republic of Kazakhstan* v. *Biedermann International*, 168 F. 3d 880 (5th Cir. 1999), each of which held that District Courts were prohibited from extending § 1782 (a) assistance to arbitral tribunals. The Committee also considered the recent U.S. Supreme Court consideration of § 1782 in *Intel v. Advanced Micro Design*, 542 U.S. 241 (2004). In *Intel*, the Supreme Court held that the § 1782 could be utilized to provide assistance in connection with a proceeding pending before the European Community's Directorate General for Competition, an administrative body. The Report noted that, while the case did not involve an international arbitration panel, the breadth of the language in the *Intel* decision has since led to various courts determining that the statute should be extended to international arbitration panels, notwithstanding the holdings in *NBC* and *Kazakhstan*.

Having considered the history of what has become § 1782, recent case law and the needs of an increasingly global business community, the Committee concluded that § 1782 discovery should be available in aid of foreign and international arbitration. The Committee based this conclusion on the following:

- The plain meaning of the text of § 1782. The Committee noted that the plain meaning of the phrase "for use in a proceeding in a foreign or international tribunal" would clearly include a foreign or international arbitral tribunal (Id.);
- The *Intel* decision. While noting that the "tribunal" at issue in *Intel* was not an arbitral panel, the Committee found that *Intel* did "provide guidance." (Report at 27.) Given that the quasi-judicial agency at issue in *Intel* served as a "first instance decision-maker," much as an arbitral tribunal does, the Committee concluded that the Supreme Court's decision reinforced the conclusion that the plain meaning of § 1782 meant that "foreign arbitral tribunals qualify as a § 1782 tribunal" (Id.);
- The legislative history of the statute. The Committee also considered the lengthy legislative history of the statute, concluding that the intent of the legislature was to make the statute broadly available for the benefit of tribunals and litigants handling litigation with an international aspect. (Report at 28); and
- The recognized status of international arbitration under U.S. law. Finally, the Report noted that, while arbitration is

The Committee concluded that section 1782 discovery should be available in aid of foreign and international arbitration.

a creature of private contract, under the Federal Arbitration Act, it enjoys the special status of being binding and legally enforceable. (Report at 29.) This again strongly supported the extension of § 1782 to arbitration.

Having concluded that § 1782 is appropriately used in the context of international arbitration, the Committee considered the "best practices" for applying § 1782 to private commercial arbitration. The Report made the following recommendations:

- That U.S. courts observe "comity" by granting discovery only to the extent consistent with the wishes of the arbitral tribunal. Thus, the Report concluded that in the context of private arbitration, discovery should only be granted where the request was either made by the tribunal or with the tribunal's consent;
- That any "foreign" tribunal and any "international" tribunal located anywhere in the world should be entitled to utilize § 1782, noting again that this interpretation was consistent again with plain language of the statute; and
- Finally, consistent with its prior conclusion that § 1782 only be utilized by arbitral panels or with their consent, that the use of § 1782 prior to the creation of a tribunal, or by non-party to an arbitration proceeding, be strongly disfavored.

The Committee's careful analysis is a welcome consideration of a confounding issue that is growing in importance with the proliferation of international arbitration. ◎

Et al.

Newsworthy

- Oliver Armas has had numerous speaking engagements, including moderating a discussion on recent developments, cases, laws and trends in international ADR in North America at the International ADR Reporting Program Series in Sao Paulo, Brazil, August 11, 2008, and leading a discussion on "Controversial Provisions in the NY Convention," at the 4th Rio de Janeiro International Arbitration Conference in Rio De Janeiro, Brazil, May 13, 2008. He also served as a panelist for a discussion on "International Litigation and Arbitration," at the International Legal Training Seminar, April 2008, and discussed "Overcoming Corruption Challenges in Emerging Markets," at the American Conference Institute's (ACI) FCPA and International Anti-Corruption Seminar in New York, May 2008.
- Luis Enrique Graham spoke on "The Impact of Law on International Arbitration in Latin America — Recent Experiences," at the International Arbitration Conference in Panama City, Panama, September 8-9, 2008.
- Luis Enrique Graham and Salvador Fonseca are serving as faculty for a course on commercial arbitration. It is being offered in Mexico City by the Barra Mexicana, Colegio de Abogados (BMA), the Centro de Arbitraje de Mexico (CAM) and the Instituto Tecnologico y de Estudios Superiores de Monterrey, Santa Fe campus (ITESM) from April 3 to October 23.
- Thomas Pieper served as a Panelist at Tribunal Superior de Justicia/ICDR, Sesión Práctica: Arbitraje, Mexico City, June 26, 2008 (Salvador Fonseca was also a Panelist at this event) and at CANACO, Ejercicio de la Abogacía en el Arbitraje — Argumentación escrita y oral, Mexico City (June 26, 2008). Thomas also represented Chadbourne at the 4th German American Renewable Energy Conference in Syracuse, NY on June 24, 2008.
- Salvador Fonseca served as moderator for the international arbitration roundtable at the 2008 International ADR Reporting Program Series on August 25 in Santiago, Chile. The panel discussed the advantages and challenges of using ADR in the Americas, and the future for ADR in the region. He also moderated a panel discussion on criteria for selecting arbitrators on August 20 at the Regional Course on Arbitration as a Mechanism for Solving Commercial Controversies in Central America, held in Guatemala City August 19-22.
- Ricardo Ramirez spoke on "International Arbitration: NAFTA" at the 35th annual general assembly of the Comision Interamericana de Arbitraje Comercial, held September 5-9 in Guadalajara, Mexico.

Publications

- Oliver Armas, Luis Enrique Graham and Salvador Fonseca published an article in the April 30, 2008 edition of the *Latin American Law & Business Report* entitled "Mexico Enacts Important Commercial Litigation Reform."
- Hon. George Bundy Smith published an article in the April/May edition of the *Federal Bar Council News* entitled "Reflections of Justice Marshall."

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- Thomas Hall, assisted by Robert Kirby, published an article in the May 2008 edition of *The Metropolitan Corporate Counsel* entitled "The Public Policy Exception To The Enforceability Of Damage Waiver Clauses."
- Scott S. Balber published an article in the May 16, 2008 edition of *law.com* entitled "Recent Pro-Defendant Trends in Securities Class Action Litigation."
- Hon. George Bundy Smith and Thomas Hall, assisted by Jason Park and Caroline Pignatelli, published an article in the June 2008 edition of *The Securities Reform Act Litigation Reporter* entitled "After 'Stoneridge': Securities Liability Scheme." *Reprinted from the February 29, 2008 issue of the New York Law Journal.*
- Hon. George Bundy Smith and Thomas Hall published an article in the June 30, 2008 edition of the *New York Law Journal* entitled "When Tort Claims Duplicate Contract Claims."
- Alan Raylesberg and Larry Buterman published an article on *Law.com* entitled "Responding to Auditors Without Waiving Attorney Work Product Protection," on July 14, 2008.
- On August 13, 2008, Doug Jensen published an article on *Law.com* entitled "Parallel Investigations Continue to Pose Challenges."
- Robert Schwinger published an article in the August 18, 2008 edition of the *New York Law Journal* entitled "First-Party Reliance Not Required For Mail Fraud RICO."
- Hon. George Bundy Smith and Thomas Hall published an article entitled "Judicial Estoppel Use Freer as Policy Directives Change?" in the August 21, 2008 Commercial Division Update in the *New York Law Journal*. Matthew Moody, Jason Park and Caroline Pignatelli assisted in the preparation of this article.
- Oliver Armas and Thomas Pieper published an article entitled "The Scope of Judicial Review of Arbitral Awards under the U.S. Federal Arbitration Act," *Revista del Club Español de Arbitraje*, N°2/2008.

Contributors to this edition of *The Gavel* include: Thomas Butler, Thomas Pieper, Robert Kirby, Matthew Moody and Caroline Pignatelli.

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