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OVER-PREEMPTION OF STATE VACATUR LAW

- Excerpts from original article

I. INTRODUCTION

Several recent decisions in state courts vacating multi-million dollar arbitration awards have garnered significant attention from the media due to the size of the award vacated.[1] A subsidiary issue, however, has escaped attention: the courts' inconsistent use of the preemption doctrine[2] under the Federal Arbitration Act (FAA)[3] to preempt state statutory grounds governing motions to vacate. The FAA preemption doctrine provides that the federal substantive law of arbitrability[4] preempts conflicting state laws in federal and state court.[5] For example, in *Sawtelle v. Waddell & Reed, Inc*,.[6] a panel in New York's Appellate Division, First Department vacated a $25 million punitive damages award arising out of an employment dispute in the securities industry, on the ground that the arbitrators "completely ignored applicable law" in awarding punitive damages to the claimant.[7] Without discussion - other than an acknowledgement that the FAA governs employment disputes in the securities industry - the court summarily decided the threshold issue that the standard of review of the award was found in section 10 of the FAA and the federal judicially created "manifest disregard of the law" test and not New York's arbitration statute.[8]

In contrast, two other panels of the same court applied New York statutory grounds to motions to vacate securities arbitration awards. In *Sands Bros. & Co. v. Generex Pharmaceuticals, Inc.*[9] the First Department, also without discussion, affirmed the lower court's vacatur of a $28 million arbitral award on state law grounds, stating that the panel failed to comply with an earlier directive of the court[10] and that the award was "totally irrational," a ground for reversal in New York's [Civil Practice Law and Rules] CPLR section 7511.[11]

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9. 749 N.Y.S.2d 17 (N.Y. App. Div. 2002). *Sands Bros.* involved a dispute arising out of a financial services agreement between a brokerage firm and a startup company. The agreement did not contain a predispute arbitration clause, but the lower court compelled Sands Bros. to arbitrate the dispute pursuant to New York Stock Exchange (NYSE) rules because Sands Bros. is a NYSE member. Telephone Interview with **Richard A. Roth, Esq.**, Counsel for Sands Bros. (Sept 29, 2003).

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STATE COURTS' INCONSISTENT USE OF FAA PREEMPTION OF VACATUR MOTIONS

A. New York

Perhaps the clearest example of intrastate judicial inconsistency is in New York. In *Hackett v. Milbank, Tweed, Hadley & McCloy*, [106] the Court of Appeals addressed FAA preemption in the context of the parties' New York choice of law clause. In that case, a former partner in a law firm, invoking an arbitration clause in a partnership agreement, brought an arbitration proceeding against his former firm seeking payments allegedly owed to him following his departure from the partnership. After losing the arbitration, the partner moved to vacate the award, challenging the arbitrator's power.[107] The New York Supreme Court vacated the award on public policy grounds and the Appellate Division affirmed.[108]

On appeal, the law firm contended that the FAA provided the grounds for vacatur. The Court of Appeals disagreed, and ruled that the state law grounds for vacatur under N.Y. CPLR section 7511 governed the dispute.[109] First, the court recognized that, while the FAA generally governed the partnership agreement, the parties' New York choice of law clause in the agreement displaced the FAA.[110] Second, the court noted that the choice of law clause explicitly provided that the only grounds for vacating an award were those specified in CPLR sections 7509 and 7511.[111] Thus, the Court of Appeals honored and gave effect to the parties' "explicit and unambiguous choice of law" under *Volt.*[112] *Hackett* left unsettled the issue of what law would govern in New York where the arbitration agreement contained a generic choice of law clause.

Following *Hackett*, the lower courts in New York have inconsistently used the FAA preemption doctrine to preempt state statutory grounds governing motions to vacate. Thus, lower courts in New York apply the FAA grounds (1) where the parties' arbitration agreement does not contain a choice of law clause;[113] (2) without discussion of a choice of law clause;[114] and (3) even where the parties chose a state law to govern.[115] Conversely, several recent vacatur decisions by lower courts in New York have - without a discussion of a choice of law clause - applied the CPLR grounds for vacatur to arbitration agreements governed by the FAA either (1) based on the parties' New York generic choice of law clause; [116] or (2) without discussion of the preemption doctrine or a choice-of-law clause.[117] There appears to be little explanation for the discrepancy.

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117. Sands Bros. & Co. v. Generex Pharms., Inc., 749 N.Y.S.2d 17 (N.Y. App. Div. 2002) (discussed *supra* notes 9-11 and accompanying text); *In re* Donald & Co. Secs., Inc. v. Jones, 270 A.D.2d 56 (N.Y. App. Div 2000) (brokerage customer dispute); Markby v. Painewebber Inc., 650 N.Y.S. 2d 950 (N.Y. Sup. Ct. 1996) (NYSE arbitration of broker's employment dispute); Republic N.Y. Secs. Corp. v. Lloyd, N.Y.L.J. 28, Oct. 27, 1997, at 28 (N.Y. Sup. Ct. 1997) (same); Berman v. Stratton Oakmont, Inc., N.Y.L.J., Oct 18, 1996, at 34 (N.Y. Sup. Ct. 1996). In *Sands*, the parties' agreement contained a generic New York choice-of-law clause, but it did not contain a pre-dispute arbitration clause. Rather, Sand Bros. was compelled to arbitrate the dispute because it was a New York Stock Exchange member. Thus, the parties could not have contemplated that its choice-of-law clause would include New York state arbitration law, as arbitration was not contemplated at the time the parties entered into their business arrangement. Telephone Interview with **Richard Roth, Esq**., Counsel for Sands Bros. (Sept. 29, 2003).