

# International Arbitration Alert

**Akin Gump**  
STRAUSS HAUER & FELD LLP

## Second Circuit and New York Appellate Division Decisions Affirm Pro-Arbitration Policies

February 4, 2019

### Key Points

- In *Deasang Corp. v. NutraSweet Co.*, the Appellate Division overturned a ruling by a lower court vacating an arbitral award on the ground that the arbitral panel manifestly disregarded the law. The Appellate Division reaffirmed that “manifest disregard” is a “severely limited doctrine” that “gives extreme deference to arbitrators.”
- In *General Re Life Corp. v. Lincoln National Life Insurance*, the 2nd Circuit adopted an exception to the *functus officio* doctrine that allows an arbitral panel to clarify its own ambiguous award.
- Both decisions reaffirm the strong state and federal policies in favor of arbitration and once again make clear that arbitral awards will be given substantial deference by New York courts..

In two recent decisions, the 2nd Circuit Court of Appeals and the New York Appellate Division reaffirmed the strong state and federal policies in favor of arbitration and once again made clear that arbitral awards will be given substantial deference by the courts. In *Deasang Corp. v. NutraSweet Co.*, the Appellate Division overturned a ruling by an overzealous lower court that had vacated an arbitral award on the purported ground that the arbitral panel had manifestly disregarded the law. In *General Re Life Corp. v. Lincoln National Life Insurance*, the 2nd Circuit made clear that an arbitral panel has the authority to clarify its own ambiguous award. These decisions emphasize that the U.S. remains a strongly “arbitration friendly” jurisdiction.

### ***Daesang Corp. v. Nutrasweet Co.***

In a decision with important implications for the confirmation of arbitration awards in New York state courts, the New York Appellate Division, First Department, reinstated an arbitral award that had been vacated by the lower court, holding that the lower court incorrectly vacated the award on the ground of manifest disregard for the law. The decision, *Deasang Corp. v. NutraSweet Co.*, reaffirms that New York state courts will vacate arbitral awards under only exceedingly rare circumstances and that the New

### Contact

#### **Mitchell P. Hurley**

Partner  
mhurley@akingump.com  
New York  
+1 212.872.1011

#### **Justin Williams**

Partner  
williamsj@akingump.com  
London  
+44 20.7012.9660

#### **Jack Murphy**

Counsel  
jmurphy@akingump.com  
New York  
+1 212.872.7442

York state court system remains a favorable forum in which to seek confirmation of an arbitral award.

The decision arose from an asset purchase agreement and processing agreement between NutraSweet and Daesang through which Daesang sold all of its aspartame assets to NutraSweet, including a manufacturing facility, and agreed to provide aspartame production services going forward at the same facility. Both agreements were governed by New York law and provided that disputes were to be resolved by a three-member tribunal in New York under the rules of the International Chamber of Commerce. The parties also entered into a joint defense and confidentiality agreement that allowed NutraSweet to rescind the transaction if legal proceedings challenging the deal as an antitrust violation were instituted by any customer that met certain size requirements.

Three years after the transaction closed, NutraSweet sought to rescind the deal based on an antitrust class action filed against NutraSweet and Daesang by several industrial aspartame customers. As a result, Daesang commenced arbitration proceedings against NutraSweet for breach of the agreements. NutraSweet defended the claims on several grounds, including that (1) NutraSweet was entitled to equitable rescission of the agreements based on the alleged falsity of certain representations and warranties made by Daesang, which NutraSweet argued allowed it to rescind the agreement on the basis of fraudulent inducement; and (2) Daesang breached the agreements by failing to maintain the plant and failing to manufacture aspartame according to the agreed-upon specifications and at sufficient quantities.

The panel sided with Daesang on all claims and dismissed all of NutraSweet's counterclaims and defenses. With respect to equitable rescission, the panel found that NutraSweet's arguments were contractual in nature and could not be pursued on a theory of fraudulent inducement. With respect to NutraSweet's breach-of-contract claim, the panel dismissed the claim because it found that NutraSweet had not asserted a breach of contract claim independent of its equitable rescission arguments, based on a finding that any such breach-of-contract claim had been waived.

Daesang moved to confirm the award in the Supreme Court, New York County. NutraSweet answered and cross-moved to vacate the award on the grounds that the arbitrators manifestly disregarded the law and evidence, violated public policy, and failed to discharge their duties in accordance with the law. After a hearing, the Supreme Court sided with NutraSweet and vacated the award on manifest disregard grounds. Regarding equitable rescission, the Supreme Court held that the panel "chose to disregard the well-established principle [invoked by NutraSweet during the arbitration] that a fraud claim can be based on breach of contractual warranties where the misrepresentations are of present facts (in contrast to future performance)." Regarding the counterclaim for breach of contract, the Court held that the record failed to establish that NutraSweet had waived this claim.

On appeal, the Appellate Division, First Department, squarely rejected the Court's rationale and granted Daesang's petition to confirm the arbitration award. The First Department reiterated that "manifest disregard" is a "severely limited doctrine" that "gives extreme deference to arbitrators." To modify or vacate an award on the ground of manifest disregard for the law, 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.” The First Department held that this standard had not been met.

Without addressing whether the panel’s legal reasoning was correct or incorrect, the First Department reasoned that the panel, at worst, **misapplied** the law regarding equitable rescission, rather than ignoring it altogether, as evidenced by the fact that the panel expressly quoted and applied the governing legal principles in its decision. A manifest disregard of the law “requires more than a simple error in law or a failure by the arbitrators to understand or apply it.” Moreover, to the extent that NutraSweet argued that the arbitrators misapplied the facts, the First Department explained that “manifest disregard of the facts is not a permissible ground for vacatur of an award.”

The First Department also rejected NutraSweet’s argument that the panel improperly found that NutraSweet had waived its breach-of-contract claim. NutraSweet relied on the provision of the Federal Arbitration Act authorizing vacatur of an award “where 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.” The First Department, however, held that the mere fact that this counterclaim was rejected on procedural grounds (i.e., waiver), rather than on the merits, did not prevent it from being a “mutual, final, and definite award on that claim or defense.” Furthermore, the court explained that, even if it ultimately disagreed with the panel’s finding of waiver, the court “is not empowered to review the arbitrator’s procedural findings, any more than it is empowered to review the arbitrator’s determinations of law or fact.” Thus, “an arbitral decision even arguably construing or applying the procedural record must stand, regardless of a court’s view of its (de)merits.”

### ***General Re Life Corp. v. Lincoln National Life Insurance***

In *General Re Life Corp. v. Lincoln National Life Insurance*, the 2nd Circuit joined a number of other Courts of Appeals in adopting an exception to the *functus officio* doctrine, holding that, where an arbitral award is ambiguous, the arbitrator retains authority to clarify it.

The case involved a dispute between a life insurance company, Lincoln, and its reinsurer, General Re, arising under a reinsurance agreement that permitted General Re to increase premiums under certain circumstances, but gave Lincoln the option to “recapture” its policies (i.e., sever the reinsurance relationship) rather than pay the increased premiums. General Re sought to increase its premiums, and Lincoln challenged the increase in arbitration. The parties agreed to maintain the status quo while the arbitration was proceeding, with Lincoln paying the pre-increase premiums and General Re continuing to pay claims as they arose.

The panel held that General Re had the right to increase its premiums, and provided for the unwinding of premium and claim transactions if Lincoln opted to recapture the policies. After Lincoln elected to recapture its policies, the parties disagreed about the meaning of the portion of the award requiring premium and claims transactions to be unwound. In response, the panel issued a clarification to its award, explaining that its original award was ambiguous and that **neither** party had correctly interpreted it. General Re, unhappy with the clarification, petitioned the United States District Court for the District of Connecticut to confirm the **original** (i.e., unclarified) award, and Lincoln filed a cross-petition to confirm the award with the clarification. The district

court denied General Re's petition and granted Lincoln's petition to confirm the clarified award.

The 2nd Circuit affirmed. On appeal, General Re argued that the arbitral panel exceeded its powers in issuing the clarification because the panel was "functus officio." Under this doctrine, "once arbitrators have fully exercised their authority to adjudicate the issues submitted to them, their authority over those questions is ended, and the arbitrators have no further authority, absent authority of the parties, to redetermine those issues." The 2nd Circuit disagreed, adopting an exception to the *functus officio* doctrine that had been previously adopted by the 3rd, 5th, 6th, 7th and 9th circuits where an arbitral award "fails to address a contingency that later arises when the award is susceptible to more than one interpretation." The court set forth three elements that must be met before the exception will be applied: "(1) the final award is ambiguous; (2) the clarification merely clarifies the award rather than substantively modifying it; and (3) the clarification comports with the parties' intent as set forth in the agreement that gave rise to the arbitration."

The court's decision is in keeping with existing law in the 2nd Circuit, which requires that a court tasked with confirming an ambiguous award remand to the arbitrator for clarification. Furthermore, because it was the arbitrator that issued the ambiguous ruling in the first place, it makes sense for the arbitrator to clarify it. As such, the decision promotes the strong federal policy in favor of arbitration by allowing the arbitrator to retain authority to interpret its own awards and allowing the parties to avoid expensive litigation outside of the arbitration.