

7-1-2011

## Ninth Circuit Denies Insurer's Gamble on Vacatur in Nevada

Emma M. Kline

Follow this and additional works at: <http://elibrary.law.psu.edu/arbitrationlawreview>

 Part of the [Dispute Resolution and Arbitration Commons](#)

---

### Recommended Citation

Emma M. Kline, *Ninth Circuit Denies Insurer's Gamble on Vacatur in Nevada*, 3 276 (2011).

This Student Submission - Comment is brought to you for free and open access by Penn State Law eLibrary. It has been accepted for inclusion in Arbitration Law Review by an authorized editor of Penn State Law eLibrary. For more information, please contact [ram6023@psu.edu](mailto:ram6023@psu.edu).

NINTH CIRCUIT DENIES INSURER’S GAMBLE ON VACATUR IN NEVADA

By  
Emma M. Kline \*

I. INTRODUCTION

In *Lagstein v. Certain Underwriters at Lloyd’s, London*, the defendant insurer’s motion to vacate the arbitration award upon reasons beyond the scope of Section 10 of the Federal Arbitration Act (“FAA”) was denied by the United States Court of Appeals for the Ninth Circuit.<sup>1</sup> The Court of Appeals explained that FAA § 10 commands the only circumstances in which a court may vacate an arbitral award, which include standard contract defenses like fraud, duress, or corruption, evident partiality on behalf of the arbitrator(s), arbitrator misconduct in administering the proceeding, or excess arbitrator authority.<sup>2</sup> Relying on *Hall Street Associates, L.L.C. v. Mattel, Inc.* and *Kyocera Corp. v. Prudential-Bache Trade Services, Inc.*, the Court maintained that FAA §§ 10-11 “provide the exclusive grounds for expedited vacatur and modification.”<sup>3</sup>

II. BACKGROUND

Lev Lagstein, M.D. (“Lagstein”), a cardiologist and disability examiner, obtained an insurance policy from Certain Underwriters at Lloyd’s, London (“Lloyd’s”) in 1999.<sup>4</sup> Lloyd’s agreed to pay Lagstein \$15,000 per month for up to fifteen years if an event occurred which prevented Lagstein from practicing

---

\* Emma Kline is a 2012 Juris Doctor candidate at the Pennsylvania State University Dickinson School of Law

<sup>1</sup> *Lagstein v. Certain Underwriters at Lloyd’s, London*, 607 F.3d 634, 640 (9th Cir. Nev. 2010).

<sup>2</sup> *Id.* at 640 (citing 9 U.S.C. § 10(a)).

<sup>3</sup> *Id.*; see *Hall St. Assocs., L.L.C. v. Mattel Inc.*, 552 U.S. 576, 584 (2008); see also *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 994 (9th Cir. 2007).

<sup>4</sup> *Lagstein*, 607 F.3d at 638.

medicine.<sup>5</sup> When Lagstein developed heart disease in 2001, he filed for benefits with Lloyd's.<sup>6</sup> By early 2002, Lloyd's had yet to disburse benefits or make a decision on Lagstein's claim, forcing Lagstein to return to work against the advice of his physicians.<sup>7</sup> Lagstein still had not heard from Lloyd's as of September 2003, and he consequently filed a complaint in the United States District Court for the District of Nevada for "breach of contract, breach of the covenant of good faith and fair dealing, and unfair trade practices."<sup>8</sup> Lloyd's motioned to stay the lawsuit and submit the dispute to arbitration.<sup>9</sup>

Lagstein's policy required both parties to select an arbitrator, and for the two party-appointed arbitrators to select a third, neutral arbitrator.<sup>10</sup> Lagstein chose Jerry Carr Whitehead and Lloyd's chose Ralph Williams, III.<sup>11</sup> Whitehead and Williams chose Charles Springer.<sup>12</sup> The arbitrators each submitted a disclosure form to the parties to ensure arbitrator neutrality.<sup>13</sup> The first arbitration proceeding lasted from July 11, 2006 through July 14, 2006.<sup>14</sup> In the August 31, 2006 award, the arbitrators found in Lagstein's favor, but could not agree as to the appropriate amount of damages.<sup>15</sup> Arbitrators Springer and Whitehead believed that Lagstein should receive the full value of his policy, estimated at \$900,000, and an additional \$1,500,000 for emotional distress.<sup>16</sup> Further, they believed that Lagstein was entitled to punitive damages but were unsure as to the sum and ordered a separate hearing to determine the award.<sup>17</sup> Williams disagreed, believing that Lagstein was

---

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at 638.

<sup>8</sup> *Id.*

<sup>9</sup> *Lagstein*, 607 F.3d at 638.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Lagstein*, 607 F.3d at 638.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

only entitled to \$11,000 under his policy, and that he should not receive additional emotional distress or punitive damages.<sup>18</sup>

The arbitrators held a separate punitive damages hearing on November 20 and 21, 1996, although Lloyd's contended that the panel's jurisdiction had lapsed after the initial hearing was completed.<sup>19</sup> Whitehead and Springer again constituted the majority, and concluded that Lagstein was entitled to \$4,000,000 in punitive damages.<sup>20</sup>

Lloyd's filed a motion in district court to vacate the awards.<sup>21</sup> The district court agreed with Lloyd's, and concluded that vacatur was appropriate as the damages were excessive and the arbitrators acted in manifest disregard of the law.<sup>22</sup> Additionally, the district court found that the punitive damages award was contrary to public policy, and that the arbitrators acted in excess of their authority.<sup>23</sup> Lagstein appealed to the United States Court of Appeals for the Ninth Circuit, which reversed the district court.<sup>24</sup>

### III. DISCUSSION

#### A. *Vacatur of the Overall Arbitral Award*

In reversing the district court, the United States Court of Appeals for the Ninth Circuit began by explaining that the FAA limits judicial review of an arbitral award by "enumerat[ing] limited grounds upon which a federal court may vacate,

---

<sup>18</sup> *Id.* at 639.

<sup>19</sup> *Lagstein*, 607 F.3d at 639. Lloyd's contention likely was based on the doctrine known as *functus officio*, which provides that an arbitrator's jurisdiction ceases at the point that the award is rendered or the case is determined to be without merit.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Lagstein*, 607 F.3d at 640.

modify, or correct an arbitral award.”<sup>25</sup> The Court claimed to rely exclusively on FAA § 10(a) for the foundation of its analysis, and maintained that unless an award contravenes either FAA § 10 or § 11, the court must enforce the award.<sup>26</sup>

#### 1. Excessive Arbitral Award

The Court of Appeals began by addressing Lloyd’s contention that the arbitral panel issued an excessive award.<sup>27</sup> It explained that although a court may disagree with an arbitral award, it may not vacate simply because it would have awarded a different amount of damages or decided the issue in a completely dissimilar manner.<sup>28</sup> When parties agree to arbitrate, they have vested the arbitral panel with the authority to weigh the evidence on matters “such as the length and severity of Lagstein’s disability,” and of Lloyd’s conduct.<sup>29</sup> The Court explained that “Section 10 of the FAA ‘does not sanction judicial review of the merits,’” which is precisely the activity in which the district court engaged.<sup>30</sup> The Court therefore determined that the district court erred in vacating the panel’s award solely because it disagreed with the size of the award.<sup>31</sup>

#### 2. Manifest Disregard of the Law

The Court next addressed Lloyd’s contention that the arbitrators acted in manifest disregard of the law, and explained that an arbitrator does so when he or

---

<sup>25</sup> *Id.* (citing *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 994 (9th Cir. 2007)).

<sup>26</sup> *Id.* (citing 9 U.S.C. § 10(a) and explaining that FAA § 11 was not applicable to the current case, as it allowed courts to *modify* or *correct* awards in the presence of clerical errors or miscalculations) (emphasis added).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Lagstein*, 607 F.3d at 640.

<sup>30</sup> *Id.* (citing *Collins v. D.R. Horton, Inc.* 505 F.3d 874, 879 (9th Cir. 2007)).

<sup>31</sup> *Id.*

she recognizes the pertinent law and then fails to apply it.<sup>32</sup> Although the district court believed that the arbitration panel acted in manifest disregard of the law, the court failed to point to a specific law that the arbitral tribunal identified and ignored.<sup>33</sup> Neither the district court nor Lloyd's cited any Nevada statute or case law that the arbitral tribunal intended to apply and then failed to do so. The Court went on to explain that manifest disregard of the law is a "high standard for vacatur," and that "it is not enough . . . to show that the panel committed an error—or even a serious error."<sup>34</sup> Consequently, the Court of Appeals reversed on the issue of manifest disregard of the law.<sup>35</sup>

The Court of Appeals also rejected Lloyd's claim that the arbitrators acted in manifest disregard of the facts of the case and that the panel's factual analysis was "irrational."<sup>36</sup> Vacatur on the basis of improper factual analysis would require the courts to engage in merits based review, which is antithetical to the arbitral process.<sup>37</sup> The Court explained that although the "facts of Lagstein's continuing disability were hotly contested," the arbitration panel was justified in finding on his behalf.<sup>38</sup> Further, for a court to consider an arbitration award "irrational," it must "fail to draw its essence from the agreement."<sup>39</sup> Lloyd's did not contend that the award was contrary to the parties' contract, but rather that it was insupportable by the arbitrator's interpretation of the facts at issue. The Court rejected Lloyd's contention explaining that the issue was not whether the award was contrary to the

---

<sup>32</sup> *Id.*; see *Comedy Club, Inc. v. Improv W. Associates*, 553 F.3d 1277, 1281 (9th Cir. 2009)

<sup>33</sup> *Lagstein*, 607 F.3d at 640.

<sup>34</sup> *Id.* (citing *Stolt-Neilson v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1767 (2010)).

<sup>35</sup> *Id.*

<sup>36</sup> *Id.* (citing *Coutee v. Barington Capital Group, L.P.*, 336 F.3d, 1128, 1133 (9th Cir. 2003)).

<sup>37</sup> *Id.*

<sup>38</sup> *Lagstein*, 607 F.3d at 640.

<sup>39</sup> *Id.* (citing *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 994 (9th Cir. 2007)).

facts of a case, but whether the award is “irrational with respect to the contract” and its content.<sup>40</sup>

### 3. Public Policy

The Ninth Circuit also rejected Lloyd’s public policy argument.<sup>41</sup> The lower court believed that the size of the award violated public policy because the arbitrators referenced an insurance benefit that Lagstein had not purchased.<sup>42</sup> To succeed on a public policy challenge, the court or aggrieved party must point to an overriding public policy “rooted in something more than general considerations of proposed public interests . . . it must demonstrate that the policy is one that specifically militates against the relief ordered by the arbitrator.”<sup>43</sup> That an arbitral award is merely inconsistent with a court’s general views on public policy is not enough to vacate an award.<sup>44</sup>

#### *B. Vacatur of the Punitive Damages*

The district court vacated the punitive damages award on grounds that the arbitral panel no longer had jurisdiction over the dispute after issuing the initial award.<sup>45</sup> But the Court of Appeals reversed, and explained that the “timing of the arbitration award was a procedural matter” reserved for the panel.<sup>46</sup> Although other courts may have interpreted the parties’ agreement differently, the panel’s understanding of the parties’ agreement to arbitrate was reasonable. The Court explained that “[i]n the absence of an express agreement to the contrary,

---

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> *Id.* at 641.

<sup>43</sup> *Lagstein*, 607 F.3d at 641 (citing *Stead Motors of Walnut Creek v. Auto. Machinists Lodge No. 117*, 886 F.2d 1200, 1204 (9th Cir. 1989)).

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* at 643.

<sup>46</sup> *Id.*

procedural questions are submitted to the arbitrator . . . along with the merits of the dispute.”<sup>47</sup>

The American Arbitration Association’s (“AAA”) Commercial Arbitration Rules and Mediation Procedures governed the parties’ arbitration agreement,<sup>48</sup> and provide that an award “shall be made promptly by the arbitrator and, unless otherwise agreed by the parties or specified by the law, no later than [thirty] days from the date of closing the hearing.”<sup>49</sup> After issuing an initial award on August 31, 2006, pursuant to the AAA’s Rule R-38, the panel announced that a punitive damages hearing would be held at a later date.<sup>50</sup> Because the decision to hold a later hearing was a procedural matter, the Court explained that the arbitrators had exclusive authority to decide the issue.<sup>51</sup> Furthermore, the AAA’s Rule R-43(b) permits arbitration panels to pursue “interim” or “partial rulings” *in addition to* final awards.<sup>52</sup> Although the panel had found generally on Lagstein’s behalf, it had not issued a complete award. The Agreement did not contain a specific date by which the panel had to determine the final award, and the arbitrators were therefore free to interpret the contract in a plausible manner.<sup>53</sup> The Court recognized that reasonable judges and arbitrators are often prone to interpreting rules and agreements in varying ways. If an arbitrator’s interpretation is at least sensible, however, that interpretation likely will stand.<sup>54</sup>

---

<sup>47</sup> *Id.*

<sup>48</sup> *Lagstein*, 607 F.3d at 643.

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* (citing *United Paperworkers Int’l Union, AFL-CIO v. Misco, Inc.*, 484 U.S. 29, 40 (1987), which held that procedural questions growing out of the dispute are not for the court but rather for the arbitrator to decide).

<sup>52</sup> *Id.* at 645.

<sup>53</sup> *Lagstein*, 607 F.3d at 645.

<sup>54</sup> *Id.*



C. *Vacatur Claim for Want of Arbitrator Impartiality*

Lloyd's final claim rested on his discovery that arbitrators Springer and Whitehead were concurrently involved in an ethics controversy in 1993.<sup>55</sup> He maintained that their failure to disclose their involvement in the 1993 controversy warranted vacatur of the award.<sup>56</sup> The Court of Appeals disagreed, explaining that Lloyd's had failed to point to evidence indicating an inappropriate relationship between the arbitrators.<sup>57</sup> The Court clarified that evident partiality requires a demonstration that an arbitrator had *actual bias* toward a party or that the arbitrator failed to disclose information that could result in a "reasonable impression of bias."<sup>58</sup> Lloyd's failed to meet this burden. The Court explained that the cited controversy occurred over a decade before the current proceeding, and that all three arbitrators satisfied their disclosure obligations when they explained their relationships with the parties and their respective law firms.<sup>59</sup>

IV. SIGNIFICANCE

This case, like *Hall Street Associates*, claims to articulate that the only means of vacatur are those delineated in FAA § 10, yet discusses methods of

---

<sup>55</sup> *Id.* at 639. (Arbitrator Whitehead, in 1993, was involved in an ethics controversy that dealt with the way he handled peremptory strikes entered against him under Nevada's rule for peremptory striking of judges. The Nevada Commission on Judicial Discipline's complaint was eventually dropped, although the FBI investigated Whitehead on "unspecified charges." Whitehead ended up signing a "non-prosecution agreement," which provided that he would retire from the bench, would not seek reelection, and would never again serve as a judge in any state. Further, a controversy related to the Commission's procedures in the matter began, which the Nevada Supreme Court addressed. At the time, Arbitrator Springer was a member of the Court, and "consistently sided with Whitehead on these procedural and jurisdictional issues.").

<sup>56</sup> *Id.* at 645.

<sup>57</sup> *Id.*; see 9 U.S.C. § 10(a)(2) (explaining that evident partiality or corruption on behalf of any arbitrator will force a court to vacate an otherwise valid arbitral award).

<sup>58</sup> *Lagstein*, 607 F.3d at 645-646 (citing *Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 393 U.S. 145 (1968)).

<sup>59</sup> *Id.* at 646.

vacatur that lie outside of the statute.<sup>60</sup> While the court succeeds in avoiding merits-based review, it inadvertently clouds the standards by which courts will review future arbitral awards. In referencing common law methods of vacatur such as manifest disregard of the law and manifest disregard of the facts, the Court threatens the efficiency and finality of arbitration rather than enforces it. Additionally, the Court further confuses the distinction between *actual* arbitrator bias and the *appearance* of arbitrator bias.<sup>61</sup> Rather than deciding on a single way to disqualify an arbitrator for want of impartiality, the Court straddles the line between both theories, providing dissatisfied parties with further means by which to challenge arbitral awards. Although this case upholds the panel's decision and speaks favorably of the FAA, it has unintentionally allowed for the arbitral process to become further judicialized.

---

<sup>60</sup> Hall St. Assocs., L.L.C. v. Mattel Inc., 552 U.S. 576, 585 (2008).

<sup>61</sup> Commonwealth Coatings Corp. v. Cont'l Cas. Co., 393 U.S. 145, 150 (1968) (holding that arbitral tribunals must not only be unbiased, but must also seek to avoid even the *appearance* of bias) (emphasis added).