

5-22-2014

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Recommended Citation

Jill I. Gross & Olivia Darius, Arbitration Case Law Update 2014, in *Securities Arbitration 2014* (PLI Course Handbook, May 22, 2014), <http://digitalcommons.pace.edu/lawfaculty/1045/>.

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Arbitration Case Law Update 2014

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Pace Law School, J.D. 2014

May 22, 2014

This chapter identifies decisions by the U.S. Supreme Court, the Financial Industry Regulatory Authority (“FINRA”) and selected lower federal and state courts in the past year that interpret and apply the Federal Arbitration Act (“FAA”) and could have an impact on securities arbitration practice.¹

I. SUPREME COURT DECISIONS

Since the publication of last summer’s PLI Arbitration Law Update 2013, the Supreme Court decided three new arbitration cases.²

A. “Effective Vindication” Doctrine: *American Express Co. v. Italian Colors Restaurant*

In June 2013, the Supreme Court decided *American Express Co. v. Italian Colors Restaurant*.³ In that case, the Court reversed the Second Circuit Court of Appeals⁴ and enforced a pre-dispute arbitration clause containing a class action waiver in American Express merchants’ credit card processing agreements. The Court rejected a claim – endorsed three separate times by the Court of Appeals⁵ – that the class action waiver was unenforceable

¹ 9 U.S.C. §§ 1 *et seq.* (2013). Because securities arbitration necessarily “involves commerce” (FAA § 2), courts apply the FAA to issues arising out of securities arbitrations. *See* *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002).

² Two of these cases were decided before the August 2013 PLI program, but after the publication of the 2013 Update, so we summarize them here.

³ 133 S. Ct. 2304 (2013).

⁴ *In re Am. Exp. Merch. Litig.*, 667 F.3d 204 (2d Cir. 2012) (“Amex III”), *rev’d*, 133 S. Ct. 2304 (2013).

⁵ *See Id.*; *In re American Exp. Merch. Litig.*, 554 F.3d 300 (2d Cir. 2009) (“Amex I”); *In re Am. Exp. Merch. Litig.*, 634 F.3d 187 (2d Cir. 2011); (“Amex II”). The Court of Appeals reconsidered *Amex I* in light of the Supreme Court’s subsequent ruling in *Stolt-Nielsen S.A. v. AnimalFeeds Intern. Corp.*, 559 U.S. 662 (2010) (holding that arbitrators cannot apply their own policy views when construing an arbitration agreement that is

because it precluded plaintiff merchants from vindicating their statutory rights under the federal antitrust laws.

Until this decision, lower courts had interpreted the “vindicating statutory rights” or “effective vindication” doctrine to provide that a disputant could argue that an arbitration agreement is unenforceable because an unfair aspect of the arbitration process precluded that party from vindicating its federal statutory rights.⁶ The doctrine derived from the Supreme Court’s pronouncement that “so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the [federal] statute [providing that cause of action] will continue to serve both its remedial and deterrent function.”⁷ The Second Circuit concluded that the *Amex* plaintiffs had demonstrated through expert testimony that pursuing their statutory claims individually as opposed to through class arbitration would not be economically feasible, “effectively depriving plaintiffs of the statutory protections of the antitrust laws.”⁸

In the 5-3 majority opinion authored by Justice Scalia, the Court recognized the validity of the “effective vindication” doctrine generally, but held that, in this case, the “fact that it is not

silent on the allowability of class arbitration to permit it), and reconsidered *Amex II* in light of the Supreme Court’s 2011 ruling in *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740, 1746 (2011) (enforcing class action waiver in consumer services arbitration agreement and holding that FAA preempted California’s *Discover Bank* rule, which “classif[ied] most collective-arbitration waivers in consumer contracts as unconscionable”).

⁶ See *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985); see also *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 92 (2000) (recognizing in *dicta* that, if a party showed that pursuing its statutory claims through arbitration would be prohibitively expensive, and thus it could not vindicate its statutory rights, a court could validly refuse to enforce a pre-dispute arbitration agreement).

⁷ *Mitsubishi Motors*, 473 U.S. at 637.

⁸ *Amex III*, 667 F.3d at 217.

worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy.” Because the class action waiver in the merchants’ credit card services agreement with American Express did not eliminate the *right to pursue* individual claims under the antitrust laws, the Court deemed the waiver enforceable. Justice Scalia wrote:

The “effective vindication” exception to which respondents allude originated as dictum in *Mitsubishi Motors* [v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985)] where we expressed a willingness to invalidate, on “public policy” grounds, arbitration agreements that “operat [e] ... as a prospective waiver of a party’s *right to pursue* statutory remedies” (citation omitted) (emphasis added). Dismissing concerns that the arbitral forum was inadequate, we said that “so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function. ...”

As we have described, the exception finds its origin in the desire to prevent “prospective waiver of a party’s *right to pursue* statutory remedies,” *Mitsubishi Motors*, *supra*, at 637, n. 19, 105 S.Ct. 3346 (emphasis added). That would certainly cover a provision in an arbitration agreement forbidding the assertion of certain statutory rights.

And it would perhaps cover filing and administrative fees attached to arbitration that are so high as to make access to the forum impracticable. See *Green Tree Financial Corp.–Ala. v. Randolph*, 531 U.S. 79, 90, 121 S.Ct. 513, 148 L.Ed.2d 373 (2000) (“It may well be that the existence of large arbitration costs could preclude a litigant ... from effectively vindicating her federal statutory rights”). “But the fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy.”⁹

⁹ 133 S. Ct. at 2311.

Of course, in our view, the right to pursue a remedy is meaningless and hollow if, as a practical matter, it is not financially possible to pursue. Together with the Court's 2011 decision in *AT&T Mobility*,¹⁰ *Italian Colors* effectively eliminates class arbitration as a procedural method of aggregating consumers' low value claims that are subject to an otherwise enforceable arbitration agreement.

Since FINRA does not permit class arbitration in its forum, and it bars class action waivers in customer agreements,¹¹ this decision has a more limited impact on customer claims in FINRA arbitration. *Italian Colors* appears to be applicable, however, to FINRA intra-industry and employment arbitration.¹²

B. Silent Arbitration Agreements and Class Arbitration: *Oxford Health Plans v. Sutter*

In recent years, Supreme Court FAA jurisprudence has, in effect, restricted the use of class arbitration as inconsistent with the FAA. For example, in *Stolt-Nielson v. AnimalFeeds Int'l Corp.*,¹³ the Court ruled that, when an arbitration clause is silent on whether the parties agreed to class arbitration, the arbitration panel cannot apply its own views of policy and infer that a mere agreement to

¹⁰ 131 S. Ct. 1740 (2011). For a detailed discussion of the case, see Jill I. Gross, *Arbitration Case Law Update 2011*, in SECURITIES ARBITRATION 2011, at 205 (Practising Law Institute 2011).

¹¹ See Part II.A, *infra*.

¹² See, e.g., *Hendricks v. UBS Financial Servs., Inc.*, 546 F. App'x 514 (5th Cir. 2013) (compelling FINRA arbitration of employees' class claims against employer despite class action waiver and forum prohibition on class arbitration and leaving it to arbitration panel to reconcile). Cf. *Alokazai v. Chase Inv. Servs. Corp.*, ___ F. App'x ___, 2014 WL 487075 (9th Cir. Feb. 7, 2014) (denying motion to compel FINRA arbitration of employees' class claims despite arbitration clause because no class action waiver).

¹³ 559 U.S. 662 (2010).

arbitrate evidences the parties' intent to consent to class arbitration.¹⁴ The Court, however, did not decide "what contractual basis may support a finding that the parties agreed to authorize class-action arbitration."¹⁵ Some commentators speculated that the Court would reject any attempt by an arbitrator to interpret an arbitration agreement silent on the availability of class arbitration to allow for the process.¹⁶

Surprisingly, in *Oxford Health Plans LLC v. Sutter*,¹⁷ a unanimous June 2013 opinion authored by Justice Kagan, the Court held that when parties agree that an arbitrator should determine what their contract means, a court cannot overturn the arbitrator's ultimate interpretation of a contract unless the arbitrator exceeded his or her power in violation of § 10(a)(4) of the FAA.¹⁸

In *Oxford Health Plans*, Sutter, a pediatrician, and Oxford Health Plans, a health insurance company, entered into a contract that stated "[n]o civil action concerning any dispute arising under this Agreement shall be instituted before any court, and all such disputes shall be submitted to final and binding arbitration in New Jersey, pursuant to the rules of the American Arbitration Association with one arbitrator."¹⁹ When Sutter sued on behalf of himself and others in state court, the court granted Oxford's motion to compel arbitration based on their contract.²⁰ Both parties agreed that an arbitrator should determine whether the contract

¹⁴ *Id.* at 672 (holding that an arbitrator 'exceeded [his] powers' under FAA §10(a)(4) when he imposed his own public policy views rather than interpreted and enforced a contract that was silent on class arbitration).

¹⁵ *Id.* at 687 n.10.

¹⁶ *See, e.g.*, Kristen Blankley, "Blankley on the Newest Class Arbitration Case to Reach the Supreme Court," ADR Prof Blog, *available at* <http://www.indisputably.org/?p=4165> (Dec. 8, 2012).

¹⁷ 133 S.Ct. 2064 (2013).

¹⁸ *Id.* at 2071.

¹⁹ *Id.* at 2067.

²⁰ *Id.*

between the parties allowed for class action arbitration.²¹ However, when the arbitrator decided against Oxford and found that the contract authorized class action arbitrations because class actions are a form of civil actions, Oxford sought to vacate the arbitrator's decision on the basis that the arbitrator violated § 10(a)(4) by exceeding his power.²² The District Court denied its motion and the Third Circuit affirmed.

In affirming the Third Circuit, the U.S. Supreme Court held that, since the parties agreed to let the arbitrator interpret the contract, as long as the arbitrator construed the document, his interpretation must stand, even if he made a grave error in the ultimate interpretation.²³ Unlike the arbitration panel in *Stolt-Nielson*, the arbitrator in *Oxford* did not impose his own views of policy when interpreting the arbitration contract. Thus, the Court still permits class arbitration when arbitrators interpret the arbitration agreement as manifesting the parties' intent to allow for it.

Since FINRA does not permit class arbitration in its forum, if the parties incorporate FINRA rules by reference in their arbitration agreement, then presumably a court or arbitrator would construe that arbitration agreement to exclude the possibility of class arbitration.²⁴

**C. Arbitration Treaties as Arbitration
Agreements: *BG Group v. Repub. of Argentina***

In March 2014, in a 7-2 opinion authored by Justice Breyer, the Supreme Court held, in *BG Group, PLC v. Republic of*

²¹ *Id.*

²² *Id.*

²³ *Id.* at 2070.

²⁴ *See* note 12, *supra*.

Argentina,²⁵ that arbitrators, not judges, should interpret and apply a local litigation requirement of an international treaty provision, and, on motions to affirm or vacate arbitral awards, courts must give appropriate deference to the arbitrators' decisions.²⁶

In the early 1990s, BG Group, a British firm, had an investment interest in an Argentine entity called MetroGAS, a privatized natural gas utility.²⁷ When Argentina faced economic problems in the early 2000s, it enacted new laws that called for calculating gas tariffs in pesos instead of dollars.²⁸ This change in the basis for calculating gas tariffs led to BG Group's profits quickly turning into losses.²⁹ BG Group claimed Argentina had violated the investment treaty between the two countries and sought arbitration according to Article 8 of the treaty which allowed for "the parties to agree to proceed directly to arbitration."³⁰

However, Article 8(2)(a) of the treaty also contained a local litigation requirement that either party must first submit a dispute to a competent tribunal, and, if after 18 months that tribunal fails to reach a final decision, then the parties may take the dispute to arbitration.³¹ Although Argentina argued that the arbitration panel lacked jurisdiction to decide the dispute because of Article 8(2)(a), the panel determined that it did have jurisdiction, and that compliance with Article 8(2)(a) was excused because of a series of Argentinian laws that would block any

²⁵ 134 S.Ct 1198 (2014).

²⁶ *Id.* at 1207-08, 1212.

²⁷ *Id.* at 1204.

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.* at 1203.

³¹ *Id.*

lawsuit by BG Group.³² The arbitration panel awarded BG Group \$185 million in damages.³³

The District Court for the District of Columbia affirmed the award,³⁴ but the D.C. Circuit reversed. After reviewing the award *de novo*, the Court of Appeals found that Article 8(2)(a) stripped the arbitration panel of its jurisdiction to hear the dispute since the parties had not first brought the dispute to a competent tribunal.³⁵

BG Group appealed to the U.S. Supreme Court. The Court analyzed the treaty as if it were an ordinary contract between private parties, and concluded that the fact that it was a treaty made no difference to the critical question of whether arbitrators or judges “[bear] primary responsibility for interpreting and applying Article 8’s local court litigation provision.”³⁶ Since courts dealing with ordinary contracts decide substantive issues of arbitrability while arbitrators decide procedural issues, and the local litigation requirement clause was a “purely procedural requirement,” the Court deferred to the arbitration panel’s determination of jurisdiction.³⁷ Although the United States (as *Amicus Curiae*) argued that, because the Supreme Court was dealing with a treaty and not an ordinary contract, it should not apply the “ordinary interpretive framework,” the Court found no express language in the treaty to set aside this framework.³⁸

³² *Id.* at 1205.

³³ *Id.*

³⁴ *Repub. of Argentine v. BG Group*, 715 F.Supp.2d 108 (D.D.C. 2010), *rev’d*, 665 F.3d 1363 (D.C. Cir. 2012), *rev’d*, 134 S.Ct. 1198 (2014).

³⁵ *Repub. of Argentine v. BG Group*, 665 F.3d 1363 (D.C. Cir. 2012), *rev’d*, 134 S.Ct. 1198 (2014).

³⁶ *BG Group, PLC v. Republic of Argentina*, 134 S.Ct. 1198, 1206 (2014).

³⁷ *Id.* at 1207-08.

³⁸ *Id.* at 1209.

Under this holding, all U.S. courts that review arbitration treaties should interpret and apply threshold questions pertaining to arbitration using the framework developed for interpreting similar questions in ordinary contracts unless there is explicit language in the treaty stating otherwise.³⁹

II. Administrative Law Decisions

A. *FINRA v. Schwab* Enforcement Action

The 2012 and 2013 PLI Arbitration Law Updates detailed FINRA's enforcement action against the broker-dealer Charles Schwab for inserting a class action waiver in its standard form customer agreement's arbitration clause, as well as the procedural developments of that action through May of 2013.⁴⁰ In the past year, the case concluded with its final chapter.

In that enforcement action, initiated in February 2012, FINRA argued that Schwab's class action waiver, which required customers to waive their right to bring or participate in a class or consolidated action, violates NASD Rule 3110(f)(4)(A) and (C), and its successor rules FINRA Rule 2268(d)(1) and (3) (effective Dec. 5, 2011).⁴¹ Those rules prohibit member firms from placing "any condition" in a pre-dispute arbitration agreement that "limits or contradicts the rules of any self-regulatory organization," and

³⁹ See generally *BG Group, PLC*, 134 S.Ct. 1198. This decision will likely have little or no impact on FINRA arbitration, because FINRA rules rather than a treaty are the basis for arbitration.

⁴⁰ See Jill I. Gross, *Arbitration Case Law Update 2013*, in *SECURITIES ARBITRATION 2013*, at 293-94 (Practising Law Institute 2013); Jill I. Gross, *Arbitration Case Law Update 2012*, in *SECURITIES ARBITRATION 2012*, at 233-34 (Practising Law Institute 2012).

⁴¹ Complaint and Request for Expedited Hearing, Department of Enforcement v. Charles Schwab & Co., Inc., Disc. Proc. No. 2011029760201, available at <http://www.finra.org/web/groups/industry/@ip/@enf/@ad/documents/industry/p125516.pdf> (FINRA Office of Hearing Officers Feb. 1, 2012).

“limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement,” respectively. FINRA argued that, because Rule 12204(d) of the FINRA Code of Arbitration Procedure for Customer Disputes (“FINRA Customer Code”) addresses the manner in which customers can bring and participate in class actions against member firms in court, the forum rules clearly bar class arbitrations, and Schwab’s class action waiver contradicts Rule 12204.⁴² In response, Schwab argued that the holding of *AT&T Mobility* applies in the securities context, and displaces conflicting FINRA rules. Schwab acknowledged that the mandate of the FAA may be “overridden by a ‘contrary congressional command,’”⁴³ but contended there was no such contrary command to displace the FAA in favor of FINRA rules.

In February 2013, A FINRA panel of hearing officers agreed with Schwab, and found that, while Schwab’s actions violated FINRA rules, FINRA enforcement could not enforce those rules against Schwab as preempted by the FAA.⁴⁴ FINRA appealed that decision to the National Adjudicatory Council (“NAC”).⁴⁵

⁴² *Id.*

⁴³ *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665, 669 (2012) (quoting *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987)).

⁴⁴ Hearing Panel Decision, Department of Enforcement v. Charles Schwab & Co., Inc., Disc. Proc. No. 2011029760201, available at <http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=33101> (FINRA Office of Hearing Officers Feb. 21, 2103).

⁴⁵ Appeals from FINRA disciplinary actions are heard by the National Adjudicatory Council. See FINRA Code of Procedure R. 9310-13. In an amicus brief jointly filed by Professors Gross and Barbara Black, they argued that the hearing panel’s decision was wrong, and that the Securities Exchange Act of 1934, as amended by Dodd-Frank, provides the “contrary congressional command” required by *CompuCredit* to displace the FAA. That amicus brief was based largely on a law review article authored by Professors Black and Gross. See Barbara Black & Jill

In an April 2014 ruling, FINRA's Board of Governors⁴⁶ reversed the aspect of the hearing panel's decision that concluded that the FAA precluded enforcement of FINRA rules.⁴⁷ Rather, the Board of Governors held that the Securities Exchange Act constituted a sufficient Congressional command to overcome the FAA's mandate to courts to enforce arbitration agreements as written. Since the Exchange Act delegated to the SEC, which in turn delegated to FINRA, the authority to regulate broker-dealers' arbitration agreements for the protection of investors, FINRA's rules barring class action waivers and mandating that investors be able to bring class claims in court were enforceable.⁴⁸

Simultaneous with the issuance of the decision, Schwab entered into a Letter of Acceptance, Waiver and Consent ("AWC") with FINRA, settling the enforcement action by consenting to a \$500,000 penalty and agreeing not to appeal the decision further.⁴⁹ Thus, the AWC ends the matter, and no court will have the chance to review FINRA's ruling on the important legal issues arising under the FAA, at least in this case.⁵⁰

Gross, *Investor Protection Meets the Federal Arbitration Act*, 1 STAN. J. COMPLEX LITIG. 1 (2012).

⁴⁶ Under FINRA Code of Procedure Rule 9349, NAC submits its proposed decision to the Board of Governors, which almost always becomes final without Board action. The Board can, however, under rule 9351, call a proposed decision for review and affirm, modify or reverse the proposed decision and/or its sanctions. While the Board rarely exercises this power, it did so in the Schwab case, taking the final decision away from NAC.

⁴⁷ Dep't of Enforcement v. Charles Schwab & Co., Inc., Complaint No. 2011029760201, 2014 WL 1665738 (FINRA Apr. 24, 2014).

⁴⁸ *Id.* at *13-18.

⁴⁹ FINRA, Letter of Acceptance, Waiver and Consent, No. 2011029760202, available at

<http://www.finra.org/web/groups/industry/@ip/@enf/@ad/documents/industry/p493597.pdf> (Apr. 24, 2014).

⁵⁰ If Schwab had not agreed to the AWC, it could have appealed FINRA's adverse decision to the SEC. See Exchange Act § 19(d), 15 U.S.C. §

B. NLRB's *D.R. Horton* Decision

In December 2013, the U.S. Court of Appeals for the Fifth Circuit, in *D.R. Horton, Inc. v. N.L.R.B.*,⁵¹ rejected the National Labor Relations Board's ("NLRB") position⁵² that mandatory arbitration provisions that waived employees' ability to file class and collective actions interfered with employee rights under federal labor law.⁵³ The court found that employees could not bring a class action suit against employer Horton alleging Horton violated federal labor laws because it concluded the arbitration agreement was not an unfair labor practice under the National Labor Relations Act ("NLRA"). In particular, the court noted that the NLRB's argument that Horton violated the NLRA was unfounded because the NLRB did not give "proper weight" to the FAA which made the arbitration agreement enforceable.⁵⁴

78s(d) (2006); FINRA Code of Procedure R. 9370 (A person "aggrieved" by a FINRA decision may then appeal to the SEC, or the SEC may review the matter on its own motion.). A person aggrieved by an SEC final order may obtain review in the Circuit Court of Appeals in which he resides or has his principal place of business or to the District of Columbia Court of Appeals. *See* Exchange Act § 25(a), 15 U.S.C. § 78y. A court of appeals decision is then subject to review by the Supreme Court upon certiorari or certification. 28 U.S.C. § 1254 (2006).

Interestingly, if Schwab had won at the NAC or FINRA Board level, FINRA could not have appealed to the SEC. FINRA, acting in its adjudicative capacity as a lower tribunal subject to SEC plenary review of its disciplinary decisions, is not an "aggrieved person." *NASD, Inc. v. SEC*, 431 F.3d 803 (D.C. Cir. 2005).

⁵¹ 737 F.3d 344 (5th Cir. 2013).

⁵² The NLRB determined that Horton violated section 7 of the NLRA which allows for employees to act in concert with each other. *See* *D.R. Horton, Inc. and Michael Cuda*, 357 NLRB No. 184 (Jan. 3, 2012). The NLRB also concluded that Horton violated section 8(a)(1) of the NLRA which prevents employers from interfering with employees' rights outlined in section 7. *Id.*

⁵³ *D.R. Horton*, 737 F.3d at 349.

⁵⁴ *Id.* at 348.

The Court of Appeals found no congressional command in the text of the NLRA sufficient to override the FAA.⁵⁵ Likewise, the Fifth Circuit pointed out that numerous decisions have held that there is no substantive right to class or collective actions under the NLRA.⁵⁶

The NLRB filed a petition for rehearing (pending at the time of publication) asking the Fifth Circuit to reverse its holding that a class action waiver in an arbitration agreement did not interfere with employees' statutory rights.⁵⁷ In the petition, the Board contends that the Fifth Circuit failed to recognize that a core right under the NLRA is for employees to be able to engage in class or collective actions.⁵⁸ The NLRB's petition contends that, although individual rights statutes such as the Age Discrimination in Employment Act or Fair Labor Standards Act do not provide employees with a substantive right to act in concert, the NLRA is different because it does vest employees with this right. Therefore, the Board asserts that the Fifth Circuit should have relied on the "FAA precedent that 'a substantive waiver of federally protected civil rights will not be upheld.'"⁵⁹

III. Federal Court Decisions

The lower federal courts continue to apply the Supreme Court's FAA jurisprudence when ruling on challenges to the

⁵⁵ The Fifth Circuit determined that the general language of the NLRA was insufficient to find a congressional command. Although one of the purposes of the NLRA was to "protect[] the exercise by workers of full freedom of association ... for the purpose of negotiating the terms and conditions of their employment or other mutual aid or protection," the court stated that "more explicit language has been rejected in the past." *Id.* at 360.

⁵⁶ *Id.* at 357.

⁵⁷ D.R. Horton Inc. v. NLRB, 5th Cir., No. 12-60031, petition for rehearing Mar. 3, 2014 [hereinafter Petition for Rehearing].

⁵⁸ *Id.*

⁵⁹ Petition for Rehearing, *supra* note 57.

arbitrability of a particular dispute, and when ruling on motions to confirm or vacate arbitration awards. The remainder of this chapter summarizes some of those decisions that involve FINRA arbitration.

A. Defenses to Arbitrability

Under the Supreme Court’s most recent FAA decisions (referenced above in Parts I and II), courts must enforce arbitration agreements according to their terms unless:

1. There is an explicit contrary Congressional command;
2. The arbitration agreement expressly strips one party of the substantive right (but not the procedural ability) to pursue a federal statutory claim (“effective vindication” defense); OR
3. The arbitration agreement is invalid pursuant to a state law defense to the enforceability of any contract, but only if that defense
 - applies to all contracts,
 - doesn’t discriminate against arbitration, and
 - doesn’t frustrate the purposes of the FAA, which include enforcing agreements according to their terms AND promoting efficient, streamlined arbitration procedures.

This section will summarize important Courts of Appeal decisions that have ruled on challenges to an arbitration agreement based on one of these three exceptions.

1. Contrary Congressional Command

As stated above, *Italian Colors* reaffirmed the principle that the FAA requires courts to enforce arbitration agreements even as to federal statutory claims, “unless the FAA’s mandate has

been ‘overridden by a contrary Congressional command.’⁶⁰ Courts have held that one such explicit command is found in §922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”),⁶¹ which declares that pre-dispute arbitration agreements purporting to require arbitration of whistleblower claims arising under the Sarbanes-Oxley Act of 2002 (“SOX”)⁶² are not enforceable.⁶³

In *Santoro v Accenture Federal Services, LLC*,⁶⁴ the Fourth Circuit affirmed the district court’s grant of an order compelling arbitration of an employee’s federal age discrimination claims. The Court of Appeals rejected plaintiff’s contention that Dodd-Frank’s ban on the arbitrability of whistleblower claims against publicly-traded companies extended to other federal statutory claims brought by a non-whistleblower against a publicly-traded company.⁶⁵ Thus, the court narrowly interpreted the “contrary Congressional command” of Dodd-Frank.

2. Effective Vindication: Enforceability of Class Action Waivers

Since the Supreme Court’s decisions in *AT&T Mobility* and *Italian Colors*, the Courts of Appeal have had no choice but to enforce class action waivers in arbitration clauses against unconscionability and “effective vindication” challenges.⁶⁶ For

⁶⁰ *Italian Colors*, 133 S.Ct. at 2309 (citing *CompuCredit Corp. v. Greenwood*, 132 S.Ct. 665, 668-69 (2012)) (second internal citation omitted).

⁶¹ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁶² Pub. L. No. 107-204, 116 Stat. 745 (2002).

⁶³ 18 U.S.C. § 1514A(e)(2) (2012). §806 of SOX gives a right of action to “whistleblowers” who report fraud at publicly-traded companies. 18 U.S.C. §1514A (2012).

⁶⁴ ___ F.3d ___, 2014 WL 1759072 (4th Cir. May 5, 2014).

⁶⁵ *Id.* at *5.

⁶⁶ *Raniere v. Citigroup Inc.*, 533 F. App’x 11, 12 (2d Cir. 2013) (relying on *Italian Colors* to reverse an order denying defendants’ motion to

example, in *Sutherland v. Ernst & Young*,⁶⁷ the Second Circuit Court of Appeals enforced a class action waiver in an arbitration agreement and rejected plaintiff employees' argument that they could not effectively vindicate their rights because the proceeding would be too financially burdensome.⁶⁸

In that case, Stephanie Sutherland filed a putative class action against her former employer, Ernst & Young, in order to recover approximately \$2,000 of unpaid overtime compensation in violation of the Fair Labor Standards Act ("FLSA") and the New York Labor Law ("NYLL").⁶⁹ Ernst & Young then filed a motion to compel arbitration on an individual basis pursuant to the arbitration agreement Sutherland signed when her employment began.⁷⁰ That agreement stated that all disputes between Sutherland and the firm would be submitted to mediation and arbitration and barred all class action proceedings.⁷¹

The District Court denied Ernst & Young's motion and agreed with Sutherland that requiring her to individually arbitrate would prevent her from effectively vindicating her rights under the FLSA and the NYLL because the cost of arbitrating her claims "on an individual basis would dwarf her potential recovery of less than

compel arbitration on an individual basis); *Murphy v. DirectTV, Inc.*, 724 F.3d 1218, 1224-28+ (9th Cir. 2013) (applying *AT&T Mobility* retroactively to enforce a class action waiver in a customer agreement); *Walthour v. Chipio Windshield Repair, LLC*, 745 F.3d 1326, 1336 (11th Cir. 2014) (citing to *Italian Colors* to uphold a provision in an arbitration agreement waiving the ability to bring a collective action); *see also* *Duran v. J. Hass Grp., L.L.C.*, 531 F. App'x 146, 147 (2d Cir. 2013) (holding that because arbitration agreements must be rigorously enforced, "it was for the arbitrator, rather than the court, to decide...whether the forum selection clause was unconscionable.").

⁶⁷ 726 F.3d 290 (2d Cir. 2013).

⁶⁸ *Id.* at 298.

⁶⁹ *Id.* at 294.

⁷⁰ *Id.* at 295.

⁷¹ *Id.*

\$2,000.”⁷² Sutherland found that her attorney’s fees during arbitration alone would amount to around \$160,000.⁷³

The Second Circuit reversed, in light of the U.S. Supreme Court’s mandate in *Italian Colors* that lower courts “rigorously enforce arbitration agreements according to their terms, including terms that specify *with whom* [the parties] choose to arbitrate their disputes, and the rules under which that arbitration will be conducted.”⁷⁴ The Second Circuit found that the FLSA does not contain a congressional command that overrides the FAA mandate.⁷⁵ It also found that *Italian Colors* bars Sutherland from using the effective vindication doctrine to invalidate a class action waiver based on the fact that the recovery would be dwarfed by the cost of individual arbitration.⁷⁶

3. State law defenses

a. FAA Preemption

Under the Supreme Court’s FAA preemption doctrine, the FAA preempts any state law or rule that conflicts with the policies and purposes underlying the FAA.⁷⁷ In January 2014, the Tenth

⁷² *Id.* at 294-95; *see also* Sutherland v. Ernst & Young, 768 F. Supp.2d 547 (S.D.N.Y. 2011).

⁷³ *Sutherland*, 726 F.3d at 295.

⁷⁴ *Id.* at 296 (quoting *Italian Colors*, 133 S.Ct. 2304 (2013)).

⁷⁵ *Id.* at 296-97 (finding that “the FLSA does not ‘evinc[e] an intention to preclude a waiver’ of class-action procedure.”) Moreover, it found that Supreme Court precedents prove “that the waiver of collective action claims is permissible in the FLSA context.”)

⁷⁶ *Id.* at 298; *see also* Raniere v. Citigroup Inc., 533 F. App’x. 11 (2d Cir. 2013).

⁷⁷ *See e.g.* Marmet Health Care Center, Inc. v. Brown, 132 S.Ct. 1201 (2012) (holding that the FAA preempts West Virginia Supreme Court of Appeals rule that voided as against public policy pre-dispute arbitration clauses in nursing home contracts with respect to negligence claims); AT&T Mobility LLC v. Concepcion, 131 S.Ct. 1740 (2011) (holding that

Circuit applied the FAA preemption doctrine and held that a state law that asserts that arbitration is inferior to litigation in court is preempted by the FAA. In *THI of New Mexico at Hobbs Center, LLC v. Patton*,⁷⁸ a nursing home required its residents to sign an arbitration agreement that required arbitration of all claims except claims “relating to guardianship proceedings, collection or eviction actions by THI, or disputes of less than \$2,500.”⁷⁹ Mrs. Patton, whose husband passed away while at THI, wanted to sue the nursing home for misrepresentation and negligence on behalf of her husband’s estate.⁸⁰ THI filed a complaint to compel arbitration, and the District Court for New Mexico initially held that the arbitration agreement was not unconscionable but reversed its holding when the New Mexico Court of Appeals found an identical agreement to be unconscionable.⁸¹

However, the Tenth Circuit held that “just as the FAA preempts a state statute that is predicated on the view that arbitration is an inferior means of vindicating rights, it also preempts state common law—including the law regarding unconscionability—that bars an arbitration agreement because of the same view.”⁸² The court therefore held

FAA preempts California Supreme Court rule that class action waivers in consumer arbitration agreements are unconscionable).

⁷⁸ 741 F.3d 1162 (10th Cir. 2014).

⁷⁹ *Id.* at 1164.

⁸⁰ *Id.*

⁸¹ *Id.* at 1164-65. The New Mexico Court of Appeals found the arbitration agreement to be unconscionable because it forced claims that were most likely to be brought by the nursing home residents to be arbitrated while leaving the claims that THI would most likely bring open to litigation in courts. The Court of Appeals found this unfair to the nursing home residents, relying on the assumption that arbitration was inferior to litigation in courts. *Id.* at 1168-69.

⁸² *Id.* at 1167.

that New Mexico’s law was preempted, and reversed the decision of the District Court.⁸³

b. Unconscionability

While the Supreme Court in *AT&T Mobility* barred lower courts from finding class action waivers in arbitration agreements to be substantively unconscionable, lower courts have struck down arbitration clauses as unconscionable on other grounds. For example, in *Chavarría v. Ralphs Grocery Co.*,⁸⁴ the Court of Appeals for the Ninth Circuit found an arbitration agreement between an employee and her employer to be procedurally and substantively unconscionable.⁸⁵ First, although employee Chavarría signed the agreement when she applied for employment at Ralphs, her employer did not provide the terms of the arbitration agreement until three weeks after she began working.⁸⁶ The Ninth Circuit stated that procedural unconscionability is enhanced when an employee is given the binding terms of a contract after the employee agreed to the terms.⁸⁷ Second, Chavarría was unable to negotiate the terms and was given the agreement on a “take it or leave it” basis.⁸⁸

⁸³ *Id.* at 1170. *Accord* *McInnes v. LPL Financial, LLC*, 994 N.E.2d 790 (Mass. 2013) (in case arising out of FINRA arbitration, holding FAA preempted Massachusetts judicial doctrine that declined to compel arbitration of claims of unfair or deceptive trade practices).

⁸⁴ 733 F.3d 916 (9th Cir. 2013).

⁸⁵ “Procedural unconscionability concerns the manner in which the contract was negotiated and the respective circumstances of the parties at that time, focusing on the level of oppression and surprise involved in the agreement.” *Id.* at 922.

⁸⁶ *Id.*

⁸⁷ *Id.* at 923.

⁸⁸ *Id.* at 922.

The court also found the arbitration agreement to be substantively unconscionable⁸⁹ for several reasons. First, the agreement provided that if “the parties do not agree on an arbitrator, the policy provides for the following procedure: (1) Each party proposes a list of three arbitrators; (2) The parties alternate striking one name from the other party's list of arbitrators until only one name remains; (3) The party ‘who has not demanded arbitration’ makes the first strike from the respective lists; and (4) The lone remaining arbitrator decides the claims.”⁹⁰ When enforced, this procedure assures that an arbitrator chosen by the person who did not seek arbitration would be selected. Therefore, in most cases where employees seek arbitration against Ralphs, Ralphs would get to choose the arbitrator.

Likewise, another term of the arbitration agreement stated that arbitration fees must be allocated at the beginning of the arbitration and must be split evenly between the employer and the employee, despite the merits of the case.⁹¹ This apportionment of fees is unfair because it imposes costs on an employee who may be dissuaded from bringing a valid claim because it would be financially impracticable to do so.⁹² The court stated that the Supreme Court’s *Italian Colors* decision does not foreclose it from considering the financial burden the arbitration agreement would have on employees because the Court in *Italian Colors* “explicitly noted that the result might be different if an arbitration provision required a plaintiff to pay ‘filing and administrative fees attached to arbitration that are so high as to make access to the forum

⁸⁹ “A contract is substantively unconscionable when it is unjustifiably one-sided to such an extent that it ‘shocks the conscience.’” *Id.* at 923.

⁹⁰ *Id.* at 920.

⁹¹ *Id.* at 925.

⁹² The cost of a qualified arbitrator would be \$7,000-\$14,000 per day. Making employees pay this amount would keep them from bringing claims because any recovery would most likely be dwarfed by the costs of arbitration. *Id.* at 925-26.

impracticable.”⁹³ In this case, Chavarria would be expected to pay those types of fees, making it impracticable for her to bring her claim. Therefore, *Italian Colors* was inapposite.

c. **Waiver**

In past years, this chapter has covered cases applying the waiver doctrine. Under this doctrine, one party to an arbitration clause claims the other party waived its right to arbitrate based on conduct in related litigation. While the arbitration waiver test varies slightly among the federal circuits, courts typically consider factors such as: (1) the time elapsed from commencement of litigation to the request for arbitration; (2) the amount and nature of litigation, including substantive motions and discovery; and (3) prejudice to the party opposing arbitration.⁹⁴

This year, courts continue to examine these factors when ruling on waiver arguments. In *ABF Freight Sys., Inc. v. Int'l Bhd. of Teamsters*,⁹⁵ the Eighth Circuit found that “the defendants' initial motions to dismiss did not substantially invoke the litigation machinery, and therefore did not waive the right” to arbitrate.⁹⁶ In support of its conclusion, the Court of Appeals found that:

defendants did not file the lawsuit or engage in extensive discovery. They did not seek to serve discovery requests after the adversary proceeding commenced, or move to continue the case. They did not present ‘multiple matters

⁹³ *Id.* at 927 (citing *Italian Colors*, 133 S. Ct. at 2310-11).

⁹⁴ *See, e.g.*, *Nat'l Union Fire Ins. Co. of Pittsburgh, P.A. v. NCR Corp.*, 376 F. App'x. 70, 71 (2d Cir. 2010); *see also* *Zuckerman Spaeder, LLP v. Aufferberg*, 646 F.3d 919, 924 (D.C. Cir. 2011) (“By this opinion we alert the bar in this Circuit that failure to invoke arbitration at the first available opportunity will presumptively extinguish a client's ability later to opt for arbitration.”).

⁹⁵ 728 F.3d 853 (8th Cir. 2013).

⁹⁶ *Id.* at 864-65.

of first impression.’ This is not a case where ‘a party actively litigates a case for an extended period only to belatedly assert that the dispute should have been arbitrated, not litigated, in the first place.’ The litigation at issue here was not an alternative to the grievance process...⁹⁷

The Court reasoned that if the defendants had “file[d] a lawsuit on arbitrable claims, engage[d] in extensive discovery, or fail[ed] to move to compel arbitration and stay litigation in a timely manner, then they would have sufficiently invoked the litigation machinery and lost their right to arbitrate;”⁹⁸ however, their inaction was not substantial enough to warrant a waiver of arbitration.

Likewise, in *BP American Prod. Co. v. Chesapeake Exploration, LLC*,⁹⁹ the Tenth Circuit, in assessing whether seller Chesapeake waived its right to arbitrate, took into consideration “the extent to which the party invoked and took advantage of litigation.”¹⁰⁰ The Circuit Court held that because Chesapeake continuously tried to avoid arbitrating its claim by “protest[ing] the authority of the panel to adjudicate it, initiat[ing] litigation to prevent the panel from doing so, and expressly agree[ing] to have the issue decided on joint motions for summary judgment, Chesapeake...waived its right to arbitrate.”¹⁰¹

⁹⁷ *Id.* (citations omitted).

⁹⁸ *Id.* at 862.

⁹⁹ ___F.3d___, 2014 WL 1724314, *4 (10th Cir. May 2, 2014).

¹⁰⁰ *Id.* at *4.

¹⁰¹ *Id.*; *see also* Tech. in P'ship, Inc. v. Rudin, 538 F. App'x 38, 40 (2d Cir. 2013) (holding that defendants waived arbitration by actively participating in extensive pretrial discovery after spending a year in litigation); Cooper v. Asset Acceptance, LLC, 532 F. App'x 639, 640 (7th Cir. 2013) (finding that defendant did not waive its right to arbitration by participating in discovery “because the district court declined to stay discovery pending its ruling on the motion to dismiss”).

B. Who is a “Customer” Under FINRA Rule 12200?

In FINRA arbitration, even in the absence of a pre-dispute arbitration clause in an agreement between the parties, a FINRA member firm must arbitrate a claim if “requested by a customer,” “[t]he dispute is between a customer and a member or associated person of a member; and [t]he dispute arises in connection with the business activities of the member or the associated person”¹⁰²

Thus, in a customer case, respondents may resist arbitration on the ground that the claimant is not a “customer” of the FINRA member firm within the meaning of FINRA Customer Code Rule 12200. Courts continue to interpret FINRA Rule 12200 when a broker-dealer resists arbitration.

In *Goldman, Sachs, & Co. v. City of Reno*,¹⁰³ the Ninth Circuit Court of Appeals concluded that the City of Reno, which had retained Goldman, Sachs for advisory and underwriting services in connection with its issuance of auction-rate securities to finance a series of city projects, was a “customer” under FINRA Rule 12200.¹⁰⁴ When financial problems arose, Reno initiated arbitration proceedings against Goldman, Sachs before FINRA, relying on FINRA Rule 12200.¹⁰⁵ In turn, Goldman, Sachs moved for a preliminary injunction arguing that Reno was not its “customer.” The Ninth Circuit relied on previous Court of Appeals decisions¹⁰⁶ and concluded that, for purposes of FINRA Rule 12200, a customer is “a non-broker and non-dealer who

¹⁰² FINRA R. 12200.

¹⁰³ 747 F. 3d 733, 2014 WL 1272784 (9th Cir. 2014).

¹⁰⁴ *Id.*, 2014 WL 1272784, at *6.

¹⁰⁵ *Id.* at *1.

¹⁰⁶ Wachovia Bank, N.A. v. VCG Special Opportunities Master Fund, Ltd., 661 F.3d 164 (2d Cir. 2011); UBS Financial Servs. Inc. v. West Virginia University Hospitals Inc., 660 F.3d 643 (2d Cir. 2011).

purchases commodities or services from a FINRA member in the course of the member's FINRA-regulated business activities.”¹⁰⁷

Using this definition, the Ninth Circuit concluded that Reno certainly qualified as Goldman, Sachs’ “customer” because Goldman, Sachs, “served as the underwriter for the 2005 and 2006 Bonds and as the broker-dealer for...ARS auctions,” “sold Reno interest rate swaps to protect the financing structure,” “acted as Reno's agent in dealing with the rating agencies,” and “conducted discussions with bond insurers on Reno's behalf.”¹⁰⁸ Furthermore, Goldman “provided these services in the course of its securities business activities [while] Reno compensated Goldman in the form of underwriter's discounts and annual broker-dealer fees.”¹⁰⁹

C. Nonsignatories to Arbitration Agreements

Under state law theories of equitable estoppel, agency or third-party beneficiary, nonsignatories may be able to compel arbitration of claims arising out of an arbitration agreement between signatories.¹¹⁰ Under the doctrine of equitable estoppel, generally a nonsignatory can enforce an arbitration clause with a signatory:

¹⁰⁷ *Goldman*, 2014 WL 1272784, at *6; *see also* SunTrust Banks, Inc. v. Turnberry Capital Management LP, 13-2075-cv (2d Cir. May 15, 2014) (summary order) (applying the *WVUH* test and finding hedge fund not a customer of bank when fund bought through a broker-dealer an investment vehicle sponsored by a now-defunct subsidiary of the bank).

¹⁰⁸ *Goldman*, 2014 WL 1272784, at *6.

¹⁰⁹ *Id.* Although Reno persuaded the court it was Goldman’s customer, the Ninth Circuit ultimately held that, because the city had agreed to a forum selection clause in its 2005 and 2006 agreements with Goldman, Sachs, it had waived its right to arbitrate under FINRA Rule 12200. *Id.* at *7.

¹¹⁰ *See* Arthur Andersen LLP v Carlisle, 556 U.S. 624 (2009) (holding that, under the FAA, state law principles may permit an arbitration agreement to be enforced by or against a nonsignatory).

(1) when a signatory must rely on the terms of the written agreement in asserting its claims against the nonsignatory or the claims are ‘intimately founded in and intertwined with’ the underlying contract, and

(2) when the signatory alleges substantially interdependent and concerted misconduct by the nonsignatory and another signatory and ‘the allegations of interdependent misconduct [are][founded in or intimately connected with the obligations of the underlying agreement.’¹¹¹

Likewise, if a nonsignatory can demonstrate it is a third-party beneficiary of an arbitration agreement, it can enforce that agreement against signatories.¹¹² Under the agency theory, a nonsignatory can invoke arbitration against a signatory “if a preexisting confidential relationship, such as an agency relationship between the nonsignatory and one of the parties to the arbitration agreement, makes it equitable to impose the duty to arbitrate upon the nonsignatory.”¹¹³

Some Courts of Appeal continue to narrowly construe these three exceptions. This past year, the Ninth Circuit rejected -- under all three theories -- a retailer’s motion to compel arbitration of claims with its retail customers who had entered into a customer service agreement with a satellite television service provider by purchasing the service after leasing equipment in the retailer’s stores.¹¹⁴

¹¹¹ See *Kramer v. Toyota Motor Corp.*, 705 F.3d 1122, 1128-29 (9th Cir. 2013) (internal citations omitted).

¹¹² See *Fundamental Admin. Servs., LLC v. Patton*, 504 F. App’x. 694, 698 (10th Cir. 2012).

¹¹³ *Murphy v. DirectTV, Inc.*, 724 F.3d 1218, 1232 (9th Cir. 2013) (internal quotations and citations omitted).

¹¹⁴ See *Murphy*, 724 F.3d at 1228-34. *Accord* *Hirsch v. Amper Financial Servs, LLC*, 71 A.3d 849 (N.J. 2013) (refusing to apply equitable estoppel doctrine to compel arbitration of nonsignatory’s claims merely

Other courts are more willing to compel arbitration with a nonsignatory. For example, the Fifth Circuit found that under the first exception, when a signatory plaintiff's "claims against the nonsignatory are founded in and inextricably bound up with the obligations imposed by the agreement containing the arbitration clause," state law would permit the nonsignatory to compel the plaintiff signatory to arbitrate their claims.¹¹⁵ Similarly, the Sixth Circuit used both the first and third exceptions to hold that since nonsignatory Nair was an agent of defendant, a debt resolution service, Nair could compel arbitration against signatory plaintiff.¹¹⁶ The court further found that the plaintiff's claims against Nair were intertwined with the underlying contract.¹¹⁷

D. Vacating Arbitration Awards

1. Evident Partiality

Losing parties to arbitration awards can seek vacatur pursuant to FAA § 10(a)(2) if they show "evident partiality" in the arbitrators. Courts have had difficulty developing a test for "evident partiality," since the Supreme Court's only decision under that subsection is the 45-year old decision in *Commonwealth Coatings v. Continental Casualty Co.*,¹¹⁸ and that case yielded plurality and concurring opinions that are difficult to synthesize. Most circuits follow the test set forth by the Second Circuit in

because claims and parties were intertwined with signatories); *Belzberg v. Verus Investments Holdings, Inc.*, 999 N.E.2d 1130 (N.Y. 2013) (refusing to compel arbitration of nonsignatory's claims under theory of equitable estoppel because nonsignatory did not benefit directly from the arbitration agreement).

¹¹⁵ *Crawford Profl Drugs, Inc. v. CVS Caremark Corp.*, __F.3d__, No. 12-60922, 2014 WL 1343608, *6 (5th Cir. Apr. 4, 2014).

¹¹⁶ *Bowie v. Clear Your Debt, LLC*, 523 F. App'x 315, 317 (6th Cir. 2013).

¹¹⁷ *Id.*

¹¹⁸ 393 U.S. 145 (1968).

Morelite Constr. v. New York City Dist. Council Carpenters Ben. Funds,¹¹⁹ where the court held that “evident partiality” is “where a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration.”¹²⁰

Courts differ on how an arbitrator’s failure to disclose potential sources of conflicts of interest factors into an evident partiality analysis. This past year, in *Stone v. Bear Stearns & Co., Inc.*,¹²¹ the Third Circuit refused to vacate an arbitration award against an investor even though one of the arbitrators failed to disclose that her husband recently earned consulting income from the Respondent broker-dealer. In that case, Laurence Stone sued Bear Stearns for \$7.6 million in investment losses. The panel rejected all of his claims. Stone later discovered that one panelist, Jerrilyn Marston, had disclosed to FINRA that her husband “was a well-known professor of finance at the Wharton School and that he regularly lectured to brokerage firms, financial consultants, banks, and investors,” including the Respondent.¹²² However, FINRA disclosed to the parties only that Ms. Marston had a “Family Member associated with the University of Pennsylvania.”¹²³

The district court denied Stone’s motion to vacate the award on the ground of evident partiality. It concluded that this failure to disclose did not constitute “evident partiality” and that Stone waived his right to that contention because he failed to discover this information earlier. The Third Circuit affirmed summarily.¹²⁴

¹¹⁹ 748 F.2d 79 (2d Cir. 1984).

¹²⁰ *Id.* at 83.

¹²¹ 538 F. App’x 169 (3d Cir. 2013).

¹²² *Id.* at 170.

¹²³ *Id.*

¹²⁴ *Id.* at 170-71.

2. Exceeding Powers: Availability of Attorney's Fees

If a FINRA arbitration panel includes attorney's fees in an award, the losing party sometimes challenges that award on the grounds that the panel exceeded its powers under FAA §10(a)(4), or was otherwise "arbitrary." The Tenth Circuit recently held that FINRA arbitrators have the authority to award attorney's fees to parties when "'all of the parties request *or agree* to such fees.'"¹²⁵ In *Adviser Dealer Services*, both parties requested attorney's fees in their respective arbitration pleadings. The FINRA submission agreement they both signed stated that they agreed to submit their dispute and "all issues identified in those pleadings" to FINRA.¹²⁶ Thus, the parties empowered the arbitrators to award attorney's fees, and by doing so, the arbitrators did not exceed their powers.

Similarly, in a promissory note case, the Fourth Circuit reinstated an award of more than \$60,000 in attorney's fees that the district court had vacated on the grounds that the panel failed to articulate any analysis of the amount.¹²⁷ The Court of Appeals reasoned that arbitrators are not required to explain their reasons and courts must give deference to arbitrator's factual findings. Since the underlying promissory note's arbitration agreement expressly provided for the recovery of attorney's fees by the broker-dealer in the event it had to initiate an arbitration proceeding to collect on the note, the district court should have confirmed, not vacated, the panel's fee award.¹²⁸

3. Manifest Disregard of the Law

¹²⁵ *Adviser Dealer Servs., Inc. v. Icon Advisers, Inc.*, ___ F. App'x ___, 2014 WL 541914, *3 (10th Cir. Feb. 12, 2014) (citation omitted) (emphasis in original).

¹²⁶ *Id.*

¹²⁷ *Wells Fargo Advisers LLC v. Watts*, 540 F. App'x 229 (4th Cir. 2013).

¹²⁸ *Id.* at 231-32.

Since the Supreme Court’s holding in *Hall St. Assoc., L.L.C. v. Mattel, Inc.*¹²⁹ that the FAA provides the exclusive grounds for review of an arbitration award and parties to an arbitration agreement cannot contractually expand the judicial grounds of review, the circuit courts have split on whether an arbitration panel’s “manifest disregard of the law” is a valid ground to vacate an arbitration award. The Supreme Court expressly declined to resolve this split in *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*¹³⁰ The circuit split continues, as follows:

- The Second, Fourth, Sixth, and Ninth Circuits acknowledge the continued vitality of the “manifest disregard” ground of vacatur.¹³¹
- The Fifth, Eighth and Eleventh Circuits have expressly ruled that manifest disregard is no longer a valid vacatur ground.¹³²
- The First and Tenth Circuits have addressed “manifest disregard” subsequent to *Hall Street*, but only in *dicta*.¹³³

¹²⁹ 552 U.S. 576 (2008).

¹³⁰ 130 S. Ct. 1758, 1768 n.3 (2010).

¹³¹ See *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 548 F.3d 85, 94 (2d Cir. 2008), *vacated on other grounds*, 130 S. Ct. 1758 (2010); *Wachovia Securities, LLC v. Brand*, 671 F.3d 472, 482 (4th Cir. 2012) (“Although we find that manifest disregard continues to exist as either an independent ground for review or as a judicial gloss, we need not decide which of the two it is because Wachovia’s claim fails under both”); *Coffee Beanery, Ltd. v. WW, L.L.C.*, 300 F. App’x. 415, 419 (6th Cir. 2008); *Comedy Club, Inc. v. Improv West Assocs.*, 553 F.3d 1277, 1290 (9th Cir. 2009). *But see* *Schafer v. Multiband Corp.*, 551 F. App’x 814, 2014 WL 30713,*4 (6th Cir. Jan. 6, 2014) (suggesting that the Sixth Circuit might revisit the issue, “which has not been firmly settled”).

¹³² See *Citigroup Global Markets, Inc. v. Bacon*, 562 F.3d 349, 352 (5th Cir. 2009); *Medicine Shoppe Intern., Inc. v. Turner Investments, Inc.*, 614 F.3d 485 (8th Cir. 2010); *Frazier v. CitiFinancial Corp.*, 604 F.3d 1313, 1324 (11th Cir. 2010).

¹³³ See *Kashner Davidson Secs. Corp. v. Mscisz*, 601 F.3d 19, 21 (1st Cir. 2010) (acknowledging that the circuit has “not squarely determined whether our manifest disregard case law can be reconciled with *Hall*

- The Third and Tenth Circuits have expressly declined to address the issue.¹³⁴
- The Seventh Circuit has held that “manifest disregard” is not a ground of vacatur, except if arbitrators order parties to violate the legal rights of others.¹³⁵

Street”); *Affinity Financial Corp. v. AARP Financial, Inc.*, 468 F. App’x 4, 5 (D.C. Cir. 2012) (assuming, without deciding, that the manifest disregard of the law standard survived *Hall Street*).

¹³⁴ See *Bellantuono v. ICAP Sec. USA, LLC*, ___ F. App’x ___, No. 12-4253, 2014 WL 323380, *4 (3d Cir. Jan. 30, 2014) (recognizing circuit split and expressly declining to decide that issue); *Rite Aid New Jersey, Inc. v. United Food Commercial Workers Union, Local 1360*, 449 F. App’x. 126, 129 (3d Cir. 2011) (assuming without deciding that the manifest disregard standard survived *Hall Street*); *Abbott v. Law Office of Patrick J. Mulligan*, 440 F. App’x. 612, 620 (10th Cir. 2011) (“in the absence of firm guidance from the Supreme Court, we decline to decide whether the manifest disregard standard should be entirely jettisoned”). *But see* *Adviser Dealer Servs., Inc. v. Icon Advisers, Inc.*, ___ F. App’x ___, 2014 WL 541914 (10th Cir. Feb. 12, 2014) (in *dicta*, recognizing manifest regard as an available ground of vacatur).

¹³⁵ See *Affymax, Inc. v. Ortho-McNeil-Janssen Pharm., Inc.*, 660 F.3d 281, 285 (7th Cir. 2011) (“Except to the extent recognized in *George Watts & Son v. Tiffany & Co., Inc.*, 248 F.d 577 (7th Cir. 2001) (ruling that “a court may set aside an award that directs the parties to violate the legal rights of third persons who did not consent to the arbitration”)], ‘manifest disregard of the law’ is not a ground on which a court may reject an arbitrator’s award under the Federal Arbitration Act.”).