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Arbitration Case Law Update 2016

Jill I. Gross¹

July 15, 2016

This chapter² identifies decisions by the U.S. Supreme Court and selected federal and high state courts in the past year that interpret and apply the Federal Arbitration Act (FAA).³ This chapter also analyzes the impact some of these cases might have on securities arbitration practice.

I. SUPREME COURT

Since last year's update,⁴ the Supreme Court decided one case involving the FAA and granted petitions for a writ of certiorari in four others: of those four, the Court immediately vacated judgments in three of the cases and the parties settled the fourth before the Court could rule. This section describes those cases.

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³ 9 U.S.C. §§ 1 *et seq.* (2014). Because disputes resolved through securities arbitration necessarily “involve commerce” (FAA § 2), courts apply the FAA to legal issues arising out of securities arbitrations. *See* *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002).

⁴ My arbitration law updates for the PLI Securities Arbitration Course Book for the years 2011 to 2016 can be accessed at <http://ssrn.com/author=485809>. The 2015 update is dated May 27, 2015, so this year's chapter covers almost fourteen months of cases.

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.⁵ Those policies and purposes include the requirement that courts place arbitration contracts “on equal footing with all other contracts.”⁶

As predicted in last year’s update, in *DIRECTV, Inc. v. Imburgia*,⁷ the Supreme Court held once again that the FAA preempted a state court’s interpretation of its own law – in this case the California Court of Appeal. The California court had held that a California choice of law clause in the parties’ service contract (which contract the parties agreed was governed by the FAA) prevailed over the federal law-based FAA preemption doctrine.⁸

In *DIRECTV*, consumers filed a class action in state court against the satellite television service provider alleging it charged early termination fees in violation of various California statutes.⁹ The form contract governing the satellite service contained a pre-

⁵ See *Marmet Health Care Ctr., 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 arbitration clauses in nursing home contracts with respect to negligence claims); *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011) (ruling that FAA preempts state law unconscionability defense that declares class action waivers in consumer arbitration agreements *per se* unconscionable as inconsistent with the FAA).

⁶ *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006). The doctrine stems from the “savings clause” contained within FAA §2, which preserves defenses to the enforcement of arbitration agreements on “grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. §2.

⁷ 136 S.Ct. 463 (2015).

⁸ See *Imburgia v. DIRECTV, Inc.*, 170 Cal.Rptr.3d 190 (2014), *rev’d*, 136 S.Ct. 463 (2015).

⁹ *DIRECTV*, 136 S.Ct. at 466.

dispute arbitration agreement (PDAA), a class action waiver, and a choice of law clause that provided:

The interpretation and enforcement of this Agreement shall be governed by the rules and regulations of the Federal Communications Commission, other applicable federal laws, and the laws of the state and local area where Service is provided to you. This Agreement is subject to modification if required by such laws. Notwithstanding the foregoing, Section 9 [the arbitration clause including class action waiver] shall be governed by the Federal Arbitration Act.¹⁰

The class action waiver clause added: “If, however, the law of your state would find this agreement to dispense with class arbitration procedures unenforceable, then this entire Section 9 is unenforceable.”¹¹

Based on this sentence in the class action waiver clause, defendant did not initially move to compel arbitration because the governing law of California at the time—known as the *Discover Bank* rule¹²—would have voided the PDAA as unconscionable due to the class action waiver. However, after the Supreme Court held in *Concepcion* that the FAA preempted California’s *Discover Bank* rule, defendant moved to compel individual arbitration.¹³

The trial court denied the motion and the California Court of Appeal affirmed. The Court of Appeal interpreted the class

¹⁰ *DIRECTV*, 170 Cal.Rptr.3d at 193 (quoting parties’ agreement).

¹¹ *Id.*

¹² *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005) (classifying most class action waivers in consumer contracts as unconscionable).

¹³ *DIRECTV*, 170 Cal.Rptr.3d at 193.

action waiver provision and found that reigning California law “would find this agreement to dispense with class arbitration procedures unenforceable.”¹⁴ As a result, the entire PDAA was not enforceable, according to the precise language of the contract. The court rejected defendant’s argument that *Discover Bank* was no longer state law because it was preempted, and instead accepted plaintiffs’ argument that it should interpret state law without regard to FAA preemption.¹⁵

Because the California Court of Appeal’s decision conflicted with a Ninth Circuit holding that the FAA preemption doctrine supersedes the parties’ choice of law clause,¹⁶ DIRECTV sought review in the U.S. Supreme Court (the California Supreme Court had denied its request for review.)¹⁷ The Supreme Court agreed to decide the question: “Whether the California Court of Appeal erred by holding, in direct conflict with the Ninth Circuit, that a reference to state law in an arbitration agreement governed by the Federal Arbitration Act requires the application of state law preempted by the Federal Arbitration Act.”¹⁸

Acknowledging in its majority opinion that interpretation of contracts is a matter of state law, the Supreme Court framed the issue not as whether the state court’s interpretation was correct, but whether it was consistent with the FAA.¹⁹ The Court reasoned that the California Court of Appeal’s decision that “the law of your state” included “invalid California law” (i.e., the *Discover Bank*

¹⁴ *Id.*

¹⁵ *Id.* at 194-97.

¹⁶ *See* *Murphy v. DirecTV, Inc.*, 724 F.3d 1218 (9th Cir. 2013).

¹⁷ *DIRECTV*, 136 S.Ct. at 467.

¹⁸ Pet. for Writ of Cert., *DIRECTV, Inc. v. Imburgia*, 2014 WL 5359805, *j (2014).

¹⁹ *DIRECTV*, 136 S.Ct. at 468.

rule) was a decision unique to arbitration contracts.²⁰ As a result, the Court concluded that the California Court of Appeal’s interpretation of the parties’ choice of law clause did not place arbitration contracts on equal footing with all other contracts and was thus preempted by the FAA.²¹

This predictable outcome in *DIRECTV* follows from the Court’s extremely broad application of the FAA preemption doctrine in recent years. It also signals the Court’s continued impatience with state courts that attempt to circumvent the FAA by finding a state law basis to invalidate an arbitration agreement.²²

After *DIRECTV*, the Supreme Court granted petitions for writs of certiorari in four other arbitration-related cases. However, again showing impatience for state courts that seemingly ignore the FAA, in all four cases, the Court summarily vacated the underlying judgments and remanded the cases back to the state

²⁰ *Id.* at 469. The Court analyzed California law and concluded that a California court would not interpret “law of your state” to include invalidated law in any context other than arbitration. *Id.* at 469-71.

²¹ *Id.* at 471.

²² *Id.* at 468 (“The Federal Arbitration Act is a law of the United States, and *Conception* is an authoritative interpretation of that Act. Consequently the judges of every State must follow it.”); *see also* Nitro-Lift Techs., L.L.C. v. Howard, 133 S. Ct. 500, 501 (2012) (holding that FAA preempts Oklahoma Supreme Court’s ruling and stating that, when interpreting the FAA, “it is a matter of great importance, therefore, that state supreme courts adhere to a correct interpretation of the legislation. Here, the Oklahoma Supreme Court failed to do so”); *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201, 1202 (2012) (holding that FAA preempts Supreme Court of Appeals of West Virginia’s ruling and stating that “[w]hen this Court has fulfilled its duty to interpret federal law, a state court may not contradict or fail to implement the rule so established”).

court for “further consideration in light of [*DIRECTV*].”²³ All four cases arose from state high courts that declared a PDAA unconscionable under state law. In *Spencer*, the Supreme Court of Appeals of West Virginia had found a PDAA in a construction contract unconscionable despite the presence of a delegation clause that purported to delegate questions of arbitrability to the arbitrator.²⁴ In the three related Hawaii cases, the Supreme Court of Hawaii had declared the same PDAA in a “condominium declaration” ambiguous with respect to the condominium owners’ intent to arbitrate, and unconscionable because of its limitations on discovery and punitive damages, and its confidentiality clause.²⁵ Presumably, with the remand, the Court was instructing these state courts that they did not sufficiently consider the FAA preemption doctrine in reaching their decisions.

Before *DIRECTV*, the Supreme Court agreed to hear a case stemming from a federal Court of Appeal’s apparent refusal to apply the FAA preemption doctrine, but the parties settled the

²³ See *Schumacher Homes of Circleville, Inc. v. Spencer*, 136 S.Ct. 1157 (2016) (remanding to Supreme Court of Appeals of West Virginia); *Ritz-Carlton Development Co. v. Narayan*, 136 S.Ct. 800 (2016) (remanding to Supreme Court of Hawaii); *Ritz-Carlton Development Co. v. Narayan*, and *Ritz-Carlton Development Co. v. Nath*, 136 S.Ct. 799 (2016) (remanding both cases to Supreme Court of Hawaii).

²⁴ See *Schumacher Homes of Circleville, Inc. v. Spencer*, 774 S.E.2d 1 (W.Va. 2015), *vacated*, 136 S. Ct. 1157 (2016). On remand, the West Virginia high court concluded that defendant waived its right to challenge the delegation clause, and thus referred the case to arbitration for an arbitrability determination. *Schumacher Homes of Circleville, Inc. v. Spencer*, ___ S.E.2d ___, 2016 WL 3475631 (W.Va. June 13, 2016).

²⁵ See *Narayan v. Ritz-Carlton Dev. Co.*, 350 P.3d 995 (Haw. 2015), *vacated*, 136 S. Ct. 800 (2016); *Nath v. Ritz-Carlton Hotel Co.*, 356 P.3d 1043 (Haw. 2015), *vacated*, 136 S. Ct. 799 (2016); *Narayan v. Marriott Intern.*, 350 P.3d 1043 (Haw. 2015), *vacated*, 136 S. Ct. 799 (2016).

case before the Court could rule.²⁶ In *Zaborowski*, the Ninth Circuit found a PDAA in an employment contract unconscionable and, applying a California rule that allows courts not to sever offending parts of a PDAA if it is “permeated” by unconscionability,²⁷ declared the arbitration agreement unenforceable.²⁸ Petitioners sought review on the ground that the Ninth Circuit should have held the FAA preempted the *Armendariz* rule because California applies a more lenient severability doctrine to ordinary contracts as opposed to that applied to arbitration contracts.²⁹

II. FEDERAL AND STATE COURT DECISIONS

The remainder of this chapter summarizes decisions from lower federal courts and state high courts applying the Supreme Court’s FAA jurisprudence when ruling on challenges to the arbitrability of a particular dispute and on motions to confirm or vacate arbitration awards. Where applicable, the chapter will discuss implications for FINRA arbitration.

A. Who Decides Arbitrability?

It is well-settled that courts, not arbitrators, decide challenges to the substantive arbitrability of a dispute “unless the

²⁶ *MHN Government Services, Inc. v. Zaborowski*, 136 S.Ct. 27 (2015), *cert. dismissed*, 136 S. Ct. 1539 (2016).

²⁷ *See Armendariz v. Foundation Health Psychcare Services., Inc.*, 6 P.3d 669 (Cal. 2000).

²⁸ *See Zaborowski v. MHN Gov’t Servs., Inc.*, 601 F. App’x 461 (9th Cir. 2014), *cert. granted*, 136 S. Ct. 27 (2015), and *cert. dismissed*, 136 S. Ct. 1539 (2016).

²⁹ *Pet. for Writ of Cert., MHN Government Services, Inc. v. Zaborowski*, 2015 WL 3637766 (U.S. June 10, 2015).

parties clearly and unmistakably provide otherwise.”³⁰ The majority of lower courts considering this question find that the incorporation by reference of a forum’s rules that empower arbitrators to decide substantive arbitrability constitutes such “clear and unmistakable evidence.”³¹

However, this past year in the FINRA context, in *Morgan Stanley & Co., LLC v. Couch*,³² one district court concluded that “incorporation of the FINRA rules into the Arbitration Clause does not provide clear and unmistakable evidence that the parties intended to submit the issue of arbitrability to arbitration.”³³ In *Couch*, an industry employment dispute, the firm argued that the financial advisor (FA) had waived his right to arbitrate, because he first litigated his claims in court for more than one year. Before deciding that the FA had indeed waived his right to arbitration, the district court concluded that the issue was one for the court to decide—not the arbitrator— because it could not locate a FINRA

³⁰ *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S 79, 83 (2002).

³¹ *E.g.*, *Brennan v. Opus Bank*, 796 F.3d 1125, 1131 (9th Cir. 2015) (incorporation of AAA rules); *Considine v. Brookdale Senior Living, Inc.*, 124 F. Supp.3d 83, 91 (D. Conn. 2015) (incorporation of AAA rules); *Adtile Techs. Inc. v. Perion Network Ltd.*, __ F. Supp.3d __, No. CV 15-1193-SLR, 2016 WL 3475335, at *6 (D. Del. June 24, 2016) (incorporation of JAMS Comprehensive Arbitration Rules). *But see* *Chesapeake Appalachia, LLC v. Scout Petroleum, LLC*, 809 F.3d 746 (3d Cir. 2016) (incorporation of AAA rules is not “clear and unmistakable” evidence parties intended to delegate issue of class arbitrability to arbitrators); *Global Client Solutions, LLC v. Ossello*, 367 P.3d 361 (Mont. 2016) (incorporation by reference of AAA rules is not “clear and unmistakable” evidence that parties intended arbitrators to decide arbitrability).

³² 134 F. Supp. 3d 1215 (E.D. Cal. 2015) (holding that court would decide whether employee waived his right to arbitrate).

³³ *Id.* at 1226.

arbitration rule comparable to the AAA rule that arbitrators have the power to decide their own jurisdiction.³⁴

In light of *Couch*, if firms want to delegate a substantive arbitrability determination to FINRA arbitrators rather than courts, they should include a more specific delegation clause rather than rely on incorporating by reference FINRA arbitration rules.

B. Defenses to Arbitrability

Once deciding questions of arbitrability, courts must apply the *Moses H. Cone* presumption of arbitrability,³⁵ but compel arbitration of only those disputes that the parties contracted to submit to arbitration. Thus, courts must construe the terms of the parties' arbitration agreement like any other contract to give effect to the parties' intent.³⁶ This section turns to substantive arbitrability determinations by courts in the past year.

1. Scope

Courts sometimes conclude that a particular dispute is not encompassed within the scope of the parties' arbitration agreements. For example, in *Lloyd v. J.P. Morgan Chase & Co. & Chase Investment Services Corp.*,³⁷ the Second Circuit affirmed the district court's conclusion that plaintiffs' claims fell outside the scope of the parties' arbitration agreement. In *Lloyd*, plaintiffs, former employees of the affiliated defendants, brought a

³⁴ *Id.*

³⁵ See *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983) (instructing courts to presume a dispute is arbitrable).

³⁶ See *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 682 (2010) (stating that "as with any other contract, the parties' intentions control") (internal quotations and citations omitted).

³⁷ 791 F.3d 265 (2d Cir. 2015).

class/collective action in district court alleging violations of state (class) and federal (collective) overtime laws. Defendants moved to compel arbitration and argued that the arbitration agreements, which plaintiffs had entered into via their employment agreements and executed Form U4s, required plaintiffs to submit to FINRA arbitration.³⁸ The arbitration agreements provided that:

Any claim or controversy concerning you arising out of or in connection with the business activities of [Chase], your activities and/or your appointment as a registered representative or your employment and/or the termination thereof *required to be arbitrated by the FINRA Rules* shall be resolved by individual (not class or collective) arbitration *in accordance with the Code of Arbitration Procedure of the FINRA...*, and in accordance with applicable law.... Further, no claims shall be arbitrated on a class or collective action or collective or class-wide basis.³⁹

The district court denied the motion to compel on the ground that plaintiffs' class claims fell outside the scope of their arbitration agreement; the Second Circuit agreed.⁴⁰ Since class or collective action claims are prohibited under FINRA Rule 13204, plaintiffs were not required to arbitrate their claims in the FINRA

³⁸ *Id.* at 266-69.

³⁹ *Id.* at 268 (emphasis in original). Notably, the agreement prevented plaintiffs only from asserting their claims in FINRA arbitration, not from asserting their claims in court.

⁴⁰ *Id.* at 269.

forum. Thus, plaintiffs were not subject to the parties' arbitration agreement governed by FINRA rules.⁴¹

This case is significant because the holding effectively nullifies the class and collective arbitration waiver that the firm inserted in its PDAA in its employment agreement with its FAs. Chase clearly wanted to avoid class and collective claims and wanted to arbitrate disputes with employees. By using the language quoted above, the firm not only faces class and collective claims, it has to face them in court.

2. Contrary Congressional Command

Even if a dispute falls within the scope of an arbitration agreement, courts can refuse to enforce the agreement as to federal statutory claims if “the FAA’s mandate has been ‘overridden by a contrary Congressional command.’”⁴²

In *Cohen v. UBS Financial Services*,⁴³ the Second Circuit rejected an employee’s argument that FINRA Rule 13204, which bars class and collective claims in FINRA arbitration in intra-industry cases, is a “contrary Congressional command” that

⁴¹ *Id.* at 271-73. The court also ruled that incorporation by reference of FINRA arbitration rules invokes the rule in effect at the time of the arbitration, not the rule in effect when the parties entered into the agreement. *Id.* at 273.

⁴² *Am. Express Co. v. Italian Colors Rest.*, 133 S.Ct. 2304, 2309 (2013) (citing *CompuCredit Corp. v. Greenwood*, 132 S.Ct. 665, 668-69 (2012)) (second internal citation omitted). For example, Dodd-Frank §922 declares that PDAAs purporting to require arbitration of whistleblower claims arising under Sarbanes-Oxley are not enforceable. 18 U.S.C. § 1514A(e)(2) (2012).

⁴³ 799 F.3d 174, 175 (2d Cir. 2015).

supersedes the FAA’s command to enforce PDAAAs as written, even if they contain a class action waiver.

Cohen, an FA with UBS Financial Services, Inc. (UBS), filed a putative class and collection action alleging federal and state wage-and-hour claims against UBS in the United States District Court for the Central District of California.⁴⁴ The case was transferred to the Southern District of New York, and the complaint was amended to add other employees of UBS.⁴⁵

UBS moved to stay the action and compel arbitration, asserting that plaintiffs’ employment agreements included an enforceable PDAA with a class action waiver. Cohen—not disputing that he had entered into an arbitration agreement that covered all of his claims—opposed the motion, arguing that FINRA Rule 13204 is a “contrary Congressional command” that bars UBS from enforcing the arbitration agreement as well as the class and collective action waivers.⁴⁶ The district court agreed with UBS and stayed the court case pending FINRA arbitration.⁴⁷

On appeal, the Second Circuit affirmed. The Court of Appeals concluded that enforcement of the PDAA would not be “‘contrary’ to Rule 13204 because the Rule bars neither the enforcement of pre-dispute waivers of class and collective action procedures nor the arbitration of Cohen’s individual claims.”⁴⁸ The court further stated: “True, the Rule bars arbitration of a claim so long as it is embedded in a class action or collective action; but it does not preserve the right to assert a claim in class or collective

⁴⁴ *Id.* at 176.

⁴⁵ *Id.*

⁴⁶ *Id.* at 177-78.

⁴⁷ *Id.*

⁴⁸ *Id.* at 178.

form notwithstanding a contractual waiver.”⁴⁹ The court noted that class/collective action waivers are “conceptually distinct” from PDAAs.⁵⁰ Thus, the court concluded that Rule 13204 does not prohibit the enforcement of class and collective action waivers.⁵¹

In the labor context, the Seventh Circuit recently concluded that the National Labor Relations Act (NLRA) precludes enforcement of a collective action waiver as protected “concerted action.”⁵² However, because the court concluded that the NLRA did not conflict with the FAA in that context (because the arbitration agreement was unenforceable under state law as illegal and thus covered by the FAA’s savings clause), the court did not need to decide whether the NLRA is a “contrary Congressional command.”⁵³ The Seventh Circuit’s approach sets up a conflict with other circuits that have concluded the NLRA does not void class/collective action waivers in labor contracts.⁵⁴

⁴⁹ *Id.*

⁵⁰ *Id.* at 179. The court also noted that FINRA does not restrict the content of firms’ PDAAs with their employees (only those with their customers). *Id.*

⁵¹ *Id.* at 180. In contrast, FINRA has held that, in the customer context, FINRA Rule 12204 is a “contrary Congressional command” that supersedes the FAA, and thus barred broker-dealers from inserting class action waivers in their customer agreements. *See* Dep’t of Enforcement v. Charles Schwab & Co., Inc., Disc. Proc. No. 2011029760201 (FINRA Office of Hearing Officers Feb. 21, 2013).

⁵² *See* *Lewis v. Epic Sys. Corp.*, ___ F.3d ___, No. 15-2997, 2016 WL 3029464 (7th Cir. May 26, 2016).

⁵³ *Id.* at *6.

⁵⁴ *See* *Murphy Oil USA, Inc. v. NLRB*, 808 F.3d 1013 (5th Cir. 2015); *Cellular Sales of Missouri LLC v. NLRB*, ___ F.3d ___, No. 15-1620 and No. 15-1860, 2016 WL 3093363 (8th Cir. June 2, 2016).

3. Effective Vindication Doctrine

Another defense to arbitrability asserted by disputants is that a court should not enforce an arbitration agreement because enforcement would prevent them from vindicating their statutory rights. The Supreme Court limited this “effective vindication” doctrine to cases where claimants can establish they are stripped of the *right* to pursue statutory rights, not the *ability* to pursue them.⁵⁵ Since *Italian Colors*, lower federal courts enforce class action waivers in PDAs against an “ineffective vindication” challenge.⁵⁶

On the other hand, several courts have refused to enforce other aspects of arbitration agreements under the effective vindication doctrine. In *Hayes v. Delbert Services Corp.*,⁵⁷ plaintiffs brought a putative class action against a payday lending company asserting that the company’s lending practices violated various state and federal lending laws. The PDA in the parties’ loan agreement provided that the agreement was subject only to Indian law and not applicable state and federal law.⁵⁸ The Fourth Circuit concluded that the clause, which expressly forbid plaintiffs from invoking protections guaranteed to them under federal law, was unenforceable under the effective vindication doctrine.⁵⁹

Similarly, in *Nesbitt v. FCNH, Inc.*,⁶⁰ a massage therapy student brought a putative class action in federal district court

⁵⁵ *Am. Exp. Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304, 2311 (2013).

⁵⁶ *See, e.g., Kaspers v. Comcast Corp.*, 631 F. App’x 779, 783-84 (11th Cir. 2015).

⁵⁷ 811 F.3d 666 (4th Cir. 2016).

⁵⁸ *Id.* at 668-89.

⁵⁹ *Id.* at 675.

⁶⁰ 811 F.3d 371 (10th Cir. 2016).

against the operator of massage therapy schools for violations of the Fair Labor Standards Act (FLSA) for failing to pay students for performing massages on customers.⁶¹ The student enrollment agreement contained a PDAA providing for arbitration at the American Arbitration Association pursuant to its commercial arbitration rules. Those rules provide, among other things, that each party bears its own arbitration expenses. The PDAA also stated that each party would bear its own attorney's fees.⁶²

The district court denied defendants' motion to compel arbitration, and the Tenth Circuit affirmed under the effective vindication doctrine.⁶³ The Court of Appeals noted that plaintiff's affidavit stated that she could not afford the forum fees. The court also noted that the arbitration agreement was ambiguous as to whether the arbitrators were permitted to ignore the fee-shifting provisions of the FLSA.⁶⁴ The court concluded that "it is unlikely that an employee in [the plaintiff's] position, faced with the mere possibility of being reimbursed for arbitrator fees in the future, would risk advancing those fees in order to access the arbitral forum." As a result, the court held that the arbitration agreement precluded plaintiff from vindicating her statutory rights and was thus unenforceable.⁶⁵

Because the Supreme Court has never expressly invalidated an arbitration agreement under the "effective vindication" doctrine, it remains to be seen precisely what type of

⁶¹ *Id.* at 373.

⁶² *Id.* at 374.

⁶³ *Id.* at 375.

⁶⁴ *Id.* at 379-80.

⁶⁵ *Id.* at 380-81.

right-stripping provision in an arbitration agreement the Court would view as rendering the agreement unenforceable.

4. State law defenses

Finally, as stated above,⁶⁶ the FAA's "savings clause" preserves ordinary state law defenses to the enforcement of any contract as viable challenges to arbitrability, as long as that defense does not discriminate against arbitration contracts. This section identifies those defenses and some recent cases interpreting them.

i. Lack of Mutual Assent

One state law-based defense parties invoke to challenge the enforceability of an arbitration agreement is lack of mutual assent. Federal courts occasionally examine this defense in the context of a "click-wrap" agreement, where an online purchaser must click a box to complete a purchase, and that "click" then binds the consumer to certain terms of service. While most click-wrap agreements are enforced, the Seventh Circuit recently refused to enforce an arbitration clause contained in a click-wrap agreement, reasoning that the purchaser did not receive ample notice of the terms of the clause through the act of clicking.⁶⁷

Online brokerage firms should ensure that customers who open accounts online necessarily must see the full account agreement including any PDAA when they go through the process

⁶⁶ *See supra* Part I.

⁶⁷ *See Sgouros v. TransUnion Corp.*, 817 F.3d 1029, 1035-36 (7th Cir. 2016) (affirming district court's refusal to enforce an online agreement where the user did not get clear notice of its terms by clicking through the "I accept" button).

of opening an account. This could insulate the firm from challenges to the PDAA on the ground of lack of mutual assent.

ii. Unconscionability

While the Supreme Court in *Concepcion* barred lower courts from finding class action waivers in arbitration agreements to be *per se* substantively unconscionable under state law, lower courts continue to strike down select arbitration clauses as unconscionable on other grounds.⁶⁸

However, in the securities arbitration context, because the Securities and Exchange Commission has substantial oversight of the arbitration process and rules and FINRA regulates the content of PDAA in customer agreements,⁶⁹ it is unlikely a court would conclude that a PDAA in a customer agreement that complies with FINRA Rule 2268 is unconscionable.

iii. Waiver

Another state law-based defense to the obligation to arbitrate is 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 and states, courts typically consider factors such as: (1) the time elapsed from commencement of litigation to the request for

⁶⁸ *See, e.g.*, *Global Client Solutions, LLC v. Ossello*, 367 P.3d 361 (Mont. 2016) (affirming lower court's finding that PDAA in a debt collection plan was unconscionable because obligations of parties to arbitrate disputes were not mutual). *Cf. Merkin v. Vonage Am., Inc.*, 639 F. App'x 481 (9th Cir. 2016) (enforcing arbitration clause but severing unconscionable language).

⁶⁹ *See* FINRA R. 2268.

arbitration; (2) the amount and nature of litigation, including substantive motions and discovery; and (3) prejudice to the party opposing arbitration.⁷⁰

This past year, courts continued to examine these factors when ruling on waiver arguments. For example, in *Grigsby & Associates, Inc. v. M. Securities Inv.*,⁷¹ underwriters of a municipal bond offering sought to enjoin arbitration with co-underwriters on the ground that respondents waived their right to arbitrate the dispute.

The Eleventh Circuit affirmed the district court's judgment that the co-underwriters did not waive their right to arbitrate the dispute. In so ruling, the Eleventh Circuit recognized that "a party who 'substantially invokes the litigation machinery prior to demanding arbitration may waive its right to arbitrate.'"⁷² However, the court noted that the lawsuits respondents had filed before the arbitration were insubstantial, in that they largely did not progress past the filing stage.⁷³ Moreover, the fact that respondents waited for ten years after the offering to seek arbitration did not in and of itself constitute a waiver.⁷⁴ Finally, petitioners did not show they suffered any prejudice from respondents' litigation conduct. Therefore, the Court of Appeals found that petitioners failed to meet their heavy burden of proving

⁷⁰ 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.").

⁷¹ 635 F. App'x 728 (11th Cir. 2015).

⁷² *Id.* at 731.

⁷³ *Id.* at 732.

⁷⁴ *Id.* at 733.

that respondents acted so inconsistently with their right to arbitrate as to constitute waiver.⁷⁵

In contrast, the Tenth Circuit found that a disputant had waived its right to arbitrate in *In re Cox Enterprises, Inc. Set-top Cable Television Box Antitrust Litig.*⁷⁶ In that case, a putative antitrust class action, defendant cable company moved to compel arbitration two years after plaintiffs filed the action.⁷⁷ During that two-year time frame, the plaintiffs fought off motions to dismiss, sought (and achieved) class certification, and engaged in extensive discovery with defendant. Defendant did not inform the district court of the existence of the PDAs in the cable subscribers' service agreements at the class certification stage. Instead, defendant moved to compel arbitration the same day it filed its motion for summary judgment.⁷⁸ The district court denied defendant's motion to compel, finding that defendant's "failure to inform it about the presence of the arbitration agreements until after certification was inconsistent with an intent to arbitrate and suggested 'an attempt to manipulate the process, or at least to attempt multiple bites at the apple.'"⁷⁹ Based on that fact as well as other factors, including prejudice to plaintiffs and the judicial process, the Court of Appeals affirmed the finding of waiver.⁸⁰

⁷⁵ *Id.* at 734; *see also* Hoover Gen. Contractors-Homewood, Inc. v. Key, ___ So.3d ___, No. 1141208, 2016 WL 687070, *4 (Ala. Feb. 19, 2016) (contractor did not waive its right to enforce arbitration clause by moving to compel arbitration six months after complaint was filed where its "participation in [the] case consists of filing three separate pleadings, twice moving to continue the pretrial conference, and filing counterclaims").

⁷⁶ 790 F.3d 1112, 1116 (10th Cir. 2015).

⁷⁷ *Id.* at 1115.

⁷⁸ *Id.*

⁷⁹ *Id.* at 1116 (quoting district court).

⁸⁰ *Id.* at 1120-21; *see also* Principal Investments, Inc. v. Harrison, 366

If arbitration has not been ruled out as desirable, practitioners in this field should be cognizant of taking too many steps in a litigation so as to avoid inadvertently waiving any right to arbitrate the dispute.

iv. Nonsignatories to Arbitration Agreements

Some parties resist arbitration on the ground that they did not sign the relevant arbitration agreement. However, courts sometimes compel nonsignatories to arbitrate under various state law contract doctrines.⁸¹ For example, in *Akpele v. Pac. Life Ins. Co.*,⁸² plaintiff, a widow who learned that she had not been designated as her husband's beneficiary in three of his retirement accounts, brought suit against Pacific Life Insurance Company, Oppenheimer & Co., Inc., two of Oppenheimer's agents and the temporary administrator of her husband's estate. In opening his first two accounts, plaintiff's deceased husband had signed a client agreement containing a PDAA that was binding on successors. The district court required plaintiff to arbitrate her dispute before a FINRA panel.⁸³ The panel ruled in favor of Oppenheimer and one of its agents. The district court confirmed the award.⁸⁴

On appeal, plaintiff argued, *inter alia*, that she was not bound by the arbitration clause because "she did not benefit from,

P.3d 688 (Nev. 2016) (denying payday loan company's motion to compel arbitration on ground that it had waived its right to arbitrate).

⁸¹ 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).

⁸² ___ F. App'x ___, No. 15-11529, 2016 WL 1319354 (11th Cir. Apr. 5, 2016).

⁸³ *Id.* at *1.

⁸⁴ *Id.*

consent to, or ratify an action of her husband that would bind her under the client agreement.”⁸⁵ The district court reasoned, and the Court of Appeals affirmed, that she was bound by the agreement as a “successor” under both federal and state law.⁸⁶

Likewise, in *Evans v. Bayles*,⁸⁷ the Supreme Court of Appeals of West Virginia compelled a widow to arbitrate claims arising out of her deceased husband’s Ameriprise brokerage account even though the account agreement containing the PDAA was not signed.⁸⁸ Her husband had signed an IRA Application, which included an acknowledgement that the client had received and read the Brokerage Client Agreement, and that the agreement included a PDAA. However, he never signed the Brokerage Agreement itself. The Supreme Court of Appeals ruled the arbitration agreement was incorporated by reference into the IRA Application, which he did sign.⁸⁹ Thus, the court required his widow to arbitrate her dispute over the payout of the proceeds of her late husband’s account.

Some courts are unwilling to enforce an arbitration agreement against a nonsignatory if there is no evidence that the nonsignatory actually knew of the agreement, nor any evidence it received a tangible or direct benefit from it. For example, in *Pershing, L.L.C. v. Bevis*,⁹⁰ plaintiffs were a group of 16 investors

⁸⁵ *Id.* at *3.

⁸⁶ *Id.* at *4-5; *see also* Tamsco Props., LLC v. Langemeier, 597 F. App’x 428 (9th Cir. 2015) (affirming lower court’s grant of motion to compel arbitration of nonsignatories whose agents attended conferences sponsored by the defendants and signed PDAA’s at those conferences on investors’ behalf).

⁸⁷ No. 15-0600, 2016 W. Va. LEXIS 427, at *1 (June 1, 2016).

⁸⁸ *Id.* at *5.

⁸⁹ *Id.* at *15.

⁹⁰ 606 F. App’x 754, 758 (5th Cir. 2015) (affirming order enjoining arbitration).

who bought Stanford certificates of deposit (CDs) from the now infamous Stanford Ponzi scheme.⁹¹ Pershing was Stanford's clearing broker during the relevant time period. The 16 investors along with 84 others who invested in the CDs commenced a FINRA arbitration against Pershing, alleging Pershing had played a material role in defrauding them.⁹² Pershing did not resist arbitration with the 84 investors, as they had used Pershing's services in purchasing the CDs. However, Pershing persuaded the district court to enjoin the group of 16 from arbitrating their claims against it, as Pershing had no contractual relation with them; rather, they had purchased their CDs directly through the bank or Stanford's trust company. The Fifth Circuit agreed, refusing to compel arbitration of Pershing as a nonsignatory.⁹³

5. Unavailability of forum

Another defense to arbitrability is that the forum designated in the PDAA is unavailable. The Eleventh Circuit refused to compel arbitration of a dispute that was subject to an arbitration clause because the designated forum was not available. In *Flagg v. First Premier Bank*,⁹⁴ plaintiff filed a class action lawsuit against First Premier Bank, alleging that defendant facilitated illegal transactions of online payday lenders.⁹⁵ Plaintiff's loan agreement included a PDAA that stated that all disputes were to be resolved "by and under the Code of Procedure of the National Arbitration Forum [NAF]."⁹⁶ However, NAF

⁹¹ *Id.* at 756.

⁹² *Id.* at 755.

⁹³ *Id.* at 758.

⁹⁴ ___ F. App'x ___, No. 15-14052, 2016 WL 703063 (11th Cir. Feb. 23, 2016).

⁹⁵ *Id.* at *1.

⁹⁶ *Id.*

declined plaintiff's request to arbitrate her claim, as it had not been accepting consumer arbitration claims since 2009.⁹⁷

Plaintiff then sued in federal district court. Defendant, arguing that §5 of the FAA requires the appointment of a substitute for NAF,⁹⁸ moved to compel arbitration and appoint a substitute forum, and to stay or dismiss the proceedings.⁹⁹ The district court denied defendant's motion.¹⁰⁰

The Court of Appeals affirmed, finding that the forum selection "was an integral part of the agreement to arbitrate."¹⁰¹ If the selected forum is not available, the court would not enforce the arbitration agreement.

6. Arbitration "has been had" under FAA section 3

Under FAA §3, upon motion of a party, a district court must stay court proceedings on issues subject to arbitration "until such arbitration has been had in accordance with the terms of the agreement."¹⁰² In *Tillman v. Tillman*,¹⁰³ the Ninth Circuit permitted a lawsuit to go forward in court despite the existence of a valid arbitration agreement because the arbitrator had dismissed the arbitration after one party could not afford to pay her share of

⁹⁷ *Id.*

⁹⁸ FAA §5 "requires the [court's] appointment of a substitute arbitrator when the arbitrator designated by the parties is unavailable." *Khan v. Dell Inc.*, 669 F.3d 350, 350-51 (3d Cir. 2012).

⁹⁹ *Id.* at *3.

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at *4.

¹⁰² 9 U.S.C. §3.

¹⁰³ *Tillman v. Tillman*, ___ F.3d ___, No. 13-56624, 2016 WL 3343785 (9th Cir. June 15, 2016).

the arbitrator fees.¹⁰⁴ In *Tillman*, a legal malpractice action arising out of a wrongful death lawsuit, defendant law firm first moved to compel arbitration and stay the court action based on an arbitration clause in its retainer agreement with the widow, Mrs. Tillman.¹⁰⁵ The district court granted the motion, and the parties proceeded to arbitrate their dispute at the American Arbitration Association (AAA) as provided for in their agreement.¹⁰⁶

In the arbitration, Mrs. Tillman was unable to deposit \$18,562.50 required by the AAA as a condition of continuing the proceedings. Thus, pursuant to AAA Rules, the arbitrator terminated the arbitration due to the insufficient deposit.¹⁰⁷ The firm then moved in district court under Federal Rule of Civil Procedure 41(b) to lift the stay and dismiss Mrs. Tillman's complaint for failure to comply with the court order to arbitrate. In response, Mrs. Tillman submitted an affidavit attesting to her financial condition and inability to pay the arbitration deposit.¹⁰⁸

The district court ultimately dismissed the complaint, though not pursuant to Rule 41(b). The court instead reasoned that, because the AAA's rules required the parties "to bear the costs of arbitration equally and allowed the arbitrator to suspend the proceedings," the FAA "deprived the district court of authority to hear 'the claims that would have been subject to the arbitration agreement,' and dismissal was required."¹⁰⁹

¹⁰⁴ The Tenth Circuit ruled similarly this past year. See *Pre-Paid Legal Services, Inc. v. Cahill*, 786 F.3d 1287 (10th Cir. 2015) (lifting stay of action pending arbitration because employee defendant failed to pay his share of arbitration fees and arbitrators terminated arbitration).

¹⁰⁵ 2016 WL 3343785, at *1-2.

¹⁰⁶ *Id.* at *2.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* at *3.

On appeal, the Ninth Circuit ruled that, under FAA §3, the district court had the power to lift the stay of the court proceedings and allow the court case to go forward.¹¹⁰ Since the AAA’s rules expressly allowed the arbitrator to terminate the arbitration proceeding without entering an award or judgment when one party failed to make a required deposit, the court concluded that Mrs. Tillman’s arbitration had been “had in accordance with the terms of the [arbitration] agreement” under FAA §3.¹¹¹ The Court of Appeals noted that no section of the FAA compels a court to dismiss a case once the arbitration had concluded in accordance with agreed-upon rules.¹¹²

This unusual case strikes me as an alternative to the “effective vindication” doctrine for a disputant that can demonstrate he or she cannot afford arbitration forum fees and costs. Rather than show the unaffordable arbitration fees strip the disputant of the right to pursue the claim, the disputant can rely on the procedural rules of the forum that permit a final dismissal of the arbitration if one party does not deposit fees. The arbitration has thus “been had” within the meaning of FAA §3, allowing the case to go forward in court.

¹¹⁰ *Id.*

¹¹¹ *Id.* at *4 (quoting FAA §3).

¹¹² *Id.* at *6. On a related question characterized as a “matter of first impression,” the Second Circuit ruled that the district court has the power to lift a stay, but not dismiss the action, when it refers all claims in the complaint to arbitration under FAA §3. *See Katz v. Cellco Partnership*, 794 F.3d 341 (2d Cir. 2015). The court reasoned that a dismissal creates an immediately appealable order, which leads to more, not less, litigation, an outcome that is inconsistent with the FAA. *Id.* at 345-46.

C. Defenses to Arbitrability Unique to FINRA Context

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

In FINRA arbitration, even in the absence of a PDAA 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”¹¹³

Thus, in a customer case, respondents may resist arbitration on the ground that claimant is not a “customer” of the FINRA member firm within the meaning of Rule 12200. FINRA does not define “customer,” except for its mention in Rule 12100(i) (a “customer shall not include a broker or dealer”), and courts struggle to define the term. The leading definition is from *Citigroup Global Markets Inc. v. Abbar*.¹¹⁴ There, the Second Circuit issued “a bright-line rule” and held that “a ‘customer’ under FINRA Rule 12200 is one who, while not a broker or dealer, either (1) purchases a good or service from a FINRA member, or (2) has an account with a FINRA member.”¹¹⁵

¹¹³ FINRA R. 12200.

¹¹⁴ 761 F.3d 268 (2d Cir. 2014).

¹¹⁵ *Id.* at 275. *See* Dougherty v. VFG, LLC, 118 F. Supp. 3d 699, 713 (E.D. Pa. 2015) (applying *Abbar* definition of “customer” and granting motion to compel brokerage firm to arbitrate).

However, in *AXA Advisors, LLC v. Lee*,¹¹⁶ the district court held that *Abbar* did not change the Second Circuit’s prior holding¹¹⁷ that a customer of an associated person who does not have an account with the associated person’s firm was nevertheless a “customer” of that firm under Rule 12200. In *Lee*, investors who did not have accounts with AXA brought an arbitration proceeding against AXA arising out of losses from the “selling away” activities of an AXA registered representative. AXA sued in federal court to enjoin the arbitration.¹¹⁸ While recognizing the utility of the *Abbar* definition of “customer,” the district court went further. The *Lee* court concluded that the investors had the right to seek arbitration against AXA under Rule 12200 because they were customers of its associated person.¹¹⁹

2. Can a Forum Selection Clause Trump the Duty to Arbitrate?

A question related to “who is a customer” is whether a FINRA member’s duty to arbitrate at the request of a customer under Rule 12200 supersedes a forum selection clause in a *customer* agreement. Last year’s update covered a recent Second Circuit case holding that it does not.¹²⁰ This year, the Second

¹¹⁶ No. 1:15-CV-137-BLW, 2016 WL 335852 (D. Idaho Jan. 27, 2016) (slip op.) (compelling broker-dealer to arbitrate investors’ claim that its registered representative was “selling away” from the firm).

¹¹⁷ See *John Hancock Life Ins. Co. v. Wilson*, 254 F.3d 48 (2d Cir. 2001).

¹¹⁸ *Lee*, 2016 WL 335852, at *1.

¹¹⁹ *Id.* at *4.

¹²⁰ See *Goldman, Sachs & Co. v. Golden Empire Sch. Fin. Auth.*, 764 F.3d 210 (2d Cir. 2014). *But see* Jill I. Gross, *The Customer’s Non-Waivable Right to Choose Arbitration in the Securities Industry*, 10 BROOK. J. CORP. FIN. & COM. L. 383 (2016) (arguing that recently amended section 29(a) of the Securities Exchange Act voids a forum selection clause in a customer agreement that purports to force a customer to waive its right to compel a FINRA member to arbitrate).

Circuit similarly held that a “more specific” forum selection clause in a broker-dealer’s *employment* agreement with an associated person trumped the firm’s duty to arbitrate a dispute with its employee under FINRA Rule 13200.¹²¹

D. Vacating Arbitration Awards

To successfully challenge an arbitration award that is governed by the FAA, parties must establish one of the four grounds for vacatur listed in FAA §10(a).¹²² Disputants rarely invoke section 10(a)(1) (“where the award was procured by corruption, fraud, or undue means”), but they more frequently invoke sections 10(a)(2)-(4), which are discussed below.

1. Evident Partiality

Losing parties to arbitration awards can seek vacatur pursuant to FAA § 10(a)(2) if they show “evident partiality” in one or more arbitrators. The Supreme Court’s only decision under that subsection is the 48-year old decision in *Commonwealth Coatings v. Continental Casualty Co.*,¹²³ which yielded plurality and concurring opinions that are difficult to synthesize. As a result, lower courts have had difficulty developing a test for “evident partiality,” since most circuits follow a version of the test set forth thirty years ago by the Second Circuit.¹²⁴ “evident partiality” is

¹²¹ See *Credit Suisse Sec. (USA) LLC v. Tracy*, 812 F.3d 249 (2d Cir. 2016).

¹²² See *Hall St. Assoc., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008).

¹²³ 393 U.S. 145 (1968).

¹²⁴ See *Morelite Constr. v. New York City Dist. Council Carpenters Ben. Funds*, 748 F.2d 79 (2d Cir. 1984).

“where a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration.”¹²⁵

Under that strict test, courts routinely reject claims of evident partiality. Thus, it is unusual when a district court vacates an award on the ground that the arbitrator was biased. It is even more notable when an appellate court reverses a vacatur on this ground – which happened several times in the past year.¹²⁶

For example, in *Mendel v. Morgan Keegan & Co.*, plaintiff filed a FINRA arbitration against Morgan Keegan, claiming losses in mutual funds due to the fund’s investments in risky asset-backed securities.¹²⁷ Though a unanimous panel awarded the investor \$279,500.31, he challenged the arbitral award in Alabama state court, claiming that the award represented less than a tenth of his actual losses.¹²⁸

In his motion to vacate, Mendel argued that one of the panel members had an undisclosed potential conflict of interest because Mendel discovered post-hearing that the arbitrator’s employing law firm had previously represented Morgan Keegan in unrelated matters.¹²⁹ However, Mendel did not show that the panel

¹²⁵ *Id.* at 83.

¹²⁶ *See, e.g.*, *Ruhe v. Massimo Corp.*, __ F. App’x __, Nos. 14–55556, 14–55725, 2016 WL 685115 (9th Cir. Feb. 19, 2016); *Mendel v. Morgan Keegan & Co.*, __ F. App’x __, No. 15-12801, 2016 WL 3626783 (11th Cir. Mar. 23, 2016); *Johnson v. Directory Assistants, Inc.*, 797 F.3d 1294 (11th Cir. 2015) (per curiam) (reversing district court’s vacatur of award for evident partiality despite panelist’s disclosed past service as an arbitrator on a previous case involving the defendant and the undisclosed number of cases the defendant had at the forum).

¹²⁷ 2016 WL 685115, at *1.

¹²⁸ *Id.*

¹²⁹ *Id.* The arbitrator had disclosed the name of his law firm pre-hearing.

member actually knew of the conflict.¹³⁰ After Morgan Keegan removed the case to federal court, the district court applied Alabama’s definition of “evident partiality” and vacated the award under §10(a)(2).¹³¹

The Eleventh Circuit reversed, holding that the Northern District of Alabama erred in applying Alabama state law rather than federal law in interpreting §10(a)(2).¹³² The Eleventh Circuit stated that, under federal law, there “are two ways to show evident partiality: (1) an actual conflict, or (2) knowing nondisclosure of a potential conflict.”¹³³ The court concluded that Mendel did not meet this standard because he did not argue that the panel member was actually biased and did not show the panel member knew of but failed to disclose the potential conflict.¹³⁴ Thus, the appellate court reversed the district court’s vacatur of the award.

Is an arbitrator automatically “evidently partial” when the parties’ arbitration agreement provides for an arbitrator to assess the propriety of his own conduct?¹³⁵ In an opinion arising out of the Tom Brady “Deflategate” scandal,¹³⁶ the Second Circuit considered this very question. There, the NFL Commissioner

¹³⁰ *Id.* at *2.

¹³¹ *Id.*

¹³² *Id.* at *3. *But see* Finn v. Ballentine Partners, LLC, __ A.3d __, 2016 WL 3268852, *9 (NH June 14, 2016) (state law grounds for vacatur not preempted by FAA).

¹³³ *Id.* at *2 (quoting Gianelli Money Purchase Plan & Trust v. ADM Inv’r Servs., Inc., 146 F.3d 1309, 1312 (11th Cir. 1998)).

¹³⁴ *Id.* at *3-4.

¹³⁵ Though this scenario is unlikely to occur in the FINRA context, it is conceivable that a FINRA arbitrator might be called upon to assess the propriety of a FINRA disciplinary ruling as a predicate for a claim brought in arbitration.

¹³⁶ Nat’l Football League Mgmt. Council v. Nat’l Football League Players Ass’n, 820 F.3d 527 (2d Cir. 2016).

suspended Tom Brady four games for allegedly deflating footballs in a championship game more than permitted. Brady demanded arbitration to challenge the suspensions pursuant to the NFL Players Association’s collective bargaining agreement (CBA).¹³⁷ In the CBA, the parties agreed that the NFL Commissioner would serve as the arbitrator. After arbitration, the Commissioner upheld the discipline that he had imposed.

The Players Association moved to vacate the award on numerous grounds, and the district court granted the motion. On appeal, the Second Circuit reversed. The Court of Appeals rejected, *inter alia*, the Players Association’s contention that the NFL Commissioner who served as the arbitrator was “evidently partial” because he was “adjudicating the propriety of his own conduct.”¹³⁸ Because the CBA provided that the Commissioner would serve as arbitrator, the Court of Appeals concluded that “parties to an arbitration can ask for no more impartiality than inheres in the method they have chosen.”¹³⁹

2. Refusal to Hold a Hearing

A court can vacate an award under FAA §10(a)(3) if the losing party shows “the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of

¹³⁷ *Id.* at 531-32.

¹³⁸ *Id.* at 548. The Players Association claimed that the Commissioner had improperly delegated his disciplinary authority during the investigation. *Id.* at 534-35.

¹³⁹ *Id.*

any party have been prejudiced.’¹⁴⁰ The Second Circuit recently interpreted this ground:

Vacatur under 9 U.S.C. § 10(a)(3) is warranted only when the arbitration proceedings were ‘fundamentally unfair.’ Fairness requires arbitrators to give a party an ‘adequate opportunity to present its evidence and argument,’ but it does not require them to ‘hear all the evidence proffered by a party.’ Moreover, ‘[a]rbitrators have substantial discretion to admit or exclude evidence.’¹⁴¹

In *Akpele v. Pac. Life Ins. Co.*,¹⁴² a widow arbitrated negligence and intentional torts claims against defendants after she discovered that she was not named as a beneficiary in three of her husband’s retirement accounts.¹⁴³ At the hearing, plaintiff offered into evidence a defined benefit plan and its trust document, sponsored by her late husband’s medical practice, presumably to show that spousal consent was required to change a beneficiary.¹⁴⁴ The panel excluded the two documents, however, because plaintiff did not produce the documents in a timely manner in violation of FINRA discovery rules.¹⁴⁵

After she lost in arbitration, plaintiff moved to vacate the award under this section, claiming the panel’s preclusion of the two documents was arbitrator misconduct under section 10(a)(3).

¹⁴⁰ 9 U.S.C. § 10(a)(3).

¹⁴¹ *Glob. Gold Min., LLC v. Ayvazian*, 612 F. App’x 11, 14 (2d Cir. 2015) (internal citations omitted).

¹⁴² __ F. App’x __, No. 15-11529, 2016 WL 1319354 (11th Cir. Apr. 5, 2016).

¹⁴³ *Id.* at *1. Plaintiff claimed defendants improperly changed the beneficiary designated in the accounts.

¹⁴⁴ *Id.* at *4.

¹⁴⁵ *Id.*

The Eleventh Circuit agreed with the district court’s conclusion that the exclusion of the documents was reasonable because of the discovery violation. Further, the Court of Appeals agreed with the district court that the panel’s decision was not made in bad faith, and did not deprive plaintiff of a fair hearing.¹⁴⁶

Similarly, the Second Circuit also rejected the argument that violation of the forum’s arbitral rules – in this case, an arbitrator’s disclosure obligations – could constitute arbitrator “corruption” or “misbehavior” within the meaning of section 10(a)(1), (2) or (3).¹⁴⁷ The Court of Appeals emphasized

that the shipper's attempt to secure vacatur based on a violation of private arbitral rules runs headlong into the principle that parties may not expand by contract the FAA’s grounds for vacating an award. ...if an arbitrator’s failure to comply with arbitral rules, without more, could properly be considered ‘corruption’ or ‘misbehavior,’ the FAA’s grounds for vacatur would be precisely as varied and expansive as the rules private parties might choose to adopt. We accordingly reject this argument.¹⁴⁸

3. Exceeding Powers

Since arbitrators derive all of their authority to decide disputes from the parties’ arbitration agreement, a court can vacate an award under §10(a)(4) if the arbitrators exceed the authority provided by that agreement. Under this ground for vacatur, courts consider only “whether the arbitrator (even arguably) interpreted

¹⁴⁶ *Id.*

¹⁴⁷ *Zurich Am. Ins. Co. v. Team Tankers A.S.*, 811 F.3d 584, 589 (2d Cir. 2016).

¹⁴⁸ *Id.*

the parties' contract, not whether he got its meaning right or wrong."¹⁴⁹ Parties sometimes invoke this ground when challenging an award (or no award) of attorney's fees, with varying success.¹⁵⁰

In *Leeward Constr. Co., Ltd. v. Am. Univ. of Antigua-Coll. of Med.*, the Second Circuit affirmed the district court's denial of a motion to vacate on a number of grounds, including "exceeding powers."¹⁵¹ The losing party contended that the arbitrators exceeded their powers by not issuing a "reasoned award" as required. The Court of Appeals first concluded that the arbitrators were in fact required to issue a reasoned award because they agreed to do so in the preliminary hearing.¹⁵² Next, the court considered, as a matter of first impression, the definition of a reasoned award. The court wrote:

[W]e ...hold today that a reasoned award is something more than a line or two of unexplained conclusions, but something less than full findings of fact and conclusions of law on each issue raised before the panel. A reasoned award sets forth the basic reasoning of the arbitral panel on

¹⁴⁹ *Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064, 2068 (2013).

¹⁵⁰ *See, e.g., Jones v. Dancel*, 792 F.3d 395, 405 (4th Cir. 2015) (arbitrator did not exceed authority by declining to award additional attorney's fees because he "interpreted the parties' arbitration provision and the applicable legal authorities in rendering the award"); *Beacon Towers Condo. Trust v. Alex*, 42 N.E.3d 1144 (Mass. 2016) (affirming vacatur of arbitration award under Massachusetts law on ground that arbitrators exceeded their authority by awarding attorneys' fees not authorized by PDAA or AAA rules).

¹⁵¹ ___ F.3d ___, No. 13-1708-CV, 2016 WL 3457266, at *4 (2d Cir. June 24, 2016).

¹⁵² *Id.* at *3.

the central issue or issues raised before it. It need not delve into every argument made by the parties.¹⁵³

I do not believe this definition of “reasoned award” applies to FINRA arbitration, because FINRA uses the term “explained decision” when the parties jointly request the arbitrator to include an explanation in the award. Moreover, FINRA rules expressly define the term: “An explained decision is a fact-based award stating the general reason(s) for the arbitrators' decision. Inclusion of legal authorities and damage calculations is not required.”¹⁵⁴

4. Manifest Disregard of the Law

Since the Supreme Court’s holding in *Hall St. Assoc., L.L.C. v. Mattel, Inc.*¹⁵⁵ 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.*¹⁵⁶ The circuit split continues unchanged since last year’s Arbitration Law Update, (with one adjustment for the Fifth Circuit) as follows:

- The Second, Fourth, Sixth, and Ninth Circuits acknowledge the continued vitality of the “manifest disregard” ground of vacatur.¹⁵⁷

¹⁵³ *Id.* at *4.

¹⁵⁴ See FINRA R. 12904(g).

¹⁵⁵ 552 U.S. 576 (2008).

¹⁵⁶ 559 U.S. 662, 672 n.3 (2010).

¹⁵⁷ See *Singh v. Raymond James Fin. Servs., Inc.*, 633 F. App’x 548, 551 (2d Cir. 2015) (affirming district court’s denial of motion to vacate on

- The Eighth and Eleventh Circuits have expressly ruled that manifest disregard is no longer a valid vacatur ground.¹⁵⁸
- The Fifth Circuit has held that manifest disregard is not available as a *non-statutory* ground for review,¹⁵⁹ but this past year declined to decide whether it could be a *statutory* ground for review.¹⁶⁰
- The First and D.C. Circuits have addressed “manifest disregard” subsequent to *Hall Street*, but only in *dicta*.¹⁶¹

manifest disregard grounds and reaffirming principle that arbitrators need not provide any rationale for their award); *Wachovia Sec., 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 (6th Cir. 2014) (suggesting that the Sixth Circuit might revisit the issue, “which has not been firmly settled”).

¹⁵⁸ See *Medicine Shoppe Intern., Inc. v. Turner Inv., Inc.*, 614 F.3d 485 (8th Cir. 2010); *Frazier v. CitiFinancial Corp.*, 604 F.3d 1313, 1324 (11th Cir. 2010). *But see* *SBC Advanced Sols., Inc. v. Commc’ns Workers of Am., Dist. 6*, 794 F.3d 1020, 1027 (8th Cir. 2015) (considering but ultimately rejecting merits of manifest disregard argument in labor arbitration).

¹⁵⁹ See *Citigroup Global Mkts., Inc. v. Bacon*, 562 F.3d 349, 352 (5th Cir. 2009).

¹⁶⁰ See *McKool Smith, P.C. v. Curtis Int’l, Ltd.*, No. 15-11140, ___ F. App’x ___, 2016 WL 2989241, at *3 (5th Cir. May 23, 2016) (“While we have yet to explicitly decide whether the bases for vacatur asserted by Curtis can be statutory grounds for vacatur, we need not decide this issue today”).

¹⁶¹ See *Raymond James Fin. Servs., Inc. v. Fenyk*, 780 F.3d 59, 65 (1st Cir. 2015) (acknowledging that the circuit has “not squarely determined whether our manifest disregard case law can be reconciled with *Hall Street*”) (internal quotation and citation omitted); *Affinity Fin. Corp. v. AARP Fin., Inc.*, 468 F. App’x 4, 5 (D.C. Cir. 2012) (assuming without deciding that manifest disregard of the law standard survived *Hall Street*).

- The Third and Tenth Circuits have expressly declined to address the issue.¹⁶²
- 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.¹⁶³

5. Waiver of Vacatur Right

Finally, in a cautionary tale to parties to diligently research their arbitrators before the hearing, the Third Circuit held in the past year that a party can waive its right to challenge an award if it had constructive knowledge of the alleged ground of vacatur at the hearing. In *Goldman, Sachs & Co. v. Athena Venture Partners, L.P.*,¹⁶⁴ the Court of Appeals held that the claimant had waived its right to challenge the award on the basis that one arbitrator had not made full disclosures.¹⁶⁵

¹⁶² See *Whitehead v. Pullman Grp., LLC*, 811 F.3d 116, 120-21 (3d Cir. 2016) (recognizing circuit split and expressly declining to decide that issue); *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”).

¹⁶³ 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.3d 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.”). *But see Renard v. Ameriprise Fin. Servs., Inc.*, 778 F.3d 563, 567 (7th Cir. 2015) (stating, in *dicta*, that an award can be vacated under §10(a)(4) “if the arbitrator deliberately disregards what he knows to be the law”) (internal quotation omitted).

¹⁶⁴ 803 F.3d 144 (3d Cir. 2015).

¹⁶⁵ *Id.* at 150-51.

Athena brought a FINRA arbitration against Goldman Sachs (GS) for multi-million dollar losses in a GS product that claimed to be a short-term, low-risk investment. After losing the arbitration, Athena moved to vacate the award, arguing that a post-award investigation revealed that a panel member, in addition to a disclosed [on the day of hearing] bar association complaint against him, had several other ethical and criminal complaints pending against him.¹⁶⁶

The district court granted Athena's motion to vacate, finding that FINRA had failed to provide parties with three qualified arbitrators.¹⁶⁷ GS appealed, arguing that Athena had waived its right to seek to vacate the award by failing to object during the FINRA hearing to the arbitrator's incomplete and misleading disclosure.¹⁶⁸

The Third Circuit agreed with GS and reinstated the award in GS's favor. The court stressed that a party should not wait until losing to begin its search for adverse information to use to challenge the award, and that the arbitrator's initial disclosure should have been enough to provoke alarm in Athena.¹⁶⁹ Because Athena had constructive knowledge of a basis to challenge the arbitrator's participation and failed to do so until after an unfavorable award, it waived its right to seek vacatur on that basis.¹⁷⁰

¹⁶⁶ *Id.* at 145-46.

¹⁶⁷ *Id.* at 147.

¹⁶⁸ *Id.*

¹⁶⁹ *Id.* at 148-50.

¹⁷⁰ *Id.* at 150.