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# Arbitration Case Law Update 2015

Jill I. Gross

*Pace Law School*, [jgross@law.pace.edu](mailto:jgross@law.pace.edu)

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**Arbitration Case Law Update 2015**

By

Jill I. Gross

James D. Hopkins Professor of Law  
Director, Investor Rights Clinic, Pace Law School

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This chapter<sup>1</sup> identifies decisions by the U.S. Supreme Court and selected federal circuit and high state courts in the past year that interpret and apply the Federal Arbitration Act (FAA) and could have an impact on securities arbitration practice.<sup>2</sup>

## I. SUPREME COURT

For the first time in several years, the Supreme Court has not decided an arbitration case in the time period since the publication of the previous PLI Arbitration Law Update. The Court did, however, grant a petition for a writ of certiorari in one case.

In *DIRECTV, Inc. v. Imburgia*,<sup>3</sup> the Supreme Court agreed to hear an appeal from a California Court of Appeal decision<sup>4</sup> holding that a California choice of law clause in the parties' arbitration agreement (which the parties agreed was governed by the FAA) trumped the federal law-based FAA preemption doctrine (which provides that the FAA preempts conflicting state law). In *DIRECTV*, consumers filed a class action in state court against the satellite television provider for charging customers an early termination fee allegedly in violation of various California statutes.<sup>5</sup> The form contract governing the satellite service contained a pre-dispute arbitration clause, a class action waiver, and a choice of law clause that provided:

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<sup>1</sup> In writing this chapter, I am grateful for the able research assistance of Rana Marie Abihabib, Pace Law School, J.D. candidate 2016.

<sup>2</sup> 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).

<sup>3</sup> 135 S.Ct. 1547 (2015).

<sup>4</sup> *See* *Imburgia v. DIRECTV, Inc.*, 170 Cal.Rptr.3d 190 (2014), *cert. granted*, 135 S.Ct. 1547 (2015).

<sup>5</sup> *Id.* at 192-93.

“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.”<sup>6</sup>

Notably, the class action waiver clause also stated: “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.”<sup>7</sup>

Based on this sentence, defendants did not initially move to compel arbitration because the governing law of California at the time – known as the *Discover Bank* rule<sup>8</sup> – would have voided the arbitration agreement as unconscionable due to the class action waiver. However, after the Supreme Court held in *AT&T Mobility v. Concepcion*<sup>9</sup> that the FAA preempted California’s *Discover Bank* rule, defendants moved to compel individual arbitration.<sup>10</sup>

The trial court denied the motion and the California Court of Appeal affirmed. The Court of Appeal interpreted the class action waiver provision and found that reigning California law “would find this agreement to dispense with class arbitration procedures unenforceable.”<sup>11</sup> As a result, the entire arbitration

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<sup>6</sup> *Id.* at 193 (quoting parties’ agreement).

<sup>7</sup> *Id.* (quoting parties’ agreement).

<sup>8</sup> *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005) (classifying most class action waivers in consumer contracts as unconscionable).

<sup>9</sup> 131 S.Ct. 1740 (2011).

<sup>10</sup> *DIRECTV*, 170 Cal.Rptr.3d at 193.

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

clause was not enforceable, according to the precise language of section 9 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.<sup>12</sup>

Because the California Court of Appeal's decision conflicts with a Ninth Circuit holding that the FAA preemption doctrine supersedes the parties' choice of law clause,<sup>13</sup> DIRECTV sought review in the Supreme Court (the California Supreme Court had denied its request for review.) The question presented is: "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."<sup>14</sup>

It is not likely that the Supreme Court will permit parties to opt out of the FAA preemption doctrine via a choice of law clause, particularly if the arbitration contract is governed by the FAA. The Court will likely distinguish *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*,<sup>15</sup> in which the Supreme Court held that parties can avoid the application of the FAA through a choice-of-law clause in their pre-dispute arbitration agreement. However, *Volt* involved the alleged preemption of a state procedural rule favoring arbitration, not preemption of a substantive state anti-arbitration principle. Thus, I predict that the Court will reverse the California Court of Appeal's decision.

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<sup>12</sup> *Id.* at 194-97.

<sup>13</sup> See *Murphy v. DirecTV, Inc.*, 724 F.3d 1218 (9th Cir. 2013).

<sup>14</sup> Pet. for Writ of Cert., *DIRECTV, Inc. v. Imburgia*, 2014 WL 5359805 (U.S. Oct. 21, 2014).

<sup>15</sup> 489 U.S. 468 (1989).

## II. FEDERAL 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 substantive arbitrability of a dispute “unless the parties clearly and unmistakably provide otherwise.”<sup>16</sup> Lower courts continue to find that the incorporation by reference of a forum's rules that permit arbitrators to decide arbitrability constitutes such “clear and unmistakable evidence.”<sup>17</sup> In an interesting twist that calls to mind a state court's hostility to arbitration, the Supreme Court of West Virginia recently held that a clause stating that “[t]he arbitrator(s) shall determine all issues regarding the arbitrability of the dispute” is NOT clear and unmistakable evidence that the parties intended arbitrators to decide an unconscionability challenge to the arbitration agreement.<sup>18</sup>

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<sup>16</sup> *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002).

<sup>17</sup> *E.g.*, *Eckert/Wordell Architects, Inc. v FJM Properties of Willmar LLC*, 756 F.3d 1098, 1100 (8<sup>th</sup> Cir. 2014) (holding that arbitrators decide threshold question of whether nonsignatory can compel signatory to arbitrate because arbitration agreement incorporates by reference AAA rules).

<sup>18</sup> *See Schumacher Homes of Circleville, Inc. v. Spencer*, --- S.E.2d ----, 2015 WL 1880234 (W. Va. Apr. 24, 2015).

## B. Defenses to Arbitrability

In deciding questions of arbitrability, courts must apply the *Moses H. Cone* presumption of arbitrability,<sup>19</sup> but must 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.<sup>20</sup>

Even if a court finds that a dispute falls within the scope of an arbitration agreement, the dispute might not be arbitrable under a few limited exceptions. Under the Supreme Court's most recent FAA jurisprudence, courts must enforce arbitration agreements according to their precise terms unless:

1. there is an explicit contrary congressional command;
2. the arbitration agreement expressly strips one party of the substantive right to pursue a federal statutory claim; or
3. a state law contract defense invalidates the agreement, but only if that defense doesn't discriminate against arbitration, and doesn't frustrate the purposes of the FAA.<sup>21</sup>

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<sup>19</sup> See *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983) (instructing courts to presume a dispute is arbitrable).

<sup>20</sup> 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).

<sup>21</sup> See *Am. Express Co. v. Italian Colors Rest.*, 133 S.Ct. 2304 (2013) (holding that claimants can establish they cannot vindicate their federal statutory rights only if they show they are stripped of the *right to pursue* them, not the *ability to pursue* them); *CompuCredit Corp. v. Greenwood*, 132 S.Ct. 665 (2012) (reaffirming that federal statutory claims are arbitrable absent an explicit "contrary congressional command"); *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740 (2011) (ruling that FAA preempts state law unconscionability defense that declares class action

This section summarizes important federal Courts of Appeal decisions that have ruled on challenges to an arbitration agreement based on these principles.

### 1. Scope

Courts sometimes conclude that a particular dispute is not encompassed within the scope of the parties' arbitration agreements. For example, in *The NASDAQ OMX Group, Inc. v. UBS Securities, LLC*,<sup>22</sup> the Second Circuit found that UBS' indemnification claims against the NASDAQ stock market for its trading losses stemming from trading delays on the morning of Facebook's 2012 initial public offering were not covered by an arbitration agreement because they were encompassed within an express carve-out. In that case, UBS sought to arbitrate its indemnification claims in the American Arbitration Association (AAA) pursuant to the parties' Services Agreement. That Agreement provided that the parties agree to submit all disputes arising out of the agreement to arbitration at AAA, "[e]xcept as may be provided in the NASDAQ OMX requirements."<sup>23</sup> In lieu of answering, NASDAQ filed an action in the United States District Court for the Southern District of New York seeking, *inter alia*, a preliminary injunction halting the arbitration proceeding. The district court granted the injunction, and UBS appealed.<sup>24</sup>

On appeal, after addressing issues of jurisdiction, the Court of Appeals rejected UBS' argument that an arbitrator, not the district court, should have decided the arbitrability of the dispute. It found that the Services Agreement did not "clearly and unmistakably direct that questions of arbitrability be decided" by

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waivers in consumer arbitration agreements *per se* unconscionable as inconsistent with the FAA).

<sup>22</sup> 770 F.3d 1010 (2d Cir. 2014).

<sup>23</sup> *Id.* at 1016.

<sup>24</sup> *Id.* at 1017.



the arbitrator.<sup>25</sup> On the merits question of arbitrability, the court of Appeals concluded that the Services Agreement carved out UBS' claims against NASDAQ from the arbitration clause.<sup>26</sup> The court reasoned that, since the NASDAQ OMX requirements referenced in the arbitration clause include the regulations allegedly violated by NASDAQ which caused UBS' trading losses, disputes stemming from those violations were exempted from the clause.<sup>27</sup>

## 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.’”<sup>28</sup> 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”).<sup>29</sup> That section declares that pre-dispute arbitration agreements purporting to require arbitration of whistleblower claims arising under the Sarbanes-Oxley Act of 2002 (“SOX”)<sup>30</sup> are not enforceable.<sup>31</sup>

However, at least one court has held that this no-arbitration provision does not apply to whistleblower claims

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<sup>25</sup> *Id.* at 1032.

<sup>26</sup> *Id.* at 1033.

<sup>27</sup> *Id.* at 1034.

<sup>28</sup> *Italian Colors*, 133 S.Ct. at 2309 (citing *CompuCredit Corp. v. Greenwood*, 132 S.Ct. 665, 668-69 (2012)) (second internal citation omitted).

<sup>29</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>30</sup> Pub. L. No. 107-204, 116 Stat. 745 (2002).

<sup>31</sup> 18 U.S.C. § 1514A(e)(2) (2012); *see* *Laubenstein v. Conair Corp.*, No. 5:14-CV-05227, 2014 WL 6609164, at \*4 (W.D. Ark. Nov. 19, 2014) (slip op.) (holding that arbitration agreement is unenforceable as to plaintiff’s wrongful termination claim arising under SOX). §806 of SOX gives a right of action to “whistleblowers” who report fraud at publicly-traded companies. *See* 18 U.S.C. §1514A (2012).

arising under Dodd-Frank. In *Khazin v. TD Ameritrade Holding Corp.*,<sup>32</sup> a former employee of TD Ameritrade sued his former employer in federal district court, alleging he was terminated in retaliation for reporting securities law violations to his supervisor. He claimed the termination violated the whistleblower protections accorded to him under Dodd-Frank.<sup>33</sup> TD moved to dismiss the complaint and compel arbitration pursuant to a pre-dispute arbitration agreement the employee signed when he began his employment at TD. The district court granted the motion to compel arbitration.<sup>34</sup>

The Third Circuit affirmed. Addressing an issue of first impression, the Court of Appeals held that the “anti-arbitration” provision of Dodd-Frank rendered unenforceable pre-dispute arbitration agreements with respect to whistleblower claims under SOX non-arbitrable, but not with respect to those arising under Dodd-Frank.<sup>35</sup> The Court noted that whistleblower causes of action arising under SOX are “substantively different” from those arising under Dodd-Frank, and “each has its ‘own prohibited conduct, statute of limitations, and remedies.’”<sup>36</sup> The Court of Appeals closely examined the statutory language and concluded that Congress intended to apply its non-arbitration provision in Dodd-Frank to SOX whistleblower claims only; not to Dodd-Frank whistleblower claims.<sup>37</sup> Thus, claimant’s claims were arbitrable.

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<sup>32</sup> 773 F.3d 488 (3d Cir. 2014).

<sup>33</sup> See 15 U.S.C. § 78u–6(h)(1)(B)(i). This section of Dodd-Frank gives a private right of action to “whistleblowers” who are terminated in retaliation for providing information to the SEC, “participating in an SEC proceeding, or making disclosures required or protected under [SOX] and certain other securities laws.” *Lawson v. FMR LLC*, 134 S. Ct. 1158, 1174 (2014) (citing 15 U.S.C. § 78u–6(a)(6), (b)(1), (h)).

<sup>34</sup> 773 F.3d at 490.

<sup>35</sup> *Id.* at 492.

<sup>36</sup> *Id.* at 491 (citing *Ahmad v. Morgan Stanley & Co.*, 2 F. Supp.3d 491, 497 (S.D.N.Y. 2014)).

<sup>37</sup> *Id.* at 492-94.

Practitioners asserting whistleblower claims should be sure to cite the correct statutory authority for clients' claims, especially if they want to avoid arbitration, as pre-dispute arbitration agreements are non-enforceable with respect to SOX, but not Dodd-Frank, whistleblower claims.

In another case in which the court refused to compel arbitration in light of a competing statute, *National Credit Union Administration Board v. Goldman, Sachs & Co.*,<sup>38</sup> the liquidating agent for a failed credit union sued an investment bank, claiming that the bank committed securities fraud in the offering documents covering sales of residential mortgage-backed securities. The district court for the Southern District of New York denied the bank's motion to compel arbitration.<sup>39</sup>

The Court of Appeals affirmed and held that, *inter alia*, the liquidating agent could repudiate the arbitration agreement pursuant to its statutory repudiation powers under the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA).<sup>40</sup> While the court does not reference the Federal Arbitration Act or the "contrary congressional command" exception to the enforceability of arbitration agreements, one can infer that the court found that the statute providing the National Credit Union Administration Board with the power to repudiate agreements, FIRREA, superseded the FAA's mandate that arbitration agreements be enforced according to their terms.

### **3. Effective Vindication: Enforceability of Class Action Waivers**

Another defense to arbitrability that disputants have asserted is that a court should not enforce an arbitration agreement

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<sup>38</sup> 775 F.3d 145 (2d Cir. 2014).

<sup>39</sup> *Id.* at 146.

<sup>40</sup> *See* 12 U.S.C. §1787 (2014).

because enforcement would prevent them from vindicating their statutory rights. In *Am. Exp. Co. v. Italian Colors Restaurant*,<sup>41</sup> 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. In the past year, based on *Italian Colors*, at least one federal circuit has enforced a class action waiver in an arbitration clause against an “ineffective vindication” challenge.<sup>42</sup>

#### 4. State law defenses

##### a. Unconscionability

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.<sup>43</sup> While the Supreme Court in *AT&T Mobility* applied this preemption doctrine to bar lower courts from finding class action waivers in arbitration agreements to be substantively unconscionable under state law,<sup>44</sup> lower courts continue to strike down arbitration clauses as unconscionable on other grounds. For example, in *Jackson v. Payday Financial, LLC*,<sup>45</sup> the Seventh Circuit found an arbitration clause in a payday loan agreement to be unconscionable. In that case, plaintiffs, a

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<sup>41</sup> 133 S.Ct. 2304 (2013).

<sup>42</sup> *See, e.g., Torres v. Simpatico, Inc.*, 781 F.3d 963 (8<sup>th</sup> Cir. 2015) (rejecting unit franchisees’ ineffective vindication challenge to a franchise agreements’ arbitration clause with a class action waiver).

<sup>43</sup> *See, e.g., 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 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 FAA preempts California’s *Discover Bank* rule that class action waivers in consumer arbitration agreements are unconscionable).

<sup>44</sup> *See, e.g., Torres v. Simpatico, Inc.*, 781 F.3d 963 (8<sup>th</sup> Cir. 2015) (class action waiver clause not unconscionable).

<sup>45</sup> 764 F.3d 765, 781 (7<sup>th</sup> Cir. 2014).

putative class of borrowers who obtained allegedly usurious payday loans from an enrolled member of the Cheyenne River Sioux Tribe, sued the lender for various violations of Illinois laws. The district court dismissed the action for improper venue because the loan agreements contained a forum selection clause that required all disputes be resolved through arbitration conducted by the Cheyenne River Sioux Tribe.<sup>46</sup>

The Court of Appeals reversed, finding that the “arbitral mechanism specified in the agreement is illusory.”<sup>47</sup> The court noted that the forum specified “does not exist: The Cheyenne River Sioux Tribe ‘does not authorize Arbitration,’ it ‘does not involve itself in the hiring of ... arbitrator[s],’ and it does not have consumer dispute rules.”<sup>48</sup>

The court further concluded that the illusory agreement was procedurally and substantively unconscionable under Illinois law.<sup>49</sup> The court stated:

It is procedurally unconscionable because the Plaintiffs could not have ascertained or understood the arbitration procedure to which they were agreeing because it did not exist. It is substantively unconscionable because it allowed the Loan Entities to manipulate what purported to be a fair arbitration process by selecting an arbitrator and proceeding according to nonexistent rules.<sup>50</sup>

Therefore, the arbitration clause was not enforceable.

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<sup>46</sup> *Id.* at 768.

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

<sup>48</sup> *Id.* at 776 (citing evidence in the record).

<sup>49</sup> *Id.* at 778, 780 (“The arbitration clause here is void not simply because of a strong possibility of arbitrator bias, but because it provides that a decision is to be made under a process that is a sham from stem to stern.”).

<sup>50</sup> *Id.* at 781.

b. **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, 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.<sup>51</sup>

This past year, courts continued to examine these factors when ruling on waiver arguments. For example, in *Joca-Roca Real Estate, LLC v. Brennan*,<sup>52</sup> an asset purchaser sued the seller for fraud in court, even though the asset purchase agreement contained an arbitration clause. After the parties engaged in extensive discovery, including sixteen depositions, substantial interrogatories and document production, and four discovery conferences before the magistrate, plaintiff moved to stay proceedings pending arbitration.<sup>53</sup> Defendant objected, arguing plaintiff had waived its right to arbitrate.<sup>54</sup>

The court first identified a “salmagundi of factors” relevant to the determination as to whether a party waived its right to arbitrate.<sup>55</sup> Those factors include: “the length of the delay, the

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<sup>51</sup> 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. Auffenberg, 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.”).

<sup>52</sup> 772 F.3d 945 (1<sup>st</sup> Cir. 2014).

<sup>53</sup> *Id.* at 947.

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

<sup>55</sup> *Id.* at 948.

extent to which the party seeking to invoke arbitration has participated in the litigation, the quantum of discovery and other litigation-related activities that have already taken place, the proximity of the arbitration demand to an anticipated trial date, and the extent to which the party opposing arbitration would be prejudiced.”<sup>56</sup>

In concluding that plaintiff had waived its arbitration right, the court found, “the plaintiff commenced a civil action, vigorously prosecuted it, and then—after many months of active litigation—tried to switch horses midstream to pursue an arbitral remedy. To make matters worse, it made this abrupt about-face in the absence of any material change in circumstances.”<sup>57</sup> The court also had no difficulty finding prejudice to the defendant in the form of the substantial time and cost it devoted to the litigation.<sup>58</sup>

In contrast, in *Shy v. Navistar Int’l Corp.*,<sup>59</sup> an accounting dispute, the Sixth Circuit held that defendant-appellant had not waived its right to arbitrate a dispute with intervenor-appellee. The case arose out of a consent decree settling a class action lawsuit relating to Navistar’s obligations to its retired employees. The fiduciary for the trust set up to receive profit-sharing contributions from defendant sought to intervene into the class action to challenge the calculation of those contributions.<sup>60</sup> The agreement setting up that entity, however, contained a dispute resolution clause requiring an accounting arbitration if disputes over such calculations arose.<sup>61</sup>

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

<sup>57</sup> *Id.* at 948-49.

<sup>58</sup> *Id.* at 949; *see also* *In re Checking Account Overdraft Litig.*, 754 F.3d 1290, 1296 (11th Cir. 2014) (by pursuing arbitrability challenge in district court and losing, bank waived its right to invoke delegation clause in arbitration agreement that delegated to arbitrator the power to decide arbitrability disputes).

<sup>59</sup> 781 F.3d 820 (6th Cir. 2015).

<sup>60</sup> *Id.* at 822.

<sup>61</sup> *Id.* at 822-23.

Defendant opposed the motion to intervene. However, once it was granted and the fiduciary filed an amended complaint against defendant in the class action, defendant moved to dismiss the complaint on the ground that those claims belonged in arbitration.<sup>62</sup> The district court denied the motion to dismiss and ruled, *sua sponte*, that defendant had waived its right to arbitration by its conduct before and during litigation.<sup>63</sup>

The Court of Appeals reversed. The court noted that “[a] party waives arbitration if it acts in a manner ‘completely inconsistent with any reliance on an arbitration agreement’ or delays asserting arbitration ‘to such an extent that the opposing party incur[red] actual prejudice.’”<sup>64</sup> The court also held that “[b]oth inconsistency and actual prejudice are required.”<sup>65</sup> After examining defendant’s conduct and the timing of its various motions in the related litigation, the court concluded that its conduct was not totally inconsistent with its right to arbitrate and, in any event, it caused no actual prejudice because plaintiff “wasted relatively few resources on unnecessary litigation.”<sup>66</sup>

### c. Lack of Mutual Assent

Another common law contract doctrine that disputants can assert as a defense to arbitrability is the parties did not enter into a valid contract due to a lack of mutual assent. In *Knutson v. Sirius*

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<sup>62</sup> *Id.* at 824.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.* at 827-28 (citing *Hurley v. Deutsche Bank Trust Co. Americas*, 610 F.3d 334, 338 (6th Cir.2010)).

<sup>65</sup> 781 F.3d at 828.

<sup>66</sup> *Id.* at 830. The dissent vigorously disputed both of these findings. *Id.* at 831-37; see also *Rushaid v. Nat’l Oilwell Varco, Inc.*, 757 F.3d 416, 421-23 (5<sup>th</sup> Cir. 2014) (reversing district court’s finding of waiver and holding that litigation conduct of codefendants cannot be attributed to unserved defendant for waiver purposes).



*XM Radio Inc.*,<sup>67</sup> the Ninth Circuit applied the common law defense of lack of mutual assent to rule that no valid agreement to arbitrate existed between a satellite radio customer and the radio company. There, the customer bought a car with a pre-loaded 90-day trial subscription to satellite radio. One month after buying the car, Sirius XM sent a “Welcome Kit” to the customer, which contained, among other things, a Customer Agreement with an arbitration clause and a class action waiver. The customer never opened the Welcome Kit. Alleging he received unauthorized phone calls from Sirius XM during the trial period, the customer brought a class action under the federal Telephone Consumer Protection Act.<sup>68</sup> Sirius XM moved to compel individual arbitration. The district court granted the motion.<sup>69</sup>

On appeal, the Ninth Circuit reversed and ruled that there was no agreement to arbitrate because of a lack of mutual assent. The Court of Appeals found that the customer’s failure to open the Welcome Kit meant he could not have seen or read the Customer Agreement containing the arbitration clause. Thus, the customer could not have assented to the arbitration provision. The court distinguished prior “shrinkwrap” cases that found mutual assent when a customer opened the packaging of a consumer product because the customer here never purchased anything directly from the consumer company.<sup>70</sup> Rather, the customer purchased a car directly from Toyota, and he had no reason to know that the Welcome Kit that arrived a month later had a Customer Agreement with Sirius XM in it. Without notice of the existence of an agreement, the customer could not have assented to it.<sup>71</sup> Therefore, the class action could proceed in court.

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<sup>67</sup> 771 F.3d 559 (9<sup>th</sup> Cir. 2014).

<sup>68</sup> *Id.* at 561-64.

<sup>69</sup> *Id.* at 564.

<sup>70</sup> *Id.* at 567.

<sup>71</sup> *Id.* at 567-68; *see also* Nguyen v. Barnes & Noble Inc., 763 F.3d 1171, 1173 (9<sup>th</sup> Cir. 2014) (refusing to compel arbitration pursuant to a provision in company’s Terms of Use where customer used Barnes &

### C. 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 . . . .”<sup>72</sup>

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 FINRA Customer Code Rule 12200. FINRA does not define “customer,” except for its mention in Rule 12100(i) (a “customer shall not include a broker or dealer”). Courts continue to refine the definition of the term “customer” under FINRA Rule 12200.

The day after last year’s PLI Securities Arbitration program, the Second Circuit detailed “the precise boundaries of the FINRA meaning of ‘customer.’” In *Citigroup Global Markets Inc. v. Abbar*,<sup>73</sup> the Second Circuit concluded that a Saudi businessman who managed family trusts that lost \$383 million invested with a U.K. affiliate of Citigroup, Inc. (“Citi UK) was not a “customer” of Citigroup Global Markets, Inc. (“Citi NY”) under Rule 12200, and thus could not compel Citi NY to arbitrate their

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Noble's website to purchase a product but was “never prompted to assent to the Terms of Use and never in fact read them”). *Accord Walker v. Builddirect.Com Technologies Inc.*, \_\_\_ P.3d \_\_\_, 2015 OK 30, ¶ 10, 2015 WL 207496 (Okla. May 5, 2015) (answering question certified to it by the Tenth Circuit and concluding that “Terms of Sale” located on defendant’s website, which included an arbitration clause, were not incorporated by reference into the parties’ written contractual agreement).

<sup>72</sup> FINRA R. 12200.

<sup>73</sup> 761 F.3d 268 (2d Cir. 2014).

dispute. The Court of Appeals 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.”<sup>74</sup> The court reasoned that a “simple, predictable and suitably broad definition of ‘customer’” is “necessary” to avoid a “sprawling litigation” that its previous definition required, which “defeats the express goals of arbitration to yield economical and swift outcomes.”<sup>75</sup> Because Abbar purchased no goods or services from Citi NY (though some of its employees helped develop trading strategies for his accounts) and had no account with it, he was not a “customer” of Citi NY.<sup>76</sup>

Of course, the court recognized that, as with all legal definitions, exceptions exist for “rare instances of injustice.”<sup>77</sup> In my view, this exception seems to swallow the rule, as litigants will now call for a detailed examination of the facts to mine for injustices.

#### **D. 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. The Courts of Appeal currently are split on the question.

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<sup>74</sup> *Id.* at 275.

<sup>75</sup> *Id.* at 276.

<sup>76</sup> *Id.*; see also *SagePoint Fin., Inc. v. Small*, No. 15-CV-0571, 2015 BL 150905 (E.D.N.Y. May 15, 2015) (applying *Abbar* test and finding investor, who invested with an associated person four years after he left plaintiff broker-dealer, was not a “customer” of broker-dealer).

<sup>77</sup> *Id.*

Last August, the Second Circuit followed an April 2014 decision by the Ninth Circuit in *Goldman, Sachs & Co. v. City of Reno*<sup>78</sup> — rejecting an opposite holding by the Fourth Circuit<sup>79</sup> — and held that a forum selection clause in a contract supersedes a broker-dealer’s obligation to arbitrate disputes with a customer under FINRA Rule 12200. The Court of Appeals, in a single opinion, resolved two cases: ***Goldman, Sachs & Co. v. Golden Empire Sch. Fin. Auth., and Citigroup Global Mkts. Inc. v. N.C. E. Mun. Power Agency***.<sup>80</sup> In the first case, Golden Empire Schools Financing Authority & Kern High School District issued approximately \$125 million of auction-rate securities (“ARS”) in 2004, 2006 and 2007, for which Goldman Sachs was an underwriter and broker-dealer. In the second case, the North Carolina Eastern Municipal Power Agency retained Citigroup Global Markets Inc. as its underwriter and broker-dealer. In both cases, the issuers claimed that the member firms fraudulently induced them to issue the ARS.<sup>81</sup>

For each issuance, the parties executed an underwriter agreement, and a broker dealer agreement. While the underwriting agreements were silent as to dispute resolution, the broker-dealer agreements contained forum selection clauses which required “all actions and proceedings” related to the transactions between the parties be brought in court.<sup>82</sup>

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<sup>78</sup> 747 F. 3d 733 (9th Cir. 2014) (concluding 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). For a more detailed discussion of the *Reno* case, see *Arbitration Case Law Update 2014*, in *PLI Securities Arbitration 2014 Coursebook*, at pp. 24-25.

<sup>79</sup> *UBS Fin. Servs., Inc. v. Carilion Clinic*, 706 F.3d 319 (4th Cir. 2013).

<sup>80</sup> 764 F.3d 210 (2d Cir. 2014).

<sup>81</sup> *Id.* at 212-13.

<sup>82</sup> *Id.*

In 2012, Golden Empire commenced a FINRA arbitration, alleging that Goldman fraudulently induced it to issue the ARS. Also in 2012, NCEMPA brought a similar FINRA arbitration against Citigroup. In both cases, the member firm sought to enjoin the FINRA arbitration on the ground that the forum selection clause superseded its duty to arbitrate under Rule 12200.<sup>83</sup> The issuer responded that, because it was a customer of a FINRA member firm, the firm had a duty to arbitrate the dispute under FINRA Rule 12200.<sup>84</sup>

The Court of Appeals held that the forum selection clause superseded FINRA's mandatory arbitration rule.<sup>85</sup> The court reasoned that Rule 12200 was a "default" agreement to arbitrate that was trumped by the later-executed agreement – the forum selection clause.<sup>86</sup> The court further reasoned that the underwriting agreement contained a merger clause and thus the earlier agreement under Rule 12200 merged into the forum selection clause.<sup>87</sup>

I believe the Second Circuit's ruling is wrong. A fundamental premise to the ruling (that I believe is flawed) is that Rule 12200 is an agreement to arbitrate that somehow is executed before the parties entered into the underwriting agreements. However, the duty to arbitrate arose at the exact same time as the execution of the agreements establishing the broker-customer relationship. And, as I see it, the duty to arbitrate is ongoing – at

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<sup>83</sup> *Id.*

<sup>84</sup> *Id.* at 214.

<sup>85</sup> *Id.* at 215.

<sup>86</sup> *Id.*; see also *Credit Suisse Sec. (USA) LLC v. Tracy*, 2015 WL 170241, \*51 (S.D.N.Y. Jan. 8, 2015) (slip op.) (holding that "more specific" forum selection clause trumped duty to arbitrate a member dispute with its employee under FINRA Rule 13200).

<sup>87</sup> *Id.* at 216. In an interesting development, the Second Circuit agreed to stay the issuance of its mandate blocking arbitration to allow the issuers time to appeal the case to the Supreme Court.

any time a customer can invoke Rule 12200 and request a FINRA member firm to arbitrate a dispute.

In addition, one argument the parties did not pursue is that recently amended sec. 29(a) of the Exchange Act voids the parties' forum selection clause. That provision voids "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of a self-regulatory organization..."<sup>88</sup> Dodd-Frank amended § 29(a) to include the phrase "or of any rule of a self-regulatory organization." Thus, since 2010, § 29(a) explicitly invalidates provisions in brokerage agreements that require customers to waive compliance with FINRA rules. To the extent courts have held in the past that parties could contract around FINRA rules, that line of cases seems to be vitiated by amended § 29(a).

Now that there is a split in the circuits, perhaps the issue will ultimately make its way to the Supreme Court.

### **E. 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.<sup>89</sup> Under the doctrine of equitable estoppel, generally a nonsignatory can enforce an arbitration clause with a signatory:

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<sup>88</sup> 15 U.S.C. §78cc (2014).

<sup>89</sup> *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.’<sup>90</sup>

Likewise, if a nonsignatory can demonstrate it is a third-party beneficiary of an arbitration agreement, it can enforce that agreement against signatories.<sup>91</sup> 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.”<sup>92</sup>

In the past year, some Courts of Appeal narrowly construed these three exceptions.<sup>93</sup> Other courts were more willing

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<sup>90</sup> See *Kramer v. Toyota Motor Corp.*, 705 F.3d 1122, 1128-29 (9th Cir. 2013) (internal citations omitted).

<sup>91</sup> See *Fundamental Admin. Servs., LLC v. Patton*, 504 F. App’x 694, 698 (10th Cir. 2012).

<sup>92</sup> See *Murphy v. DirectTV, Inc.*, 724 F.3d 1218, 1232 (9th Cir. 2013) (internal quotations and citations omitted).

<sup>93</sup> *E.g.*, *Flintkote Co. v. Aviva PLLC*, 769 F.3d 215 (3d Cir. 2014) (reversing district court’s invocation of equitable estoppel doctrine to compel nonsignatory to arbitrate); *Griswold v. Coventry First LLC*, 762 F.3d 264 (3d Cir. 2014) (affirming district court’s refusal to compel nonsignatory to arbitrate on equitable estoppel grounds). *Accord Pinnacle Trust Co., L.L.C. v. McTaggart*, 152 So. 3d 1123, 1124 (Miss. 2014) (refusing to compel nonsignatory beneficiaries to trust agreement to arbitrate claims against trust advisor for mishandling funds because the agreement specifically excluded nonsignatories, including third-party beneficiaries).

to compel arbitration with a nonsignatory.<sup>94</sup>

#### **F. Unavailability of forum**

The Eleventh Circuit this past year refused to compel arbitration of a dispute that was subject to an arbitration clause because the designated forum was not available. In *Inetianbor v. Cashcall, Inc.*,<sup>95</sup> plaintiff borrowed money from defendant, a loan servicer, at a high interest rate. The loan agreement contained a pre-dispute arbitration clause that called for “Arbitration, which shall be conducted by the Cheyenne River Sioux Tribal Nation by an authorized representative in accordance with its consumer dispute rules and the terms of this Agreement.”<sup>96</sup> When Plaintiff sued in district court for the Southern District of Florida, the court initially compelled arbitration. However, when plaintiff returned with a letter from the tribe that stated that it “does not authorize Arbitration,” the district court ultimately denied the motion.<sup>97</sup>

The Court of Appeals affirmed, finding that the forum selection clause in the arbitration agreement was an “integral part of the agreement to arbitrate” rather than an “ancillary logistical provision.”<sup>98</sup> Since the tribal forum was not available to arbitrate the dispute, the court could preclude arbitration under “strong” Eleventh Circuit precedent.<sup>99</sup>

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<sup>94</sup> See *Torres v. Simpatico, Inc.*, 781 F.3d 963, 971 (8<sup>th</sup> Cir. 2015) (affirming district court’s order compelling nonsignatory to arbitrate as third-party beneficiary). Accord *Machado v. System4 LLC*, 28 N.E.3d 401 (Mass. 2015) (compelling franchisees to arbitrate claims against nonsignatory regional franchisor under doctrine of equitable estoppel).

<sup>95</sup> 768 F.3d 1346 (11<sup>th</sup> Cir. 2014).

<sup>96</sup> *Id.* at 1348 (quoting loan agreement).

<sup>97</sup> *Id.* at 1348-49.

<sup>98</sup> *Id.* at 1350 (internal quotation and citation omitted).

<sup>99</sup> *Id.* (citing *Brown v. ITT Consumer Fin. Corp.*, 211 F.3d 1217, 1222 (11<sup>th</sup> Cir. 2000) (holding that “the failure of the chosen forum preclude[s] arbitration” whenever “the choice of forum is an integral part of the agreement to arbitrate, rather than an ancillary logistical concern”)).



## **G. Vacating Arbitration Awards**

To challenge a valid arbitration award that is governed by the FAA, parties must establish one of the four grounds listed under section 10 of the FAA.<sup>100</sup> 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. Courts have had difficulty developing a test for “evident partiality,” since the Supreme Court’s only decision under that subsection is the 47-year old decision in *Commonwealth Coatings v. Continental Casualty Co.*<sup>101</sup> That case yielded plurality and concurring opinions that are difficult to synthesize. Most circuits follow a version of the test set forth thirty years ago by the Second Circuit:<sup>102</sup> “evident partiality” is “where a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration.”<sup>103</sup>

Courts differ on how an arbitrator’s failure to disclose potential sources of conflicts of interest factors into an evident partiality analysis. In one interesting case this past year, the Court of Appeals for the Ninth Circuit vacated a district court order intervening in an ongoing arbitration and disqualifying an

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<sup>100</sup> See *Hall St. Assoc., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008).

<sup>101</sup> 393 U.S. 145 (1968).

<sup>102</sup> See *Morelite Constr. v. New York City Dist. Council Carpenters Ben. Funds*, 748 F.2d 79 (2d Cir. 1984).

<sup>103</sup> *Id.* at 83.

arbitrator on the grounds that respondents in the arbitration would likely prevail on a motion to vacate for evident partiality.<sup>104</sup>

After an arbitrator was appointed to hear disputes over condominium purchases, respondents learned the arbitrator was involved in the litigation finance business. When the AAA denied respondents' pre-hearing disqualification motion, respondents sought extraordinary relief in the district court.<sup>105</sup> Respondents asked the district court to intervene in the arbitration for purposes of disqualifying the arbitrator before the hearing so as to avoid the delay and expense of a hearing.<sup>106</sup>

The district court ruled that the arbitrator's involvement in the litigation finance activities suggested an eventual award could be vacated for "evident partiality." The lower court "reasoned that the undisclosed facts regarding Hare's litigation financing activities suggested he had a financial interest in the outcome of the arbitration, because a victory and large financial award for Sussex would help Hare promote his company, which was designed to generate profits from funding large, potentially profitable litigations."<sup>107</sup>

Claimants filed with the Court of Appeal a petition for a writ of mandamus directing the district court to vacate its order disqualifying the arbitrator. The Ninth Circuit granted the writ. The Court concluded that the circumstances did not give rise to a claim of "evident partiality" within the meaning of FAA §10(a)(2). The court reasoned that the "undisclosed facts regarding [the arbitrator's] modest efforts to start a company to attract investors for litigation financing do not give rise to a reasonable impression

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<sup>104</sup> *In re Sussex*, 781 F.3d 1065 (9<sup>th</sup> Cir. 2015).

<sup>105</sup> *Id.* at 1069-70.

<sup>106</sup> *Id.*

<sup>107</sup> *Id.* at 1070.

that [the arbitrator] would be partial toward either party.”<sup>108</sup> In addition, the court concluded that the district court’s decision to intervene pre-award was “clear error,” as respondents would have the option of filing a motion to vacate if they lost the arbitration.<sup>109</sup>

In a state case, the Supreme Court of Alabama vacated a FINRA arbitration award on the ground of evident partiality.<sup>110</sup> Claimant, the administrator of a self-insured group workers’ compensation fund, sued respondents, which served as the investment advisor and broker-dealer for the fund, for breach of fiduciary duty and other claims arising out their alleged mishandling of the fund’s investments.

After the panel denied all of claimant’s claims, claimant moved to vacate the award under FAA §10(a)(2) on the grounds that two of the three panelists “failed to disclose material and relevant information during the arbitrator-selection process.”<sup>111</sup> Claimant alleged first that one of the public panelists failed to disclose that he was “a defendant in five lawsuits alleging against him claims substantially similar to those asserted” in this arbitration.<sup>112</sup> In addition, claimant alleged that the non-public arbitrator failed to disclose that he was a long-time vice president/partner in a financial services firm that “had a close, ongoing, and material relationship with [respondent] and its counsel at the time of the arbitration proceeding.”<sup>113</sup> The trial court denied the motion to vacate.

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<sup>108</sup> *Id.* at 1074.

<sup>109</sup> *Id.* at 1075.

<sup>110</sup> *Mun. Workers Comp. Fund, Inc. v. Morgan Keegan...*, --- So.3d ---, 2015 WL 1524911 (Ala. Apr. 3, 2015).

<sup>111</sup> *Id.* at \*4.

<sup>112</sup> *Id.*

<sup>113</sup> *Id.* Claimant presented, among other things, evidence that the arbitrator’s firm had been a co-underwriter with respondent on 36 different multi-million dollar offerings.

The Supreme Court of Alabama reversed. The court first adopted a “reasonable impression of partiality” standard rather than require that a movant demonstrate “actual bias” in order to succeed on a §10(a)(2) motion.<sup>114</sup> The court then found that the non-public arbitrator’s failures to disclose did present a “reasonable impression of partiality.” As a result, the court vacated the award, concluding that claimant had demonstrated that at least one arbitrator was evidently partial.<sup>115</sup>

## 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 any party have been prejudiced.”<sup>116</sup> 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.”<sup>117</sup>

In *Global Gold*, the Court of Appeal denied the motion to vacate under this prong despite the arbitral tribunal’s refusal to conduct an

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<sup>114</sup> *Id.* at \*21.

<sup>115</sup> *Id.* at \*28. In light of this finding, the court did not address the alleged evident partiality of one of the public arbitrators. *Id.*

<sup>116</sup> 9 U.S.C. § 10(a)(3) (2014).

<sup>117</sup> *Global Gold Mining, LLC v. Ayvazian*, \_\_\_ F. App’x \_\_\_, 2015 WL 1881361, at \*3 (2d Cir. Apr. 27, 2015) (internal citations and quotation marks omitted).

evidentiary hearing because it considered documents and heard oral arguments before reaching the challenged ruling.<sup>118</sup> Thus, the arbitration proceedings were not “fundamentally unfair.”

### 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.<sup>119</sup> Under this ground for vacatur, courts consider only “whether the arbitrators even arguably interpreted the Agreement in reaching their award; ...not whether their interpretations of the Agreement or the governing law were correct.”<sup>120</sup> The Fifth Circuit noted recently that, “[b]y submitting issues for an arbitrator’s consideration, parties may expand an arbitrator’s authority beyond that provided by the original arbitration agreement.”<sup>121</sup>

This past year, the Supreme Court of South Dakota vacated an award that included attorney’s fees to claimant when

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<sup>118</sup> *Id.*

<sup>119</sup> *See, e.g.,* PoolRe Ins. Corp. v. Organizational Strategies, Inc., 783 F.3d 256, 265 (5th Cir. 2015) (affirming district court’s vacatur of award because arbitrator exceeded his authority since he was not appointed pursuant to the contract’s arbitrator selection provision and because he acted contrary to the forum-selection clauses in the relevant arbitration agreements).

<sup>120</sup> BNSF Ry. Co. v. Alstom Transp., Inc., 777 F.3d 785, 789 (5th Cir. 2015); *see also* First State Ins. Co. v. Nat’l Casualty Co., 781 F.3d 7 (1<sup>st</sup> Cir. 2015) (affirming denial of motion to vacate because arbitrators arguably interpreted underlying agreement); Davis v. Producers Agric. Ins. Co., 762 F.3d 1276 (11<sup>th</sup> Cir. 2014) (reversing district court’s vacatur of award on exceeding powers ground).

<sup>121</sup> OMG, L.P. v. Heritage Auctions, Inc., No. 14-10403, \_\_\_ F. App’x \_\_\_, 2015 WL 2151779, at \*1 (5th Cir. May 8, 2015).

the parties' arbitration agreement expressly provided that "each shall pay their own attorney's fees."<sup>122</sup>

#### 4. Manifest Disregard of the Law

Since the Supreme Court's holding in *Hall St. Assoc., L.L.C. v. Mattel, Inc.*<sup>123</sup> 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.*<sup>124</sup> The circuit split continues unchanged since last year's Arbitration Law Update, as follows:

- The Second, Fourth, Sixth, and Ninth Circuits acknowledge the continued vitality of the "manifest disregard" ground of vacatur.<sup>125</sup>

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<sup>122</sup> See *Black Hills Surgical Physicians, LLC v. Setliff, III*, 855 N.W.2d 407 (S.D. 2014). The court applied standards for vacatur under South Dakota law but cited precedent interpreting the "exceeding powers" ground of the FAA.

<sup>123</sup> 552 U.S. 576 (2008).

<sup>124</sup> 559 U.S. 662, 672 n.3 (2010).

<sup>125</sup> See *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 548 F.3d 85, 94 (2d Cir. 2008), *vacated on other grounds*, 559 U.S. 662 (2010); *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, 2014 WL 30713,\*4 (6th Cir. Jan. 6, 2014) (suggesting that the Sixth Circuit might revisit the issue, "which has not been firmly settled").

- The Fifth, Eighth and Eleventh Circuits have expressly ruled that manifest disregard is no longer a valid vacatur ground.<sup>126</sup>
- The First and Tenth Circuits have addressed “manifest disregard” subsequent to *Hall Street*, but only in *dicta*.<sup>127</sup>
- The Third and Tenth Circuits have expressly declined to address the issue.<sup>128</sup>
- 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.<sup>129</sup>

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<sup>126</sup> See *Citigroup Global Mkts., Inc. v. Bacon*, 562 F.3d 349, 352 (5th Cir. 2009); *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).

<sup>127</sup> 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*).

<sup>128</sup> See *Bellantuono v. ICAP Sec. USA, LLC*, 557 F. App’x 168, 174 (3d Cir. 2014) (recognizing circuit split and expressly declining to decide that issue); *Rite Aid N.J., 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”).

<sup>129</sup> 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).