August 24, 2022

ADR Case Update 2022 - 15

Federal Circuit Courts

- **COURT ERRED IN FAILING TO CONSIDER EVIDENCE TO SUPPORT ALTERNATIVE ATTACHMENT AMOUNTS**

  Iraq Telecom Limited v IBL Bank
  United States Court of Appeals, Second Circuit
  2022 WL 3130640
  August 5, 2022

  Iraq Telecom (Telecom) successfully pursued an arbitration for declaratory relief (First Arbitration), which found Lebanese bank IBL, Korek Telecom, and a holding company, IHL, jointly and severally liable for defrauding Telecom of nearly $100 million. Telecom then filed a subsequent arbitration (Second Arbitration) against IBL for $97 million in damages. While the Second Arbitration was pending, the district court confirmed the First Arbitration award, authorizing attachment of up to $100 million from IBL's New York bank accounts. After three IBL correspondent accounts were attached for $42 million, the court granted IBL's motion to vacate the attachment. The court reasoned that, although Telecom would likely prevail against IBL in the Second Arbitration, it was "entirely conceivable" that the panel would require IBL to pay only the $5.92 million IBL retained after funneling all other fraudulently acquired funds to IHL's majority owner, Barzani. Adding in $3 million in costs and fees from the First Arbitration, the court concluded that the proper attachment amount was $8.92 million. The court then exercised its discretion to reduce the amount to $3 million for "extraordinary circumstances" based on its finding that the original attachment risked forcing IBL into insolvency and destabilizing the Lebanese economy. The court opined that attachment "should not be lightly imposed" against IBL because Barzani, not IBL, was the principal wrongdoer. Telecom appealed.

  The United States Court of Appeals, Second Circuit affirmed in part, vacated in part, and remanded. The lower court properly held discretion to consider non-statutory factors, including the "extraordinary circumstances" relating to the Lebanese economy, even where the statutory conditions for attachment were otherwise met. The court erred, however, in failing to consider alternative attachment amounts. The court based its ruling on the determination that freezing IBL's $42 million correspondent accounts would force IBL into non-compliance with Lebanese

foreign currency reserve requirements, precluding IBL from providing banking services in U.S. dollars. The court erroneously failed to consider whether some amount between $42 million and $3 million would avoid those risks, even though IBL conceded in oral argument that attachment of $17 million would not adversely affect IBL or the Lebanese banking system. The court abused its discretion in relying on a "conceivable" rather than "probable" assessment that the Second Arbitration panel would limit IBL's liability to $5.92 million. The court provided no legal basis to support the conclusion that "a tortfeasor is liable only for the amount it can pay" or that a defendant can avoid joint and several liability "merely because it did not retain all of the fraud proceeds."

- **ARBITRATION AWARD PROCURED BY FRAUD**

  France v Bernstein
  United States Court of Appeals, Third Circuit
  2022 WL 3206408
  August 9, 2022

  Sports agent Jason Bernstein filed an NFLPA grievance against Todd France, an agent at CAA Sports, for poaching Bernstein's client, wide receiver Kenny Golladay. Bernstein claimed that, while Golladay was still under Bernstein's exclusive representation, France arranged an autograph signing event (the Event) for Golladay and used the proceeds to induce Golladay to sign with France. In arbitration, Bernstein issued document requests and, when those proved unproductive, arbitral subpoenas to France and related parties for any document, contract, email, or other communication relating to the Event. France responded that he had no such documents, and none were produced by related parties. At the hearing, France denied organizing Golladay's appearance and, absent contrary evidence, the arbitrator held for France. Bernstein later discovered, in related tort litigation against CAA Sports, that France had in fact arranged the appearance. Based on this new evidence, Bernstein moved to vacate the arbitration award for fraud. The court denied the motion, holding Bernstein failed to show that the new evidence was not discoverable before or during the arbitration because he had not sued to enforce his arbitral subpoenas. Bernstein appealed.

  The United States Court of Appeals, Third Circuit reversed. To complete the "steep climb" required to vacate an award on fraud grounds, a claimant must show 1) clear and convincing evidence of fraud in the arbitration; 2) that the fraud was not discoverable through reasonable diligence before or during the arbitration; and 3) that the fraud was materially related to an issue in the arbitration. Here, the record showed that France lied under oath and withheld important information demanded in discovery, rendering the fraud undiscoverable before or during the arbitration. Bernstein exercised reasonable diligence by requesting documents and "should not be penalized for accepting his opponent's representations." Reasonable diligence "does not require parties to assume the other side is lying," and requiring Bernstein to "double-check" France's truthfulness by suing for judicial enforcement piled "one unfairness on another." The fraud was central to Bernstein's claims, as the arbitrator identified the fact that "France had nothing to do with" Golladay's Event appearance as a primary finding. Accordingly, the court concluded that the award was procured by fraud and reversed and remanded for entry of an order vacating the award.

- **COURT MUST ALLOW DISCOVERY TO DETERMINE WHETHER RESPONDENTS RECEIVED ARBITRATION AGREEMENT**

  Robert D. Made, Inc. v. OptumRX
  United States Court of Appeals, Third Circuit
  2022 WL 3094577
  August 4, 2022

  Pharmacy benefits manager OptumRX administers prescription drug programs on behalf of insurance plans. More than four hundred pharmacies (Pharmacies) contracted with OptumRX, all but twenty acting through pharmacy services administrative organizations (PSAOs). The Pharmacies brought a mass action against OptumRX for underpayment and breach of good faith, and Optum moved to compel arbitration under its Provider Agreements. All the Pharmacies that had contracted through PSAOs opposed, claiming that the Agreements had not been made

available to them. The court denied the motion to compel as unconscionable, finding that Optum had prohibited the PSAOs from giving the Agreements to individual pharmacies, making it impossible for the pharmacies to have knowledge of the Agreements' arbitration provisions. Optum appealed.

The United States Court of Appeals, Third Circuit, vacated in part and remanded. The Agreements included language prohibiting the "Pharmacy" from sharing the terms of the Agreement with "any other person or entity" without Optum's permission. When a PSAO, rather than an individual pharmacy, negotiated an Agreement, the PSAO signed as "Pharmacy," and this language could be read to prohibit the PSAO from sharing the Agreement with any third party, including the PSAO's member pharmacies. Additionally, an Optum representative testified that she did not recall Optum ever giving any PSAO permission to disclose the Agreements. It was therefore plausible that all the Pharmacies who had contracted through PSAOs were never given the Agreements and "likewise plausible" that enforcing the Agreements against those Pharmacies "would be procedurally unconscionable." The court below erred, however, in applying a Rule 56 review standard without allowing for limited discovery on the question of arbitrability. The Court remanded for the lower court to allow such discovery, highlighting the need for factual findings regarding the Pharmacies' access to the Agreements.

- **PARTY'S APPEARANCE AT ARBITRATION MAY CONSTITUTE AGREEMENT TO ARBITRATE**

Greenhouse Holdings, LLC v International Union of Painters and Allied Trades District Council 91
United States Court of Appeals, Sixth Circuit
2022 WL 3148210
July 26, 2022

Greenhouse Holdings, LLC (Greenhouse), which operates in Kentucky under the name Clearview Glass and Glazing, owns 90% of Clearview Glass and Glazing Contractors of Tennessee (Clearview Tennessee), which has a CBA with the Painters Union. The Union filed a grievance against "Clearview Glass" for CBA violations. Before and during the resulting arbitration, the Union made clear that it believed Greenhouse was bound by and in violation of the CBA. Daniel Kinney, part owner of Greenhouse and Clearview Tennessee, was the only non-Union representative to appear at the hearing, arguing that Greenhouse was a non-union shop. The arbitrator held for the Union, ordering "Clearview Glass and Glazing" to pay the Union underpaid wages and benefits due to its "non-Tennessee" shop employees. The district court subsequently vacated the award, holding that the arbitrator exceeded his authority to the extent that the award applied to non-signatory Greenhouse. The Union appealed.

The United States Court of Appeals, Sixth Circuit vacated and remanded, finding that the court below failed to determine whether Greenhouse consented to the arbitration. A party may agree to arbitration not only by written agreement but by choosing to participate in the arbitration. Here, the Union argued that Kinney spoke at the arbitration on behalf of Greenhouse, while Kinney asserted that he appeared only on behalf of Clearview Tennessee. The Court directed the lower court, on remand, to resolve this factual dispute. If Greenhouse was not represented at the arbitration, or if Kinney appeared on behalf of Greenhouse only to object to the arbitrator's authority, the court could decide de novo whether the CBA bound Greenhouse. If the court found that Greenhouse did consent to arbitration, the question of whether Greenhouse was bound by the CBA was for the arbitrator to decide.

- **ARBITRATION AWARD NOT DISCHARGEABLE IN BANKRUPTCY WHERE RESPONDENT KNOWINGLY PARTICIPATED IN SECURITIES LAW VIOLATIONS AND FRAUD**

In re Fusco
United States Bankruptcy Court, E.D. New York
2022 WL 3106635
August 3, 2022

Investment client Fred Blake initiated FINRA arbitration against Legend Securities, several Legend agents, and supervisor Anthony Fusco for securities violations and state law fraud claims. The arbitration award found the respondents jointly and severally liable for approximately

$1 million in damages based on “clear and convincing evidence” that Fusco and the other respondents had “knowingly participated, condoned, ratified and consented to” misconduct violating state blue sky laws, and fraudulently misrepresented or failed to disclose markups, exorbitant commissions, and the non-registered status of certain brokers. Fusco had filed for Chapter 7 bankruptcy while the arbitration was pending, and Blake sued to confirm the award and determine that Fusco’s liability was non-dischargeable under Bankruptcy Code § 5239(a)(19). The court confirmed the award, and Blake moved for summary judgment on his non-dischargeability claim. Fusco opposed, arguing that the award was “irrational,” as it failed to establish that he “set out to cause the losses,” and none of the claims had been made against him specifically.

The United States Bankruptcy Court, E.D. New York, granted summary judgment for Blake. Under Bankruptcy Code § 5239(a)(19), a debt is non-dischargeable in bankruptcy if 1) the debt is for violation of state or federal securities laws or for “common law fraud, deceit, or manipulation” connected to sale or purchase of a security; and 2) the debt results from a judgment, agreement, or award. This provision “accords preclusive effect” to “appropriately memorialized judgments” without resort to common law principles of issue preclusion, and the Court’s “only function” in this process is to determine whether the Award meets the two-pronged test. Here, the express language of the Award found Fusco liable for violations of Florida’s blue sky laws and for “churning,” fraud, and non-disclosures, all of which “caused the debt” to Blake. The Court rejected Fusco’s claim that the Court must additionally find Fusco to be “personally” responsible for the violations at issue. While case law shows that some “innocent” debtors not directly involved in security violations or fraud are not subject to the provision’s exception, the Award here specifically found that Fusco “knowingly participated” in the alleged misconduct. The Court rejected Fusco’s argument that the Award, issued by an arbitration panel, did not constitute a “judgment, agreement, or award” for purposes of § 5239(a)(19). A judgment confirming an arbitration award – here, the Court’s Confirmation Order – provides a sufficient basis to satisfy the requirements of the provision.

California

- **ATTORNEY’S LACK OF LICENSURE DID NOT RENDER LAW FIRM’S RETAINER AGREEMENT UNENFORCEABLE**

  Brawerman v Loeb & Loeb LLP
  Court of Appeal, Second District, Division 8, California
  2022 WL 3053302
  August 3, 2022

  Mark Brawerman hired law firm Loeb & Loeb to negotiate a financing transaction with venture capital firm Wasserstein & Co., making clear that his top priority was maintaining control of his company. When Wasserstein later took majority control and forced sale of the company, Brawerman, fearing litigation, hired the Steven R. Friedman law firm to be on “standby,” ultimately paying Friedman a $5.6 million contingency fee from the company’s sales proceeds, although no such litigation ensued. Brawerman then sued Loeb, and Loeb attorney Mark Kelly, to recoup Friedman’s fee, claiming professional negligence and breach of fiduciary duty. Loeb successfully compelled arbitration under Brawerman’s Retainer Agreement. Brawerman moved to remand to trial court, claiming the Agreement was unenforceable because Kelly was not licensed in California for part of the time he worked on the deal. The arbitrator denied the motion, finding the Agreement’s arbitration clause severable. The arbitrator held that Loeb and Kelly were liable for failing to protect Brawerman’s interests but that Brawerman failed to show that this failure caused the Friedman fee. The arbitrator awarded Brawerman arbitration costs and disgorgement of fees paid to Kelly while he was unlicensed. Brawerman sued to vacate, arguing that the arbitrator exceeded his powers by enforcing a contract that was illegal and against public policy. The court confirmed the award, and Brawerman appealed.

  The Court of Appeal, Second District, Division 8, California affirmed, holding that the arbitrator had not exceeded his authority in enforcing the contract. Brawerman’s challenge went to the validity of the contract as a whole, claiming that Kelly’s unlicensed work in drafting and

negotiating the Agreement, and performing work subsequent to the Agreement, inherently tainted the entire Agreement. Although Kelly's performance pursuant to the Agreement was illegal, there was "nothing inherently illegal" about the Agreement itself. Kelly's involvement in drafting and negotiating the Agreement was irrelevant to its enforceability, and Loeb had been "capable of performing it legally" at the time of formation. Engaging Kelly was not the object of the Agreement, Kelly was not a signatory to the Agreement and, although Kelly illegally did substantial work under the Agreement, other licensed Loeb attorneys did as well. Any consideration for the Agreement based on Kelly's work was properly severed by the Award's order of fee disgorgement for work performed by Kelly before his licensure.

Georgia

- **PARTY FAILED TO SHOW "VERY UNUSUAL CIRCUMSTANCES" NECESSARY TO REVERSE ARBITRAL AWARD**

  Wells Fargo Clearing Services, LLC v Leggett
  Court of Appeals of Georgia
  2022 WL 3038377
  August 2, 2022

  Brian Leggett initiated a FINRA arbitration against Wells Fargo for mismanaging his investments. The arbitrator held that Leggett, not his Wells Fargo brokers, was responsible for his losing investment strategy and ordered Leggett to pay costs and fees. The trial court granted Leggett's motion to vacate the award, finding that the arbitration panel exceeded its authority and engaged in misconduct by 1) allowing Wells Fargo to "manipulate" the selection process by having arbitrators moved from the selection list and panel; 2) refusing to grant a continuance to Leggett after Wells Fargo produced 1,800 documents less than 20 days before hearing; 3) refusing to hear Leggett's proposed rebuttal witness and limiting cross-examination; 4) basing the award on the fraudulent testimony of Leggett's former Wells Fargo broker; and 5) improperly assessing Leggett for costs and fees. Wells Fargo appealed.

  The Court of Appeals of Georgia reversed, finding that Leggett had failed to show the "very unusual circumstances" necessary to justify reversal of an arbitral award. Applying a de novo standard of review, the Court held: 1) FINRA grants the Director discretion to remove an arbitrator for cause before the arbitration begins, whether that occurs before or after the panel has been selected. The removal provision is intended to eliminate bias and conflicts of interest, and the Director did not abuse his discretion by removing an arbitrator with a publicly acrimonious relationship with Wells Fargo and another who, since his appointment to the panel, had filed an adverse case against Wells Fargo; 2) the panel engaged in no misconduct by failing to allow a continuance based on Wells Fargo's large document production. Wells Fargo produced the documents within a mutually agreed-upon 10-day extension, and, as the arbitration was eventually continued from September to June for unrelated reasons, Leggett had sufficient time to review the documents before hearing; 3) the panel reasonably assessed that Leggett's proposed rebuttal witness was unnecessary, as that witness was identified as relating to the "characterization" of evidence rather than presentation of any new evidence; 4) inconsistent and contradictory testimony by Leggett's broker did not fraudulently procure the award, as those inconsistencies were made apparent during the hearing and subject to cross-examination by Leggett's counsel; and 5) FINRA authorizes arbitrators to impose monetary sanctions, including assessing costs and fees, against a party who fails to comply with its arbitration procedures, and the arbitrators specifically found that Leggett provided false testimony.

Case research and summaries by Deirdre McCarthy Gallagher and Rene Todd Maddox.

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