April 15, 2020

ADR Case Update 2020 - 7

Federal Circuit Courts

- **PER CONTRACT, ARBITRATOR TO RENDER EXPLAINED DECISION ONLY UPON JOINT REQUEST OF PARTIES**

  Lanza v. FINRA
  2020
  United States Court of Appeals, First Circuit
  March 24, 2020

  Giovanni and Mariantonia Lanza alleged account mismanagement against their broker and brokerage firm, Ameriprise. The arbitration clause in the parties' contract provided for arbitration in accordance with the FINRA By-Laws, Rules, and Code of Arbitration Procedure. After settling the claim against their broker, the Lanzas requested, unilaterally, that the arbitrators issue an explained decision as to the remaining claims against Ameriprise. A three-arbitrator panel provided little explanation in its dismissal of the Lanzas' claims and the Lanzas sued FINRA for breach of contract – specifically, breach of the implied covenant of good faith and fair dealing – due to the arbitrators' failure to provide a reasoned decision. FINRA moved to dismiss for failure to state a claim on which relief could be granted. The court granted the motion and the Lanzas appealed.

  The United States Court of Appeals for the First Circuit affirmed. The scope of the implied covenant of good faith and fair dealing is only as broad as the contract governing the relationship. The FINRA Code required an arbitrator to render an explained decision only upon the joint request of all parties. Because Ameriprise did not join in the Lanzas' request, the court appropriately dismissed the complaint for failure to state a claim.

- **ARBITRATORS' CONCLUSION REASONABLE**

  Ebbe v. Concorde Investment Services, LLC
  2020 WL 1429581

United States Court of Appeals, First Circuit
March 24, 2020

Upon his retirement, Kenneth Ebbe cashed out his pension and invested money with Richard Cody, at Westminster Financial. When FINRA suspended Richard for unsuitable investments, he transferred Ebbe's account to Concord Investment Services, where his wife, Jill Cody, was an investment advisor. Ebbe continued to meet with Richard during the suspension and testified that he did not know that Jill was his registered agent, though Concorde sent Ebbe monthly statements that reflected Jill's role. Richard went to work for Concorde after his suspension; however, Jill continued to be listed as Ebbe's advisor. Ebbe never contacted Jill or thought anything amiss until Concorde closed his account when his balance hit zero. Ebbe filed for arbitration with FINRA against Richard, Jill, Westminster, and Concorde. The arbitral panel awarded Ebbe compensatory damages against Richard and Jill and denied the request for relief against Westminster and Concorde. Ebbe moved to confirm the damages award and vacate the denial of relief against the employers. The court confirmed the award and Ebbe appealed.

The United States Court of Appeals for the First Circuit affirmed. Ebbe did not come close to showing that the arbitrators engaged in manifest disregard of the law. Ebbe's principal argument was that because Jill Cody was found jointly and severally liable with her husband, Concorde must be liable under the doctrine of respondeat superior for her misconduct. Neither Cody appeared at the hearing and the finding of liability against both could reasonably have been nothing more than entry of a default judgment. Ebbe produced no evidence of tortious misconduct or any misconduct by Jill when she was his representative. The expert testimony before the arbitrators was that Concorde met all of its obligations imposed on it by securities law and Ebbe failed to put in any contrary evidence. The arbitrators' conclusion was reasonable in light of the claims made and the evidence presented.

- **ARBITRATOR GROUNDED AWARD MODIFICATION WITHIN AAA RULES GOVERNING THE CBA**

Communications Workers of America, AFL-CIO v. Southwestern Bell Telephone Company, et al.
2020 WL 1482543
United States Court of Appeals, Fifth Circuit
March 27, 2020

CWA and Southwestern Bell (the Company) were parties to a CBA under which they agreed to resolve all disputes by arbitration in accordance with AAA Rules. CWA filed a grievance against the Company, alleging it violated the CBA by assigning cable-splicing duties to a group of Company workers known as Prem Techs. After allowing CWA to introduce Exhibit 4, demonstrating that splicing had been specifically excluded from the Prem Techs task list in another district, the arbitrator found for CWA. The Company moved for reconsideration, contesting the arbitrator's reliance on Exhibit 4. The arbitrator reconsidered and, in his new decision, concluded that no violation had occurred. He held that Rule 40 of the AAA rules empowered him to make this modification by permitting him to correct a technical error contained in an earlier award. CWA sued to enforce the first award, the Company counterclaimed to enforce the second, and both parties moved for summary judgment. The court adopted a magistrate's judge report and recommendation advising the court to grant summary judgment for the Company and confirmed the second award. CWA appealed.

The United States Court of Appeals, Fifth Circuit affirmed. An extraordinarily narrow standard of review applies in consideration of arbitration awards. To determine whether an arbitrator exceeded his authority, courts apply the essence test, evaluating whether the award has a basis that is at least rationally inferable from the letter or purpose of the CBA. Here, the arbitrator's decision was consistent with the essence test. In issuing the second award, the arbitrator relied upon the language in the parties' agreement, situating his decision and interpretation of authority within the rules that governed their dispute resolution process. He found that he had committed a technical error in relying on Exhibit 4 and that Rule 40 allowed him to vacate his first award. This was an arguable interpretation of the contract.

- **PRIVATE ARBITRAL PANEL IN U.K. IS "FOREIGN OR INTERNATIONAL TRIBUNAL"**

Servotronics v. The Boeing Company
2020 WL 1501954
United States Court of Appeals, Fourth Circuit
March 30, 2020

Rolls Royce used a Servotronics valve in an engine that it manufactured and supplied to Boeing for installation on a new Boeing aircraft. During testing, the engine caught fire and Boeing's aircraft was damaged. After Rolls Royce settled Boeing's claim for damages, it sought indemnification from Servotronics, contending that a valve malfunction caused the fire. Servotronics rejected the claim and Rolls Royce commenced arbitration in the U.K., as required by the parties' contract. Seeking evidence to use in the U.K. arbitration, Servotronics filed an application in the district court under 28 USC §1782 (Assistance to Foreign International Tribunals and to Litigants Before Such Tribunals) to obtain testimony from three Boeing employees residing in South Carolina. The court denied the application, concluding that the U.K. arbitral panel was not a foreign tribunal for purposes of §1782. Servotronics appealed. The United States Court of Appeals for the Fourth Circuit granted the motions of Boeing and Rolls Royce to intervene and participate in the appeal (referred to collectively as Boeing).

The United States Court of Appeals for the Fourth Circuit reversed and remanded. §1782 reflects Congress' policy to facilitate cooperation with foreign countries by providing federal court assistance in gathering evidence for use in private tribunals. Boeing's assertion that "tribunal" referred only to an entity that exercised government-conferred authority reflected a too narrow understanding of arbitration, whether conducted in the U.K. or the U.S. With the enactment of the FAA, Congress endorsed the arbitration alternative and undertook to regulate the process and confer supervisory authority on U.S. district courts. Thus, contrary to Boeing's assertion that arbitration is not a product of government-controlled authority, under U.S. law, it clearly is. To an even greater degree than arbitrations in the U.S., U.K. arbitrations are sanctioned, regulated, and overseen by the government and its courts.

- **ARBITRATION AWARD OF SWEDISH TRIBUNAL CONFIRMED IN FACE OF ARGUMENT THAT UNDISCLOSED CHANGE IN PLACE OF INCORPORATION RESULTED IN NO AGREEMENT**

OJSC Ukrnafta v. Carpatsky Petroleum Corporation
2020 WL 1671559
United States Court of Appeals, Fifth Circuit
April 6, 2020

Ukraine's oil and gas enterprise, OJSC Ukrnafta contracted with Carpatsky, a Texas company, to develop petroleum. Two years later, Carpatsky merged into a newly incorporated Delaware company of the same name. Leslie Texas, the president of both companies, said that he told a Ukrnafta official about the change but did not formally notify them. In subsequent amendments to the agreement, including a 1998 change of the arbitration venue to Stockholm, Mr. Texas stamped the Carpatsky-Texas seal next to his name. When the parties ended up in litigation, Carpatsky filed an arbitration request in Stockholm and identified itself as a DE company. When Carpatsky filed its statement of claim, it again described itself as a DE company. A year after the arbitration began and six months after the statement of claim was filed, Ukrnafta challenged jurisdiction in TX state court, alleging that every amendment to the agreement after Carpatsky moved from TX to DE was null and void. Carpatsky removed the case to federal court and the court stayed the lawsuit. Ukrnafta then sued Carpatsky in Sweden and the Ukraine, with Ukrainian courts ruling that there was never an agreement to arbitrate in Sweden and Swedish courts ruling against Ukrnafta. Having determined it had jurisdiction because Ukrnafta's objection was untimely, the arbitral tribunal proceeded and awarded Carpatsky $147 million. The court confirmed the arbitration award, and granted summary judgment to dismiss Ukrnafta's state law claims on preclusion grounds. Ukrnafta appealed.

After determining that the district court had jurisdiction to resolve the lawsuit, the United States Court of Appeals for the Fifth Circuit upheld the order confirming the arbitration award. With secondary jurisdiction over this award (Sweden had primary), the Court could deny enforcement only on a ground listed in Article V of the Convention, none of which applied here. Mr. Texas had capacity to bind Carpatsky-DE when he signed the 1998 amendment to the agreement because he was the President of the company; the post-merger use of the seal was irrelevant. Moreover,

Ukrnafta waived this argument by submitting to the jurisdiction of the Stockholm arbitration. Even more than amounting to waiver, agreeing to an arbitration demand constituted an independent agreement to arbitrate. When it received, and consented to the arbitration, Ukrnafta knew of the change in domicile. When it challenged jurisdiction six months after filing its statement of defense, it was too late. Also unavailing was Ukrnafta's argument that the U.S. courts could not enforce the award because it was unable to present its case in violation of Article V(1)(b) of the Convention, which ensures that a court will enforce an award only if the arbitration afforded the basic due process rights they would have received in the jurisdiction where enforcement is sought. The tribunal held multiple hearings. The parties submitted witness statements, expert reports, and multiple rounds of briefings before and after the hearing. Ukrnafta also asserted that the federal courts could not enforce the award because it disregarded the limitation of liability; the Court rejected the attempt to use this limited non-recognition ground as a vehicle for reconsideration. Also unsuccessful was Ukrnafta's argument that recognition of the award would be contrary to the public policy of the U.S. because it would disrespect the Ukrainian courts' holdings that the 1998 amendment was invalid, contrary to U.S. interest in international comity. Giving a party's home court veto power over recognition actions in American courts would undermine the strong policy favoring international arbitration. The arbitral ruling in this case had the same preclusive effect as would a judicial ruling.

- **SECTION 10 OF THE FAA PROVIDES THE EXCLUSIVE REMEDY FOR CHALLENGING AN AWARD BASED ON ARBITRATORS' FAILURE TO DISCLOSE CONFLICTS OF INTEREST**

  Texas Brine Company, LLC v. American Arbitration Association
  2020 WL 168277
  United States Court of Appeals, Fifth Circuit
  April 7, 2020

  Texas Brine's contract with Occidental Chemical Corporation (Oxy) included an arbitration clause, providing for arbitration conducted by AAA Rules and governed by the FAA. After Texas Brine invoked the arbitration clause, three arbitrators were appointed (including Anthony DiLeo and Charles Minyard), each of whom had a continuing duty to disclose potential conflicts of interest. Texas Brine later learned that DiLeo was representing a corporation in a dispute in which opposing counsel was Texas Brine's counsel in its dispute with Oxy and that Minyard was involved as DiLeo's attorney in a related legal malpractice action. Louisiana granted Texas Brine's motion to vacate the arbitral award. Texas Brine then brought suit in state court against AAA and LA residents DiLeo and Minyard, seeking over $2 million in damages and equitable relief. AAA was served with process and immediately removed the case to federal court before DiLeo and Minyard were served. The AAA, DiLeo, and Minyard each filed answers and moved to dismiss Texas Brine's claims. Texas Brine challenged the removal and moved to remand. The court denied the motion and granted the defendants' motion to dismiss Texas Brine's claims with prejudice. Texas Brine appealed from the denial of remand and from the final judgment.

  The United States Court of Appeals for the Fifth Circuit affirmed. A defendant may remove a civil case brought in state court to the federal district court in which the case could have been brought. In diversity cases, the forum-defendant rule limits removal, providing that a civil action otherwise removable solely on the basis of jurisdiction may not be removed if any of the parties in interest properly joined and served as defendants is a citizen of the State in which the action is brought. Texas Brine accepted that the statute's plain language allowed for snap removal – since neither DiLeo and Minyard had been served when the case was removed - and argued that removal was absurd and defeated Congress's intent. The absurdity bar is high and was not met here. The court was correct to dismiss Texas Brine's suit. Texas Brine alleged wrongdoing involving the arbitrators' failure to disclose potential conflicts of interest. This was squarely within the scope of Section 10 of the FAA, which provided the exclusive remedy for challenging the arbitration award based on arbitrators' failure to disclose potential conflicts of interest.

California

- **ARBITRATION AGREEMENT PERMEATED WITH UNCONSCIONABILITY**

Dougherty v. Roseville Heritage Partners
2020 WL 1501701
Court of Appeal, Third District, California
March 30, 2020

When Lori Dougherty toured Somerford Place (owned by Roseville), she told staff that Somerford was the "last feasible care option" for her father, who would be released from the hospital that evening with no place to go. Dougherty was then presented with 70 pages of admission documents, including an arbitration agreement on pages 43 through 45. Dougherty later testified that she did not know she could modify, negotiate, or refuse any part of the admission documents or that she had even signed an arbitration agreement. After Dougherty's father died and she and her sister sued Roseville for elder abuse and wrongful death, Roseville moved to compel arbitration. The court denied the motion due to unconscionability and declined Roseville's request to sever the offending provisions. Roseville appealed.

The Court of Appeal, Third District, California, affirmed. Under the doctrine of unconscionability both procedural and substantive elements must be shown, but they need not be present in the same degree and are evaluated on a sliding scale. This arbitration agreement had a high degree of procedural unconscionability. It was buried in 70 pages of admissions documents and presented as a take it or leave it. Roseville also failed to make available the AAA commercial rules that governed the agreement. The agreement was substantively unconscionable due to discovery limitations under the AAA commercial rules, which ran the risk of frustrating plaintiffs' rights under the Elder Abuse and Dependent Adult Civil Protection Act, and limited plaintiffs' rights to recover remedies available under the Act. The agreement also required plaintiffs to waive in advance their right to a jury trial for any dispute for which arbitration was not allowed by law; the CA Supreme Court had made clear that pre-dispute contractual jury trial waivers were unenforceable under CA law. Given the unconscionability permeating the agreement, the court did not abuse its discretion in finding that the offending clauses could not be severed.

Case research and summaries by Deirdre McCarthy Gallagher and Richard Birke.

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