NELA 2019 Annual Convention (June 26-29, 2019)

How to Make Arbitration Work for You

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When representing employees who are faced with having to arbitrate their claims against their employer (or an employer's claims against current or former employees), having an understanding of some key issues in navigating the arbitration process can save you and your client time and stress. This article focuses on three key issues:

(1) Which sources of arbitration law apply to an employment-related arbitration?

(2) What authority does the arbitrator have to order pre-hearing document discovery or deposition testimony from non-parties?

(3) What grounds are available to argue in court that an arbitration decision should be modified or vacated, or, in the alternative, to counter an employer's attempt to modify or vacate an arbitration decision?

I. The Statutory Law Governing an Employment-Related Arbitration.

For any arbitration, there are usually at least three sources that govern the procedures under which the arbitration is to be conducted.

The first source is the arbitration agreement. This agreement, in addition to specifying that some or all disputes arising out of the employment relationship are to be arbitrated, may also include procedures for how that arbitration is to be conducted, such as the choice of the arbitrator, the scope of the arbitration, and related procedures.

However, many arbitration agreements, instead of attempting to spell out all the procedures, will instead specify that the rules of a certain arbitration service provider will be used to govern the arbitration. Those rules, which are the second source of procedures, are usually quite detailed, and tend to track the Federal Rules of Civil Procedure, albeit with significant limitations to discovery.

In some employment disputes, the third source that governs the procedures are the underlying statutes that form the basis for the legal claims. For example, many employment

discrimination statutes require administrative exhaustion with the EEOC or a comparable state fair employment practices agency before going to court; some courts have held that this procedural requirement applies in arbitration (*infra*).

Finally, the fourth source that governs the procedures of arbitration is the federal or state arbitration statute that applies to a particular employer. Counsel for an employee who is facing arbitration needs to determine the identity of this statute at the outset, because it is not always obvious as to which law governs arbitration, and the choice of law can have a significant procedural and substantive effect on the arbitration. For private sector employees, there are three potential statutory sources: (1) the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1 *et seq.*; (2) the Labor Management Relations Act ("LMRA"), 29 U.S.C. § 185; and (3) state arbitration statutes that may track the FAA or the LMRA, but may also have unique provisions or have been interpreted by the state courts differently from the federal statutes.[1]

The LMRA is the easiest one to determine its applicability, since it only applies to arbitrations that arise under collective bargaining agreements, *i.e.*, in the context of grievances by or on behalf of unionized private-sector workers, as well as disputes between a private-sector union and management. 29 U.S.C. § 185.

The FAA, which historically was viewed as onerous for employees, applies to most private sector, non-unionized arbitrations, other than those who fall into three exemptions. The FAA was originally enacted in 1925, and then re-codified without amendment into Title 9 of the U.S. Code. Section 1 of the FAA defines "commerce" to correspond to interstate commerce, and then sets forth the three "exceptions to operation of title [9]," *i.e.*, "nothing herein contained shall apply to contracts of employment of seamen, railroad employees, **or any other class of workers engaged in foreign or interstate commerce**." 9 U.S.C. § 1 (emphasis added). The third exemption has historically been read to exclude employees who were involved in interstate transportation, such as interstate truck or bus drivers, and does <u>not</u> exclude employees in other fields even if they are engaged in work that involves interstate commerce, *i.e.*, the FAA's exemption is narrower in scope than the Constitution's interstate commerce clause.

However, the Supreme Court recently issued a unanimous decision that actually broadens the scope of the transportation worker exemption by extending it to independent contractors, not just employees. This arose in the context of truck drivers who had claims for violation of the federal, Maine, and Missouri wage laws. *New Prime Inc. v. Oliveira*, 586 U.S. __, 139 S. Ct. 532 (2019). The company argued that the truck drivers were independent contractors and that the FAA exemption only applied to employees. Justice Gorsuch's opinion for the Court

[1] These materials do not address arbitrations (or grievances) involving federal or state government employees; those who are unionized are typically governed by specialized statutes specific to unionized government employees.

explained that the FAA referred to "workers," not "employees," and that at the time the FAA was enacted (1925), the statutory term "contract of employment" "did not necessarily imply the existence of an employer-employee or master-servant relationship," *id.* at 542, so that independent contractors in the transportation industry were excluded from the FAA.

The impact of the *New Prime* decision may be limited by earlier court rulings holding that the "transportation worker exemption" only applied to individuals who themselves were directly engaged in interstate commerce, usually by driving a vehicle across state lines. Several lower court decisions have refused to apply this exemption to couriers and other delivery drivers who only engaged in intra-state transportation. *See, e.g.*, *Lee v. Postmates, Inc.*, No. 18-cv-03421-JCS, 2018 WL 4961802, at *7-*8 (N.D. Cal. Oct. 15, 2018); 2018 WL 6605659, at *6-*7 (N.D. Cal. Dec. 17, 2018) (couriers and delivery drivers not engaged in interstate commerce), *appeal docketed*, No. 19-15024 (9th Cir. Jan. 4, 2019); *Levin v. Caviar, Inc.*, 146 F. Supp. 3d 1146, 1152-54 (N.D. Cal. 2015) (same).

U.S. District Judge Coughenour in Seattle recently issued an interesting decision addressing Amazon drivers, who transport goods from one Amazon warehouse or distribution center to another. *Rittmann v. Amazon.com, Inc.*, No. 2:16-cv-01554-JCC, 2019 WL 1777725 (W.D. Wash. Apr. 23, 2019). Here, Amazon attempted to classify the plaintiffs and putative class members as "independent contractors," and they each had contracts requiring individual arbitration, with the FAA specified as governing any disputes. *Id.* at *1. Judge Coughenour agreed with the plaintiffs that the arbitration provision was unenforceable, since they fell within the transportation worker exemption to Section 1 of the FAA, for two reasons: First, the Supreme Court's intervening *New Prime* decision meant that the plaintiffs' status as "independent contractors" resulted in their being included within the transportation worker exemption of Section 1. *Id.* at *2 n.3. Second, even though the transportation worker exemption "require[s] a stricter association between the employee and interstate commerce than might otherwise be required under other legislation," *id.*, the Amazon drivers were "akin to UPS and FedEx" drivers since all three involved delivery of goods that "must have originated, or transformed into its final condition, in a different state than the delivery state." *Id.* at *2-*3. Even if some Amazon drivers only engaged in short-haul trips within a single state, they were still transporting goods that were manufactured in another state. *Id.* at *3.

However, this was not the end of the analysis as to the Amazon drivers, since the result was only to exclude their "contracts from FAA coverage entirely," *id.* at *4, so Judge Coughenour had to determine whether any other arbitration statute would apply, thereby making the arbitration agreement enforceable. Remarkably, while Amazon's contracts with the drivers had a choice of law provision ("These Terms are governed by the law of the state of Washington without regard to its conflict of laws provision"), that provision then went on to state that: "However, the preceding sentence does not apply to [the Arbitration Provision] which is

governed by the Federal Arbitration Act and applicable federal law." *Id.* at *4. Faced with this conundrum, Judge Coughenour concluded that the Amazon contract specifically excluded Washington state law from the arbitration provision ("it appears that it is precisely *against* the parties' intent to apply Washington law to the Arbitration Provision"), and since the FAA was also inapplicable (due to the transportation worker exemption), neither statute could apply, so that Amazon's motion to compel arbitration had to be denied:

> Because it is not clear what law to apply to the Arbitration Provision or whether the parties intended the Arbitration Provision to remain enforceable in the event that the FAA was found to be inapplicable, the Court finds that there is not a valid agreement to arbitrate.

Id. at *5. In response, Amazon quickly filed a notice of appeal. *Rittman v. Amazon.com, Inc.*, *appeal docketed*, No. 19-35381 (9th Cir. May 3, 2019).

The courts are now analyzing *New Prime* in a range of factual scenarios. For example, the California Court of Appeal recently held that a truck driver who transfers freight from California freight terminals to various in-state destinations was covered by the transportation worker exemption, and was not required to arbitrate his wage claims. *Muller v. Roy Miller Freight Lines, LLC*, No. G-055053, __ Cal. Rptr. 3d ___, 2019 WL 1929662 (Cal. Ct. App. May 1, 2019). Even though this plaintiff "never transported freight across state lines," *id.* at *1, the California Court of Appeal held that because "the vast majority – over 99 percent – of the goods Muller transported originated across state lines," that was sufficient, since "he played an integral role in transporting goods through interstate commerce." *Id.* at *7.

In contrast, a district court in Chicago held that Grubhub drivers – who typically transport prepared meals from restaurants to customers – did not qualify for the FAA's transportation worker exemption. *Wallace v. Grubhub Holdings, Inc.*, No. 18-C-4538, 2019 WL 1399986 (N.D. Ill. Mar. 28, 2019). Judge Chang held that the plaintiffs had to arbitrate their wage claims, because after applying *New Prime*, it was clear that "Grubhub drivers do not belong to a class of workers engaged in interstate commerce. Their day-today duties do not involve handling goods that remain in the stream of interstate commerce, traveling to and from other states." *Id.* at *4.

Another district court in Colorado recently granted a motion for reconsideration brought by truck drivers for a freight company, and held that *New Prime* meant that the FAA did not apply to these truck drivers. *Merrill v. Pathway Leasing, LLC*, No. 16-cv-02242-KLM, 2019 WL 1915597, at *2 (D. Colo. Apr. 29, 2019). However, Magistrate Judge Mix found that the plaintiffs' employment contract included a provision stating that any disputes would be resolved under the Missouri Uniform Arbitration Act, *id.* at *3, and that state statute controlled here, since determining that the FAA did not apply only left "the arbitration of disputes in the excluded

categories as if the FAA had never been enacted." *Id.* at *4. Thus, the truck drivers were required to arbitrate their claims under the Missouri statute. *Id.* at *4-5.

In another truck driver case also involving New Prime, Judge David Carter held that while *New Prime* precluded using the FAA as a basis for ordering arbitration, the plaintiffs' arbitration agreements required arbitration under the Missouri Uniform Arbitration Act, even though these plaintiffs lived and worked in California. *Ratajesak v. New Prime, Inc.*, No. SA CV 18-9396-DOC, 2019 WL 1771659 (C.D. Cal. Mar. 20, 2019). The plaintiffs, truck drivers who resided in Los Angeles, brought wage claims under California state law as a potential class and collective action. *Id.* at *3. New Prime moved for arbitration, arguing that both the FAA and the Missouri Uniform Arbitration Act applied. *Id.* Since the Supreme Court's intervening decision rendered the former argument moot, Judge Carter turned to the Missouri Uniform Arbitration Act argument, and granted New Prime's petition to compel arbitration under that statute. *Id.* at *4-*7. Even though a California statute (Cal. Lab. Code § 228) purports to prevent an employer from forcing employees from arbitrating claims for unpaid wages, the arbitration agreement "delegate[d] issues of arbitrability to the arbitrator," so it was up to the arbitrator to determine whether the California Labor Code "render[s] the claim unarbitrable." *Id.* at *6.

Interestingly, the "transportation worker exemption" may lead to different results within the same industry. The perfect example may be drivers for Uber and Lyft, who are classified as independent contractors and who usually have arbitration agreements with these ride-sharing app companies. On the one hand, *New Prime* means that their nominal status as independent contractors does not prevent them from seeking to invoke the transportation worker exemption in order to avoid the limitations of arbitration. On the other hand, Uber and Lyft drivers in many larger states (*e.g.*, California, Texas, Florida, Washington) seldom if ever take customers across state lines due to the geography of those states (with few or no large cities located right on the border with another state), nor do they transport goods that originated in another state. As a result, Uber drivers in those states will likely remain subject to arbitration. Thus, a district court in Tampa recently held that even under *New Prime*, arbitration was required, since "Plaintiff did not argue or demonstrate that his position with Uber required him to transport goods in interstate commerce." *Gray v. Uber, Inc.*, No. 8:18-cv-3093-T-30 SPF, 2019 WL 1785094, at *2 (M.D. Fla. Apr. 10, 2019), *appeal docketed*, No. 19-11576 (11th Cir. Apr. 24, 2019). Uber drivers in California have previously been unsuccessful in arguing that the arbitration agreements, including the class action waivers, were unenforceable. *See O'Connor v. Uber Technologies, Inc.*, 904 F.3d 1087 (9th Cir. 2018).

In contrast, Uber and Lyft drivers in Washington, D.C. regularly make trips to and from Maryland and Virginia, and thus are engaged in interstate commerce that qualifies under the FAA's transportation worker exemption. It remains to be seen how this geographical quirk will play out in the context of potential class actions involving Uber and Lyft.

Finally, state arbitration statutes – which may track the FAA – are a third source of law that governs arbitrations in those circumstances where neither the LMRA nor the FAA apply. But, as in the Amazon truck driver case, *supra*, if the parties' arbitration agreement excludes state law with respect to arbitration, and federal law also does not apply to the employees, then there will be no resort to state laws governing arbitration.

II. The Authority of Arbitrators to Order Non-Party Discovery or Testimony.

A major difference between arbitration and civil litigation in the state or federal courts is that discovery is usually significantly limited in arbitration. Even though arbitrators are typically viewed as having largely the same powers as do judges in adjudicating disputes, the authority of arbitrators is restricted in several ways, of which the most significant is whether the arbitrator can authorize pre-hearing documentary or deposition discovery of non-party witnesses.

Usually, arbitrators will allow only party discovery to take place prior to the hearing, *i.e.*, interrogatories, document requests, and depositions of individual parties and current or former employees and officers of corporate parties. Under Section 7 of the FAA, an arbitrator can also issue witness subpoenas, but those are limited to witnesses who will appear at a hearing before the arbitrator: "The arbitrators … may summon in writing any person **to attend before them or any of them as a witness** and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case." 9 U.S.C. § 7 (emphasis added). This language tracks the pre-1991 version of Rule 45, Fed. R. Civ. P., under which pre-trial discovery did not include non-party discovery in advance of the trial, *i.e.*, such witnesses could only be summoned to provide testimony at a trial.

In contrast, the current version of Rule 45, Fed. R. Civ. P. (since 1991), and analogous state court civil procedure rules, specifically provide for non-party discovery (both documents and depositions) that can take place prior to trial.

The result has been a circuit split as to whether arbitrators have the authority under the FAA to order pre-hearing discovery from non-parties. Of the circuits that have addressed this issue, one (Eighth) has recognized that authority; three (Second, Third, and Ninth) have held that the arbitrator lacks that authority; and one (Fourth) suggested that showing "special need or hardship" would allow for that authority. Since discovery disputes are seldom addressed by the U.S. Supreme Court, it may be some time before this issue is resolved on a nation-wide basis.

In contrast, under the LMRA, at least two circuits (Sixth and Seventh) have recognized that authority, which is a significant procedural difference from how the courts have addressed this issue under the FAA.

A. Arbitrators Have the Authority to Issue Pre-Hearing Non-Party Subpoenas.

The minority view under the FAA – apparently adopted by only the Eighth Circuit – is that arbitrators do indeed have the authority to order pre-hearing discovery from non-parties. This decision arose in the context of arbitration of a reinsurance dispute, where the insurance company sought documents from another reinsurer, Transamerica. *In re Security Life Ins. Co. of America*, 228 F.3d 865 (8th Cir. 2000). The Eighth Circuit recognized that Section 7 of the FAA "does not, however, explicitly authorize the arbitration panel to require the production of documents for inspection by a party." *Id.* at 870. Nonetheless, the Eighth Circuit held that the "interest in efficiency" of arbitration merited allowing the arbitrator the authority to issue subpoenas for pre-hearing discovery:

> Although the efficient resolution of disputes through arbitration necessarily entails a limited discovery process, we believe this interest in efficiency is furthered by permitting a party to review and digest relevant documentary evidence prior to the arbitration hearing. **We thus hold that implicit in an arbitration panel's power to subpoena relevant documents for production at a hearing is the power to order the production of relevant documents for review by a party prior to the hearing**.

Id. at 870-71 (emphasis added). However, other circuits have <u>not</u> followed this approach when applying the FAA, *infra*.

Arbitration under the LMRA (arising under collective bargaining agreements for unionized, private sector employees) differs significantly from arbitration under the FAA with respect to pre-hearing discovery from non-parties. At least two circuits – Sixth and Seventh – have held that the federal common law permits such pre-hearing discovery.

The Sixth Circuit addressed this in a dispute under a collective bargaining agreement arising from a TV station's news anchor who was terminated when he allegedly "misused automobile privileges extended to him by certain automobile companies." *American Fed'n of TV and Radio Artists, AFL-CIO v. WJBK-TV*, 164 F.3d 1004, 1006 (6th Cir. 1999). The Sixth Circuit reviewed several district court decisions in which the district judges had held that arbitrators could issue non-party subpoenas under the FAA, and concluded that the same principle applied under the LMRA:

> We hold that under [29 U.S.C.] § 301, a labor arbitrator is authorized to issue a subpoena duces tecum to compel a third party to produce records he deems material to the case either before or at an arbitration hearing. We caution that this

> decision should not be read to mean that a party to the arbitration is entitled to any such discovery, only that a labor arbitrator may issue such a subpoena.

Id. at 1009. This holding expressly did not address whether this authority under the LMRA extended to depositions of non-parties. *Id.* at 1009 n.7.

The Seventh Circuit addressed this issue in a labor grievance where the union alleged that the company had improperly transferred work to a non-unionized company, where both companies shared the same owner. *Teamsters Nat'l Automotive Transporters Indus. Negotiating Committee v. Troha*, 328 F.3d 325 (7th Cir. 2003). The Seventh Circuit held that such discovery was allowable under the LMRA:

> We therefore hold that federal common law under § 301 creates a cause of action by which a party to a collective bargaining agreement that is otherwise covered by § 301 can enforce an arbitration subpoena against a non-signatory of the agreement.

Id. at 330.

B. Arbitrators May Have the Authority to Issue Pre-Hearing Non-Party Subpoenas.

The Fourth Circuit addressed this issue in an arbitration involving a contractual dispute between the recipient of a government research award and a company (COMSAT) that was to build a telescope for the award recipient. COMSAT obtained a non-party subpoena to the National Science Foundation (the agency that made the award), but the NSF refused to respond. *COMSAT Corp. v. National Science Foundation*, 190 F.3d 269, 272 (4th Cir. 1999). COMSAT then filed a motion to compel with the district court; the NSF argued that the arbitrator lacked "the authority to subpoena third parties for pre-arbitration discovery." *Id.* at 274. The district court agreed with COMSAT that the subpoena should be enforced. The Fourth Circuit reversed, albeit recognizing a narrow category where such subpoenas could be enforced. The Fourth Circuit stated that the FAA only grants the arbitrator the "power to compel non-parties to appear before the arbitration tribunal," and does not allow for pre-hearing discovery from non-parties:

> Nowhere does the FAA grant an arbitrator the authority to order non-parties to appear at depositions, or the authority to demand that non-parties provide the litigating parties with documents during prehearing discovery. By its own terms, the FAA's subpoena authority is defined as the power of the arbitration panel to compel non-parties to appear "before them;" that is, to compel testimony by non-parties at the arbitration hearing.

Id. at 275 (citing 9 U.S.C. § 7). Nonetheless, the Fourth Circuit did recognize that "**a showing of special need or hardship**" could allow for such non-party discovery in advance of the hearing. *Id.* at 276 (emphasis added). While the Fourth Circuit did not set forth a formal definition of "special need or hardship," it recognized that "at a minimum, a party must demonstrate that the information it seeks is otherwise unavailable." *Id.* Here, COMSAT had not made that showing, in part because much of the information it sought from the NSF could be obtained either through a FOIA request or through discovery from the opposing party in arbitration. *Id.* at 276-77.

C. Arbitrators Lack the Authority to Issue Pre-Hearing Non-Party Subpoenas.

The majority view is that arbitrators lack the authority to issue pre-hearing subpoenas for documents or depositions to non-parties. The Third Circuit, in an opinion by then-Judge Alito, was apparently the first to adopt this restrictive view. *Hay Group, Inc. v. E.B.S. Acquisition Corp.*, 360 F.3d 404 (3d Cir. 2004). This case involved a suit by an employer against a former employee for alleged violation of a non-solicitation clause, where the former employer sought documents from the former employee's current employer. *Id.* at 405. The district court adopted the Eighth Circuit's approach in *Security Life* (*supra*), and ordered that the non-party subpoenas be enforced. *Id.* at 406. The Third Circuit reversed, agreeing with the non-party (the current employer) that the FAA did not give the arbitrator the authority to issue pre-hearing subpoenas on non-parties.

Judge Alito noted that the FAA had essentially the same language as did Rule 45 prior to its 1991 amendment, and "From its adoption in 1937 until its amendment in 1991, Rule 45 did not allow federal courts to issue pre-hearing subpoenas on non-parties." *Id.* at 407. Judge Alito stated that while "policy grounds" might favor allowing this discovery, the appropriate remedy was for Congress to amend Section 7, not to allow a judicially-created exemption to Section 7:

> Of course, one may well think that it would be preferable on policy grounds for arbitrators to be able to require non-parties to produce documents without also subpoenaing them to appear in person before the panel. But if it is desirable for arbitrators to possess that power, the way to give it to them is by amending Section 7 of the FAA, just as Rule 45 of the Federal Rules of Civil Procedure was amended in 1991 to confer such a power on district courts.

Id. at 409. The Third Circuit also rejected the Fourth Circuit's attempt to import a "special need or hardship" exception: "we cannot agree with this dicta because there is simply no textual basis for allowing any such 'special need' exception. Again, while such a power might be desirable, we have no authority to confer it." *Id.* at 410.

In a short concurring opinion, then-Judge Chertoff stated that if the arbitration was before a panel, then one of the arbitrators could order a non-party witness to appear before him or her solely for purposes of producing the documents, and that such witnesses likely would "deliver the documents and waive [the arbitrator's] presence," thus avoiding "the limitations of Section 7." *Id.* at 413 (Chertoff, J., concurring).

The Third Circuit also noted that some state arbitration statutes, including those of Delaware and Pennsylvania, had subpoena provisions that were based on the Uniform Arbitration Act, which is broader than the FAA in allowing the issuance of subpoenas without restricting that power to subpoenas to testify at the hearing. *Id.* at 407 n.1 ("The language of these state statutes clearly shows how a law can give authority to an arbitrator to issue pre-hearing document-production orders on third parties."); *see also In re Roche Molecular Syst., Inc.*, 60 Misc. 3d 222, 76 N.Y.S.3d 752 (N.Y. Sup. Ct. 2018) (Uniform Instate Depositions and Discovery Act, not FAA, applied to allow arbitrator to issue deposition subpoena to non-party).

The Second Circuit followed the Third Circuit's reasoning in 2008, thereby abrogating several earlier decisions that had allowed such non-party discovery in advance of the hearing. *Life Receivables Trust v. Syndicate 102 at Lloyd's of London*, 548 F.3d 210 (2d Cir. 2008). This dispute arose from arbitration over viatical insurance policies (purchase of life insurance policies from elderly insureds); here, the purchaser obtained reinsurance in the event the insured lived longer than expected, and the reinsurer refused to cover its obligations when that event happened. *Id.* at 212-13. The reinsurer sought documents from a third party, and the district court granted the reinsurer's motion to enforce the subpoena. *Id.* at 213-14. The Second Circuit reversed, based on its review of the aforementioned decisions of the Third, Fourth, and Eighth Circuits. *Id.* at 214-17. The Second Circuit concluded:

> The language of section 7 is straightforward and unambiguous. Documents are only discoverable in arbitration when brought before arbitrators by a testifying witness. The FAA was enacted in a time when pre-hearing discovery in civil litigation was generally not permitted. The fact that the Federal Rules of Civil Procedure were since enacted and subsequently broadened demonstrates that if Congress wants to expand arbitral subpoena authority, it is fully capable of doing so. There may be valid reasons to empower arbitrators to subpoena documents from third parties, but we must interpret a statute as it is, not as it might be . . .

Id. at 216.

Most recently, the Ninth Circuit, in a dispute involving the pharmacy industry, followed the Third and Ninth Circuits in holding that the district court properly denied the petition to enforce the arbitrators' subpoena for documents from a non-party. *CVS Health Corporation v.*

Vividus, LLC, 878 F.3d 703 (9th Cir. 2017). The statutory language of Section 7 did not grant arbitrators the authority to order pre-hearing discovery from non-parties:

> A plain reading of the text of section 7 reveals that an arbitrator's power to compel the production of documents is limited to production at an arbitration hearing. The phrase "bring with them," referring to documents or other information, is used in conjunction with language granting an arbitrator the power to "summon ... any person to attend before them." Under this framework, any document productions ordered against third parties can happen only "before" the arbitrator. The text of section 7 grants an arbitrator no freestanding power to order third parties to produce documents other than in the context of a hearing.

Id. at 706. That said, the Ninth Circuit did recognize, as had the Second Circuit, that an arbitration agreement could circumvent Section 7 and "provide arbitrators [with] greater discovery powers." *Id.* at 706 n.1 (citing *Life Receivables Trust*, 549 F.3d at 217).

III. Judicial Review of Arbitration Decisions – Federal vs. State Court.

Under the FAA, there are at least four phases of arbitration in which a party may attempt to seek judicial relief or judicial review:

(1) Petitions to compel arbitration, typically filed after the opposing party initiates a lawsuit in court, 9 U.S.C. § 4;
(2) Petitions to compel an arbitrator to issue a subpoena, 9 U.S.C. § 7;
(3) Petitions to enforce or quash a subpoena issued by an arbitrator, 9 U.S.C. § 7; or
(4) Petitions to confirm, vacate, or modify an arbitrator's decision, 9 U.S.C. § 9 (confirm an award), § 10 (vacate an award), § 11 (modify or correct an award).

However, the FAA does not by itself confer jurisdiction on the U.S. district courts to review these disputes. Instead, as the Supreme Court held, federal subject matter jurisdiction only exists if there is "an independent jurisdictional basis over the parties' dispute." *Vaden v. Discovery Bank*, 556 U.S. 49, 59 (2009) (Section 4 petition to compel arbitration). Thus, in *Vaden*, the Supreme Court stated that "A federal court may 'look through' a § 4 petition to determine whether it is predicated on an action that 'arises under' federal law." *Id.* at 62. In other words, an arbitration involving claims that arise under state law would not qualify for federal court review. *Accord Landau v. Eisenberg*, __ F.3d __, 2019 WL 1924224, at *2 (2d Cir. May 1, 2019) (Section 9 petition to confirm award); *McCormick v. America Online, Inc.*, 909 F.3d 677, 683-84 (4th Cir. 2018) (Section 10 or 11 petition); *Ortiz-Espinosa v. BBVA Secs. of Puerto Rico, Inc.*, 852 F.3d 36, 45-47 (1st Cir. 2017) (Section 9 petition).

A complication is that some circuits have refused to extend *Vaden* from Section 4 petitions into the post-arbitration review under Sections 9, 10, and 11, *i.e.*, those circuits only apply *Vaden* in the Section 4 context. *Goldman v. Citigroup Global Markets*, Inc., 834 F.3d 242, 252-55 (3d Cir. 2016) (petition to vacate under Section 10); *Magruder v. Fidelity Brokerage Servs., LLC*, 818 F.3d 285, 287-88 (7th Cir. 2016) (petition to enforce under Section 9); *accord Kasap v. Folger Nolan Fleming & Douglas, Inc.*, 166 F.3d 1243, 1247 (D.C. Cir. 1999).

Thus, an arbitration that addresses violations of *federal* employment law would qualify for judicial review by the federal courts, at least for Section 4 petitions, as well as for Section 9, 10, and 11 petitions in the First, Second, and Fourth Circuits. In contrast, an arbitration that addresses only violations of *state* employment law (whether statutory or common law) would not qualify for judicial review by the federal courts, even if that arbitration proceeding otherwise falls within the scope of the FAA. For those latter arbitrations, any judicial proceedings would have to be brought in state court, unless the arbitration is in a circuit that only applies *Vaden* to Section 4 petitions to compel arbitration.

IV. Judicial Review of Arbitration Decisions – Limited Grounds for Review.

Sections 10 and 11 of the FAA set forth the limited grounds on which a court can review a challenge to an arbitrator's decision, whether through seeking to vacate the decision (Section 10) or to modify or correct the decision (Section 11). Section 10 has four categories, of which the fourth is the most likely one to be invoked:

> (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—
>
> (1) where the award was procured by corruption, fraud, or undue means;
>
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) where 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; or
>
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10(a)(1)-(4). Section 11 similarly provides limited grounds for correcting or modifying an award, typically when a mistake was made in calculating the award, or the arbitrator addressed an issue not properly submitted:

> In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration—
>
> (a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.
>
> (b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.
>
> (c) Where the award is imperfect in matter of form not affecting the merits of the controversy.
>
> The order may modify and correct the award, so as to effect the intent thereof and promote justice between the parties.

9 U.S.C. § 11.

Therefore, it is important to understand the limited grounds on which the courts have allowed vacating, modifying or correcting an arbitration award. As a threshold matter, the courts (particularly the Supreme Court) have routinely applied FAA standards to challenges to LMRA arbitration decisions, and vice versa, so that case law under one statute can be relevant to addressing these disputes under the other statute.

V. Judicial Review of Arbitration Decisions – Key Grounds.

It is safe to say that the courts, including the Supreme Court, are extremely deferential to arbitration and are reluctant to vacate an arbitrator's decision. In the widely-cited *Stolt-Nielsen* decision, the majority stated forthrightly:

> It is not enough for petitioners to show that the [arbitration] panel committed an error – or even a serious error. It is only when an arbitrator strays from interpretation and application of the agreement and effectively dispenses his own brand of industrial justice that his decision may be unenforceable. In that situation, an arbitration decision may be vacated under § 10(a)(4) of the FAA on the grounds that the arbitrator exceeded his powers, for the task of an arbitrator is to interpret and enforce a contract, not to make public policy.

Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 559 U.S. 662, 671-72 (2010) (citations and quotation marks omitted).

A. Arbitrator Exceeded His or Her Authority.

The Supreme Court and the lower courts can and will vacate arbitration decisions where the arbitrators exceeded their authority. In *Stolt-Nielsen*, the arbitration panel in a price-fixing case decided that the arbitration clause allowed for class arbitration, even though the arbitration clause was silent on whether class actions were allowed. *Id.* at 669. In *Stolt-Nielsen*, the majority held "that what the arbitration panel did was simply to impose its own view of sound policy regarding class arbitration." *Id.* at 672. This was improper because arbitrators lack the "authority of a common-law court to develop what it viewed as the best rule to be applied" in response to a request for class arbitration. *Id.* at 674. Therefore, when an arbitrator has exceeded his authority, that can be grounds for vacating the award under Section 10(a)(4).

In contrast, even if the arbitrator made some error of law or fact, that by itself does not justify vacatur if the arbitrator did not exceed his or her delegated authority under the arbitration agreement. The Supreme Court, in a decision arising under the LMRA (and often applied in the FAA context), stated this unambiguously:

> Courts are not authorized to review the arbitrator's decision on the merits despite allegations that the decision rests on factual errors or misinterprets the parties' agreement. If an arbitrator is even arguably construing or applying the contract and acting within the scope of his authority, **the fact that a court is convinced he committed serious error does not suffice to overturn his decision**. . . . When an arbitrator resolves disputes regarding the application of a contract, and no dishonesty is alleged, **the arbitrator's improvident, even silly, factfinding does not provide a basis for a reviewing court to refuse to enforce the award.**
>
> In discussing the courts' limited role in reviewing the merits of arbitration awards, we have stated that courts have no business weighing the merits of the grievance or considering whether there is equity in a particular claim.

Major League Baseball Players Ass'n v. Garvey, 532 U.S. 504, 509 (2001) (*per curiam*) (emphasis added) (citations and quotation marks omitted). Thus, it is reversible error for a court to "overturn[] the arbitrator's decision because it disagreed with the arbitrator's factual findings, particularly those with respect to credibility." *Id.* at 510.

Several employment law disputes provide illuminating examples addressing whether or not an arbitrator exceeded his or her authority in fashioning relief for the prevailing employee.

The Second Circuit addressed a labor arbitration of the termination of a unionized employee who allegedly engaged in two workplace violence incidents. *187 Concourse Assocs.*

v. Fishman, 399 F.3d 524 (2d Cir. 2005). The arbitrator agreed with the employer that the former employee had engaged in "incomprehensible" behavior that "is completely unacceptable in the workplace and the Employer had no option but to terminate the Grievant." *Id.* at 525. Despite this finding, the arbitrator went on to order that the employee should be reinstated given his "past good work record" and returned him "on a six-month probationary basis." *Id.* The Second Circuit held that this was improper, because under the collective bargaining agreement, the arbitrator could only fashion a "remedy" if the arbitrator had found no just cause to terminate the employee. *Id.* at 527. Here, since the arbitrator had found that the employer "had no option but to terminate" the employee, that should have been the end of the arbitration, as a remedy could only be fashioned if the arbitrator instead found that the termination was not justified. *Id.*

In an employment agreement dispute involving a senior director at an investment company, the arbitration panel awarded nearly $5.7 million to the fired employee, and issued an "award [that] did not explain the rationale behind the arbitrators' decision." *Fellus v. Sterne, Agee & Leach, Inc.*, 783 F. Supp. 2d 612, 616 (S.D.N.Y. 2011). The investment company contested the award, but Judge Scheindlin denied the petition to vacate or modify the award. In short, the investment company was improperly seeking to argue "that the arbitrators reached the wrong decision on the facts" and made "miscalculations regarding the revenue numbers disputed at the arbitration." *Id.* at 621-22. However, it "is improper for a court to review the arbitrator's decision on the merits," particularly where "the award does not explain the arbitrators' rationale in reaching their decision or reference any numbers other than the total damages awarded." *Id.* at 622. Indeed, the "arbitrators could have based the award on grounds wholly independent of the disputed revenue numbers." *Id.* Thus, when an arbitrator issues an award, the courts cannot second-guess the award as long as it is within the arbitrator's authority.

B. Arbitrator's Decision was a Manifest Disregard of the Law.

The district courts have reached divergent results in addressing an arbitrator's decision whether or not to require an employee to comply with Title VII's exhaustion requirements as a prerequisite for arbitration. One court held that exhaustion was not required (*i.e.*, the former employee did not have to go through the EEOC administrative process), while another court held that an employee who waited more than 90 days after receiving a right-to-sue letter from the EEOC before filing her arbitration complaint could not proceed with arbitration.

In a gender discrimination and hostile work environment case involving a defense contractor, the terminated employee initially filed a charge with the EEOC "alleging discrimination based on sex and retaliation," including harassment by her supervisor. *CACI Premier Technology, Inc. v. Faraci*, 464 F. Supp. 2d 527, 530 (E.D. Va. 2006). The EEOC closed out its investigation. The terminated employee then initiated arbitration, but included additional claims, such as harassment by "other coworkers [and] clients," and a retaliation claim

Id. At the arbitration, the arbitrator rejected the employer's argument that the latter claims were not properly exhausted at the EEOC, since the arbitration agreement did not require administrative exhaustion. *Id.* The arbitrator awarded "$64,000 in backpay, $50,000 in compensatory damages, and $31,848 in attorneys' fees." *Id.* at 531-32. Judge Ellis rejected the employer's attempt to seek vacatur of the arbitration award, because there was no showing that the arbitrator had "manifestly disregarded the law." *Id.* at 533. Specifically, "no authority exists squarely addressing and deciding whether Title VII's exhaustion requirement applies to an arbitration clause that does not explicitly or implicitly require exhaustion." *Id.*

In contrast, another district court held that an arbitrator properly decided that the arbitration demand was untimely as it was filed after the 90-day deadline in the EEOC right-to-sue notice. *Hagan v. Katz Communications, Inc.*, 200 F. Supp. 3d 435 (S.D.N.Y. 2016). Here, the plaintiff was in charge of radio advertising sales for a communications company; after she was terminated, she filed a charge of discrimination with the EEOC, alleging both age and national origin discrimination. *Id.* at 439. The EEOC issued a right-to-sue notice, and she then filed a complaint in district court within the 90 day period. *Id.* However, counsel for the parties then agreed that arbitration was required given the arbitration provision in the former employee's employment contract, which also included the provision that "Any claims received after the applicable / relevant statute of limitations period has passed shall be deemed null and void." *Id.* Nonetheless, the plaintiff's counsel delayed nearly a year before filing the arbitration demand, over fourteen months after the EEOC issued the right-to-sue notice.

The arbitrator granted summary judgment in the employer's favor, because the arbitration agreement had a statute of limitations, and the "ninety-day limitation applicable to Title VII and the ADEA was the only statute of limitations to which the Employment Agreement might refer." *Id.* at 440. The arbitrator concluded that "the overwhelming weight of authority supports Respondent's position that the filing of a suit, which is subsequently dismissed for improper venue or other purposes, does not toll the [ninety-day] limitations period." *Id.* at 441.

Judge Abrams rejected the employee's petition to vacate the arbitrator's decision, because the arbitration agreement required compliance with the relevant statute of limitations, which here was the 90-day deadline. *Id.* at 444. Otherwise, there would be "no limitations period for commencing an arbitration." *Id.* Moreover, the plaintiff's counsel's delay in filing for arbitration – nearly one year after conceding that the arbitration agreement applied – was a lack of diligence that precluded any attempt to argue tolling or estoppel. *Id.* at 444-45.

The Eighth Circuit reviewed an arbitration dispute where a terminated employee at a factory alleged that her termination for absences violated the FMLA, since she had taken FMLA leave and was not absent without leave. *Electrolux Home Products, Inc. v. United Auto., Aerospace & Agricultural Implement Workers of America*, 416 F.3d 848, 849-50 (8th Cir. 2005).

When the employee became ill while at work, she first went to a physician's assistant who refused her "request to certify the ailment as incapacitating or as protected by the FMLA." *Id.* at 850. Electrolux then terminated the employee "because she had not submitted a leave form certifying the absence as an FMLA occurrence." *Id.* The employee then sought a second opinion from a nurse practitioner who reached the opposite conclusion and issued a FMLA leave form. However, Electrolux refused to accept this documentation, since the nurse practitioner "was not her treating physician and who saw her that many days after the absence." *Id.*

The arbitrator ruled in favor of the terminated employee, ordered reinstatement with back wages, and rejected the employer's argument that the documentation was defective on the grounds that the nurse practitioner was not the treating physician, because the FMLA does not require that the "health care provider for the employee" be the treating physician. *Id.*

The district court then denied Electrolux's petition to vacate the arbitration award, and the Eighth Circuit affirmed. Although Electrolux argued that the arbitrator erred in allowing the allegedly deficient FMLA certification, the district court and the Eighth Circuit both recognized that the FMLA does not prohibit employees from "tendering second opinions not requested by the employer." *Id.* at 854. Further, the arbitrator's recognition that the second opinion was "close enough to qualify" was not a determination that the second opinion failed to meet all the criteria for obtaining FMLA leave. *Id.* at 854-55. The fact that the second opinion "did not expressly state that Ms. Cook was incapacitated" (as required under the FMLA) was not determinative since the nurse practitioner "implied as much in her answers to the questions on the certification form and through her statement that the absence was related to the ailment." *Id.* at 855. Thus, the arbitrator had the authority to find a violation of the FMLA, even if the FMLA certification did not expressly meet the statutory criteria.

C. Arbitrator Improperly Decided Issues That are Excluded from Arbitration.

There are several other grounds on which an arbitration decision can be vacated. One of the more obvious is that an arbitrator cannot decide issues that are excluded from the arbitration agreement. When an arbitration agreement provides that certain issues are <u>not</u> subject to arbitration, then an arbitration award must be set aside when the arbitrator purports to decide those forbidden issues and makes an award to the prevailing party based on those issues.

In a stock price valuation dispute between the two shareholders of a corporation, the arbitration panel was faced with "a finality provision manifestly excluding the accountants' purchase price determination from the consideration of arbitrators, or any review or modification whatsoever." *Katz v. Feinberg*, 167 F. Supp. 2d 556, 567 (S.D.N.Y. 2001). Nonetheless, the arbitration panel attempted to revisit the accountants' purchase price determination on the grounds that it did not comply with certain procedural requirements, resulting in a substantially

higher award to the departing shareholder than would otherwise be warranted (*i.e.*, an award of $2,466,879, instead of $1,859,879). Judge Haight held that this was error, which required that the award be recalculated at the lower amount, since the valuation determination was not subject to arbitration. *Id.* at 571-73.

In a high-profile dispute involving allegations that Fox Television failed to pay two Hollywood stars their full share of profits from licensing the TV show *Bones*, an arbitrator awarded the actors (along with the producer and the author) $32,769,473 in actual damages; $10,055,360 in prejudgment interest, $7,401,551.24 in attorneys' fees and costs to two law firms, and $13,663.66 in the arbitrator's fees, for a total of $50,240,048.90. *Twentieth Century Fox Film Corp., et al., v. Wark Entertainment, Inc., et al.*, Amended Final Award, JAMS No. 1220052735 (JAMS Feb. 20, 2019). The arbitrator also awarded $128,455,730 in punitive damages, for a total award of $178,695,778.90. *Id.*; *see also* J. Koblin & E. Lee, "Fox Stunned by Penalty over 'Pattern of Deceit,'" *N.Y. Times*, Feb. 28, 2019, at B-1.

The four employees and their companies filed a motion to confirm the arbitration award, while Fox filed a motion to vacate or correct the arbitration award based on the argument that the arbitration agreement precluded the arbitrator from awarding any punitive damages. Judge Rico of the Los Angeles County Superior Court agreed with Fox that the arbitrator exceeded his authority in awarding punitive damages, because the arbitration agreement specifically stated that:

> Each of Company and Artist agrees that Company's and Artist's sole remedy against Fox for any alleged failure by Fox to comply with the terms of this paragraph shall be actual damages, and Company and Artist hereby **waive any right to seek or obtain** preliminary or permanent equitable relief or **punitive relief** in connection with any such alleged failure.

Wark Entertainment, Inc. v. Twentieth Century Fox Film Corp., No. BC 602287, Ruling, at 3 (Los Angeles Super. Ct. May 2, 2019) (emphasis added) (attached hereto as Attachment 1).

Judge Rico held that the express and unambiguous language of the arbitration agreement precluded any argument that Fox had waived its objection to punitive damages; instead it was clear that the "arbitrator exceeded his powers" by ignoring this limitation on his authority to award relief. *Id.* at 8-9. Therefore, Judge Rico vacated the $128,455,730 award of punitive damages, leaving in place the award of just over $50 million in actual damages (including fees and costs). *Id.* at 10; *see also* "Judge Overturns Award in 'Bones' Dispute," *N.Y. Times*, May 4, 2019, at B-6.

D. Arbitrator Erred in Calculating the Award.

In an employment dispute arising from a breach of an employment agreement, Judge Sweet held that the arbitrator erred in awarding the former employee commissions based on sales completed after the date of the employee's termination, because the agreement only allowed for commissions on sales that were completed prior to termination of the agreement. *Collins & Aikman Floor Coverings Corp. v. Froehlich*, 736 F. Supp. 480, 481-82, 484-85 (S.D.N.Y. 1990). Here, the arbitrator awarded $152,643.52 in commissions, but only $8,856.94 in commissions were actually earned at the time of termination, and even extending the time period to the first day of the arbitration hearing would only result in $36,868.32 in commissions. *Id.* at 484. As a result, Judge Sweet concluded that:

> There is therefore no basis on which the Award could have been reached except to consider post-termination charges.
>
> The Award therefore exceeded the limitations of liability fixed in paragraphs "5(b)" and "7" of the Agreement. Under those provisions, no commissions for sales made to Froehlich's accounts were to be awarded subsequent to the effective date of his termination.

Id. Nonetheless, even though the arbitrator had "exceeded her authority" and also "in applying New York law made a mistake of law," that error did not rise to the level of "manifest error requiring the vacating of the Award." *Id.* at 486. Instead, the remedy was to remand to the arbitrator to recalculate the award: "when the proof submitted at the hearing does not support the award, it should be set aside." *Id.* at 487.

E. Arbitrator Awarded Attorneys' Fees as a Sanction.

Another issue is whether an arbitrator can award attorneys' fees if the arbitration agreement either is silent as to fees, or states that each side will bear its own costs. Several older court decisions have held that attorneys' fees can be awarded as a sanction for bad faith conduct in the arbitration, even where the agreement does not provide for an award of fees.

In an insurance dispute, an arbitration panel awarded the prevailing party over $21 million on its claim, and "a majority of the panel awarded ReliaStar fees for its attorneys and arbitrator in the amount of $3,169,496, costs of $691,902.75, as well as interest, explaining that it viewed the conduct of National Travelers in the arbitration as 'lacking good faith.'" *ReliaStar Life Ins. Co. of N.Y. v. EMC Nat'l Life Co.*, 564 F.3d 81, 85 (2d Cir. 2009). The prevailing party then petitioned the district court to confirm the award, upon which the losing party filed a counter-petition to vacate the award as to the fees and costs, on the grounds that the arbitration

agreement required each side to "bear the expense of its own arbitrator … and related outside attorneys' fees," specifically referencing the "American Rule" (each side bears its own costs); the district court agreed with the losing party. *Id.*

However, the Second Circuit, in a split decision, reversed the vacatur of the fee award. The Second Circuit stated that the fee award was actually grounded in the "inherent authority" of "arbitrators to sanction a party that participates in the arbitration in bad faith and that such a sanction may include an award of attorney's or arbitrator's fees." *Id.* at 86. The Second Circuit reasoned that the fee provision was "in the expected context of *good faith* dealings," and "nothing in the section, however, signals the parties' intent to limit the arbitrators' inherent authority to sanction *bad faith* participation in the arbitration." *Id.* at 88. (Neither the Second Circuit's decision not the district court's decision explained exactly what the "bad faith" litigation conduct entailed.)

Judge Pooler, in her dissenting opinion, stated that "I cannot see any justification for holding that an arbitrator has the authority to apply an exception to the American Rule, even if it is a well-recognized one, in disregard of the contract between the parties which provides *without exception* that the American Rule should apply." *Id.* at 93 (Pooler, J., dissenting). However, the Second Circuit's decision allowing attorneys' fees as a remedy for bad faith litigation conduct may no longer be good law in light of both *Stolt-Nielsen* (*supra*), and the Supreme Court's recent decision in *Lamps Plus, Inc. v. Varela*, 139 S. Ct. __, 2019 WL 1780275 (U.S. Apr. 24, 2019), which held that ambiguity in an arbitration agreement did not provide a basis for the arbitrators to fashion relief that was not expressly provided for under the agreement.

The First Circuit similarly held that "public policy" grounds allowed an arbitration panel's award of attorneys' fees and costs to senior employees of a brokerage house in Puerto Rico. *Prudential-Bache Securities, Inc. v. Tanner*, 72 F.3d 234 (1st Cir. 1995). The arbitration panel awarded the five former executives a total of $2,881,775 in compensation, and an unspecified amount of attorneys' fees and costs. *Id.* at 237. Prudential challenged the fee award on various grounds, and the First Circuit upheld the award on the grounds that Puerto Rico law allowed for such an award where a "party or its lawyer has acted obstinately or frivolously," and there were "examples of Prudential's conduct to support such a conclusion." *Id.* at 243. "It is reasonable to find that the fact that the panel awarded attorney's costs indicates it found Prudential obstinate and/or temerarious in litigating some of the claims, or in its conduct." *Id.*

F. Arbitrator Refused to Hear Relevant and Material Evidence.

Although Section 10(a)(3) of the FAA does allow for vacatur upon a showing that the arbitrator "refus[ed] to hear evidence pertinent and material to the controversy," the courts have been reluctant to find that certain evidence actually was material to the outcome.

In *Fellus*, the aforementioned dispute involving a senior director at an investment company, the investment company challenged the $5.7 million award in the former employee's favor on several grounds, including that "the arbitrators were guilty of misconduct by denying [employer] the opportunity to dispute Fellus's revenues exhibit at the end of the arbitration hearing." *Fellus*, 783 F. Supp. 2d at 621. Judge Scheindlin rejected this argument, because arbitrators "need not hear every piece of relevant evidence" and instead "need only hear enough evidence to make an informed decision." *Id.* Moreover, the arbitration record evidenced that ample time was devoted during the arbitration to the disputed revenue calculations. *Id.*

Conclusion

Understanding the ins-and-outs of arbitration, particularly how arbitration intersects with judicial review, and the authority of arbitrators, can save you and your client time and money in resolving employment law disputes.

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF LOS ANGELES

WARK ENTERTAINMENT, INC. Plaintiff, vs. TWENTIETH CENTURY FOX FILM CORP, et al., Defendants.	Case No. BC 602287 Related to Case No. BC 602548 Ruling

The motions to Vacate or Correct Arbitration Award, Confirm Arbitration Award and to Seal were heard on April 29, 2019. Appearing on behalf of Plaintiffs Temperance Brennan, L. P., Snooker Doodle Productions, Inc. and Bertha Blue, Inc. was Daniel A. Saunders, esq., appearing for Plaintiff Wark Entertainment, Inc., was Dale F. Kinsella, esq. and appearing for Defendants. Twentieth Century Fox Film Corporation, Fox Broadcasting Company and Fox Entertainment Group, Inc., were Daniel M. Petrocelli, esq. and Glenn D. Pomerantz, esq. The court heard extensive oral argument and took the matter under submission. The court now rules as follows.

At issue are the claims of Plaintiffs Wark Entertainment, Inc. f/s/o Barry Josephson ("Josephson"); Temperance Brennan, L.P. f/s/o Kathleen Reichs ("Reichs"); Snooker Doodle Productions, Inc. f/s/o Emily Deschanel ("Deschanel"); and Bertha Blue, Inc. f/s/o David

Boreanaz ("Boreanaz") (collectively, "Plaintiffs") against Twentieth Century Fox Film Corporation ("TCF"); Fox Entertainment Group, LLC; Twenty-First Century Fox, Inc., and Fox Broadcasting Company (collectively, "Fox") relating to the television series *Bones*.

The claims emanate from Plaintiffs' agreements with Fox which include contingent compensation. To ensure Plaintiffs' contingent compensation remained fair, TCF was required to transact with its affiliate distributors on equally favorable terms when compared to its transactions with its non-affiliate distributors. Plaintiffs contend that TCF breached this obligation in multiple licensing transactions – domestic broadcasting, international licensing, and streaming – and they assert claims against TCF (the party with whom they contracted) and its affiliates (nonparties to the agreements) for breach of contract, fraud, tortious interference with contract and inducing breach of contract. TCF denies the claims brought by Plaintiffs and asserts that it carried out all its contractual obligations and duties.

On April 15, 2016, this court ordered the action stayed pursuant to Defendants' Motion to Compel Arbitration. (Declaration of Molly M. Lens ("Lens Decl.") ¶ 3; Exh. B.) On February 20, 2019, a JAMS Arbitrator issued an Amended Final Award, Case Reference No. 1220052735. (Lens Decl. ¶ 4; Exh. C.) The Arbitrator found for Plaintiffs, awarding them a total of $178,695,778.90, of which $128,455,730 was punitive damages. (Amended Final Award, p. 65.)

The following motions are made:

(1) Plaintiffs' motion to confirm the arbitration award;

(2) Fox's motion to vacate or correct the arbitration award;

(3) Fox's motion to seal portions of the exhibits filed in support of its motion to vacate or correct the arbitration award.

1. Confirm, vacate, or correct award

The Arbitrator awarded Plaintiffs a total of $32,769,473 in actual damages, plus prejudgment interest, attorneys' fees, costs, and arbiter's fees. In addition, the Arbitrator awarded

Plaintiffs $128,455,730 in punitive damages. Plaintiffs move to confirm the award. Fox moves to vacate or correct the award on the ground that the Arbitrator exceeded his powers by awarding punitive damages.

The Plaintiffs in this action are creators, producers, and actors involved in the television series *Bones*. In late 2004 and early 2005, plaintiffs each entered into contracts with TCF, under which they licensed their rights in *Bones* to TCF, in exchange for certain guaranteed and contingent compensation. Each contract contains a materially identical "Distribution Controls" paragraph. (Lens Decl., Exh. A, ¶ 10.) The paragraph reads in relevant part:

> **b. Dealings with Affiliates:** . . . Each of Company and Artist further acknowledges that Fox has informed Company and Artist that Fox intends to make use of Affiliated Companies in connection with its distribution and exploitation of the Series . . . . Each of Company and Artist expressly waive any right to object to such distribution and exploitation . . . or assert any claim that Fox should have offered the applicable distribution/exploitation rights to unaffiliated third parties . . . . *In consideration thereof, Fox agrees that Fox's transactions with Affiliated Companies will be on monetary terms comparable to the terms on which the Affiliated Company enters into similar transactions with unrelated third party distributors for comparable programs. Each of Company and Artist agrees that Company's and Artist's sole remedy against Fox for any alleged failure by Fox to comply with the terms of this paragraph shall be actual damages, and Company and Artist hereby waive any right to seek or obtain preliminary or permanent equitable relief or punitive relief in connection with any such alleged failure.* (Emphasis added.)
>
> **c. Arbitration:** Any dispute arising under the provisions of this Paragraph 10 shall be arbitrated . . . in binding arbitration in Los Angeles, California . . . .

Plaintiffs' claims arise from Fox's alleged breach of the portion of paragraph 10(b) requiring Fox to engage in transactions with its own Affiliated Companies on monetary terms similar to its comparable transactions with unrelated third party distributors. Accordingly, this court in its April 15, 2016 Ruling, determined that this paragraph required arbitration of certain of Plaintiffs' claims. As part of its Ruling, this court noted that because the arbitration agreement in the Distribution Controls paragraph applies to "any dispute arising under Paragraph 10," the provision also applied to Plaintiffs' tort, statutory, and equitable claims, including those against both TCS and against the Affiliated Entities. (See *Bigler v. Harker School* (2013) 213 Cal.App.4th 727, 739 ["A long line of California and federal cases holds that claims framed in tort are subject to contractual arbitration provisions when they arise out of the contractual relationship between the parties. . . . It is the dispute, not the named cause of action that is the focus of inquiry"] (internal citations omitted).)

Defendants' principal argument on these motions is that the award must be corrected because the Arbitrator "exceeded [his] powers" by awarding punitive damages when the Distribution Controls paragraph specifically disallows an award of punitive relief. (Code Civ. Proc., § 1286.2, subd. (a)(4).)

Parties to agreement/Third-party beneficiary

Plaintiffs first point out that the agreement itself defines Fox as **only** "Twentieth Century Fox Television, a unit of Twentieth Century Fox Film Corporation," and not affiliated entities, and argues that the punitive damages limitation applies only to claims brought against Fox, such that claims for punitive relief may brought against the remaining defendants (the "Affiliated Entities"). (Lens Decl., Exh. A, p. 1.)

Plaintiffs' argument contradicts this court's reasoning in its April 8, 2016 Ruling. The court compelled Plaintiffs to arbitrate their claims against the Affiliated Entities according to principles of agency and collateral estoppel. The court cited *Sourcing Unlimited, Inc. v. Asimco International, Inc.* (1st Cir. 2008) 526 F.3d 38, in which the First Circuit examined the very same

issue and concluded that since the claims of the nonsignatory defendant were "intertwined with the subject matter within the scope of the arbitration clause," equitable estoppel applied such that the plaintiff was estopped from avoiding arbitration with the nonsignatory. (*Sourcing Unlimited, supra,* 526 F.3d at p. 47.)

The same reasoning applies here with respect to whether the nonsignatory Affiliated Entities can invoke the punitive damages limitation. The Affiliated Entities have the right to invoke the punitive damages limitation because the contract interference claims against the nonsignatories are inextricably intertwined with the breach of contract claims against Fox. The very same violation of Paragraph 10(b) supports both causes of action. Although TCF was originally the party which compelled arbitration (on its own behalf and on behalf of the Affiliated Entities), it is Plaintiffs who are now enjoying the benefits of arbitration; Plaintiffs are equitably estopped from reaping the rewards of having arbitrated its claims against the Affiliated Entities without also respecting the limitations to which they agreed.

It would be illogical for this court to hold in one Ruling that the Affiliated Entities were able to invoke the arbitration clause and compel Plaintiffs to arbitrate, and hold in another Ruling that the Affiliated Entities were not able to invoke one of the limitations in the arbitration clause.

Wavier by submission of issue to Arbitrator

Plaintiffs also argue that Fox submitted the punitive damages issue to the Arbitrator, thus granting the Arbitrator power to decide on the issue despite the language in the Distribution Controls paragraph. (Mot. Vacate, pp. 8-9.) In support of their argument, Plaintiffs cite *Safari Associates v. Superior Court* (2014) 231 Cal.App.4th 1400, 1410-1411, in which the fact that the parties had submitted the issue of prevailing party attorney's fees to the arbitrator rendered the arbitrator's decision on the attorney fee issue nonreviewable. As factual support for their argument, Plaintiffs assert that Fox expressly stipulated that Plaintiffs' request for punitive damages were among the issues to be decided by the Arbitrator by color-coding all fully arbitrable claims in the complaint in yellow. (Kinsella Decl., Exh. E (Exh. B thereto) ¶¶ 43-52.)

The court does not find that Fox submitted the punitive damages issue to the arbitrator. All that the yellow highlighting shows is that Fox submitted Plaintiffs' causes of action to the arbitrator. Every paragraph of each cause of action designated by the parties as "fully arbitrable" is highlighted in full, including the parts of each claim that allege that Plaintiffs are entitled to punitive damages. The highlighted punitive damages paragraphs in the complaint are boilerplate. The court will not give an implication arising from highlighted boilerplate precedence over an express contractual term limiting the power of the arbitrator to award punitive relief. Moreover, as counsel for Fox pointed out at the hearing, (1) the parties prepared the color-coded document pursuant to *this court's* ruling on which issues were arbitrable, not as any substantive statement of the issues or remedies that the parties were stipulating were arbitrable; and (2) at no point during the arbitration proceedings did Plaintiffs advance their argument about the color-coded pages.

From pre-hearing to post-hearing, Fox objected to punitive relief in light of the express contractual prohibition. (Lens Decl., Exh. G at 5305-06 (Wark); 5345, 5365-66 (Brennan et al.).) Fox did not submit the question of punitive damages to the arbitrator, and accordingly, Fox did not waive the limitation.

Waiver by non-objection to arbitrability

Plaintiffs also argue that Fox waived its ability to challenge the arbitrability of the validity of the punitive damages waiver clause (as opposed to the actual question whether Plaintiff would receive punitive relief) by not raising it until closing argument. (Plaintiffs' Reply, p. 4.) This argument is not well taken. Fox never explicitly submitted to the arbitrator the question of the validity of the waiver clause, nor did Fox ever waive its objection to the arbitrability of the validity of the waiver clause by silence. On the contrary, Fox clearly and cogently raised its objections to the arbitrability of anything other than (i) Plaintiffs' 10(b) claims and (ii) the release issue. (Lens Decl. Exh. G at 5366.)

Plaintiffs appear to insist that Fox have made the following explicit objections during arbitration proceedings in order to preserve the right to have punitive damages reviewed by this court: (1) that punitive damages were not warranted by the case; (2) that the punitive damages waiver clause was valid; and (3) that the arbitrator did not have the right to consider the validity of the waiver clause in the first place. The court will not split hairs to this degree. In reviewing the record of the arbitration proceedings, the court finds that Fox raised its objections to punitive damages in all three senses sufficiently so as to avoid waiving the issue. Moreover, as Fox's counsel pointed out at oral argument, Fox had no choice but to argue on the issue of punitive damages when the arbitrator requested briefing on the issue. Under these circumstances, the court will not interpret Fox's having argued the issue as its having capitulated to the issue.

Even if Fox is deemed to have agreed to allow the arbitrator to decide the validity of the punitive damages clause, as discussed below, the Arbitrator exceeded his powers by declaring the clause invalid.

Rational relationship

"The scope of an arbitrator's authority is not so broad as to include an award of remedies 'expressly forbidden by the arbitration agreement or submission.' [Citation.]" (*Gueyffier v. Ann Summers, Ltd.* (2008) 43 Cal.4th 1179, 1185.) If a limitation on relief is set out "explicitly and unambiguously" in the parties' agreement, and the arbitrator exceeds his authority in awarding relief beyond the limitation, then the court is empowered to vacate or correct the award. (See *Advanced Micro Devices, Inc. v. Intel Corp.* (1994) 9 Cal.4th 362, 383.) On the other hand, if the court does not find any express and unambiguous restriction on the arbitrator's power, then the court's only inquiry is whether the remedy "bears a rational relationship to the underlying contract as interpreted, expressly or impliedly, by the arbitrator." (*San Francisco Housing Authority v. Service Employees International Union, Local 790* (2010) 182 Cal.App.4th 933, 944.)

At oral argument, Plaintiffs argued that the fact that waiver clause required interpretation by the Arbitrator demonstrated that the waiver clause was not unambiguous. The Arbitrator's interpretation of an ambiguous contract clause, argued Plaintiffs, is beyond the review of the court, and accordingly, the award must be confirmed.

A contract provision, however, is not ambiguous merely because it requires a modicum of interpretation. All contract terms must be interpreted; the issue here is whether and when the Arbitrator's interpretive efforts caused him to exceed the powers granted him by the parties. A contract is ambiguous "when it is capable of two or more constructions, both of which are reasonable." (*Powerline Oil Co. v. Superior Court* (37 Cal.4th 377, 390.) Accordingly, an unambiguous contract is one that admits only one reasonable meaning. Here, the court finds that the punitive damages waiver clause is unambiguous in the context of this lawsuit. The clause waives punitive relief "in connection with" any breach by TCF of paragraph 10(b). The contract interference claims against the Affiliated Entities are quite obviously made "in connection with" TCF's breach; in fact, as this court previously ruled, the claims are inextricably intertwined. There is only one reasonable interpretation of the provision, and that is that the arbitrator did not have the power to award punitive damages on any of the claims, or against any of the parties, in this case. The arbitrator exceeded his powers by interpreting the waiver clause to mean otherwise.

At oral argument, Plaintiffs maintained that the court was not permitted to inquire into the reasonableness of an arbitrator's award in this way. The court does not agree. The court's job on this motion is to determine whether the arbitrator exceeded his powers. (Code Civ. Proc., § 1286.2, subd. (a)(4).) Under *Advanced Micro Devices, supra,* and as the parties agreed at oral argument, an arbitrator exceeds his powers when the arbitrator ignores an "explicit[] and unambiguous[]" limitation on his powers. (*Advanced Micro Devices, supra,* 9 Cal.4th at p. 383.) Accordingly, in order to issue a ruling consistent with *Advanced Micro Devices*, the court **must** make a determination as to whether the limitation is explicit and unambiguous. Analyzing contract ambiguity, by definition, involves analyzing which interpretations of the contract are

reasonable. Here, because the limitation was unambiguous under the only reasonable reading of the contract, the Arbitrator exceeded his powers by awarding otherwise.

Even if the contract contained an ambiguity with respect to the applicability of the punitive damages waiver such that the Arbitrator did not exceed his powers in interpreting the ambiguity, the court nevertheless finds that the resulting award does not bear a rational relationship to the Agreement.

Plaintiffs argue that the award is rationally related to the agreement because the Arbitrator determined rationally determined that the punitive damages limitation (1) did not apply to the Affiliated Entities as nonsignatories to the Agreement, and (2) was void as against public policy under Civil Code section 1668, and thus, the remedy bears a rational relationship to the underlying contract.

Case law runs counter to Plaintiffs' position. Here, the agreements provide that Fox and the Plaintiffs "hereby waive any right to seek or obtain preliminary or permanent equitable relief or punitive relief in connection with" any violation of Paragraph 10(b). Both Plaintiffs and Fox are sophisticated entities represented by sophisticated counsel who can be presumed to have understood both the individual and public policy ramifications of a punitive damages waiver. To flout the express terms of the parties' agreement in favor of a broadly-stated public policy in favor of recovery for those wronged ignores the clear intent of the parties. (See *Cal. Faculty Association v. Superior Court* (1998) 63 Cal.App.4th 935, 953 ["it is difficult to see how the violation of an express and explicit restriction on the arbitrator's powers could be considered 'rationally related' to a plausible interpretation of the agreement']; see also *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.* (1989) 489 U.S. 468, 479 ["Just as [parties] may limit by contract the issues which they will arbitrate [citation], so too may they specify by contract the rules under which that arbitration will be conducted"].) Rather than offer a plausible interpretation of the contract, the Arbitrator simply "disregarded specific provisions of the plain text in an effort to prevent what the Arbitrator deemed an unfair result. Such an award is 'irrational.'" (*Aspic Engineering & Construction Co. v. EEC Centcom*

Constructors LLC (9th Cir. 2019) 913 F.3d 1162, 1169.) Accordingly, in awarding punitive damages, the Arbitrator exceeded his powers.

The motion to confirm the award is denied, the motion to correct the award is granted. Punitive damages shall be stricken from the award. The award will be corrected and confirmed as so modified.

Motions to seal

Having ruled on the motions to confirm, correct or vacate, the court now turns to Fox's motions to seal. One motion seeks to seal Fox's own motion to vacate, and the other motion seeks to seal the unredacted version of the Arbitrator's Award (together, the "Sealed Materials"). Fox brings this motion on the ground that the Sealed Materials contain non-public financial information that the parties agreed to keep confidential pursuant to a protective order filed in their arbitration proceedings. (Mot. Seal, p. 3.) The motion is unopposed.

California Rules of Court, Rules 2.550 and 2.551 governs sealed records. Before ordering substantive courtroom proceedings closed, or transcripts sealed, judges must hold a hearing and make factual findings supporting the order, including "(i) there exists an overriding interest supporting closure and/or sealing; (ii) there is a substantial probability that the interest will be prejudiced absent closure and/or sealing; (iii) the proposed closure and/or sealing is narrowly tailored to serve the overriding interest; and (iv) there is no less restrictive means of achieving the overriding interest. [Citation.]" (*Mercury Interactive Corp. v. Klein* (2007) 158 Cal.App.4th 60, 96.) Moreover, an application to seal must be accompanied by a declaration containing facts sufficient to justify sealing. (CRC Rule 2.551(b) (1).)

The court finds the following with respect to these requirements:

Overriding interest that supports sealing. The parties demonstrated their interest in maintaining the confidentiality of their private financial, personal, and business information by stipulating to a protective order during arbitration in which they agreed to keep this information

confidential. (Mot. Seal Lens Decl. ¶ 3.)

Interest prejudiced absent sealing. The parties' interest in maintaining the confidentiality of their private financial information would obviously be prejudiced if the financial information is not sealed. (See *Cassidy v. California Board of Accountancy* (2013) 220 Cal.App.4th 620, 625 [finding that a corporation's right of privacy and confidentiality as to its financial records would be prejudiced if the documents were not ordered sealed].)

Narrowly tailored/no less restrictive means. The redacted versions of the Sealed Materials are in the unsealed case file. By redacting only the confidential information from the Sealed Materials, the parties have used the least restrictive means of sealing the confidential information.

The motions to seal are granted. The unredacted versions of the Agreement between Wark and TCF (Lens Decl., Exh. A) and the Amended Final Award (Lens Decl., Exh. C) are ordered sealed.

Defendants to prepare the appropriate documents.

Clerk to give notice.

DATED: May 2, 2019

RICHARD E. RICO

Judge of the Superior Court