Are California's Arbitrator Disclosure Requirements Preempted by the FAA?

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Many arbitration agreements, such as the Commercial Rules of the American Arbitration Association (AAA) or the JAMS Comprehensive Arbitration Rules, explicitly designate the particular rules that will govern any arbitration that arises. The specified rules generally address what information, if any, a potential arbitrator must disclose during the arbitrator selection process.

One issue that frequently arises in disclosure disputes is past service by a particular arbitrator in earlier proceedings involving one of the parties, particularly where one of the parties is a large corporation or other "repeat player" that has used the arbitrator in multiple proceedings.[1]

California has enacted its own rules that purport to override the parties' agreement to arbitrate with respect to these disclosures and other matters. The consequences for failing to follow California's rules when they apply can be dire because the arbitrator's mere failure to disclose certain information, even if there is no demonstrated bias or prejudice, can result in the vacation of an award. This article examines how California rules change the landscape and why parties may want to tread lightly in California arbitrations (and arbitrations governed by California law) until certain questions are answered by the courts.

AAA and JAMS Rules

Rule 16(a) of the AAA Commercial Rules provides that

> [a]ny person appointed or to be appointed as an arbitrator shall disclose to the AAA any circumstance likely to give rise to justifiable doubt as to the arbitrator's impartiality or independence, including any bias or any financial or personal interest in the result of the arbitration or any past or present relationship with the parties or their representatives. . . ."[2]

AAA Rule 16(c) makes clear that the mere disclosure of information does not mean that the arbitrator should be disqualified: "In order to encourage disclosure by arbitrators, disclosure of information pursuant to . . . Section 16 is not to be construed as an indication that the arbitrator considers that the disclosed circumstance is likely to affect impartiality or independence."[3]

Rule 15(h) of the JAMS Comprehensive Arbitration Rules provides that "[a]ny disclosures regarding the selected Arbitrator shall be made as required by law or within ten (10) calendar days from the date of appointment. The obligation of the Arbitrator to make all required disclosures continues throughout the Arbitration process." The JAMS Arbitrators Ethics Guidelines similarly require arbitrators to "promptly disclose, or cause to be disclosed all matters required by applicable law."[4]

In the author's experience, proposed arbitrators, particularly those who do not regularly practice or serve as arbitrators in California, do not routinely disclose information about all past service.

The California Rules

California is the first state to enact legislation purporting to override the private-provider ethical standards for California arbitrations, including those for preconfirmation disclosure.[5] These California ethics standards (Ethics Standards) were adopted by the California Judicial Council under the authority of the California Code of Civil Procedure section 1281.85 and apply to any person "sitting as a neutral arbitrator pursuant to an arbitration agreement" under most circumstances.[6] The Ethics Standards provide that they generally apply to arbitrations either conducted in California or to which California law applies.[7]

The Ethics Standards include a long list of required disclosures, including the disclosure of information about earlier arbitrations involving one of the parties over which the arbitrator presided as a neutral.[8] Arbitrators are also required to disclose relationships that their family members may have with arbitration participants, which one commentator calls "[p]erhaps the most obvious 'brother's keeper' responsibility that the standards place on arbitrators."[9] The Ethics Standards further provide that the arbitrator "must make a reasonable effort to inform himself or herself of matters that must be disclosed."[10]

Consequences for Failing to Disclose

Parties in proceedings to which the Ethics Standards apply can pay the ultimate price when an arbitrator fails to make the required disclosures: California law now specifically provides that failure to disclose the required information is grounds for vacating an award, regardless of any demonstrated arbitrator prejudice or bias.[11] As one commentator noted, the statutory and Ethics Standards changes "are significant not only because they expand the sphere of necessary disclosure, but also because they create 'California law providing for vacating decisions when arbitrators don't properly disclose.'"[12] This could lead opportunistic parties unhappy with an award to investigate possible minor disclosure violations and then move to vacate the award. Because the applicable statute does not require a party seeking to vacate to demonstrate any harm stemming from nondisclosure, vacation could punish the victor in the arbitration even when he had no knowledge of the violation and did not benefit from it in any way.

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The Federal Arbitration Act

The Federal Arbitration Act (FAA) was enacted in 1925 as "a response to hostility of American courts to the enforcement of arbitration agreements, a judicial disposition inherited from then-longstanding English practice."[13] The FAA provides that:

> A written provision in any maritime transaction of a contract evidencing a transaction involving [interstate][14] commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.[15]

The FAA does not make particular disputes arbitrable as a matter of law but simply provides for nationwide enforcement of arbitration clauses in privately negotiated agreements involving interstate commerce. It holds parties to their bargains and, as such, merely ensures the application of standard contract principles. The FAA therefore preempts statutes that "reincarnate the formerjudicial hostility towards arbitration."[16]

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Preemptive federal legislation may seem unnecessary for such a noncontroversial proposition as enforcing parties' private agreements. When the FAA was enacted, however, courts routinely refused to apply traditional contract rules to arbitration provisions. And despite widespread current acceptance of arbitration and the fact that over seventy-five years have passed since the FAA was enacted, parties still encounter judicial resistance to arbitration in state courts and require federal court intervention.[17] Since the FAA was enacted, the U.S. Supreme Court has broadened its applicability and repeatedly held that state law restrictions on arbitration are unenforceable in cases in which the FAA applies except, as noted above, when "grounds exist at law or in equity for the revocation of any contract."[18] Moreover, although the FAA preempts any conflicting state law when it applies, most states have also enacted some form of the Uniform Arbitration Act, which mirrors many of the provisions of the FAA and covers agreements that may not be covered by the FAA.[19]

The FAA also authorizes parties to bring federal court actions to confirm or vacate arbitration awards rendered in arbitrations to which it applies.[20] Under the FAA, an arbitral award can be vacated only in these limited circumstances:

> (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.[21]

In order to meet the heavy burden of vacating an arbitration award under the FAA, an "appearance of bias" is generally not enough.[22] Under this standard, mere failure to disclose, without more, should not be grounds for vacating an award, particularly where the disclosures would not have been sufficient to disqualify the arbitrator under the rules applicable to the proceeding.[23]

Ethics Standards Versus the FAA

The inconsistencies between federal law and the Ethics Standards have been, and will likely continue to be, fertile ground for litigation. Furthermore, court holdings have not reconciled these inconsistencies: the few recent court cases dealing with FAA preemption of the Ethics Standards have not reached similar conclusions.

In *Mayo v. Dean Witter Reynolds, Inc.,*[24] an investor sued investment house Morgan Stanley in California state court, claiming that Morgan Stanley had improperly refused to reimburse him for improper withdrawals from his investment account. Morgan Stanley removed the lawsuit to the U.S. District Court for the Northern District of California and then moved to compel arbitration before the New York Stock Exchange, Inc., (NYSE) in accordance with the arbitration provision in the parties' client agreement. The court granted Morgan Stanley's motion to compel arbitration under the FAA and stayed the lawsuit pending arbitration. The investor then demanded arbitration before the NYSE shortly before the Ethics Standards took effect. NYSE arbitrations are governed by the NYSE Arbitration Rules, which have been approved by the Securities and Exchange Commission and which differ from the Ethics Standards. When the Ethics Standards took effect, the NYSE informed the investor that it would not appoint an arbitrator because it was temporarily suspending the assignment of all arbitrators in California. It then amended its rules to require California investors to either waive application of the Ethics Standards or arbitrate outside the state. The investor refused to arbitrate under the amended NYSE rules, claiming that he was entitled to proceed with the arbitration in California before an arbitration panel that complied with the Ethics Standards, and asked the court to excuse him entirely from his obligation to arbitrate. After considering the parties' arguments, the court concluded that both the FAA and the Securities Exchange Act of 1934 preempted the Ethics Standards and denied the investor's motion.

Similarly, in *Credit Suisse First Boston Corp. v. Grunwald,* the Ninth Circuit Court of Appeals held that the Ethics Standards do not apply to National Association of Securities Dealers (NASD) arbitrations because the Securities and Exchange Act of 1934 preempts application of the conflicting state law.[25] Before this ruling, the NASD, like the NYSE, had refused to arbitrate in California unless participants agreed to waive application of the Ethics Standards.[26] Since that ruling, the California

Supreme Court also held, in *Jevne v. Superior Court,* that the Securities and Exchange Act of 1934 preempts California's arbitrator disclosure standards and that the preempted portions of the Ethics Standards are not severable.[27]

Despite the aforementioned rulings, FAA preemption of the Ethics Standards is still an open question in California state courts. Although the *Jevne* court ruled that the Securities and Exchange Act of 1934 preempts the Ethics Standards, it did not address whether the FAA similarly preempts the standards.[28] Furthermore, in October 2005, the California Court of Appeal ruled in *Ovitz v. Schulman*[29] that the Ethics Standards controlled.

In *Ovitz*, an employment dispute arose between a film company and its president. The parties' employment contract required arbitration of disputes before the AAA, and the company eventually demanded arbitration in accordance with that requirement. After many hearing days, the arbitrator entered an award in favor of the company. After the arbitrator's ruling, the AAA faxed a letter to the parties directing their attention to a disclosure from the arbitrator making clear that he was also serving as the arbitrator in another pending AAA arbitration where a party was represented by the film company's lawyers. In the letter, the arbitrator claimed that he believed the AAA would have disclosed the information to the *Ovitz* parties and offered to recuse himself from the other case. After learning of the disclosure (which occurred after she knew that she had lost the arbitration), the employee-president requested the arbitrator's disqualification under the Ethics Standards. The AAA denied the disqualification request, reaffirmed the arbitrator's appointment, and denied a request for reconsideration.

The company then filed a petition to confirm the arbitration award in California Superior Court, which vacated the award at the employee's request. The California Court of Appeal affirmed the trial court's ruling. It held that the arbitrator had violated the disclosure requirements of the Ethics Standards by failing to timely disclose his prior service and that the employee had not forfeited or waived her right to vacate the award.

The court then turned to the company's argument that the FAA preempted the Ethics Standards. The company had argued that, because the FAA permits the vacating of an arbitration award for inadequate disclosure only under certain limited circumstances, the FAA must preempt the Ethics Standards, which "mandate[] the vacating of an arbitration award for any violation of California disclosure obligations, regardless of whether the undisclosed facts" would require vacation under the FAA.[30]

Considerable Debate Among the Circuits

The court noted that there "is considerable debate among the federal circuits" concerning the proper standards for vacating arbitration awards under the FAA for failures to disclose.[31] It then cited California state court precedent for the proposition that "[i]n cases where it applies, the FAA has a 'limited preemptive effect' on state law."[32] The court also cited some of the FAA's procedural provisions applicable to motions to vacate, concluding that language in those provisions "strongly suggests that [those provisions] apply only to federal district courts, not state trial courts" and that "the wording of the relevant sections of the FAA evidences a congressional intent not to preempt state law."[33] The court further concluded that vacating arbitration awards pursuant to the Ethics Standards is not inconsistent with the purpose of the FAA and that "'[n]othing in the legislative reports and debates [concerning the FAA] evidences a congressional intention that postaward and state court litigation rules be preempted so long as the basic policy upholding the enforceability of arbitration agreements remained in full force and effect.'"[34] It also commented that

> [b]y its terms, [the California provision for vacating] does not undermine the enforceability of arbitration agreements. It neither limits the rights of contacting parties to submit disputes to arbitration, nor discourages persons from using arbitration. [It] merely requires the vacating of an award if the arbitrator failed timely to disclose a ground for disqualification of which he is aware. Indeed, because it applies to vacating an arbitration award [the provision] presupposes that the arbitration agreement has been enforced and the arbitration held. If an award is vacated, the result is not a preclusion of further arbitration, but rather a new arbitration held in accordance with the disclosure requirements.[35]

In addition, the court noted that

> the legislative purpose of [the] section . . . like the California disclosure requirements as a whole, does not reflect hostility to arbitration or an attempt to limit the ability to enter arbitration agreements. The California scheme seeks to enhance both the appearance and reality of fairness in arbitration proceedings, thereby instilling public confidence. With increased public confidence, arbitration is more attractive as a means of resolving private disputes. Hence, far from posing an obstacle to implementing the purpose of the FAA, [the] section . . . actually serves that purpose. . . [and] . . . does not violate the letter or spirit of the FAA.[36]

Accordingly, the court concluded that the FAA does not preempt California's standard for vacating based on an arbitrator's failure to disclose, at least in California state court proceedings.[37]

Waiver Not Allowed

In addition, although courts are generally supposed to enforce parties' agreements to arbitrate as written,[38] another California Court of Appeal ruling held that parties cannot waive their statutory rights for disqualification under the California Ethics Standards when they agree to arbitrate under private rules.[39] Therefore, there is potential for real conflict between the Ethics Standards and the rules designated by the parties' arbitration agreement.

There is also the possibility for additional confusion whenever the contractually agreed-upon rules or other administrative standards or guidelines may be read to implicate the Ethics Standards. For example, the AAA's Arbitrator Disclosure Worksheet that the *Ovitz* arbitrator filled out referenced the Ethics Standards, but the AAA rules themselves do not. In addition, the JAMS Arbitrators Ethics Guidelines, cited above, require arbitrators to disclose all matters required by "applicable law." Not only is there a preemption question regarding which applicable law applies for disclosure purposes, but there is also the question of how the failure to disclose might affect the standards for vacating an award and whether the FAA vacation standards apply, regardless of the applicable disclosure standards.

There is also the very substantial potential for an increased risk of a lack of finality in arbitration, as well as the possibility of usurpation of the authority of the administrative bodies to which parties have submitted their disputes. For example, in *Ovitz,* the

California Court of Appeal affirmed the trial court's order vacating the award even though the AAA had denied a disqualification request and reaffirmed the arbitrator's appointment.[40]

Conclusion

Other than the Northern District of California and a California Court of Appeal, which reached opposite conclusions, the courts have yet to determine whether the Ethics Standards apply in arbitrations governed by the FAA. Until the issue is conclusively resolved, parties interested in preserving the finality of arbitral awards may want to consider avoiding proceedings in which the Ethics Standards apply, like the NASD did. This would mean avoiding arbitration in California and outside California where California law applies.[41] When that is not possible, parties (particularly corporate parties whose various departments and subsidiaries may have information about the arbitrator) may want to consider performing due diligence on their own to make sure that arbitrators have made all disclosures that the Ethics Standards purport to require and, where appropriate, submitting their own disclosures about an arbitrator's prior service.

Endnotes

1. *See* Jaimie Kent, *The Debate in California over the Implications of the New Ethical Standards for Arbitrator Disclosure: Are the Changes Valid or Appropriate?*, 17 GEO. J. LEGAL ETHICS 903, 908–09 (2004).

2. The AAA Code of Ethics requires arbitrators to make similar disclosures. AAA Code of Ethics for Arbitrators in Commercial Disputes (2004). *See also* John M. Townsend, *Clash and Convergence on Ethical Issues in International Arbitration*, 36 U. MIAMI INTER-AM. L. REV. 1, 12–16 (Fall 2004).

3. *See* Townsend, *supra* note 2, at 14.

4. JAMS Arbitrators Ethics Guidelines § V, *available at* www.jamsadr.com/arbitration/ethics.asp. According to JAMS, JAMS arbitrators are also required to comply with the American Bar Association's Code of Ethics for Arbitrators in Commercial Disputes, which does not explicitly require disclosure of past service but does note that the code does not "take the place of or supersede" the "arbitration rules to which the parties have agreed, applicable law, or other applicable ethics rules, all of which should be consulted by the arbitrators." *See* www.abanet.org/dispute/commercial_disputes.pdf.

5. *See* Kent, *supra* note 1, at 911–12 & n.66*; see also* Keisha I. Patrick, *A New Era of Disclosure: California Judicial Council Enacts Arbitrator Ethics Standards*, 2003 J. DISP. RESOL. 271, 281 (2003).

6. CAL. CIV. PROC. CODE § 1281.85.

7. CAL. RULES OF CONDUCT app. at div. VI, standard 3 (2002).

8. CAL. RULES OF CONDUCT app. at div. VI, standard 7 (2003); *see also* CAL. CIV. PROC. CODE § 1281.9.

9. Patrick, *supra* note 5, at 294 (discussing Ethics Standard 7, *supra* note 8).

10. CAL. RULES OF CONDUCT app. at div. VI, standard 9.

11. CAL. CIV. PROC. CODE § 1286.2(a)(6).

12. Kent, *supra* note 1, at 913 (quoting *Goin' Cali: Neutrals, Providers Settle in with New Rules and Laws*, 21 ALTERNATIVES HIGH COST LITIG. 1, 17 (2003)).

13. Circuit City v. Adams, 121 S. Ct. 1302, 1307 (2001).

14. The definition of *commerce* in 9 U.S.C. § 1 makes clear that the FAA only applies to commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation or between the District of Columbia and any State or Territory or foreign nation.

15. 9 U.S.C. § 2.

16. David L. Threlkeld & Co. v. Metallgesellschaft Ltd. (London), 923 F.2d 245, 250 (2d Cir. 1991). *See also* Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996) (FAA "displaces" conflicting state statutes); Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 52–54 (1995) (central purpose of the FAA is to ensure "that private agreements to arbitrate are enforced according to their terms"); Volt Info. Scis., Inc. v. Bd. of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 474 (1989) (FAA "was designed to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate"); Southland Corp. v. Keating, 465 U.S. 1, 11 (1984) (U.S. Supreme Court sees nothing in the FAA "indicating that the broad principle of enforceability is subject to any additional limitations under state law"); Doctor's Assocs. v. Hamilton, 150 F.3d 157, 162 (2d Cir. 1998) ("recognizing the FAA's strong policy in favor of rigorously enforcing arbitration agreements"). The law firm of Wiggin and Dana LLP, the author's firm, represented Doctor's Associates, Inc., in *Casarotto* and *Hamilton.*

17. *See e.g.,* Doctor's Assocs., Inc. v. Stuart, 85 F.3d 975, 978 (2d Cir. 1996). The law firm of Wiggin and Dana LLP, the author's firm, represented Doctor's Associates, Inc., in *Stuart.*

18. *See, e.g., Southland Corp., supra* note 16; *Casarotto, supra* note 16; Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 277 (1995); Do Quijas v. Shearson / Am. Express, Inc., 490 U.S. 477 (1989); Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985). For a discussion of FAA state law preemption, see Christopher R. Drahozal, *Federal Arbitration Act Preemption*, 79 IND. L.J. 393, 409 (Spring 2004).

19. *See e.g.,* Steven K. Huber & E. Wendy Trachte-Huber, *Top Ten Developments in Arbitration in the 1990s,* 55 J. DISP. RESOL. 24, 32 (Jan. 2001).

20. 9 U.S.C. §§ 9–10.

21. 9 U.S.C. § 10.

22. *See, e.g.*, Morelite Constr. Corp. v. N.Y. City Dist. Council Carpenters Benefit Funds, 748 F.2d 79, 80–81, 83–84 (2d Cir. 1984). But see Crow Constr. Co. v. Jeffrey M. Brown Assoc., 264 F. Supp. 2d 217 (E.D. Pa. 2003) (explaining that appearance of bias is enough under some circumstances); Positive Software Solutions, Inc. v. New Century Mortgage Co., 436 F.3d 495 (5th Cir. 2006) (affirming vacation for failure to disclose), *reh'g en banc granted*, No. 04-11432, 2006 WL 1304690 (5th Cir. May 6, 2006).

23. *See* Jason v. Halliburton Co., 2002 WL 31319945, at *5–6 (E.D. La. Oct. 15, 2002) (denying motion to vacate where arbitrator had been selected in prior arbitration involving a party); *see also* Sphere Drake Ins. Ltd. v. All Am. Life Ins. Co., 307 F.3d 617, 621 (7th Cir. 2002), *cert. denied,* 538 U.S. 961 (2003) ("appearance of partiality" ground of disqualification for judges does not apply to arbitrators) (internal quotation omitted); *Morelite Constr. Corp.,* 748 F.2d at 83 ("[i]t comes as no surprise . . . that the standards for disqualification of arbitrators have been held to be less stringent than those for federal judges"); Washburn v. McManus, 895 F.Supp. 392, 399 (D. Conn. 1994) ("mere fact of prior relationship is not in and of itself sufficient to disqualify. . . . The relationship . . . must be so intimate–personally, socially, professionally, or financially–as to cast serious doubt on the arbitrator's impartiality") (internal quotations omitted); Fed. Vending, Inc. v. Steak & Ale of Fla., Inc., 71 F.Supp.2d 1245, 1250 n.2 (S.D. Fla. 1999) (noting AAA's refusal to disqualify arbitrator for past service).

24. 258 F. Supp. 2d 1097, *amended by* 260 F. Supp. 2d 979 (N.D. Cal. 2003).

25. 400 F.3d 1119 (2005).

26. *Id.*

27. 28 Cal. Rptr. 3d 685 (Cal. 2005).

28. *Id.* at 690.

29. 35 Cal. Rptr. 3d 117 (Cal. App. 2005).

30. *Id*. at 131.

31. *Id*. at 132.

32. *Id*. at 132 (quoting Hedges v. Carrigan*,* 11 Cal. Rptr. 3d 787 (2004)).

33. *Id*. at 133.

34. *Id*. at 134 (quoting Siegel v. Prudential Ins. Co., 79 Cal. Rptr. 2d 726 (1998)).

35. *Id*. at 134.

36. *Id*. at 134–35.

37. The court also held that application of the Ethics Standards for vacating for failure to disclose was not inconsistent with the parties' arbitration agreement. *Id*. at 135–36.

38. *See* 9 U.S.C. § 4; Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 221 (1985).\

39. Azteca Constr., Inc. v. ADR Consulting, Inc., 18 Cal. Rptr. 3d 142, 151 (Cal. App. 2004).

40. It is interesting to note, as discussed above, that the disclosure form that the AAA provided to the arbitrator in *Ovitz* specifically referenced the Ethics Standards, but the AAA determined that the arbitrator should not be disqualified for failure to disclose.

41. The Ethics Standards purport to apply not just to arbitrations taking place in California, but also to arbitrations under California law. Ethics Standard 3. The courts have not yet addressed the extraterritorial application of the Ethics Standards.