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Arbitration—Arbitrators

Courts Ponder Arbitrator Substitution After Minnesota AG Settlement with NAF

Should an agreement to arbitrate fail solely because the named arbitrator is no longer available to take a case?

Certainly not, many courts have concluded, pointing to language in Section 5 of the Federal Arbitration Act that permits the designation of a substitute.

Not so fast—a separate line of cases cautions—Section 5 may not permit substitution where the designation of an arbitrator was integral to the contract, rather than an ancillary concern.

At least 15 courts have specifically addressed substitution after the NAF agreed not to take any new consumer arbitration disputes after July 24, 2009, to settle a lawsuit with the Minnesota attorney general. Currently, there are seven cases appointing a substitute arbitrator and eight denying a substitute arbitrator (see related box.)

Should a Trend Emerge? The only trend that appears to emerge from the cases is that courts will center their analysis on whether the naming of NAF was integral or ancillary to the arbitration agreement. How a court will come out on that question appears to be hard to predict.

Arbitration experts that spoke with Bloomberg BNA split on whether an agreement naming NAF generally should be considered integral or addressed on a case-by-case basis.

John Vail, vice president and senior litigation counsel for the Center for Constitutional Litigation PC, Washington, D.C., told Bloomberg BNA that he believes courts generally should rule against appointing a substitute arbitrator under Section 5. Vail said that one common mistake courts make is presuming there is a ''federal policy in favor of arbitration,'' when instead, Congress intended to favor ''arbitration agreements.'' He noted that courts, and even the U.S. Supreme Court in *AT&T Mobility LLC v. Concepcion*, 78 U.S.L.W. 4279 (U.S. 2011), have misquoted *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1 (1983), and left off ''agreements.''

''The FAA was passed not to favor arbitration over litigation, but to obviate the unwillingness of courts to afford a party to an arbitration agreement the *remedy* of specific enforcement'' of that agreement, Vail said.

Vail added that courts should consider the circumstances surrounding NAF's unavailability as a reason to deny equitable relief under Section 5. He said he believed corporations chose NAF believing it to be a biased forum and therefore have unclean hands.

He said few courts have been willing to cite unclean hands as a reason to deny substitution, but did see in Judge Dolores Korman Sloviter's recent dissent in *Khan v. Dell Inc.*, 80 U.S.L.W. 995 (3d Cir. 2012), an awareness of the issue. Sloviter's dissent referenced the allegations of bias surrounding NAF and said ''[i]t cannot be insignificant that Dell named NAF as the exclusive forum in its arbitration clauses'' given that history.

A perhaps unlikely ally in Vail's belief that the naming of NAF should be considered integral is Eric P. Tuchmann, general counsel and corporate secretary for the American Arbitration Association, New York. He told Bloomberg BNA that he believed courts should see the naming of a specific arbitrator as ''a material term'' because each organization has different priorities and protocols. For example, he said that his organization has ''a whole set of due process requirements for consumer cases.'' Therefore, he said, courts should not name a substitute.

Tuchmann added that his organization would likely decline to serve as a substitute arbitrator when an agreement solely named NAF.

In contrast, Professor Peter B. ''Bo'' Rutledge, University of Georgia School of Law, Athens, Ga., told Bloomberg BNA that there should not be any per se rule regarding whether to substitute an arbitrator. Instead it is ''an interpretive question that turns on the language of the agreement'' and whether naming the arbitrator was integral to the agreement.

Similarly, F. Paul Bland Jr., senior attorney at Public Justice, Washington, D.C., also told Bloomberg BNA that it was an issue of the agreement's language. However, Bland said many agreements will have similar language because NAF promoted its services to companies by direct mail and continuing legal education seminars.

Bland added that many provisions also will specify that NAF Rules be used in the arbitration, which removes substitution because Rule 1 only allows a NAF provider.

Tuchmann made a similar point and noted that his organization's rules reference using an AAA arbitrator.

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Should Companies Avoid Specificity? One question the line of cases raises is whether companies should avoid specifying only one company in their arbitration agreements.

Rutledge said ''most experts in the field err historically in favor of selecting a single institution'' because one major purpose of arbitration agreements is to avoid forum shopping.

However, he said, given rulings that show some consumers may be able to avoid arbitration when the selected forum is no longer is available, it does raise the question of whether that trend continues to be the right default rule. He would leave it to corporate counsel to weigh the benefits of naming a single forum versus the risks the entire agreement could be nullified if it was no longer available.

Tuchmann said he believed companies should continue specifying arbitrators because each forum will be sensitive to the needs of certain case loads.

He added that ''it does not particularly bother me if an arbitration agreement is struck down'' because of the unavailability of a forum.

In contrast, Alan S. Kaplinsky, a partner at Ballard Spahr LLP, Philadelphia, told Bloomberg BNA that he had routinely crafted arbitration agreements naming more than one forum. Kaplinsky said ''he would guess our firm has done more arbitration agreements than any other firm in the country'' and that they usually provided the consumer ''the option of choosing between AAA, JAMS, and NAF.'' Thus, he said, his clients have mostly avoided the situation raised by NAF's exit from consumer arbitration.

Kaplinsky also noted that where his clients decided only to select NAF, he would insert language that expressly provided a court with the power to name a substitute. He said agreements can be crafted to guard against situations where a substitute forum becomes required.

Will Congress or CFPB Moot the Issue? Bland said there was ''a widely held perception'' that AAA and JAMS, the remaining major arbitrators in the field, held themselves to a higher ethical standard than NAF and did not engage in the same abuses.

Nonetheless, Bland and many other advocates dislike what they perceive to be forced consumer arbitration. They argue customers have not validly agreed to the alternative forum because they had no choice but to agree to the provision in a contract of adhesion.

Vail said the notion consumers had a choice with those contracts relies upon a ''pre-Industrial Revolution view of choice.''

Congress has repeatedly debated the Arbitration Fairness Act, which seeks to ban mandated consumer arbitration. Bland said the Senate Judiciary Committee had a markup hearing on the bill and it could pass the committee. However, he believed it was likely to face a filibuster from Sen. Jeff Sessions (R-Ala.), who he said even held up a narrower bill that would have banned arbitration provisions in nursing home contracts.

However, Congress did statutorily task the new Consumer Financial Protection Bureau to study the issue when it passed the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. It also allowed the agency to impose regulations that would ban the practice if it finds it warranted.

Vail said he had not heard anything regarding the timing of that study and that the agency was holding plans ''close to the vest'' and guessed it was likely ''nothing soon.'' He noted that Deepak Gupta, who argued in favor of classwide arbitration in *Concepcion*, had joined the CFPB as senior counsel.

Tuchmann also had not heard anything regarding the CFPB's study but believed the agency probably would move promptly on it now that the agency had a director.

Kaplinsky, on the other hand, said he believed the CFPB ''has not even begun to think about the study'' given there are ''many more important things on their plate.'' He added that he believed once the agency begins its study it ''will be very hard pressed to find em-

Substitute Arbitrator Named

- *Khan v. Dell Inc.*, 80 U.S.L.W. 995 (3d Cir. 2012)
- *Diversicare Leasing Corp. v. Nowlin*, No. 11-cv-1037 (W.D. Ark. Nov. 18, 2011)
- *Clerk v. Cash Central of Utah LLC*, No. 09-4964 (E.D. Pa. Aug. 25, 2011)
- *Jones v. GGNSC Pierre LLC*, 684 F. Supp. 2d 1161 (D.S.D. 2010)
- *Levy v. Cain, Watters & Associates PLLC*, No. 2:09-cv-723 (S.D. Ohio Jan. 15, 2010)
- *Adler v. Dell Inc.*, No. 08-cv-13170 (E.D. Mich. Dec. 3, 2009)
- *Wright v. GGNSC Holdings LLC*, No. 25953 (S.D. Dec. 28, 2011)

Substitute Arbitrator Denied

- *Ranzy v. Tijerina*, 393 F. App'x 174 (5th Cir. 2010)
- *Klima v. Evangelical Lutheran Good Samaritan Society*, No. 10-cv-1390 (D. Kan. Nov. 8, 2011)
- *Carideo v. Dell Inc.*, No. C06-1772JLR (W.D. Wash. Oct. 26, 2009)
- *Carr v. Gateway Inc.*, 944 N.E.2d 327, 79 U.S.L.W. 2041 (Ill. 2011)
- *Geneva-Roth v. Edwards*, 956 N.E.2d 1195 (Ind. Ct. App. 2011)
- *GGNSC Tylertown LLC v. Dillon*, No. 2010-CA-01241-COA (Miss. Ct. App. 2011)
- *Rivera v. American General Financial Services Inc.*, 259 P.3d 803 (N.M. 2011)
- *Stewart v. GGNSC-Canonsburg LP*, 9 A.3d 215 (Pa. Super. Ct. 2010)

pirical data'' to support a ban on mandatory consumer arbitration.

Indeed, he said that empirical data shows consumers are better served by arbitration and opponents have relied only on anecdotal evidence. He said there were two studies from the Searle Center on Law, Regulation, and Economic Growth at Northwestern University School of Law that showed arbitration was ''quite fair.'' He said the study showed consumers receive similar awards and the process does not take as long.

As for corporations, Kaplinsky said his clients had been encouraged to write arbitration agreements because about a decade ago many were embroiled in state court litigation in Alabama, which he said was at the time ''very much aligned with the plaintiffs bar'' prior to tort reform in the state.

Minnesota AG Investigation, Settlement. Given the issue is unlikely to be mooted any time soon by agency action, courts will likely continue grappling with whether to appoint a substitute for the NAF.

The issue began, in part, because of a June 2008 *Bloomberg Businessweek* article that discussed allegations against the NAF, including that it was biased against consumers and aggressively marketed its services to credit card companies. The article also noted that a lawsuit by San Francisco alleged only 0.2 percent of consumers won their cases.

Richard Neely, the former chief justice of the West Virginia Supreme Court of Appeals who briefly served as an NAF arbitrator, went so far as to allege in a *West Virginia Lawyer* article that ''Godless bloodsucking banks have converted apparently neutral arbitration forums into collection agencies to extract the last drop of blood from desperate debtors.''

Minnesota Attorney General Lori Swanson filed a complaint July 14, 2009, which avoided such colorful language, but made similarly serious allegations regarding NAF's impartiality. Swanson alleged that NAF worked closely with credit card companies, drafted arbitration clauses, and was itself affiliated with the debt collection industry.

NAF promptly settled July 17 with the attorney general and agreed not to take any new consumer arbitrations. The company has repeated fulfilled its promise, leaving courts to grapple with whether a substitute may be named.

Arbitrator 'Integral' to Agreement? The text of Section 5 is ambiguous on what factors should control regarding substitution, but a series of circuit court rulings has provided guidance.

In *Brown v. ITT Consumer Financial Corp.*, 211 F.3d 1217 (11th Cir. 2000), the Eleventh Circuit held that substitution is permitted only when the naming of an arbitrator was an ancillary concern as opposed to an integral part of the agreement. It concluded that the naming of NAF, which had dissolved at the time of the case, was not integral and therefore substitution could occur.

The Second Circuit similarly addressed the issue of whether designating only a specific arbitrator was an ancillary concern in an agreement in *In re Salomon Inc. Shareholders' Derivative Litigation*, 68 F.3d 554 (2d Cir. 1995). That ruling, however, declined to substitute an arbitrator under Section 5 for the New York Stock Exchange.

Reddam v. KPMG LLP, 457 F.3d 1054 (9th Cir. 2006), also used the integral or ancillary analysis when deciding to substitute an arbitrator for the National Association of Securities Dealers Inc. The court rejected *In re Salomon* and argued ''[s]omething more direct is required before we, in effect, annihilate an arbitration agreement.''

Courts Naming a Substitute Arbitrator. The Third Circuit is one court that was reluctant to ''annihilate'' an entire arbitration agreement because NAF no longer was available. In *Khan*, the court grappled with whether Dell Inc. could require arbitration even though the agreement referenced only NAF.

The agreement stated that a dispute ''SHALL BE RESOLVED EXCLUSIVELY AND FINALLY BY BINDING ARBITRATION ADMINISTERED BY THE NATIONAL ARBITRATION FORUM.'' The court, citing *Brown*, said that ''exclusively'' modified ''binding arbitration'' and not NAF. The court also held that the agreement was ambiguous regarding which rules to apply when NAF was unavailable, as opposed to the notion that the incorporation of NAF rules only permitted an NAF arbitration.

The court added, ''Although courts are divided on the issue, we conclude that the 'liberal federal policy in favor of arbitration' counsels us to favor the *Brown* line of cases.''

Jones v. GGNSC Pierre LLC, 684 F. Supp. 2d 1161 (D.S.D. 2010), parsed an agreement's language in a similar fashion. The agreement in that case stated disputes would be resolved ''exclusively by binding arbitration to be conducted at a place agreed upon by the Parties, or in the absence of such an agreement, at the Facility, in accordance with the National Arbitration Forum Code of Procedure, which is hereby incorporated into this agreement, and not by a lawsuit or resort to court process.''

The *Jones* court also read ''exclusive'' as modifying ''binding arbitration'' and added that ''not by a lawsuit or resort to court process'' also counseled against denying arbitration. It concluded there was no evidence the clause showed the selection of NAF was integral to the agreement.

A final example of a court appointing a substitute comes from a recent ruling from the South Dakota Supreme Court in *Wright v. GGNSC Holdings LLC*, No. 25953 (S.D. Dec. 28, 2011). The state supreme court said it would rule in favor of a substitute for two reasons: (1) federal and state policy favors arbitration and (2) the NAF Code of Procedure did not contain any substantive provisions that would affect the resolution of the case.

''A review of the NAF Code reflects that NAF administration involved what is commonly provided by many arbitration services available today . . . [the plaintiff] has not identified any unique NAF administrative provision that would have substantively affected the outcome of this arbitration,'' the court ruled.

Other Courts Deny Substitute. The Illinois Supreme Court, however, found an agreement's incorporation of NAF rules to be a main reason to deny a substitute arbitrator in *Carr v. Gateway Inc.*, 944 N.E.2d 327, 79 U.S.L.W. 2041 (Ill. 2011).

The state supreme court said it was unclear whether NAF rules could be used by a non-NAF arbitrator, and it also questioned whether those rules could be used for a consumer arbitration given NAF stopped taking those types of cases. It also held that a penalty provision in

NAF rules imposed upon parties using a non-NAF arbitrator "clearly indicates that the designation of the NAF as the arbitral forum is integral to the agreement."

The Fifth Circuit in *Ranzy v. Tijerina*, 393 F. App'x 174 (5th Cir. 2010), said "where the parties' agreement specifies that the laws and procedures of a particular forum shall govern any arbitration between them, that forum-selection clause is an 'important' part of the arbitration agreement" and therefore no substitute arbitrator should be provided.

A final example comes from the Supreme Court of New Mexico in *Rivera v. American General Financial Services Inc.*, 259 P.3d 803 (N.M. 2011). It held that designating a specific arbitrator, the rules of a specific arbitrator, and use of mandatory contractual language all are reasons to conclude that a provider was integral to an agreement and not an ancillary concern.

The court concluded that "[t]he pervasive references to the NAF in the contract compel our conclusion that the parties intended for the NAF to be the exclusive arbitrator in any out-of-court dispute resolution. The parties explicitly specified that arbitration would proceed under NAF rules and procedures. Arbitration 'is a matter of consent, not coercion,' and the parties 'may . . . specify by contract the rules under which that arbitration will be conducted.' "

The National Arbitration Forum did not respond to phone and e-mail requests for comment.

By Michael O. Loatman

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