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Young Lawyers: The Danger of Raising Baseless Arguments to Evade Arbitration

By Charles E. Harris II – March 26, 2018

In *Hunt v. Moore Brothers, Inc.*, 861 F.3d 655 (7th. Cir. 2017), the Seventh Circuit affirmed a $7,500 sanction that Chief Judge Michael J. Reagan of the Southern District of Illinois imposed against an attorney for filing baseless motions in her effort to avoid arbitration. The district court relied on section 1927 of the Judiciary Code, which states that an attorney "who so multiplies [a] proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct." 28 U.S.C. § 1927. Either objective or substantive bad faith can support a section 1927 sanction. *Hunt*, 861 F.3d at 657–58.

As background, James Hunt, a Nebraska truck driver, entered into two independent contractor agreements to drive trucks for Moore Brothers, a small Nebraska company. After a dispute arose between the parties, the attorney filed a scathing lawsuit in the district court that included claims against Moore Brothers under section 1581 of the Criminal Code, 18 U.S.C. § 1581, for allegedly holding Hunt in peonage and for violating the RICO laws, 18 U.S.C. § 1962. But the agreements contained an arbitration clause requiring the parties to submit any disputes that "arise under this Agreement . . . to final and binding arbitration." *Id.* at 657–58. Accordingly, Moore Brothers filed a motion to stay the litigation and to compel arbitration under sections 3 and 4 of the Federal Arbitration Act (FAA), 9 U.S.C. §§ 3, 4.

The Attorney's Arguments

The attorney raised two main arguments in response to the motion to compel. First, she claimed that Hunt need not comply with the arbitration clause, because Moore Brothers had materially breached the agreements. And, second, she argued that the agreements fell outside the scope of the FAA, because Hunt was a transportation worker. *Hunt*, 861 F.3d at 657–58. Section 1 of the FAA exempts "contracts of employment of transportation workers." *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 119 (2001) (interpreting 9 U.S.C. § 1).

The district court flatly rejected both arguments. First, it pointed out that, if a breach of an underlying contract could relieve a party from having to comply with an arbitration clause, "no one would ever arbitrate a contract dispute, because the arbitration agreement would go up in smoke as soon as the dispute arose." *Hunt*, 861 F.3d at 658. The court further concluded that the attorney's attempt to bring the agreements under the Act's transportation worker exception failed as the complaint admitted that Hunt entered into an independent contractor
agreement—not an employment contract. The court thus granted Moore Brothers' motion and ordered the parties to try to agree on an arbitrator in accordance with the terms of their arbitration clause. \textit{Id}.

The attorney wasn't giving up though. She filed a motion less than two months later reporting that the parties were unable to agree on an arbitrator and, seizeing on this failure, to argue that the arbitration clause was merely an unenforceable "agreement to agree" under Nebraska law. The district court found this argument similarly meritless. It noted that a delay in the selection of an arbitrator doesn't affect the validity of an arbitration clause, and, regardless, the FAA would preempt conflicting Nebraska law. \textit{Id}. The district court denied the attorney's motion and subsequently granted Moore Brothers' motion for sanctions.

\textbf{Prior Dealings Between the District Judge and the Attorney}

\textit{Hunt} was not the first interaction between Judge Reagan and the attorney. In an earlier case in which the judge once described the attorney's filings as "obviously flawed," \textit{Global Traffic Techs. v. KM Enters.}, No. 14-mc-0065-MJR-DGW (S.D. Ill. May 15, 2015), opposing counsel twice moved for sanctions against her. The first motion sought an order of contempt after the attorney filed unredacted versions of documents on appeal that Judge Reagan had ordered the parties to keep under seal. \textit{See KM Enters. v. Global Techs.}, 725 F.3d 718, 734 (7th Cir. 2013). The judge admonished the attorney but declined to sanction her. The second motion sought sanctions in response to the attorney filing an allegedly frivolous motion for contempt. \textit{See Global Traffic Techs. v. KM Enters.}, No. 14-mc-0065-MJR-DGW (S.D. Ill. July 19, 2016). The judge once again declined to sanction the attorney.

\textbf{The Seventh Circuit Opinion}

Writing for the unanimous panel, Chief Judge Diane Wood acknowledged that district courts have broad discretion to award sanctions under section 1927, and, thus, the court should reverse only if no reasonable person could have come to the same conclusion under the circumstances. \textit{Hunt}, 861 F.3d at 659. Applying this standard, the Seventh Circuit held that the district court was entitled to "impose a calibrated sanction" on the attorney for "her conduct of the litigation, culminating in the objectively baseless motion she filed in opposition to arbitration." \textit{Id}.

In scrutinizing the breadth of the complaint, the court noted that, although the disagreement between Hunt and Moore Brothers was a simple commercial dispute, the attorney "blew it up beyond all rational proportion" by asserting "frivolous" claims against Hunt. \textit{Id}. All told, the court described the complaint as a "disaster."

The attorney's challenges to the arbitration clause fared no better in the court's eyes. It said that her arguments disregarded the "the long line of Supreme Court decisions upholding the enforceability of arbitration clauses exactly like the one" in the agreements, as well as the
established precedent admonishing that the FAA "requires courts to place arbitration agreements on equal footing with all other contracts." *Id.* (quoting *Kindred Nursing Ctrs. Ltd. P'ship v. Clark*, 137 S. Ct. 1421, 1424 (2017) (internal quotation marks omitted)). Indeed, the court noted that, under these principles, the FAA preempts "whatever Nebraska law has to say" as to whether the arbitration clause was an unenforceable agreement to agree. *Id.*

The court also held that the "fact that an agreement to arbitrate leaves for later negotiations the selection of the particular arbitrator does not render that agreement so vague as to be unenforceable." *Id.* The court said that, if this were true, section 5 of the FAA, which provides that courts "shall designate and appoint an arbitrator" if the parties fail to do so, would be superfluous. 9 U.S.C. § 5. Not to mention, the Seventh Circuit had explicitly held before *Hunt* that "arbitration clauses remain enforceable if for any reason there is a lapse in the naming of an arbitrator." *Green v. U.S. Cash Advance Ill., LLC*, 724 F.3d 787, 791 (7th Cir. 2013) (internal quotation marks omitted).

**Conclusion**

Having litigated dozens of motions to compel, the author has seen many plaintiffs' attorneys try to circumvent arbitration by raising far-fetched arguments similar to the ones advanced in *Hunt*. Some lawyers may decide not to pursue sanctions because the motions seeking them require an investment of attorney time and there is always a fear that the court will be reluctant to impose sanctions even where an attorney has engaged in clear wrongdoing. *Hunt* shows that district courts may be willing to impose sanctions where an attorney engages in objectively unreasonable conduct. And if a district court does take that step, the decision makes clear that the standard for overturning the district court's judgment is demanding.

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Summary Disposition in Arbitration

By John A. Shope and Diana Tsutieva – March 26, 2018

When we ask in-house counsel whose companies avoid arbitration clauses to explain why, the answer frequently includes the assertion that "you can't get summary judgment in arbitration." No in-house lawyer wants his client's senior executives to have to travel a long way and undergo cross-examination in a dispute over contract interpretation that could be resolved just by having a judge read the contract, or where the email trail makes the controlling facts indisputable. But while there is a historical and continuing kernel of truth to the assumption that a summary judgment—or more appropriately in the context of arbitration, a "summary disposition"—is unlikely to be rendered in an arbitration case, that assumption is increasingly less likely to be true. Leading arbitration tribunals now expressly permit summary disposition, arbitration panels are issuing partial or total summary dispositions, courts are enforcing these awards, and parties are including provisions in their arbitration agreements to encourage summary disposition.

This article provides an overview of the current state of relevant arbitration rules and discusses the historical reasons why summary judgment has been disfavored in arbitration, the current trend of the courts towards enforcing summary arbitration awards, and how parties can encourage arbitrators to grant appropriate summary dispositions and ensure that courts will enforce the resulting awards.

The Arbitration Fora Rules

The rules of various well-known arbitration forums currently run a gamut from: (i) making no mention of early dismissal or summary disposition but arguably implicitly authorizing them in general provisions granting the panel discretion to manage the proceedings, (ii) explicitly authorizing early dismissal of facially defective pleadings but not mentioning summary disposition based on facts extrinsic to the pleadings, or (iii) explicitly authorizing both early dismissal and fact-based summary dispositions. (In this regard, summary disposition should be distinguished from expedited proceedings, sometimes confusingly called summary proceedings, or requests for interim measures.)

Three major arbitral institutions have recently implemented rules on summary disposition. Effective March 1, 2017, the International Chamber of Commerce’s Arbitration Rules feature a set of rules for "expedited procedure," which apply to claims of $2 million or less unless the parties opt out, and provide that, after consulting the parties, the tribunal may decide the case on documents only without examination of witnesses or even a hearing. In addition, the ICC Court recently announced that, within the broad scope of Article 22 of its regular rules, a party
can make an "application" to the arbitral tribunal for "the expeditious determination of one or more claims or defences, on grounds that such claims or defenses are manifestly devoid of merit or fall manifestly outside the arbitral tribunal's jurisdiction." The arbitral tribunal has full discretion to decide whether to allow the application to proceed.

This is a notable change given that just a decade ago, an ICC task force declined to amend its rules expressly to allow summary dispositions on the ground that the procedure would likely "not work in the ICC context and culture." But even before the recent changes, ICC tribunals have in fact held that they have authority to grant a summary disposition.

The ICC change falls in line with recent rule amendments by two other arbitral institutions. Article 39 of the latest revised arbitration rules of the Arbitration Institute of the Stockholm Chamber of Commerce (January 1, 2017), applicable to claims of any size, expressly permits summary procedure for issues of fact and law and arguments that pleadings are legally insufficient. The latest Singapore International Arbitration Rules (August 1, 2016) provide (in Rule 29) for "early dismissal of a claim or defence" if it is either "manifestly without legal merit" or "manifestly outside the jurisdiction of the Tribunal." The Hong Kong International Centre's recently proposed changes to its arbitration rules also contemplate an early determination procedure.

U.S. arbitral bodies led this global trend. The American Arbitration Association's Commercial Rule 33 (effective October 1, 2013) and Construction Rule 34 (effective July 1, 2015), for example, provide that an arbitrator may permit and rule upon dispositive motions upon a prior written application, although Commercial Rule 33 requires a predicate showing that the motion is likely to succeed and will dispose of or narrow the issues. The JAMS rules (Comprehensive Rule 18, Construction Rule 18, and International Rule 26) authorize the arbitrator(s) to permit motions for summary disposition if there is "reasonable notice to respond." FINRA's Rule 9264 permits the respondent to file a motion for summary disposition (without leave of the Hearing Officer if prior to hearing).

The International Institute for Conflict Prevention and Resolution (CPR) has rules that do not specifically mention summary disposition. However, CPR's guidelines for administered and non-administered proceedings specifically deem summary disposition permissible pursuant to the general provision in CPR's Rule 9.1 that "subject to these rules, the Tribunal may conduct that arbitration in such manner as it shall deem appropriate." The guidelines encourage the tribunal to admit written evidence and factual presentations as appropriate for such motions, and note that, as a disincentive to frivolous motions (perhaps filed for delay), the tribunal may assess the costs of such a motion against an unsuccessful applicant separately from the overall costs of the case.
Factors Historically Disfavoring Summary Disposition in Arbitration

Several factors have limited the frequency of summary dispositions. While the most significant is the fear of vacatur, discussed below, a number of other historical reasons have constrained the use of summary determinations in arbitration. Some older U.S. arbitrators "grew up" as lawyers before the U.S. Supreme Court revolutionized summary judgment practice in 1986. To this day, summary judgment (or disposition) is not available in many other legal systems. Some arbitrators have believed that, in contracting for arbitration, the parties essentially expected an evidentiary hearing for any dispute. But this reasoning is arguably somewhat circular, and is certainly unsound for contracts made after the adoption of rules just noted.

Some have suggested that arbitrators will nonetheless continue to decline to issue summary dispositions because doing so eliminates the fee income to them from a multi-day evidentiary hearing. We think that the likelihood is diminishing. The panels are increasingly populated by full-time arbitrators motivated to maintain reputations for professionalism and efficient case management, such that they will continue to be selected. Furthermore, arbitrators are now explicitly asked to state their views on summary disposition in publicly available responses to questionnaires.

This is not to say that arbitrators will always grant meritorious motions for summary disposition. In this regard, however, arbitration is not to be compared to an idealized court proceeding, but rather to motion practice as it actually exists (or not) in trial courts. As noted, summary disposition is not available at all in many if not all continental systems. In the United States, it is very difficult to move successfully for summary disposition in most state court systems, in which the judges are overburdened with hundreds if not thousands of cases and have little or no law clerk support. This is especially so in the majority of states where the judges are elected and the necessity of running for reelection and avoiding offense to litigants or their counsel incentivizes passing all disputed questions to the jury. Even in the minority of states where judges are appointed rather than elected, state court judges frequently serve on a rotational assignment basis under which the granting of summary disposition entails extra work and the risk of reversal for the judge hearing the motion, but the denial of summary disposition merely passes the work of an unnecessary trial to another judge. It is no surprise that meritorious motions are frequently denied in state courts.

Even in the U.S. federal courts, which enjoy judges with life tenure, single-judge docketing, and law clerk support, only a small percentage of cases are decided by summary judgement. In one study, only 12 percent of cases experienced a motion for summary judgment that was granted in whole or in part. One reason is that the federal judges have hundreds of cases before them at once, vastly more than any arbitrator will ever simultaneously consider.
The Trend of Enforcement of Arbitral Summary Dispositions

In the United States, enforcement of arbitral awards is governed by the Federal Arbitration Act, 9 U.S.C. §§ 1, et seq., or, in international cases, the New York Convention. Among other grounds, § 10(a)(3) of the FAA permits courts to vacate arbitration awards "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." Arbitration lore holds that, at least in the United States, an arbitrator's grant of summary disposition risks vacatur on the theory that, by deciding the case without a hearing, the arbitrator will be "guilty of misconduct" in "refusing to hear" "pertinent and material" evidence. But there is scant support for that position, the limited authority is predicated on now-superseded administrative rules, and the overwhelming majority of more recent cases, especially at the appellate level, effectively hold that the award should not be vacated simply because it was issued without an evidentiary hearing, but rather should be confirmed absent evident partiality or exceedance of contractual authority.

In general, arbitration awards may be vacated for misconduct rather than mistake. (See Hall St. Assocs. v. Mattel, Inc., 552 U.S. 576 (2008). The New York Convention dictates a similar standard. Judges in the United States who have practiced under the U.S. Supreme Court's 1986 trilogy of summary judgment decisions (see Celotex Corp. v. Catrett, 477 U.S. 317 (1986); Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986); Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574 (1986)), which encouraged the use of the summary judgment procedure, are very unlikely to deem it unfair per se. Courts have held that no "bright line rule" requires arbitrators to conduct oral hearings. (See Oracle Corp. v. Wilson, No. 17 Civ. 554 (ER), 2017 U.S. Dist. LEXIS 134208 (S.D.N.Y. Aug. 22, 2017)). In determining whether the arbitrators who issued a summary judgment were "guilty of misconduct," courts in effect ask not whether they disagree with the arbitrator's legal conclusions, but whether the summary judgment procedure was fundamentally unfair (see e.g., Sherrock Bros. v. DaimlerChrysler Motors Co., 260 F. App'x 497, 501-02 (3d Cir. 2008); Campbell v. Am. Family Assur. Co. of Columbus, 613 F. Supp. 2d 1114, 1118-19 (D. Minn. 2009); Laccinole v. Experian Info. Solutions, Inc., C. A. No. 15-337-M-LDA, 2017 U.S. Dist. LEXIS 19668 (D.R.I. Feb. 10, 2017)). It is hard to characterize use of a summary disposition procedure as "misconduct," when the rules of the arbitration to which the parties agreed specifically contemplate that procedure. Courts have also found that even those arbitral tribunals that operate under the rules with no express provisions for summary disposition generally have the broader power to use procedures that are not inconsistent with those rules – including summary determination (see Sheldon v. Vermonty, 269 F. 3d 1202 (10th Cir. 2001); Weirton Med. Ctr. v. Cmty. Health Sys., No. S:15CV132 (STAMP), 2017 U.S. Dist. LEXIS 203722 (N.D. W. Va. (Dec. 12, 2017)). And a party cannot challenge an award issued summarily without a hearing if it did not avail itself of the opportunity to be heard by proffering further
Evidence, seeking discovery, or requesting an evidentiary hearing. (See Oracle Corp., 2017 U.S. Dist. LEXIS 134208).

Furthermore, the FAA predicates vacatur on "refusal to hear" material evidence. Courts properly recognize the distinction between "refusing to hear" evidence, on the one hand, and receiving evidence in opposition to summary judgment but deeming it legally immaterial, on the other hand (see Battles v. Am. Van Lines, Inc., No. 15-cv-62247-BLOOM/Valle, 2016 U.S. Dist. LEXIS 43888 (S.D. Fla. Mar. 30, 2016)). An arbitrator who grants a party opposing summary disposition the opportunity to submit affidavits and documents in opposition and assumes their veracity, while deeming them legally insufficient to foreclose judgment, has not "refused" to hear evidence but, at most, made a legal error in deeming it irrelevant. Such an error, for the most part, is insufficient to support vacatur. Indeed, it would construe the FAA in a nonsensical manner to hold that an arbitrator’s legal error was unreviewable if he or she deemed oral testimony at a hearing irrelevant, but fully reversible if he or she reached the same conclusion as to the same testimony if submitted by affidavit. And although it is not necessarily binding in federal court, and has not been adopted in all states, the Revised Uniform Arbitration Act’s express authorization of summary disposition upon reasonable notice will likely be influential to validate the practice. Thus, at least in the United States, the fear of vacatur of a summary disposition, at least one in which the losing party had a reasonable opportunity to oppose with a proffer of evidence, is something of a historical bogeyman. That said, well-crafted contractual provisions can minimize any residual risk of vacatur.

The same is true in other jurisdictions. In England, so long as the tribunal adopts summary disposition procedures that give all parties a reasonable opportunity to present their case, the risk that a court will not enforce a summary award, or will set aside a summary award, is low. Vacatur of arbitral decisions based on summary disposition is unlikely in the leading civil law jurisdictions as well. Courts in France, Holland, and Switzerland have enforced summary judgments rendered in U.S. court proceedings, so it is not much of a stretch to expect such courts to enforce an arbitration award made in a similar fashion.

Proposed Clauses
The best way to both preclude any issue of enforcement or arbitrator reluctance is to include a provision for summary disposition in the agreement to arbitrate. One Big Four accounting firm’s standard engagement letter, for example, provides that "the arbitrators may render early or summary disposition of some or all issues, after the parties have had a reasonable opportunity to make submissions on those issues." This clause comprehends factual as well as legal issues, and leaves the timing and the particulars for the tribunal to decide in a particular case. It also waives any challenge to enforcement based on the absence of an evidentiary hearing. If misuse of the process for delay or other tactical advantage is feared, the agreement could also specify
that a losing movant would pay the costs and fees of the motion irrespective of the final case outcome.

**Conclusion**

One merit of arbitration is that there is, in effect, competition. The business "customer" can by contract select the forum with the rules that it considers best. Numerous competing dispute resolution providers now tout the superior efficiency of their respective rules and procedures. The different fora and individual arbitrators will distinguish themselves, and potentially gain market share, by facilitating the efficient grant of summary disposition in appropriate cases. It is not fanciful to envision the coming day when summary disposition will be easier to obtain in arbitration than in court.

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Federal Mediation Privilege—How Far Does It Go?

By Sheila J. Carpenter – March 26, 2018

Acqis, LLC v. EMC Corp., No. 14-cv-13560 (D. Mass. June 29, 2017) (Burroughs, J.), is the most recent case adopting a federal common law mediation privilege and a convenient starting point for attorneys faced with the issue of what documents are covered by such a privilege. In Acqis, a patent case, the disputed documents related to mediations that took place in other lawsuits in other courts; they involved plaintiff Acqis, LLC but not defendant EMC Corporation. EMC sought documents related to these settlement discussions and Acqis asserted that they were covered by a mediation privilege. EMC agreed that documents created for use in the mediations themselves were privileged. The mediations in question apparently failed but there were settlement discussions after the mediations were terminated. Documents relating to the later discussions were the center of the dispute.

Such disputes implicate two important Federal Rules of evidence. Federal Rule of Evidence 408 states:

Rule 408. Compromise Offers and Negotiations

(a) Prohibited Uses. Evidence of the following is not admissible—on behalf of any party—either to prove or disprove the validity or amount of a disputed claim or to impeach by a prior inconsistent statement or a contradiction:

(1) furnishing, promising, or offering — or accepting, promising to accept, or offering to accept—a valuable consideration in compromising or attempting to compromise the claim; and
(2) conduct or a statement made during compromise negotiations about the claim—except when offered in a criminal case and when the negotiations related to a claim by a public office in the exercise of its regulatory, investigative, or enforcement authority.

(b) Exceptions. The court may admit this evidence for another purpose, such as proving a witness's bias or prejudice, negating a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.

and Federal Rule of Evidence 501 states:
Rule 501. Privilege in General

The common law—as interpreted by United States courts in the light of reason and experience—governs a claim of privilege unless any of the following provides otherwise:

- the United States Constitution;
- a federal statute; or
- rules prescribed by the Supreme Court.

But in a civil case, state law governs privilege regarding a claim or defense for which state law supplies the rule of decision.

Why Create a Mediation Privilege?
The exceptions to the protections of Rule 408 contained in section (b) do not entirely inspire confidence and more important, the rule speaks only to the admissibility of evidence, not to its production in discovery. This had led to court decisions that at least some records relating to settlement discussions are relevant for discovery purposes even if not necessarily admissible. Once discovered, opposing counsel can attempt to use one of the back doors to admission provided in Rule 408. Even without using settlement documents in court, such documents can provide valuable insight into the strengths and weaknesses of an opponent's case.

These holes in the protection accorded settlement discussions have given rise to state statutes affording a privilege for mediation and/or settlement discussions as well as local rules protecting statements made during mediation. But what if a case is purely federal? And what if the mediation is in another matter, not the one in which the documents are sought? These questions have given rise to arguments that federal common law, "in light of reason and experience," should recognize a mediation/settlement privilege.

In *Jaffee v. Redmond*, 518 U.S. 1 (1996), a case in which the Supreme Court recognized the psychotherapist privilege under FRE 501, the Court reasoned that the desirable goals to be fostered by a proposed privilege must be tempered by the general rule that justice requires the testimony of everyone with information to offer. As Justice Scalia pointed out in his lengthy dissent, there is a cost to creating a new privilege - occasional injustice because an important truth may not be discovered. For this reason, courts are reluctant to introduce new privileges.
The court in *Sheldone v. Penn. Tpk. Commission*, 104 F. Supp. 2d 511 (W.D. Pa. 2000), which recognized the federal mediation privilege, succinctly summarized the *Jaffee* standards for creation of a new privilege:

The four relevant factors are:

(1) whether the asserted privilege is "rooted in the imperative need for confidence and trust";
(2) whether the privilege would serve public ends;
(3) whether the evidentiary detriment caused by an exercise of the privilege is modest; and
(4) whether denial of the federal privilege would frustrate a parallel privilege adopted by the states.

*Sheldone*, 104 F. Supp. 2d at 513. The relatively small number of courts that have considered the question have generally found that trust is essential to mediation, that the expeditious and inexpensive resolution of litigation benefits the public, that there is little evidentiary detriment because if confidentiality is not guaranteed, candid information will not be produced in mediation, and, because almost every state has some sort of mediation privilege, the adoption of a federal common law mediation privilege harmonizes with state policies. In addition, the difficulty presented to the federal courts in managing their dockets without the assistance of mediation to settle cases is often noted.

*Folb v. Motion Picture Industry Pension & Health Plans*, 16 F. Supp. 2d 1164 (C.D. Cal. 1998), is the seminal case on the federal mediation privilege. The issue in *Folb*, as in *Acqis*, was whether documents created after a mediation were discoverable. The court recognized that if communications with a mediator were not protected, not only would parties withhold information from their mediator, but the more forthcoming party would be penalized. Indeed, litigants would be less interested in mediation if they could not be candid with the mediator. Whether exchanges between the parties themselves outside a mediation should be privileged as to third parties is a more difficult question.

**What Is the Scope of the Federal Common Law Mediation Privilege?**

Relying on *Sheldone* and particularly *Folb*, the court in *Acqis* held that once a mediator is no longer involved, the privilege is no longer applicable:

[C]ommunications to which a mediator was personally privy, communications that were directly made at a mediator's explicit behest, or communications undertaken with the specific intent to present them to a mediator for purposes of mediation are protected.
by the federal mediation privilege. Settlement negotiations in which a mediator is not actively and directly involved that follow a formal mediation are not protected by the mediation privilege, even when they contain information learned during the mediation or where they occurred in light of mediation, and such communications must therefore be produced barring any other applicable rules.

_Folb_ provides the rationale for this limitation: "Any interpretation of Rule 501 must be consistent with Rule 408. To protect settlement communications not related to mediation would invade Rule 408's domain; only Congress is authorized to amend the scope of protection afforded by Rule 408. Consequently, any post-mediation communications are protected only by Rule 408's limitations on admissibility." In other words, to avoid the post-mediation pitfalls of Rule 408, the parties must continue to use the mediator to help settle the case. Not only does one of the rationales for the privilege—the need for candid admissions of weakness—go away, the privilege cannot go so far as to eliminate the risks explicitly permitted by Rule 408(b).

**Practice Point**

The question of whether the federal mediation privilege is useful may arise in cases in federal court involving federal claims. In a typical case, the parties can protect their non-mediation settlement discussions by agreement if there is no statutory or local rule protection. The mediation privilege issue more likely appears when some third party wishes to discover these discussions. For example, in _Folb_, an employee was fired for sexually harassing another employee; he sued his employer, claiming that the firing was actually due to his whistleblowing. The allegedly harassed employee also sued the employer. The fired employee sought to obtain information about the mediation with her in the hope that the employer would have, in the course of settlement discussions, denied that the alleged harasser had committed the firing offenses.

Much of the time there will be no threat that some third party will want to discover the settlement discussions. However, situations such as in _Folb_, in consumer product and mass tort cases, and other types of litigation that tend to spawn copycat or spinoff suits, counsel should give consideration to keeping the mediator involved in subsequent discussions. Unless there seems to be no hope for settlement, buying a little additional time from the mediator may be a good investment. In addition, a good mediator will increase the chances that the case will settle sooner rather than later. My mentor used to tell me to "never stop talking" if a case should be settled; perhaps that should be changed in some cases to "never stop talking to your mediator."

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Threat of Sanctions on Counsel Who Employed “Scorched Earth” Tactics

By P. Jean Baker – March 26, 2018

Round One: Arbitration of the Dispute
In September 2012 Hyatt and Shen Zhen New World I entered into a franchise agreement providing that Shen Zhen would renovate a hotel in Los Angeles and operate it using Hyatt's business methods and trademarks. In 2014 Hyatt declared that Shen Zhen had not kept its promises. In accordance with a provision in the franchise agreement Hyatt filed a demand for arbitration with the American Arbitration Association (AAA).

An AAA arbitrator was appointed by mutual agreement of the parties. The parties participated in 9 days of in-person evidentiary hearings. The arbitrator issued a 51-page interim award consisting of reasoned findings of fact with extensive cites to controlling statutory and case law authority. The district court found that after a "vigorous" review of the franchise agreement the AAA Arbitrator found that Hyatt was entitled to terminate the contract because Shen Zhen had breached its financial obligations by refusing multiple times to pay chain fees and marketing fees. Shen Zhen was ordered to pay $7,727,646 in damages.

Because the franchise agreement provided that the non-prevailing party must reimburse the prevailing party for all reasonable accounting, attorneys', arbitrators' and related fees, the interim award directed Hyatt to submit a request. In the final award Shen Zhen was ordered to pay an additional $1,324,546.36 in attorneys' fees and costs.

Round Two: Dueling Motions in District Court
Hyatt sought to have the award confirmed and entered as a court judgment. Shen Zhen sought to vacate the award on three grounds: 1. The arbitrator had engaged in misconduct under Federal Arbitration Act (FAA) Section 10(a)(3); 2. The arbitrator had engaged in a manifest disregard of the law under FAA Section 10(a)(4); 3. Public policy supported vacating the award.

Arbitrator Misconduct under FAA Section 10(a)(3)
Shen Zhen argued that denial of requests for discovery into the alleged incompetence of prior counsel and potential conflicts of interest amounted to a refusal to hear pertinent evidence and constituted arbitrator misconduct under FAA Section 10(a)(3). Shen Zhen had sought to subpoena the attorney who represented Shen Zhen during contract negotiations in 2012 to establish the attorney had provided incompetent representation. The arbitrator had ruled that such evidence would not be relevant as to whether the agreements themselves were
ambiguous or somehow flawed at the time of contracting. Based upon the fact the attorney
had been working with a sophisticated business team and in-house attorneys from Shen Zhen
during the negotiations and the attorney had stopped working for Shen Zhen in 2012, the
district court upheld the arbitrator's decision to deny issuance of the subpoena.

In 2015, three years after the attorney stopped representing Shen Zhen, the attorney joined the
law firm that was representing Hyatt in the current dispute with Shen Zhen. The arbitrator
ruled, over Shen Zhen's objections, that the franchise agreement specified application of Illinois
law. In accordance with the Illinois Rules of Professional Conduct (IRPC) and relevant Illinois
case law Hyatt's law firm should not be disqualified since the law firm had properly
implemented a conflicts screen in compliance with the IRPC. As to whether there was
misconduct when the arbitrator decided to not disqualify Hyatt's law firm, the district court
noted that Shen Zhen only cited to non-precedential and factually distinguishable cases
establishing misconduct by an arbitrator. The district court concluded that refusing additional
discovery requests were the kinds of arbitral decisions that a court is not permitted to overturn.
Thus, there was no misconduct under FAA Section 10(a)(3).

**Manifest Disregard for the Law under FAA Section 10(a)(4)**

Shen Zhen argued that the arbitrator manifested a disregard for law when the arbitrator failed
to disqualify Hyatt's law firm; failed to consider that the franchise agreement required a notice
and cure period; and failed to apply the California Franchise Investment Laws (CFIL) and the
Federal Trade Commission (FTC) regulations.

The district court began its analysis by stating that the manifest disregard standard only
encompasses scenarios in which an arbitrator intentionally disregarded a law to arrive at a
certain result or where an arbitrator instructed the parties to violate the law. Courts lacked the
authority to review for mere mistakes of law. The arbitrator applied Illinois law—the law
specified in the franchise agreement—when deciding to not disqualify Hyatt's law firm so there
was no intentional disregard for the law. As to whether the arbitrator's determination that a
provision in the franchise agreement allowed Hyatt to terminate without providing Shen Zhen
opportunity to cure, that "is precisely the kind of arbitral decision that a district court is not
permitted to overturn." If the arbitrator had been incorrect about claims under the CFIL and the
FTC being baseless (an assessment the district court was inclined to agree with), that would
again constitute an arbitral mistake of law and not a manifest disregard for law. Finally, an
arbitrator is under no obligation to apply statutes which do not provide relief for the
controversies before them so there was no legal obligation to apply either the CFIL or the FTC.
Against Public Policy

Finally, Shen Zhen asked the district court to overturn the arbitrator's rulings on public policy grounds. As noted by the district court the only support offered by Shen Zhen that a court possessed the ability to vacate a commercial arbitration award on public policy grounds was a 2013 Seventh Circuit decision that involved a collective bargaining statute. See Titan Tire Corp. of Freeport v. United Steel, Paper & Forestry, Rubber Mfg., Energy, Allied Indus. & Serv. Workers Int'l Union, 734 F.3d 708 (7th Cir. 2013).

Since the FAA does not mention public policy violations as grounds for vacating an arbitration award, the District court concluded there was no clear authority to overturn a commercial arbitration award on public policy grounds.

The district court granted Hyatt's motion to confirm the award and denied Shen Zhen's motion to vacate the award. (Hyatt Franchising, L.L.C. v. Shen Zhen New World 1, LLC, 876 F.3d 900 (7th Cir. 2017).)

Round Three: Seventh Circuit Court of Appeal

Shen Zhen filed an appeal seeking reversal of the district court's decision to confirm the award.

Arbitrator's Denial of Discovery Request

The Seventh Circuit began its analysis by finding that the statutory phrase "refusing to hear evidence" concerns the conduct of the hearing, not the conduct of discovery. The court stressed that nothing in the FAA requires an arbitrator to allow any discovery. In fact, avoiding the expense of discovery is among the principal reasons why people agree to arbitrate. Thus, Respondent's argument that the AAA arbitrator should have allowed additional discovery "rings hollow," especially when one considers that Hyatt's attorneys' fees exceeded $1 million—an indication to the court that plenty of discovery had actually occurred.

Further whether the attorney had furnished good advice when negotiating the franchise agreement might be relevant in a malpractice action against the attorney but did not bear on Hyatt's allegations that Shen Zhen breached the contract. In addition, the contract had an integration clause that foreclosed use of the negotiating history as an interpretive tool. Finally, in a commercial transaction between sophisticated parties the defense of unconscionability, if available at all, was an objective one dependent upon the agreement's terms and not on what either side's attorney might say about the actual negotiations.

Arbitrator's Refusal to Disqualify Claimant's Law Firm

Next the court found that FAA Section 10(a)(3) does not provide for substantive review of an arbitrator's decisions. It provides for judicial intervention when an arbitrator misbehaves, but
not when an arbitrator renders a mistaken decision, either as a matter of fact or as a matter of law. If Shen Zhen believed that the attorney or Claimant's law firm engaged in misbehavior, the appropriate forum was a complaint to the state bar.

**Disregard for the Law under Section 10(a)(4)**

As a "fallback argument", Shen Zhen contended that the award disregarded federal and state franchise law and therefore should be set aside under Section 10(a)(4). The court began its analysis by relying upon two prior Seventh Circuit decisions that held that Section 10(a)(4) does not make legal errors a ground on which a judge may refuse to enforce an award. See, e.g., *George Watts & Sons, Inc. v. Tiffany & Co.*, 248 F.3d 577 (2001); *Affymax, Inc. v. Ortho-McNeil-Janssen Pharmaceuticals, Inc.*, 660 F.3rd 281 (2011). The court concluded that just as an arbitrator is entitled to interpret the parties' contract without judicial review, an arbitrator is also entitled to interpret the law applied to that contract without judicial review.

Further *Watts* and *Affymax* concluded that an arbitrator acts as the parties' joint agent and may do anything the parties themselves may do. If the parties could have reached a compromise over some legal issue, such as compliance with a notice and cure provision in a state franchise statute, without being accused of "violating the law", then the arbitrator may do so on their behalf. Arbitrators only exceed their powers under Section 10(a)(4) if they order the parties to violate the rights of persons who have not agreed to arbitrate, such as ordering the parties to commit an illegal act. Thus, Section 10(a)(4) does not apply to contentions that Hyatt violated provisions of state or federal laws because none of Shen Zhen's arguments concerned the rights of third parties.

**Violation of Public Policy**

The court concluded its analysis by noting that "Shen Zhen cannot make headway by relabeling its "violation of law" arguments as "violation of public policy." The "public policy" that judges may use to annul an award is policy designed to protect the public against the parties to the arbitration. As decided by the Supreme Court when the parties are free under the law to agree on some outcome, the arbitrator's decision as their agent does not violate public policy. *Eastern Associated Coal Corp. v. United Mine Workers*, 531 U.S. 57 (2000).

**Impact of the Fee-Shifting Provision**

The court noted that when commercial parties that have agreed to final resolution by an arbitrator yet one party continues to litigate, a court may order payment of their adversaries' attorneys fee. See *Continental Can Co. v. Chicago Truck Drivers Pension Fund*, 921 F.2nd 126 (7th Cir. 1990). Because the franchise agreement included a fee-shifting clause, the court held that it was unnecessary to make a separate fee-shifting order under Continental Can. But if the
parties were unable to agree on how much Shen Zhen owed for "pointlessly extending this
dispute through the district court and the court of appeal," Hyatt could apply for an appropriate

Round Four: Attempt to Countermand Seventh Circuit's Final Decision
Instead of complying with the final decision of the court, Shen Zhen first declined to reimburse
Hyatt for fees incurred in district court. When asked by the court to respond to a motion filed
by Hyatt seeking payment, Shen Zhen indicated it was unwilling to reimburse Hyatt for any legal
expenses unless Hyatt prevailed in a separate AAA arbitration dealing with legal fees. But
instead of proceeding in arbitration, Shen Zhen asked AAA to dismiss the proceeding on the
ground that the award of fees was exclusively a judicial matter. Shen Zhen then filed a motion
in the Central District of California asking the court to relieve it of any obligation to comply with
the award.

Round Five: Imposition of Additional Fees/Costs and Threat of Section 1927 Sanctions
The Court of Appeal began by stating that "it is hard to find words to describe the conduct of a
party that refuses to accept not only the arbitrator's decision but also a final judicial outcome
and scours the nation in search of a different opinion." The court proceeded to review the
responsibility placed on counsel by 28 U.S.C. Section 1927 to not multiply proceedings in an
unreasonable and vexatious way. Should counsel fail to comply, a court may order counsel to
satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because
of counsel's conduct. The court concluded that the "scorched-earth tactics" employed by Shen
Zhen's counsel fell "comfortably" within the description of unreasonable and vexatious. The
court ordered Shen Zhen's counsel to show why counsel should not be held jointly and severally
responsible for Hyatt's excess costs, expenses, and attorneys' fees.

Referencing a line of Seventh Circuit cases that, when commercial parties wage unsuccessful
litigation against an arbitrator's award, grant a court the authority to order the vexatious
litigant to make their adversary whole, the court ordered Shen Zhen to compensate Hyatt for all
legal fees and costs incurred not only in proceedings before the court of appeal and the district
court, but in any future proceedings necessary for Hyatt to defend and enforce the court's
conclusion that Hyatt was entitled to fees.

In a final observation the court noted that the district court was now free to entertain any
application Hyatt might make seeking an injunction against Shen Zhen's duplicative litigation in
Conclusion
Challenging arbitration awards will probably become harder, at least in the Seventh Circuit, if based on cites to non-precedential and factually distinguishable cases. Failing to cease litigation following a final judicial outcome might subject counsel's vexatious client to the imposition of substantial additional costs and fees. Allowing a client to advance inaccurate and inconsistent positions in multiple unsuccessful proceedings might result in the imposition on counsel of Section 1927 sanctions.

One final observation: when an arbitrator is confronted with an extremely contentious party it would be wise to issue an award that clearly demonstrates the thoroughness with which the arbitrator reviewed the facts and the law. For example, the AAA arbitrator devoted five pages of the 51-page interim award carefully reviewing the language of the California Franchise Investment Law and the Federal Trade Commission Regulations before concluding that Shen Zhen's claims under those regulatory regimes lacked merit.

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PRACTICE POINTS

Reference to Nonexistent Arbitration Forum Nullifies Arbitration Agreement

By Robert E. Bartkus – March 8, 2018


The ADR world has seen significant litigation regarding CashCall because of its unique business model and the bizarre arbitration clauses that it included in its consumer loan agreements. New Jersey’s federal court considered that history and the CashCall arbitration clause in 2017, and found the arbitration clause wanting in several respects. See MacDonald v. CashCall, Inc., No. 16-2781, 2017 U.S. Dist. LEXIS 64761 (D.N.J. Apr. 28, 2017). After describing what it termed CashCall’s “controversial lending practices” involving interest rates so high that many states did not permit its operations, the court denied a motion to compel arbitration and allowed various usury, consumer, and RICO claims to proceed against CashCall.

To avoid state usury and other consumer protection laws, CashCall provided that any disputes under its agreements would be arbitrated in accordance with the substantive and arbitration law of the Cheyenne River Sioux Tribe. However, the tribe, which had nothing to do with CashCall’s loans, had no arbitration law, no arbitration representatives, and no arbitration procedures. As a result, the district court held that CashCall’s arbitration clause was unenforceable.

CashCall fared no better when it appealed the denial of its motion to compel arbitration to the Third Circuit. See MacDonald v. CashCall, Inc., No. 17-2161, 2018 U.S. App. LEXIS 4795 (3d Cir. Feb. 27, 2018). CashCall’s arbitration clause, which made multiple references to tribal law, stated that disputes should be “resolved by Arbitration, which shall be conducted by the [Tribe] by an authorized representative in accordance with its consumer dispute rules and the terms of this Agreement.” The clause stated that the parties had the “right” to select either AAA or JAMS “to administer the arbitration,” whose rules would then apply to the extent they did not contradict the tribe’s rules.
The fundamental problem for CashCall was that the tribal arbitration representative and rules did not exist. Offering the AAA and/or JAMS as administrators did not cure this problem. CashCall had selected a nonexistent person as arbitrator and non-existent arbitration rules to govern the arbitration. Under those circumstances, providing an administrator was meaningless.

The Third Circuit has held that the unavailability of an arbitration forum will not defeat arbitration unless that forum was an integral part of the parties’ agreement. See *Khan v. Dell, Inc.*, 669 F.3d 350 (3d Cir. 2012). Here, the Third Circuit essentially said that CashCall was hoisted on its own petard – by making nonexistent Tribal law such an integral part of the agreement, CashCall practically required the Court to deny CashCall’s motion to compel arbitration.

CashCall argued that the delegation clause in its loan agreement required the court to defer to an arbitrator to decide these issues, but the Third Circuit had no difficulty in rejecting this position. It held that delegation to an illusory and nonexistent arbitration forum made no sense.

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**Email to Employee Not Sufficient Notice of Arbitration**

*By S.I. Strong – February 28, 2018*

A recent case from the English Commercial Court considers issues relating to service of notice of arbitration by email. In *Glencore Agriculture BV v Conqueror Holdings Ltd* [2017] EWHC 2893 (Comm) (Nov. 16, 2017), Glencore Grain sought to set aside a final arbitration award of a sole arbitrator in favor of Conqueror. Glencore Grain had taken no part in the arbitration and was unaware of the proceedings until it received the award by standard mail on October 28, 2016. The notice of arbitration and other documents were sent to the email address of an employee of Glencore Grain who left Glencore Grain's employment in September 2016, although the employee was still on staff during the pendency of the arbitration. The issue is whether the notice of arbitration and notice under section 17 of the *English Arbitration Act 1996* were validly served by being sent to the employee's email address.
The case was decided on agency principles, namely whether the former employee could be considered an agent of Glencore Grain who had actual or ostensible authority to receive service to Glencore Grain under section 76 of the Arbitration Act 1996. According to the court,

[Nothing in] the facts of the present case . . . support a finding of implied authority. The most that can be said is that Mr Oosterman was a representative of the operational department who had sent operational communications in relation to the performance of the charter party and the events giving rise to the dispute. That is not sufficient to give rise to the inference that he was cloaked with authority to assume the serious and distinct responsibility for accepting service of legal process. It cannot be said that he thereby impliedly had authority to handle any legal dispute arising out of the voyage, still less to accept service of legal or arbitral process and deal with it.

Furthermore, the facts are insufficient to establish implied authority (even when taken with other evidence, such as the LinkedIn material which was not promulgated by Glencore Grain to Conqueror); on their own they do not hold Mr Oosterman out as having anything more than a limited operational role in relation to the voyage. They do not hold him out as having authority to handle any legal dispute arising out of the voyage, still less to accept service of legal or arbitral process and deal with it.

As a result, the court held there was insufficient notice of the commencement of the arbitration and ordered the award to be set aside.

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