SECURITIES LITIGATION
SLC'S WEEKLY ALERT

Morgan Stanley Smith Barney, LLC vs. Trottier, No. BS170178 (Cal. Super. Ct., Los Angeles Cty., 12/11/17).

Vacatur of Award * Arbitrator Bias (Evident Partiality) * SRO Rules (FINRA Rule 12405) * State Statutes Interpreted (Cal. CCP, §§ 1286 & 1291) * Disclosure Issues (Conflict) * Postponement, Refusal (Material Evidence) * Expert Testimony/Opinions * Discovery Issues * Account Administration (Check-Writing) * Prejudice to Party.

Arbitrators must disclose representation of clients in the same position as one of the parties to the current arbitration in matters involving the same subject matter, because it raises reasonable questions about their impartiality.

The attitude of the California courts, because arbitrators decide both the law and the facts and are relatively immune from second-guessing by the courts, holds that review of their impartiality must be more scrupulous even than for judges. In FINRA arbitration, arbitrators are not only encouraged to make full disclosure about potential conflicts on their own, they are asked specific Subject Matter and Financial Disclosure questions via a disclosure form that FINRA requires them to fill out. Here, one of the three Arbitrators in the proceeding below -- the Public Chair -- answered "no" to a question on the form, when he might have answered "yes."

The question related to a prior representation by the Arbitrator in a case of similar circumstances -- elder abuse and payments to third-party malefactors -- a circumstance that California law, in addition to the "FINRA Disclosure Rules," would require the Arbitrator to disclose. According to the Court, the California Arbitration Act "requires a potential arbitrator to disclose 'all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed neutral arbitrators would be able to be impartial.' CCP, Section 1281.9(a). Indeed, 'any matter that could reasonably create the appearance of partiality' must be disclosed...." More specifically, the California courts have held that "[a]rbitrators must disclose 'representation of clients in the same position as one of the parties to the current arbitration in matters involving the same subject matter,' because it raises reasonable questions about their impartiality."

The law requires the courts to vacate an Award in the face of required disclosures that are not made. Not satisfied with a single ground for vacatur, the Court proceeds to Morgan Stanley's next argument and sustains that as well. The Arbitrators refused a postponement request by Morgan Stanley, required to obtain material evidence. The Panel actually issued an order for the production of the information, for use in rebuttal, but declined to follow through when Claimant Trottier failed to produce the documents. Morgan Stanley sought sanctions and requested a brief postponement, while it sought the documents through other means. The Panel decided to press forward. In the Court's view, that

decision "abused [the arbitrators'] discretion by depriving Morgan Stanley of a full and fair opportunity to present their defense."
California law requires vacatur "if the rights of the party are 'substantially prejudiced by the refusal of the arbitrators to postpone the hearing upon a sufficient cause being shown...." That prejudice occurred in this case, because it "denied Morgan Stanley the right to gather discovery crucial to their defenses and their cross-examination of Mr. Trottier, including with respect to Mr. Trottier's purported inconsistent position on [his mother's] mental competency" to write checks. Despite denying the opportunity to Morgan Stanley ... to obtain this discovery, the arbitrators allowed [Claimant's expert] to testify, on behalf of Mr. Trottier."

*(ed: *The Award (FINRA ID #15-02910 (Los Angeles, 6/9/17)) resulted in an award of almost $400,000,in exchange for the assignment of a restitution order in a related criminal proceeding against the "malefactor." Representing Morgan Stanley in the vacatur proceeding (but not in the FINRA arbitration) was Peter Boutin, Keesal Young & Logan, San Francisco. Mr. Boutin serves on the Board of Editors of the SAC newsletter. **Judging from the Court's explanation alone, we'd say the two grounds independently justified vacatur. We do wonder, though, whether courts pay special scrutiny when the Chair is accused of bias. Might they, for instance, see an unwarranted refusal to postpone as evidence of Chair bias or, conversely, Chair bias as confirmed by an unwarranted refusal to postpone. While chairpersons are ultimately just one of three, they do have particular control over the course of the proceedings and, in that sense, sit in a place of somewhat higher responsibility.)*

(SLC Ref. No. 2018-03-02)