

# Alternatives

TO THE HIGH COST OF LITIGATION

The Newsletter of the International Institute for Conflict Prevention & Resolution

VOL. 32 NO. 8 SEPTEMBER 2014

## Arbitration

### Get Back—Return Arbitration to Its ADR Roots

BY M. SCOTT DONAHEY

#### INTRODUCTION

Arbitration has become a warmed-over version of litigation, rather than the truly alternative procedure it once was. While there are still creative in-house counsel and law-firm draftspersons who provide for innovative procedures that save time and money while arriving at a fair and just result, too often arbitration has become a somewhat less formal shadow of a

court trial. The innovation for which America is rightfully famous is largely absent in the arbitration arena.

Anyone involved in international arbitration has heard the recurring complaint from civil-law lawyers that international arbitration has been afflicted with “Americanization”: the creeping assimilation of American litigation practices. Discovery, which was almost unheard of in international arbitration, is now threatening to become a normal antecedent. The aggressive cross-examination conducted by common-law practitioners, unknown in civil law practice, is finding its way into almost all cases where a party is represented by American counsel. Motion practice, both as to procedural and substantive matters, is ever-increasing, resulting in additional time and expense in both domestic and international arbitration. Yet, while condemned by a chorus of objections and complaints, the infiltration of American litigation practice and tactics continues unabated.

Once, arbitration was THE alternative

dispute resolution. Now it is rarely thought of as a part of the ADR pantheon. What can be done to restore arbitration to the place it once



held as a process controlled by the parties to meet the needs of their particular commercial dispute, rather than the needs of their counsel or of the arbitrators? It requires nothing less than a revolution in thinking.

#### ARBITRATION IS FUNDAMENTALLY DIFFERENT FROM LITIGATION

The American litigation process is a product of the legislature, designed to meet the needs of society as a whole. It was never viewed as the primary means of resolving commercial disputes. It evolved to provide citizens a peaceful way to resolve disputes that might otherwise threaten the peace of the society as a whole. The general civil procedures were not designed for the resolution of business disputes, but are rather procedures intended for family disputes, boundary disputes, aggression between citizens (assault, battery, and certain other intentional torts), disputes over real and personal property rights, civil rights, and many other categories of disputes whose resolution might otherwise threaten the social fabric of the nation.

Commercial arbitration was intended to be a true “alternative” to the catch-all procedures

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# CPR News

## CPR NEWS SEPTEMBER/OCTOBER MEETINGS AND EVENTS

### Committees

CPR member-only committees are the backbone of CPR's thought-leadership and play a critical role in shaping the future of ADR. Committees provide the unique and rewarding opportunity for users and practitioners to convene, collaborate, define best practices and spearhead innovation in commercial conflict management. If you are interested in joining a committee, attending one of these meetings and strengthening your connections, contact CPR's Director of Membership **Terri Bartlett** at [tbartlett@cpradr.org](mailto:tbartlett@cpradr.org) or +1.212.949.6490.

- September 4 - Arbitration Committee Meeting, 12:15 p.m. - 2:00 p.m. (EDT), White & Case, 1155 Avenue of the Americas, New York, NY (dial-in available); for information contact Bette Shifman: [bshifman@cpradr.org](mailto:bshifman@cpradr.org).
- September 11 - Diversity Task Force Committee Teleconference,



11 a.m. - 12 noon, dial-in information to be provided; for information contact Beth Trent: [btrent@cpradr.org](mailto:btrent@cpradr.org).

- September 16 - Banking Committee Meeting, 12:30 p.m. - 2:30 p.m. (EDT), Jenner & Block, 919 Third Avenue, New York, NY; for information contact Olivier André: [oandre@cpradr.org](mailto:oandre@cpradr.org).
- September 23 - Y-ADR Steering Committee Teleconference, 10:00 a.m. (EDT), dial-in information to be provided; for information contact Olivier André: [oandre@cpradr.org](mailto:oandre@cpradr.org).
  - September 25 - European Executive Board Teleconference, 4:00 p.m. CEST / 3:00 p.m. BST / 10:00 a.m. EDT, dial-in information to be provided; for information contact Olivier André: [oandre@cpradr.org](mailto:oandre@cpradr.org).
  - October 30 - Arbitration Committee Meeting, 12:15 p.m. - 2:00 p.m. (EDT), White & Case, 1155 Avenue of the Americas, New York, NY (dial-in available); for information contact Bette Shifman: [bshifman@cpradr.org](mailto:bshifman@cpradr.org).

### Events

October 30 - Y-ADR Seminar, 5:00 p.m. - 9:30 p.m. (BST), Eversheds, 1 Wood Street, London, EC2V 7WS; for information contact *(continued on page 131)*

# Alternatives



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## Mediation

# Another Look at Mediation Confidentiality: Does It Serve Its Intended Purpose?

BY ERIC VAN GINKEL

## INTRODUCTION

In 2005, Michael Cassel sued his attorneys for malpractice, alleging they coerced him into a much lower settlement than they had agreed to in meetings held in preparation for mediation. The attorneys moved under the California mediation confidentiality statutes to exclude all evidence of communications between Cassel and his attorneys that were related to the mediation, including matters discussed at pre-mediation meetings and private communications between Cassel and the lawyers while the mediation was under way.

The Court had to decide whether the California mediation confidentiality law required exclusion of conversations and conduct solely between a client, Cassel, and his attorneys, Wasserman Comden, during meetings in which they were the sole participants and which were held outside the presence of any opposing party or the mediator. Should the public policy of protecting mediation confidentiality outweigh clients' right to sue for malpractice so that attorneys can take advantage of those mediation con-



fidentiality laws, and successfully avert their client's suit for malpractice? According to the California Supreme Court, the answer is an unqualified yes.

In its 2011 opinion, the court held that "[w]e have repeatedly said that these [mediation] confidentiality provisions are clear and absolute. Except in rare circumstances, they must be strictly applied and do not permit judicially crafted exceptions or limitations, even where competing public policies may be affected." Consequently, the Court ruled in favor of the law firm, and Mr. Cassel was unable to challenge his lawyers for having committed malpractice; *Cassel v. Superior Court*, 51 Cal.4th 113, 118 (2011) (bit.ly/1pL4as4; the case was the subject of a CPR seminar, reported at bit.ly/1B9heNV).

Given the language of the California statute, the Court was correct. As the Court observed, "[w]ith specified statutory exceptions, neither 'evidence of anything said,' nor any 'writing,' is discoverable or admissible 'in any arbitration, administrative adjudication, civil action, or other noncriminal proceeding in which . . . testimony can be compelled to be given,' if the statement was made, or the writing was prepared, 'for the purpose of, in the course of, or pursuant to, a mediation.'"

Mainly because of the *Cassel* case, the California Law Revision Commission (CLRC) is currently reviewing the statutory provisions dealing with mediation confidentiality in that state; see bit.ly/1r5rEfo. A review of the reports issued by CLRC staff reveals that there is relatively little understanding about what purpose the mediation confidentiality laws serve. This article will not reveal anything novel, but as Marcel Proust once wrote, "The real voyage of discovery consists not in seeking new landscapes, but in having new eyes." Let us therefore take another look at why we have mediation confidentiality laws.

## LACK OF EMPIRICAL DATA

To date, no study has been undertaken that would give us the empirical data that connects success in mediation proceedings with the availability of a form of confidentiality protection. In other words, we don't really know for sure that confidentiality enhances the chance of settlement in a mediation, but most of us generally assume this is the case. Both the California mediation confidentiality laws and the Uniform Mediation Act assume that mediation confidentiality promotes *candor*, which in turn promotes frank exchanges that lead more easily to settlement.

In 2006, Professor Ellen Deason conducted extensive research into this question, and concluded that the principal justification for confidentiality in mediation is that it creates *trust* in the process and thus promotes settlement (see box). What has not been explored in great detail, at least not explicitly, is whether and to what degree the need (and therefore justification) for confidentiality remains, once a settlement has been reached.

## THREE FORMS OF MEDIATION CONFIDENTIALITY

It bears repeating that we can distinguish three forms of mediation confidentiality: (1) during the mediation, when a party gives information to the mediator while meeting without the other party present (in caucus), as the express or implied obligation of the mediator not to disclose that information to the other party; (2) during and after the mediation, as a general obligation not to disclose information regarding the mediation to any third party; and (3) after the mediation, as a right or duty not to disclose mediation information in a subsequent proceeding.

For purposes of this discussion, we will focus on the legislative protection of confidentiality in the third category.

(continued on next page)

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### ADVANTAGES AND DISADVANTAGES OF MEDIATION CONFIDENTIALITY

Even if there is no scientific basis of empirical data available to determine the effective usefulness of mediation confidentiality, there is general agreement among authors with respect to the advantages of mediation confidentiality legislation (as opposed to leaving it to the parties to enter into a confidentiality agreement). As a result of the mediation privilege, mediation-related information cannot be used:

- in current litigation;
- in a different law suit;
- by adversaries or potential adversaries (including public authorities);
- to prejudice legal rights;
- to expose a party to legal liability or prosecution; or
- to prejudice a party in commercial dealings.

Of course, there are also perceived disadvantages to mediation confidentiality. The law of evidence in many jurisdictions, notably in the common law countries, views courts as entitled to every person's evidence, so that generally public policy in those jurisdictions forbids parties to agree to withhold evidence.

The generally recognized disadvantages include the fact that mediation confidentiality

- hinders the fact-finder by excluding salient information;
- runs counter to democratic principles of transparency and participation in public processes; and
- competes with other important values that are served by reporting certain conduct (preventing crime, attorney misconduct, child abuse).

### THE NEED FOR CONFIDENTIALITY AFTER MEDIATION HAS LED TO SETTLEMENT

If candor and trust are the principal motivating factors for the creation of a confidentiality privilege (or, as in California, an exclusionary

rule of evidence), it stands to reason that these factors continue to play a major role in subsequent litigation if the mediation proceedings fail to lead to settlement. The parties need to be assured that disclosures made during mediation are not revealed in subsequent proceedings (whether they be administrative, court or arbitration). In fact, that would appear to be the main purpose of confidentiality.

On the other hand, if the dispute settles, the need for confidentiality arguably persists if relevant facts disclosed in a mediation could play a role in a different but related proceeding (see, e.g., *Rojas v. Superior Court*, 33 Cal.4<sup>th</sup> 407 (2004)), but would no longer be as important with respect to the dispute that was settled. After all, the need for trust and candor has been fulfilled, the mediation is over, and now it is a matter of implementing (or enforcing or challenging) the settlement agreement.

The Supreme Court of Canada opined in a recent case involving a mediation confidentiality agreement under the laws of Quebec that "a communication that has led to a settlement will cease to be privileged if disclosing it is necessary in order to prove the existence or the scope of the settlement." In addition, the Court found that "[w]hile allowing parties to freely contract for confidentiality protection furthers the valuable public purpose of promoting settlement, contracting out of the exception to settlement privilege that applies where a party seeks to prove the terms of a settlement might prevent parties from enforcing the terms of settlements they have negotiated; *Union Carbide Canada Inc. v. Bombardier Inc.*, 2014 SCC 35 (2014)(bit.ly/Vg7kJk).

### DIFFERENT PARTICIPANTS IN THE MEDIATION HAVE DIFFERENT NEEDS

Looking at the need for confidentiality, another question arises: who needs what kind of confidentiality? Do all participants have the same needs, as the California mediation confidentiality laws assume?

The parties, the mediator, and all other participants (including any attorneys) need confidentiality, but not all to the same degree. The participants that would appear to need the most confidentiality are the parties themselves. After all, the "candor" and "trust" arguments underlying the need for confidentiality apply directly to them. For the parties it is important

that all participants in the mediation (i.e., all persons present) keep confidential all that is said, written or inferred from their respective behavior. It concerns mainly "the damaging use against a mediation disputant of tactics employed, positions taken, or confidences exchanged in the mediation," as the California Court of Appeal reasoned in *Cassel*, 51 Cal.4<sup>th</sup> at 118.

The mediator's need for confidentiality is perhaps less. Many (mostly mediators) have argued that the mediator should not be allowed to testify in any subsequent proceeding lest this might color or affect his neutrality in conducting the mediation. I tend to agree with that notion, although the protection should not be absolute. There may be circumstances in which, for example, the need for testimony regarding challenges to the settlement agreement on the grounds of mistake, misrepresentation, duress, and/or undue influence outweighs the mediator's need for confidentiality regarding the conduct of the mediation proceedings. Nor should that need for confidentiality become a shield to protect the mediator from allegations of misdeeds that could constitute malpractice, and there should be an exception to the mediation confidentiality rules allowing evidence of the mediator's behavior to come in during a malpractice suit against her.

What about the other participants—including the attorneys? Do they need protection from the mediation confidentiality rules? I am referring to friends, experts, other witnesses, and, last but not least, attorneys.

Of course, as between the attorney and his client, there is the attorney-client privilege, and there is a serious question to what degree this privilege applies in mediation, or whether the privilege (which can be waived by the client) is overruled by the mediation privilege or evidentiary rule. In *Cassel*, the California Supreme Court considered the Court of Appeal's reasoning that the mediation confidentiality statutes were not intended to trump Section 958 of the California Evidence Code, which eliminates the attorney-client privilege in suits between clients and their own lawyers. The Supreme Court rejected this theory on the ground that "the mediation confidentiality statutes include no exception for legal malpractice actions by mediation disputants against their own counsel. Moreover, though

both statutory schemes involve the shielding of confidential communications, they serve separate and unrelated purposes.”

## DEFINITIONS OF MEDIATION PARTICIPANTS

The California Evidence Code does not distinguish among the various participants in a mediation. Section 1115, the definitional section, defines only the words “mediation,” “mediator” and “mediation consultation.” The actual sections dealing with the inadmissibility of evidence are written in the passive tense, thus not distinguishing among the various participants. Section 1119(c) refers to participants and the general duty of confidentiality with respect to “all communications, negotiations, or settlement discussions by and between” them “in the course of a mediation or a mediation consultation.” The word “participants” is not defined.

In contrast, the Uniform Mediation Act (UMA)([bit.ly/1oY3Ab6](http://bit.ly/1oY3Ab6)) does make the necessary distinctions—although I would have preferred if it had given a separate definition for attorneys present at the mediation who represent one or more of the parties, so as to make more transparent what this privilege entails. Section 2 UMA defines, *inter alia*, the words “mediator” (§2(3)), “mediation party” (§2(5)), and “non-party-participant” (§2(4)). Specifically, “non-party participant” means “a person, other than a party or mediator, that participates in a mediation.”

Although not explained in so many words, the UMA introduces these different definitions because it acknowledges that the needs of these various participants are different, and it gives each category a different mediation privilege.

## PRIVILEGE VERSUS EVIDENTIARY RULE

Although the California statute introduces a rule of evidence rather than a privilege, the two are frequently confused, and often even treated as if they were the same thing. As I wrote in 2003, in a discussion of the UNCITRAL Model Law on International Commercial Conciliation (see box):

“To approach the confidentiality issue as an evidentiary privilege has the advantage

that it can clearly define (a) what is the scope of the privilege in terms of what [mediation] information and activities are covered; (b) which persons are burdened by the privilege; (c) in which later proceedings will the privilege apply; (d) who are the holders of the privilege, with the right to involve or waive the privilege (and to what extent); and (e) what information will be excepted from the privilege. This also means that such a provision can account for the separate and perhaps conflicting interests of [mediation] parties and the [mediator] in maintaining confidentiality” (citing Alan Kirtley, see box).

Having chosen the evidentiary rule rather than a privilege, and not distinguishing among the mediation parties, the mediator and non-party participant, it is perhaps no wonder that the California mediation statute lacks the nuance that can adhere to the several privileges for each of those categories, along with the specific exceptions to the privilege that are set forth in Section 6 UMA. Clearly, had the UMA been applicable to the *Cassel* case, the outcome would have been different.

## THE UMA ADDRESSES THE INDIVIDUAL NEEDS OF EACH MEDIATION PARTICIPANT

Although the Commentary to the UMA, whether in the Prefatory Note or the specific comments following each section, does not specifically address the purpose of mediation confidentiality or the extent to which each participant has a need for it, the UMA effectively addresses these points with a degree of sophistication it is not always given credit for.

One can criticize the drafters of the UMA for not going far enough with the exceptions it provides, but compared to the California statute we are approaching Nirvana. Section 4 UMA grants each of the three categories of mediation participants a mediation privilege, whereby under Section 5 the parties can agree to waive their privilege (which affects all other participants), but they need the consent of the mediator when it comes to mediation communications of the mediator, and from the relevant non-party participant when it involves mediation communications of such non-party participant.

Section 6 UMA includes the following exceptions:

- “(a) There is no privilege under Section 4 for a mediation communication that is: [ . . . ]
- (5) sought or offered to prove or disprove a claim or complaint of professional misconduct or malpractice filed against a mediator;
  - (6) except as otherwise provided in subsection (c), sought or offered to prove or disprove a claim or complaint of professional misconduct or malpractice filed against a mediation party, nonparty participant, or representative of a party based on conduct occurring during a mediation;
- (b) There is no privilege under Section 4 if a court, administrative agency, or arbitrator finds, after a hearing *in camera*, that the party seeking discovery or the proponent of the evidence has shown that the evidence is not otherwise available, that there is a need for the evidence that substantially outweighs the interest in protecting confidentiality, and that the mediation communication is sought or offered in: [ . . . ]
- (2) except as otherwise provided in subsection (c), a proceeding to prove a claim to rescind or reform or a defense to avoid liability on a contract arising out of the mediation.
  - (c) A mediator may not be compelled to provide evidence of a mediation communication referred to in subsection (a)(6) or (b)(2).

## CONCLUSION: THE UMA IS VERY GOOD, BUT NOT PERFECT

The UMA falls just a hair short of being the ideal mediation confidentiality statute in two major respects: I would prefer something in between the more general common law rule cited by the Canadian Supreme Court that the settlement privilege ceases to be effective once there is a settlement agreement, and the UMA rule that there will be an exception to the mediation privilege after a positive finding *in camera*, to the extent that only the portion

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of the communication necessary for the application of the exception from nondisclosure may be admitted, as provided in Section 6(d). My suggested “in-between” solution would maintain the limitation of Section 6(d), but eliminate the need for an *in camera* review as contemplated in Section 6(b).

The other flaw is, in my opinion, the exception of Section 6(c), pursuant to which the mediator cannot testify in cases alleging malpractice and challenges of mediated settlement agreements. I am in favor of retaining the exclusion of mediator testimony in cases alleging malpractice, but I find myself disagreeing with the exclusion of the mediator’s testimony with respect to challenges of mediated settlement agreements. Often, the mediator is the best witness as to what took place during the mediation when it comes to allegations of mistake, misrepresentation, duress, and/or undue influence, especially when all or part of the mediation took place in caucus. In such events, he may well be the only person who

## REFERENCES AND FURTHER READING

Ellen Deason, “The Need for Trust as a Justification for Confidentiality in Mediation: A Cross-Disciplinary Approach,” 54 *U. Kan. L. Rev.* 1387 (2006).


Owen V. Gray, “Protecting the Confidentiality of Communications in Mediation,” 36 *Osgoode Hall L.J.* 667 (1998).

Scott Hughes, “A Closer Look: The Case for a Mediation Privilege Still Has Not Been Made,” *Disp. Res. Mag.* 14 (Winter 1998).

Alan Kirtley, “The Mediation Privilege’s

Transition from Theory to Implementation: Designing a Mediation Privilege Standard to Protect Mediation Participants, the Process and the Public Interest,” 1995. *J. Disp. Res.* 1.


Peter Robinson, “Centuries of Contract Common Law Can’t Be All Wrong: Why the UMA’s Exception to Mediation Confidentiality in Enforcement Proceedings Should be Embraced and Broadened,” 2003 *J. Disp. Res.* 135.

Eric van Ginkel, “The UNCITRAL Model Law on International Commercial Conciliation, A Critical Appraisal,” 21 *J. Int’l Arb.* 1, 42-43 (2004). 

can provide the needed evidence (for a more detailed exposé of these points, as well as an extensive summary of the relevant cases, see Peter Robinson (box)).

That said, the drafters of the UMA realized that the need for confidentiality does not apply to situations where either an attorney or the mediator himself is accused of malpractice, or where the settlement agreement is challenged (although the latter is subject to weighing the

need for disclosure against the need to protect the mediation confidentiality).

Both these exceptions to the privilege would have protected Mr. Cassel’s situation had California adopted the UMA, as he could have used the available evidence in his malpractice suit against his attorneys and have challenged the settlement agreement. 

(For bulk reprints of this article, please call (888) 378-2537.)

## International Arbitration

# Arbitration Emerging to Resolve International Financial Disputes

BY SUYASH PALIWAL, CFA

A recent ADR trend has been the rise of international arbitration in the finance industry.

Disputes arise as to international financial instruments (bonds, stocks, swaps and other derivatives) just as they do with respect to any other contracts, and parties want efficient dispute resolution. While

financial transaction contracts have historically designated courts (e.g., New York or England) for dispute resolution, the recent decade has seen an increase in the use of arbitration clauses in deal documents. Building on this wave, the International Swaps and Derivatives Association (ISDA), a trade group that has drafted and promulgated industry-standard contracts and drafting guidance for a full suite of swaps and other derivatives, has launched model arbitration clauses for use in swaps (see bit.ly/1pMx4YN). And financial market participants have been increasingly opting for arbitration as the preferred dispute resolu-



tion mechanism. Indeed, recent surveys by the School of International Arbitration at Queen Mary University of London and PricewaterhouseCoopers noted that despite traditional use of litigation, 23% rated arbitration as the most preferred dispute resolution mechanism and 69% of financial services respondents agreed that arbitration is well suited to their industry (see box).

## THE USUAL (AND UNUSUAL) SUSPECTS

In the past, participants in the financial services industry have habitually opted for

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litigation to resolve disputes. In large part, this was because the relevant contracts designated court adjudication rather than arbitration, but as revealed in the Queen Mary/PwC survey, participants also felt that their disputes concerned legal interpretations of contractual provisions for which they wanted binding precedent. And many of the disputes in financial services were simply actions to collect on debts owed, for which courts may have provided a faster recourse compared to arbitration. To be sure, however, insurance and reinsurance has long been a field that has preferred arbitration and arbitration was frequently chosen in Islamic (*Shari'a*-compliant) financial instruments. And where more specialized knowledge was required (for instance, regarding more complex financial products), arbitration was used.

But at least two additional factors have driven a noticeable rise in arbitration in international finance. First, international finance has seen an uptick in parties from emerging markets. These jurisdictions have varying levels of reliability and sophistication among their courts, leading market participants to choose arbitration in seats with a developed *lex arbitri*. Second, private counterparties to financial transactions have entered into trades with sovereign wealth funds and other sovereign entities. For instance, the Ceylon Petroleum Corp., the national petroleum company of Sri Lanka, entered into swaps with Deutsche Bank, Citibank, and Standard Chartered Bank to hedge its oil price exposure. Private counterparties that opt for arbitration tend to avoid nettlesome issues of sovereign immunity.

The reasons for the increased preference for arbitration in international finance mirror those from other industries. When asked why they prefer arbitration, most GCs and outside counsel tout confidentiality as one of the first reasons and the same applies in finance: Complex financial instruments involve detailed, bespoke, proprietary deal terms and parties prefer that the terms remain private. As with industries like reinsurance and construction, high finance requires adjudicators with specialized knowledge and expertise. While some judges may be quite knowledgeable in this

area, the parties' ability to select arbitrators makes it easier for them to obtain knowledgeable adjudicators. Participants in industries like professional services, manufacture and energy cite continued business relationships as a reason favoring arbitration—through ADR, one can frequently resolve a dispute more amicably than in litigation and then return to doing business with the opposing party, particularly if the container contract or business relationship is long-term. Relationships matter in financial services just as much, pointing towards arbitration as a favored method of resolution at an arm's length before the parties pick up where they left off in the tenor of a subject financial instrument, other instruments in a portfolio, or new trades in a long-term trading relationship. And most industry participants favor limited document production; the same preference carries over to financial services.

### TREND SETTERS

A few institutions have emerged as leaders in the area of international financial dispute resolution. CPR's Banking and Financial Services Committee has long contributed to the development of ADR for anticipated disputes in the financial services space. CPR's Banking, Accounting & Financial Services Panel of neutrals brings together significant expertise on issues central to financial disputes and includes practitioners from leading international banks, securities regulators, and law firms, in addition to former judges (see [bit.ly/1osaYwA](http://bit.ly/1osaYwA)).

Two years ago, an institution dedicated to resolving international financial disputes opened its doors for business. The genesis of the institution, the Panel of Respected International Market Experts in Finance (or P.R.I.M.E. Finance), was to create a body that would adjudicate disputes concerning financial instruments in a consistent manner—inconsistent court or arbitral interpretations of industry-standard contracts may create confusion in global markets that straddle many jurisdictions. Based in The Hague, Netherlands, P.R.I.M.E. Finance boasts a roster of renowned experts in both finance and dispute resolution as well as arbitral rules inspired by those of the United Nations

Commission on International Trade Law (UNCITRAL) tailored to suit the needs of international arbitration in financial markets.

Last year, ISDA released its Arbitration Guide on arbitration clauses for its Model Agreements. ISDA undertook a project to provide standardized arbitration provisions for use in swaps. Parties that wish to enter into swaps under the framework of ISDA contracts enter into a Master Agreement (which would govern any swap executed under that Master Agreement) and, in determining the terms of their swap trading relationship, would accept certain standard terms in the Master Agreement and elect from a menu of other terms in the Schedule to the Master Agreement. As pertains to dispute resolution, the parties historically would choose between New York and English law in Part 4 of the Schedule and Section 13 of the Master Agreement then operated to designate New York or English courts, respectively. Arbitration provisions had been used before in swaps under ISDA Master Agreements, frequently in Asian and Middle Eastern markets, and the Tahawut Master Agreement jointly produced by ISDA and the International Islamic Financial Market included a dispute resolution clause opting for arbitration under the Arbitration Rules of the International Chamber of Commerce (ICC). To formalize the process and avoid inadequate or pathological arbitration clauses, ISDA prepared model arbitration provisions that would replace the forum selection clause in Section 13 of the Master Agreement and make corresponding changes to other affected provisions. The move was well received in the marketplace.

### A PLACE FOR EVERYTHING

ISDA's move to introduce model arbitration clauses was avowedly seat- and rule-agnostic: arbitration would be an alternative to court adjudication, but the arbitral place and rules would be subject to the users' preferences. In its first set of model clauses, ISDA put forward the following combinations:

- ICC Rules with (i) New York law and New York seat; (ii) English law and London

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## International Arbitration

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- seat; or (iii) New York or English law and Paris seat;
- American Arbitration Association – International Centre for Dispute Resolution Rules with New York law and New York seat;
- London Court of International Arbitration (LCIA) Rules with English law and London seat;
- Swiss Rules of International Arbitration with New York or English law and Geneva or Zurich seat;
- Hong Kong International Arbitration Centre (HKIAC) Rules with New York or English law and Hong Kong seat (with the arbitration clause, as opposed to the swap contract overall, governed by Hong Kong law);
- Singapore International Arbitration Centre Rules with New York or English law and Singapore seat (with the arbitration clause governed by Singapore law); and
- P.R.I.M.E. Finance Rules with (i) New York law and New York seat; (ii) English law and London seat; or (iii) New York or English law and seat at The Hague (with the arbitration clause governed by Dutch law).

In addition, a subcommittee of CPR's Banking and Financial Services Committee is currently drafting model CPR arbitration clauses that could be used in the ISDA Master Agreement.


Arbitrations concerning financial instruments have been brought under the ICC and LCIA Rules. While the awards are not public, financial disputes have also been determined pursuant to the HKIAC and CPR Rules, and these institutions have pointed to international financial disputes as a burgeoning trend in arbitration. In addition, arbitrations concerning financial instruments can take place in the investment treaty setting. For example, Sri Lanka, through its parliament and judiciary, repudiated obligations of Ceylon Petroleum Corp. to pay Deutsche Bank under a hedging agreement. Deutsche Bank brought a claim against Sri Lanka before the Interna-

tional Centre for Settlement of Investment Disputes (ICSID, part of the World Bank Group) alleging violations of the bilateral investment treaty between Germany and Sri Lanka. The tribunal found in favor of Deutsche Bank, holding that Sri Lanka's acts amounted to an unlawful expropriation and a breach of the treaty obligation to provide fair and equitable treatment, and ordered Sri Lanka to pay Deutsche Bank damages of over \$60 million pursuant to the swap contracts.

### GOING FORWARD

Certain companies and GCs have a strong penchant for arbitration as their preferred dispute resolution method. These companies enter into financial transactions for corporate finance, global operations, and risk management purposes. The ready availabil-

ity of arbitration for financial instruments disputes, a robust body of rules and awards, and the right arbitrators and advocates plays not only to the companies' preference for ADR, but also a better dispute prevention and resolution process. Imagine a supply contract that calls for arbitration, a financing arrangement for that supplier that designates a US court and a swap to hedge the financing arrangement that specifies Hong Kong courts. By choosing ADR for all three contracts, say, arbitration in New York under the CPR Rules or in Hong Kong under the HKIAC Rules, the process can be more streamlined.

It makes sense for arbitration to be available for financial disputes. Going forward, one would expect even further expansion in this area of ADR. 

(For bulk reprints of this article, please call (888) 378-2537.)

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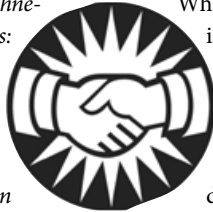


## The Master Mediator/ Part 1

# Bias, Fallacies & Decision Errors—Processing Information: Sights, Sounds and Framing

BY ROBERT A. CREO

**T**he Master Mediator addresses in a series of columns the psychological factors and cognitive bias that may affect dispute resolution. Recent columns have explored the seminal work of Professor Daniel Kahneman in identifying two cognitive modes: “System 1,” which is fast, instinctive and emotional, and “System 2,” which is slower, more deliberative, and more logical. Cognitive Bias is the tendency to make incorrect judgments based on erroneous presuppositions. It is a default to System 1, with the brain processing information quickly to reach a decision or to act, without the filter and reflection of System 2. According to Professor Max Bazerman, it arises when “a heuristic is inappropriately applied by an individual in reaching a decision” (see box).



## SIGHTS AND SOUNDS

### Sensory Information and Memory

We live in a world where data and information are constantly bombarding us. The human perception system processes thousands of stimuli at a time, in a way no one fully understands. We filter and organize stimuli in order to function and make decisions. Some scientists and psychologists believe that humans can only process, and do, one thing at a time. The challenge to that approach is that people can in fact

walk and chew gum at the same time. There is a tipping point for each of us where we become overwhelmed by the sensory information, and our performance suffers and tasks are avoided.

While we drive our vehicle, we are engaged in a multitude of tasks, some safer than others! Our attention is divided and alternates from task-to-task at an unconscious rate of speed. Research has shown that merely talking while driving, whether on the phone or to passengers, is a distraction that affects our reaction time and motor skills. Although we have distilled driving skills over the years of our own experience to routine and automatic actions, it is still complex and with the near miss—or hit—just moments around the corner.

There has been a plethora of research into what happens to the awareness of people who are tasked with one matter while being exposed to unrelated stimuli. Researchers refer to this as “divided attention,” while the layman may think of it as “multitasking.” Neuroscientists contend that the brain is juggling the tasks in a rapid manner by quickly alternating attention rather than doing separate tasks simultaneously.

### Echoic Memory

Retaining auditory information is a component of sensory memory called echoic memory. Unlike visual memory (iconic memory), which involves a static object or scene that can be scanned repetitively, auditory stimuli are not usually repeated, especially when spoken, unless the listener requests this. Auditory stimuli are processed in each ear, although either ear can process different sounds at the same time. For example, headphones can direct specific sounds to one ear or the other. Also, sounds from different directions may be more prominent in one ear than the other. One theory is that echoic memory stores a sound unprocessed until the next sound enters to provide context and mean-

ing. Echoic memory is large and brief, with sounds resonating in the mind for only three or four seconds before decay, but in the absence of interference they may last up to twenty seconds (The Master Mediator discussed memory in greater detail in his column about being right in 31 *Alternatives* 7 (Jul/Aug 2013)).

Auditory sensory memory is located in the “primary auditory cortex” and involves several different brain areas. Most of the brain regions are in the prefrontal cortex where executive function operates. This is the region responsible for attentional control. Broca’s area in the left hemisphere is the prime location for verbal rehearsal and articulating speech.

### Attention Control

Research in Britain during the 1950s explored how humans separate out individual voices by focusing on key characteristics such as gender, location and pitch. Professor Colin Cherry is credited for what is commonly called the “cocktail party effect,” where one’s auditory attention is on a particular sound stimulus while filtering out a range of other sound and sight stimuli. The nomenclature comes from the ability of people to engage effortlessly in a single conversation in a noisy place. The theory is that the auditory system is binaural, which enables it to localize at least two separate sound sources and extract the desired sound signals out of the total mixture of sources. This has been characterized as “selective attention.”

Professor Donald Broadbent developed a theory in 1958 based upon research into how the brain processes sound. As Professor Cherry demonstrated, people can hear and comprehend more than one set of simple sounds simultaneously, but once the signals became too complex a “bottleneck” forms that is difficult or impossible for the brain to man-

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## The Master Mediator

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age. Professor Broadbent had people listen to separate sets of digits played simultaneously in each ear. Subjects were still able to remember and group and keep the sets of digits separate rather than mixing them together. Professor Broadbent theorized that humans have a “filter model” where incoming information is immediately stored in “sensory memory” (“sensory store”) and then filtered by selective attention (“sensory filter”) before passing into working memory and then into short term or long term memory. One message is “filtered in” while other stimuli are “filtered out.”

Subsequent research by British psychologists such as Anne Treisman and Neville Moray suggested that unprocessed sounds, especially dramatic or important signals, were actually retained and not totally blocked or filtered by a buffer of “sensory memory.” Important auditory messages, such as your own name or taboo words, can be detected and sorted from the unattended channels of signals. The scientists divide the two sources into the “attended message” (the direct conversation of the two people at the cocktail party) and the “unattended message,” which is what is perceived through the background noise. Professor Broadbent hypothesized that the filter operates on several basic principles:

1. The focus is on the physical characteristics of the message, such as the speaker’s gender, tone, and type of sound.
2. Filtering is a “winner-takes-all” process, so that only one message is selected for further processing and the rest are lost.
3. Filtering is done consciously since people decide what they want to listen to at the moment.
4. People can switch their attention from one message to another.

In Broadbent’s model, very little information, other than gross physical features of the unattended message, or shadowing task, are noticed or retained. One criticism of the Broadbent model is that it does not take into account the meaning of the words. Some studies reveal that the meaning of the unattended message can be processed. For example, a 1973 study by Professor Donald MacKay involved sentences

in the main message with more than one meaning. Subjects heard that someone “was standing near the bank,” while the unattended channel had either the word “river” or “money” in it. The shadow message provided a context for the choice of a financial institution or a body of water for the “bank,” indicating that the meaning of information in the unattended channel is unfiltered.

### Attenuation

Professor Anne Treisman built upon the work of the Broadbent model and developed the “attenuation” model. This approach postulates that at least in the early stages information is processed in parallel channels and that selection is made a later stage. Her difference is that the main message gets through with other information being made weaker (attenuated), and with the weakened message being processed to a lesser extent. She concluded that people are permanently primed to detect personally significant words, like names, and that less perceptual information is required to trigger awareness in this context.

Professor Neville Moray experimented with the “unattended” or secondary channel of auditory stimuli. Participants were unable to detect a word although it was spoken up to 35 times within the trial in the unattended message. The theory is that information is continuously being processed in the “unat-

tended” channel or stream of perception. The subject was focusing on “shadowing” the secondary message to hear and retain the prime content of that message. Subsequent theorists suggested that the unattended stream passes through a secondary filter based upon pattern recognition, which prevents unimportant information from entering working memory.

The “late selection” models of Professors J.A. Deutsch, D. Deutsch and Donald Norman suggest that all information is processed in parallel, with selection and filtering happening much later based upon whether the information is significant or “pertinent” to the listener. Pertinence or “salience” refers to the importance of the stimuli; what is personally important, such as our name, or what has a direct effect on our current task. For example, when we are driving, a horn or a siren is salient to what we are doing. Humans are engaged in an activity and have experience with the types of stimuli that may arise that require modification of behavior.

Professor Daniel Kahneman proposes that attention is not a function of selection but should be viewed in terms of capacity. In this model, attention is a limited resource that is distributed among various stimuli. The key is not “when” but “how” attention is focused. Attention results from a state of cognitive “arousal” that is generally optimal at moderate levels; an “allocation policy” distributes attention among the stimuli and activities. Our

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physiological state, i.e., our energy level, is the platform. The Master Mediator in 31 *Alternatives* 2 (Feb. 2013) explored in greater detail the impact of energy in his column on “Fatigue and Ego Depletion in the Bargaining Room.”

“Enduring dispositions” are automatic influences on attention, while “momentary intentions” involve a conscious decision to focus on something. Some stimuli receive more attention because they are relevant to the task at hand and our current mood, emotions, or personal concerns or values. This model of “capacity theory” by Professor Kahneman supports the “cocktail party theory,” since “momentary intentions” allow the focus to be on the specific auditory exchange, while “enduring dispositions,” such as overhearing one’s name, capture the attention. The combination of Professor Kahneman’s systems 1 and 2 is not limited in the manner of how information is received from the various modalities such as auditory, visual or kinetic. All combine in a holistic or gestalt manner to process and make decisions.

### Sight

Research by Professor Kimron Shapiro and others reveals a comparable visual phenomenon of the auditory “own name effect.” The Master Mediator column explored visual issues of inattentive blindness and the attentional blink in 32 *Alternatives* 2 (Feb. 2014). The Stroop Effect, identified in 1935, is well-known in the field of psychology and social science. I have taken a Stroop test a number of times as a research subject (and have in fact participated in a variety of fascinating neuroscience research projects; see, e.g., “Looking My Way: The Brain Is Not a Computer,” 30 *Alternatives* 11 (Nov. 2012)). Many of you may have done so as children or as part of academic courses or workshops. The basic test is a list of words written in different color inks. A subject is asked to name the color of the ink and this is done easily. In the experiment, the words of one color are mismatched and printed in a different color. So the word RED is in blue ink and the word WHITE in green ink. Participants make mistakes and are slower when there is a mismatch between

the name of the color and the color of the ink.

### SO WHAT?

Humans have an amazing capacity to learn from a combination of concentration and experience. Some motor skills can be repeated so that they become automatic when prompted by the same cue. This is what occurs when talent is molded by training and practice. High performers such as athletes, musicians, carpenters, machinists, and others engage in crafts that require hand-eye-mind coordination, and they make and implement decisions in a reflexive manner. Advocates and mediators can benefit from a greater understanding of basic biology, neuroscience and human behavior. Information exchange is the heart of communication, persuasion and negotiation.

*Part 2 will explore the concept of framing information and related cognitive phenomena, and further explore their relevance to ADR.* ■

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## Arbitration

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of the American courtroom. It is a process that was created by and for the business community to deal with particular business disputes. The parties were given the ability to agree on the procedures that they would follow in resolving a particular dispute. While it may be convenient to adopt institutional rules, that solution was never intended; commercial arbitration began long before any arbitration institutions existed. And the procedural rules of almost all commercial arbitration institutions permit the parties to modify the procedures contained therein and give the arbitral tribunal almost unlimited freedom in the conduct of the process. Parties may make such modifications either at the time that they enter a commercial contract, by including an arbitration provision that spells out the process by which they will resolve any disputes that arise in connection with their contract, or by agreement to procedures that are crafted at the time a particular dispute arises, through what is called a “submission agreement.” Of course, the common default mechanism has become a passing reference incorporating the procedural rules of a particular arbitral institution, without more.

If arbitration is to return to its alternative roots, it must become again a creative, cost-effective means of resolving disputes, one that is decidedly distinct from litigation. If this requires the creation and education of “arbitrationists,” who specialize in creating alternative means of resolving particular commercial disputes, who draft arbitration provisions and submission agreements, and who represent parties in arbitration proceedings, so be it. If counsel and arbitrators must learn anew that arbitration is intended to serve the needs of the parties, so be it. The parties already have the power to control the arbitration process through their agreement. Of course, by definition the parties are or will be in fundamental disagreement concerning their dispute. But this should not prevent them from agreeing on a process that saves time, money, executive resources, and not a little anguish. Disagreement on substance need not lead to disagreement on procedure. There is no need to cut off one’s nose to spite one’s face.

There are certain procedural areas that lend themselves to revolutionary change; change intended to return arbitration to its status as a flexible system, responsive to the desires of its users. Parties can agree on these solutions, and they are encouraged to develop others that meet the needs of their specific dispute. Despite what

clothing manufacturers like to tell us, one size does not fit all. The ideas that follow are simply some of the alternatives available to those who are committed to make arbitration the servant of the parties. Creative arbitration practitioners will think of many others.

### Arbitrator Selection

One of the primary benefits of arbitration is that the parties are free to select their decision makers, arbitrators who are suitable resolvers of their dispute, who have some understanding of the industry, the technology, and/or the specific area of the law involved in the parties’ particular dispute. Why should the process of arbitrator selection be reduced to a practice where each side received the same list of ten names, where each party is asked to strike some number of names and rank the rest, and then return those lists to the institution who advises the parties of the highest ranked candidates? Of course, when the parties cannot agree on a procedure, the list procedure works to ensure that each has a modicum of input on the selection process and that the end result is not biased toward one side or the other.

Parties who wish to control the process can, however, do so much more. They can obtain recommendations from friends and col-

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## Arbitration

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leagues, from a number of arbitral institutions, from law societies and bar associations, etc. They can each suggest a certain number of candidates, say fifteen apiece. They can devise a written, mutually agreed upon questionnaire whose questions are designed to determine who among them has the knowledge and experience that fits the particular dispute. Then the parties, by whatever method agreed, can narrow the field to say, five candidates. The parties can then jointly interview the candidates, either by telephone, or where the amount in dispute justifies the expense, in person. Joint personal communication with the candidates enables the parties to evaluate each candidate's personality, demeanor, and "arbitral temperament," qualities that are otherwise difficult to glean, even from conversations with those who have used the candidates as arbitrators. By an agreed method, they can thereafter select one or a panel of three. Then, when the parties walk into the room on the first day of arbitration, they will already have a degree of comfort with their decision maker.

### *Discovery*

The use of interrogatories, requests for admission, document requests, and depositions, the common discovery tools, and the resolution of disputes concerning their use are generally the most expensive part of any civil litigation. However, any civil litigator will be forced to admit that the return on the investment of the discovery process is very small indeed, at least in the case of a business dispute. Generally, very little that is not already known from the correspondence and documents exchanged by the parties is ever "discovered," and the mythical "smoking gun" is almost always just that: "mythical."

The parties can (and sometimes do) agree that there shall be no or only very limited discovery in conjunction with their arbitration. Clauses I have seen in cases I have arbitrated have gone so far as to exclude all discovery, or have permitted only discovery that can be shown to be "absolutely essential to the presentation of a party's case," or prohibited the use of interrogatories and requests for admission, or permitted no or only specifically limited deposition discovery. Where the parties have failed to agree on such limitations in advance, the tribunal should exercise its

influence to forge such an agreement, and in any event impose acceptable limitations.

### *Time Limitations*

How often do two, three, even four or more witnesses testify to the same facts, facts that are frequently not in dispute? Certainly this can be controlled through objections, argument, and rulings thereon, but this practice is time consuming and disruptive. It would be better if such repetition did not occur: but how to prevent it?

The parties should be encouraged to agree on time limits on the presentation of their case. If they have not agreed in advance, the tribunal should work to encourage such an agreement. Rather than a mere agreement on days, it would be better to agree on the total number of hours each side has to present its case. Each side's remaining hours would be determined at the end of each hearing day, so that the parties can tailor their case prior to the resumption of the hearing the following day.

Perhaps one example of the benefits of this approach should suffice. In a case in which I served as arbitrator, the amount in dispute was in the tens of millions of dollars. In their arbitration provision, the parties had agreed that each side would have five hours over the course of two days to present its case. Needless to say, repetition was not a problem. Even better, at the end of the ten hours of presentation, I had more than enough factual information to determine the case. It is amazing how focused attorneys become when time is of the essence.

### *Written Submissions*

With apologies to Shakespeare, brevity is the soul of persuasion. If one can say something in two pages, one can express it more persuasively in one. The tribunal should strictly limit the number of submissions and number of pages per submission. If written submissions are deemed absolutely necessary to the resolution of a discovery dispute, the submission should be limited to no more than one page. If a party requests a hearing on a discovery motion, the hearing should be telephonic. But if the arbitrator feels that the hearing would provide little if anything additional, she should so advise the parties and agree to a hearing only if both parties continue to insist.

### *Expert Witnesses*

There is probably nothing closer to live theatre in

American litigation, save perhaps closing arguments made to the jury, than the testimony of expert witnesses. In theory, each expert is independent of the party who retained him, each has arrived at his opinion based on the facts of the case and the expert's special knowledge of his discipline, and is giving the trier of fact his unbiased scientific view. However, to accept this scenario as reality requires the same willing suspension of disbelief that is required of theatre patrons.

One way to bring the drama of dueling experts a little closer to reality is the practice of "hot-tubbing," a procedure that is perhaps less comfortable for the experts than the name of the practice suggests. In "hot-tubbing," the experts who testify on the same issue are seated side by side when they give their testimony. The experts then answer each question posed sequentially. Counsel (or the arbitral tribunal) poses the first question, which is first answered by the expert for party A. Following the completion of his answer, the expert for party B answers the same question. The second question posed is first answered by the expert for party B, which is immediately followed by an answer of the question by the expert for party A. The procedure continues with the same alternations. It is indeed remarkable how much closer the differing expert opinions become, and how truly narrow the degree of difference between the expert opinions is. The procedure serves to highlight essential differences and to minimize hyperbole.

### *Final Offer Arbitration*

Final Offer Arbitration is a form that is especially useful when the value of goods, services, contract rights, real estate, an ongoing business, or similar valuation is at issue. Because in North America this form of arbitration has so often been used to determine the value of the contribution of a baseball player to his team when the player and the ball club are unable to agree on a salary figure, it is commonly known here as "baseball arbitration."

In Final Offer Arbitration, each side produces what it considers to be the reasonable value of the good or service that is in dispute, and that figure represents its "final offer." If the parties thereafter fail to agree on a number, they submit the matter to arbitration, in which each produces evidence that it believes supports the valuation it submitted as the "final offer." Once the evidence is in, the tribunal is limited to the selection of one side's valuation or that advanced by the other

side. The arbitrator has no discretion to substitute her view or to modify the figures presented.

There are also variations on this theme. The parties may present a series of questions. The parties may then each present a proposed answer to each of the questions presented. As to each question so presented, the arbitrator must select the answer proposed by one or by the other of the parties. Once again, the arbitrator may not substitute her judgment as to the correct answer. The arbitrator is limited to selecting the answer proposed by party A as to a particular question or the answer proposed by party B.

In both examples, standard final offer arbitration or a modified version, each of the parties knows its best case scenario (the answer that it proposed) and its worst case scenario (the answer proposed by its counterpart). With such knowledge, the parties are in the best possible position to compromise and settle the dispute without the assistance of the arbitrator. However, where the parties are unable to effect such a settlement, each knows that the dispute will be ended by the arbitrator selecting the scenario she believes to be best supported by the evidence presented.

#### *Form of Award*

Why do the parties want a reasoned award? Because they want to be sure that the arbitral tribunal has considered and answered the questions that each party believes to be necessary to the resolution of the dispute. Secondarily, the parties want to understand that there is some reasoning behind the decision, although the losing party usually disagrees with that reason-

ing, or else there would not have been a dispute in the first place. Too often a reasoned award devotes time, attention, and pages and pages to explaining the reasons for the decision. The resulting opinion often approaches the length of a decision of the United States Supreme Court. However, there are alternatives to the creation of a *magnum opus* that serve to ensure that a case has been carefully considered.

Would it not be equally satisfactory, but faster, easier, and cheaper for the parties and their counsel, who are, after all, the people most familiar with the dispute, to formulate questions for the arbitrators, questions which, once answered, would resolve their dispute and serve to assure them that the questions that needed to be answered had been? The process of the joint formulation of such questions would undoubtedly increase the possibility that the parties might reach an amicable settlement. This is what all alternative dispute resolution should be about. And the settlement that results from such a joint process is subject to far less coercion than one that results from the approach of some mediators, who are determined to reach a settlement without regard to whether the mediator regards the settlement to be fair.

#### CONCLUSION

What is unique about arbitration is that the parties are given the power to shape the process. The legislature does not prescribe it. The court does not dictate it. The parties can agree to make it whatever they want. Creative in-house counsel

and law firm draftspersons will insert detailed arbitration provisions in their contracts, setting out a process tailored to deal with the disputes likely to arise under the agreement concerned. Where this has not happened, in-house and law firm counsel can craft a submission agreement at the time that a dispute does arise, although cooperation can be difficult to obtain at this juncture. Finally, where neither occurs, the arbitral tribunal can encourage the parties to vary the procedures to make the process as efficient and cost-effective as possible. Where necessary, the sole arbitrator or chair can impose limitations that are designed to promote such an alternative process. ■

*(For bulk reprints of this article, please call (888) 378-2537.)*

#### FURTHER READING

M. Scott Donahey, "Your New Guide to Arbitration Clauses" – Part I, 29 *Alternatives* 198 (Dec. 2011).

Part II, 30 *Alternatives* 3 (Jan. 2012).

Part III, 30 *Alternatives* 19 (Feb. 2012).

Part IV, 30 *Alternatives* 70 (Mar. 2012).

Michelle M. Leetham, "Making Arbitration Work: A Corporate User's View of the Future," 32 *Alternatives* 37 (Mar. 2014).

Pedro J. Martinez-Fraga, *The American Influence on International Commercial Arbitration: Doctrinal Developments and Discovery Methods* (Cambridge University Press, 2009).

Thomas J. Stipanowich, "Arbitration: The 'New Litigation,'" 2010 U. Ill. L. Rev. 1 (2010) ([bit.ly/1sHMZrI](http://bit.ly/1sHMZrI)). ■

## ADR Briefs

### **EVEN IN CALIFORNIA: STATE'S RIGHT TO REFUSE ENFORCEMENT OF CLASS-ACTION WAIVERS ON PUBLIC POLICY OR UNCONSCIONABILITY GROUNDS IS PREEMPTED BY FAA-ISKANIAN V. CLS**

Bucking the California state court trend toward refusing to enforce employment-related arbitration agreements and class-action waivers by distinguishing and limiting the scope of *Concepcion* and other recent pro-arbitration US Supreme Court cases (see 32 *Alternatives* 11

(Jan. 2014)), the California Supreme Court has reversed its precedent in *Gentry v. Superior Court*, 42 Cal.4th 443 (2007) ([bit.ly/1zCnGMD](http://bit.ly/1zCnGMD)) and upheld the validity of class action waivers in employment arbitration agreements, in *Iskanian v. CLS Transportation Los Angeles, LLC*, No. S204032 (Cal. Jun. 23, 2014) ([bit.ly/1nz9cYT](http://bit.ly/1nz9cYT)). The court also followed the Fifth Circuit's reasoning in *D.R. Horton, Inc. v. NLRB*, Case No. 12-60031, 2013 U.S. App. LEXIS 24073 (5th Cir. Dec. 3, 2013, revised Dec. 4, 2013) ([1.usa.gov/1bmmXD1](http://1.usa.gov/1bmmXD1)) to reject the



argument that class action waivers violate the National Labor Relations Act (NLRA), but nevertheless remanded to the lower court because of its finding that employers could not require waivers of representative actions under the California Private Attorney General Act (PAGA).

*Iskanian* involved an action for alleged labor code violations and an unfair competition claim, brought by the plaintiff as both an individual and putative class representative seeking damages, and also in a

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representative capacity under the PAGA seeking civil penalties for labor code violations. The Court of Appeal affirmed the trial court ruling in favor of employer CLS, ordering the case to arbitration and dismissing the class claim without prejudice, concluding that the US Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*, 563 U.S. 321 (2011) (1.usa.gov/1i8scMr) had invalidated *Gentry*, that class action waivers in adhesive employment contract did not violate the NLRA, and that the FAA precluded states from removing PAGA claims from arbitration.

The California Supreme Court agreed with the first two appellate findings, but not the third. The decision contains an extensive analysis of California's application of *Concepcion*, and distinguishes inter alia its recent holding in *Sonic-Calabazas A, Inc. v. Moreno*, 57 Cal.4th 1109 (2013) (bit.ly/1cfx7mr), which involved individual wage claims and the waiver of an administrative hearing, rather than a class action (see 32 *Alternatives* 10 (Jan. 2014)). In *Sonic*, the court concluded that, post *Concepcion*, the FAA preempted California from categorically prohibiting waiver of an administrative "Berma hearing," but did not preempt state power to carry out a case-by-case "unconscionability analysis," as long as it applied unconscionability rules that did not interfere with fundamental attributes of arbitration (citation omitted).

The California Supreme Court further agreed with the Fifth Circuit in *D.R. Horton* that "there is no inherent conflict between the FAA and the NLRA, as that term is understood by the United States Supreme Court." Thus, a collective or class-action waiver in an employment contract's arbitration clause does not violate an employee's "right of access" under the NLRA, and the NLRA's protection of a "concerted activity," which makes no reference to class actions, may not be construed as an implied bar to class action waivers (citations omitted).

With respect, however, to the PAGA actions, the court concluded that an arbitration agreement requiring an employee as a condition of employment (i.e., before any dispute arises) to give up the right to bring representative PAGA actions in any forum is contrary to public policy in accordance with the California Civil Code

(Sections 1668, 3513, 2699) and rejected CLS's contentions that the FAA preempts a PAGA action. According to the court, a PAGA claim lies outside the FAA's coverage, since it is a dispute between an employer and a state seeking to recover civil penalties, not between an employer and an employee. The FAA's goal of promoting arbitration as a means of private dispute resolution did not preclude the state legislature from "deputizing employees to prosecute Labor Code violations on the state's behalf," and did not, therefore, preempt a state law that prohibits its waiver of PAGA representative actions in an employment contract. This was sufficient basis for a remand requesting the lower court to address whether the asserted PAGA claims should proceed on a representative basis before the trial court or in arbitration.

—Lia Iannetti, CPR Institute ■

## MATERIAL RELEVANT TO US LITIGATION NOT AUTOMATICALLY SHIELDED BY ARBITRATION CONFIDENTIALITY: VELERON HOLDING, B.V. V. MORGAN STANLEY & CO.

According to the United States District Court for the Southern District of New York in *Veleron Holding, B.V. v. Morgan Stanley & Co.* (bit.ly/1i2iex5), a private arbitration of a dispute "does not cloak" documents and other evidence relevant to that dispute with a "shield of invisibility," or immunize them from public disclosure in connection with related judicial proceedings or from publication in connection with those proceedings.

In *Veleron*, the District Judge had to decide, among other issues, whether to grant plaintiff, Veleron Corporation (Veleron) a motion to unseal portions of the record of its US-based securities fraud action against Morgan Stanley (MS). The records were part of a related arbitration proceeding in London under the auspices of the London Court of International Arbitration (LCIA) between Veleron's parent, OJSC Russian Machines (RM), and BNP Paribas SA (BNP) and were covered by confidentiality.

The LCIA arbitral tribunal had recently issued an award on the guarantee issued by RM in connection with the acquisition by Veleron of certain shares on margin, with funds borrowed

by BNP and on which Veleron defaulted. Veleron's New York action charged MS, as disposal agent of BNP, with insider trading and market manipulation in connection with the sale of such stocks. When Veleron initiated the suit against MS in New York the arbitration was still pending and the judge, upon Veleron's request, agreed to seal the records out of deference to the LCIA, reserving his rights to dissolve the seal once the arbitration was concluded.

When Veleron ultimately moved to unseal some of the record after the arbitration, it was MS (not a party to the London arbitration) that argued that all matters and documents related to the completed arbitration proceeding remained covered by the confidentiality provisions of the LCIA Arbitration Rules.

The Southern District rejected this argument and granted Veleron's motion to unseal portions of the record. The court relied on First Amendment and common law rights of public access to judicial documents that are "relevant" to the performance of the judicial function and useful in the judicial process" (citations omitted), as well as the presumption that court records are open to the public and should not be sealed unless "specific, on the record findings are made demonstrating that closure is essential to preserve higher values and is narrowly tailored to serve that interest" (citations omitted). Citing the recent Third Circuit decision in *Delaware Coal. for Open Gov't, Inc. v. Strine*, 733 F.3d 510, 521 (3d Cir.2013; 1.usa.gov/1mp1XOW), cert. denied, Mar. 24, 2014; see 1.usa.gov/1ovZu9s), finding unconstitutional a Delaware program that enabled litigants to privately arbitrate certain business disputes before Court of Chancery judges, the district court recalled that the United States does not operate "secret commercial courts."

It further noted that "confidential information" in American litigation has historically been limited to "information that, if disclosed, could cause real and imminent damage to the parties' interests—the prime examples being trade secrets and premature disclosure of market moving events. Documents that relate to but do not disclose such confidential matters have, however, never been similarly endowed with confidentiality.

Furthermore, the court found no principle of international comity requiring it to conduct

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a proceeding to enforce the securities laws of the United States in secret simply because a related proceeding was cloaked in confidentiality, and also noted that even the LCIA Arbitration Rules allow disclosure if a party is under legal duty to disclose materials and documents, or if disclosure is “reasonably necessary” so that a party can “protect or pursue a legal right” in some other forum.

While the Southern District’s reasoning appears correct with respect to the specific facts of this case (and it should be noted that certain materials remain sealed or redacted), the decision appears to attack with unnecessary vehemence the established notion of arbitral confidentiality. It describes the LCIA’s confidentiality provisions as “all but guaranteed to cloak any proceeding conducted there in the utmost secrecy,” and decries Morgan Stanley’s position as “part and parcel of a well-documented effort by private business parties to get around liberal American discovery rules by finding ways to shroud, not just dispute resolution proceedings, but evidence about disputed matters, with secrecy.”

—Lia Iannetti, CPR Institute

## BRIEFS IN BRIEF

It has been a busy period for ADR; some of the summer’s most interesting developments are highlighted below.

### Case Law

**Circuits Remain Split on Manifest Disregard**  
*Schafer v. Multiband* – For the second time this term, the US Supreme Court; on June 23, 2014; denied certiorari in a case concerning the continued viability of the “manifest disregard”

doctrine (1.usa.gov/1l0n7INp; CPR discussed the Sixth Circuit’s decision at bit.ly/1mGv7ti), despite the current split among the federal appellate circuit courts. See CPR’s discussion of manifest disregard at bit.ly/1rnlGBX and bit.ly/Y1qIvv and in 32 *Alternatives* 97 (June 2014).

### Mediator Disclosure

*CEATS, Inc. v. Continental Airlines, Inc.*, No. 2013-1529 (Fed. Cir. June 24, 2014) (1.usa.gov/1oIFnG9) – Mediators are bound by disclosure requirements; standard similar to recusal requirements for judges.

### Award Vacated because Arbitrators Were Impartial

*Americo Life, Inc. v. Myer*, 2014 WL 2789429 (Tex. June 20, 2014) (bit.ly/1p2wvdT) – Texas Supreme Court found parties intended for party-appointed arbitrators to be partial, as allowed by AAA arbitration rules in effect at time of contract.

### Whether Parties Agreed to Class Arbitration is Gateway Arbitrability Issue for Court

*Opalinski v. Robert Half International*, No. 12-4444 (3d Cir. July 30, 2014) (1.usa.gov/1uLD8Cz) – According to the Third Circuit appellate court, unless the parties “unmistakably provide otherwise,” the determination of whether an agreement allows class-wide arbitration is a question of arbitrability for the courts. The court noted that its ruling was consistent with that of the Sixth Circuit, the only circuit to have decided the issue; see CPR’s discussion of the 2013 Sixth Circuit decision at bit.ly/1oIMr5I.

### Arbitrator’s Right to Raise Issues Not Advanced by Party

In *Cellu-Beep, Inc. v. Telecorp Communications,*

*Inc.*, SDNY July 18, 2014 (bit.ly/1q6ZWs1) – The US District Court for the Southern District of New York refused to vacate an award, finding that the arbitrator had not demonstrated “evident partiality” by asking for briefing on the statute of limitations, although defense not raised by the respondent.

### Court Clarifies Definition of “Customer” for FINRA Arbitration

*Citigroup Global Markets, Inc. v. Abbar*, No. 13-2172 (2d Cir. Aug. 1, 2014) (bit.ly/1uLv44K) – The Second Circuit has adopted a bright line definition of “customer.” According to FINRA Rule 12200, FINRA members are required to arbitrate claims if there is a written agreement requiring arbitration, or the claims involve disputes with their “customers,” but the FINRA rules merely provide that a “customer shall not include a broker or dealer” (see Adam Weinstein & Bette Shifman, “FINRA’s Arbitration Agreement: Second Class Status?” 32 *Alternatives* 87 (June 2014). According to the Second Circuit, a “customer” under FINRA’s rules is “one who, while not a broker or dealer, either (1) purchases a good or service from a FINRA member, or (2) has an account with a FINRA member.”

### Rules

The American Arbitration Association’s (AAA) International Centre for Dispute Resolution (ICDR) revised arbitration rules came into effect on June 1, 2014; bit.ly/1AbsdoP.

The London Court of International Arbitration (LCIA) has adopted new arbitration rules that will come into effect on October 1, 2014; bit.ly/1q6WyxB.

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## CPR News

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Olivier André: oandre@cpradr.org.

**MARK YOUR CALENDAR** for CPR’s 2015 Annual Meeting, February 19-21 at The Lodge at Torrey Pines, La Jolla, CA; for information see bit.ly/CPR-AM15 or contact Beth Trent: btrent@cpradr.org.

### Speaking Engagements

October 20 - Olivier André will speak at NY State Bar Association Dispute Resolution Section Fall Meeting

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## Join Us for the 2014 Corporate Leadership Award Dinner

Each year, CPR honors a corporation that has demonstrated leadership in the field of conflict management and has institutionalized ADR into their legal structure and corporate culture. The Award is presented at a black tie event that draws approximately 500 attendees representing the general counsel from Fortune 200 corporations, partners from leading law firms, and industry experts and scholars who come together to demonstrate the importance of ADR. Since inception, the event has raised more than \$8 million for CPR's public policy research and programs as well as our initiatives internationally.

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