Fourth Circuit Vacates Securities Arbitration Award: Raymond James Financial Services, Inc. v. Bishop

I. Introduction

Arbitration is not a perfect process for resolving disputes, but neither is court adjudication. One advantage of court adjudication is a fairly rigorous standard of review: appellate courts generally review the trial court's factual findings for clear error and legal conclusions de novo. By contrast, courts review arbitration awards under the very deferential standards of review prescribed by Sections 10 and 11 of the Federal Arbitration Act. The trade-off is one of informality, speed and reduced expense for a heightened risk that the decision maker will commit unreviewable legal and factual errors -- even some pretty egregious ones.

But every so often an arbitration award can be so far off the mark that one of the parties is deprived of the benefit of the bargain it made when it agreed to arbitrate. These are not cases where the arbitrators merely did a shoddy job, but ones where the arbitrators did not do the job the parties asked them to do. These are the cases that Section 10(a)(4) of the Federal Arbitration Act was designed to address: ones where ?the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final award on the subject matter was not made.?

Today we take a brief look at **Raymond James Financial Serv., Inc. v. Bishop**, ___ F.3d ___, No. 09-1038, slip op. (4th Cir. Feb. 22, 2010), a recent example of one of those rare cases. And we'll see how how confusion about the scope of Section 10(a)(4) resulting ? quite unintentionally ? from the United States Supreme Court decision in Hall Street Assoc., L.L.C. v. Mattel , Inc, 552 U.S. ___, slip op. at __ (March 25, 2008) apparently motivated the United States Court of Appeals for the Fourth Circuit to decide the case solely on the ground that the arbitrators were not authorized to rule on the claim on which they admittedly based their award. (See, generally, "**Hall Street Meets Pearl Street: Stolt-Nielsen and the Federal Arbitration Act's New Section 10(a)(4)**.")

The Court reached the right result, but its decision is of limited utility in future cases. For under many broad arbitration agreements and submissions the arbitrators have authority to rule on pretty much any claim that is related to the subject matter of the parties' dispute. Abitrators may have the authority to resolve a claim, but may do so in a way that has not even a barely colorable justification under the law and facts.

We would have liked to see the Court rule not only on the authority issue, but also on two other grounds relied upon by the district court: manifest disregard of the law and the award's failure to "draw its essence? from the parties' agreements. **As we have said before**, we believe that those grounds are statutorily permitted by Section 10(a)(4), and that they provide a useful safety valve for addressing those (thankfully) rare cases where the arbitrators resolve a dispute within the scope of their authority, but do so in a way that completely deprives one of the parties of the benefit of its arbitration agreement.

II. Background

Raymond James Financial arose out of three separate agreements between registered broker-dealer Raymond James Financial Services, Inc. (?Raymond James?) and registered representatives Bishop, Hamant and Scanlon, each of whom was a financial advisor. Bishop left his former firm, entered into a written, ?Independent Sales Associate? agreement with Raymond James and became the branch manager of Raymond James' Richmond, Virginia office. Apparently at Bishop's urging, Hamant and Scanlon each entered into separate ?Financial Advisor? agreements with Raymond James, and joined the Richmond Office managed by Bishop.

Each of the agreements established an independent contractor relationship between the signatory and Raymond James, and contained the following provision permitting termination without cause on five-days' notice:
Either party may terminate this Agreement by providing the other party no less than five (5) business days prior written notice of intent to terminate this Agreement. Given the unique transactional nature of the securities business, there is no need for a liquidated damages provision should either party voluntarily terminate the Agreement before the end of its term as neither party would be

significantly damaged by such termination.

None of the agreements contained arbitration clauses, but by virtue of the parties' status as registered members of the National Association of Securities Dealers (?NASD?) (now the Financial Industry Regulatory Authority, Inc. (?FINRA?)), NASD Rule 10101 -- now codified in FINRA's ?Code of Arbitration Procedure? ? required them to arbitrate ?any dispute, claim, or controversy . . . arising out of . . . employment or termination of employment . . . .?

In 2003 Raymond James received misconduct complaints from competing financial advisors concerning Bishop's Richmond, Virginia office. As a result, in April 2004 Raymond James issued five days' notice of termination to Bishop, and advised him that it was closing the Richmond office. Like notices were apparently also issued to Hamant and Scanlon.

The termination notices left open the possibility that Bishop, Hamant and Scanlon could re-affiliate with Raymond James at a different Raymond James branch. Raymond James issued a two-month extension to effect the branch closing, and in June 2004 Bishop, Hamant and Scalon voluntarily terminated their employment.

Prior to the voluntary termination, arbitration proceedings arising out of certain of the complaints were instituted against Raymond James and the three financial advisors. Bostic, an in-house lawyer in Raymond James' legal department, assumed the defense of Raymond James and each of the three financial advisors, and continued to represent the financial advisors after the Richmond office was closed. The proceedings against Scanlon were concluded in his favor, and the district court found that the proceedings against him were likewise concluded in Hamant's favor. Hamant did not contest that finding even though he contended in the subsequent arbitration against Raymond James that the third-party proceedings against him had resulted in a $10,000 award.

Raymond James discovered that an unauthorized person had gained access to its computer system, and it believed that person to be Bishop based on an internal investigation. As a result Raymond James began contemplating legal proceedings against Bishop, and, in December 2004, while the third-party arbitration proceedings against Bishop were ongoing, Bostic withdrew his representation of Bishop because of the conflict of interest. But a few days after Bostic withdrew, the parties to the arbitration against Bishop entered into a global settlement that resulted in Bishop having no liability.

In July 2005 Bishop, Scanlon and Hamant demanded a consolidated arbitration against Raymond James. They asserted claims for damages based on: (1) wrongful discharge; (2) breach of contract; (3) tortious interference with contract; (4) common law and statutory conspiracy; (5) violation of the Virginia Retail Franchising Act; and (6) violation of ?just and equitable principles of trade.?

In December 2006, after a several-day hearing, the arbitration panel ruled that Raymond James was liable on the following grounds: breach of fiduciary and legal duties; violation of just and equitable legal principles of trade; breach of promises and inducements; interference with, and unlawful termination of [the financial advisors'] . . . prospective economic advantages; interference with the performance of contractual promises and inducements; tortious and deceitful termination of [the financial advisors'] . . . legitimate and high business expectations; violation of statutory Virginia public policy set forth in Virginia code § 13.1-558; and common law and statutory conspiracy.

The Panel awarded Bishop $156,050; Hamant $74,050; and Scanlon $72,050.

The Panel's award explained that Raymond James engaged in ?unauthorized practice of law [sic] by employing staff counsel to advise and represent [the financial advisors] . . . in their individual capacities? in the underlying, third-party arbitrations. The Panel found that Raymond James did not warn the financial advisors that they would be subject to heightened scrutiny because of the complaints. And the Panel found that Bostic's withdrawal prejudiced ?some or all [of the financial advisors']. . . litigation interest and made their transfer to other Raymond James Services, Inc. branch offices impossible as a practical matter.?

On Raymond James' motion to vacate, the district court initially remanded the matter back to the arbitrators because it could not discern any basis for the award. In April 2008 the Panel issued a letter explaining three bases for its award:
(1) Raymond James provided legal representation to the [financial advisors] . . . ?in a matter involving a business relationship

between the employer and [the financial advisors] . . . that was also adversarial with a clear conflict of interest;" (2) Raymond James' "attorney favored the interest of [Raymond James] to the disadvantage of the [financial advisors]. . . who were also his clients;" (3) "if a corporation employs a lawyer to provide legal services that corporation is then engaged in the practice of law . . . . As such, it is held to the same standard as a law firm and owes to its client the highest degree of fiduciary duty. If it chooses to engage in the business with such clients, it is obligated to place the interest of those clients ahead of its own. [Raymond James] failed in that obligation and the [financial advisors] . . . suffered losses pertaining to the issues for which [Raymond James] provided its lawyer."

In June 2008, the arbitrators supplemented their clarification letter by stating that ?[t]he unauthorized practice of law was one among other factors considered by the panel and that considering the case as a whole [it] believes the liability decision to be just and appropriate."

The Court's discussion of the proceedings below was somewhat detailed, but for the purposes of this post, we need not dwell on it. Suffice it to say the district court vacated the award on three independent grounds: (1) the arbitrators exceeded the powers conferred upon them by Rule 1010 and the submission; (2) the arbitrators manifestly disregarded the law, because Florida law required a party to show damages to establish a breach of fiduciary duty claim and there were no damages; (3) the award did not ?draw its essence? from the parties' contracts because the ?gravamen? of the claim was for wrongful termination, the parties' contracts permitted termination without cause on five days' notice, and in any event, the financial advisors ultimately voluntarily terminated their relationship with Raymond James.

III. The Fourth Circuit's Decision

The Fourth Circuit affirmed, but only on the ground that the arbitrators exceeded the authority granted to them by Rule 1010 and the parties' submissions. The Court also found that the remand to the arbitrators was proper insofar as the district court did not know what to make of the award, a point we need not address here.

The Fourth Circuit's rationale was based on Rule 1010, which required arbitration of "[a]ny controversy . . . arising out of the employment or termination of employment . . . ." of registered representatives. Prior case law in the Fourth Circuit had construed this language broadly to mean ?that a dispute ?arises out of employment or termination of employment,' where the claims ?involve significant aspects of the employment relationship, including but not limited to explicit contractual terms.'? The ?'proper question is whether resolution of the claim depends upon evaluation of a party's performance either as a broker or as an employer of brokers during the time of the contractual relationship.'? Slip op. at 17 (citations omitted).

The Fourth Circuit agreed with the district court that the gravamen of the financial advisors' claims was for wrongful termination, but that the arbitrators, by their own admission, decided the case, and awarded damages, based on Raymond's James' alleged breach of fiduciary duty, a claim the parties neither submitted to arbitration nor were required to arbitrate pursuant to Rule 1010:
As we have noted, here the arbitrators based their award on Raymond James' alleged breach of "fiduciary and legal duties" in connection with their joint representation with Raymond James by Bostic, the inhouse lawyer. Under the Zandford "significant aspects" test, the appropriate question here "is whether resolution of the claim depends upon evaluation of a party's performance either as a broker or as an employer of brokers during the time of the contractual relationship." The panel's assertion that Raymond James acted improperly as a "lawyer" is inconsistent with the notion that Raymond James was acting as an "employer of brokers during the time of the contractual relationship." There is nothing whatsoever in the serial explanations provided by the arbitration panel to support the conclusion that the legal theory the panel found sustained required an evaluation of any party's "performance." Even after the district court ordered a remand to the panel, the panel simply reiterated what seemed inescapable from the original award: that the panel had adjudicated a tort claim that fell outside of the expansive interpretation of "arising out of employment" we adopted in Zandford.

Slip op. at 18 (citations omitted).

IV. Analysis

While we believe the Court's excess of authority analysis was basically sound, it required the Court to parse the language of Rule 1010 pretty thinly. The focus should have been on the parties' submission rather than the language of Rule 1010. Notwithstanding the Court's statement that Raymond James' purported activities as a "law firm" were inconsistent with it being an employer, Bostic's provision of counsel to the financial advisors was something that, at least arguably, "arose out of employment . . . ." within the meaning of Rule 1010. It would have been cleaner -- and more consistent with an "expansive interpretation" of Rule 1010 to have simply ruled that the parties did not submit to the arbitrators the issue of Raymond James' joint representation of the financial advisors in the third-party proceedings.

The Court quietly took a pass on whether the award was in manifest disregard of the law or did not ?draw its essence from? the parties' contracts and simply explained in a footnote the controversy surrounding the continued viability of those theories in light of Hall Street. See Slip op. at 18 n.13. To address these two other bases relied on by the district court, the Fourth Circuit would have had to decide: (a) whether Hall Street permitted vacatur on those bases to the extent that they were within the ambit of Federal Arbitration Act Section 10(a)(4); (b) whether they were in fact within the ambit of Section 10(a)(4); and (c) whether the facts justified vacatur under one or both of them.

We are mindful that the principal purpose of the federal judiciary is to decide cases and controversies, and the Fourth Circuit fulfilled that purpose here, while avoiding the mire created by the manifest disregard dictum in Hall Street. But we would have preferred a bolder approach under which the Court would have ruled on the manifest disregard and ?essence of the agreement? challenges, simply because that would have given litigants more guidance in future cases, particularly ones in which arbitrators reach a ruling lacking a colorable basis in the course of deciding a claim within the scope of their authority.

Had the Court opted to analyze the case from the standpoint of manifest disregard of the law and ?essence of the agreement,? we believe that it might have affirmed the district court's decision on those grounds as well. There was simply no colorable basis for this award, and we believe the only reasonable conclusion one can reach is that the arbitrators decided to punish Raymond James for what they misperceived to be wrongful conduct on the part of Bostic -- allegedly wrongful conduct that was not the basis of the financial advisors' claims.

Even if the breach of fiduciary duty claim were arbitrable, there was no basis for the damage awards. Bostic's withdrawal from the Bishop third-party proceedings had no affect on the third-party proceedings against the other two financial advisors ? those proceedings were concluded before Bostic withdrew from the Bishop proceedings. But apart from that, the Bishop proceedings resulted in a global settlement under which Bishop had no liability.

Even if we ignore what the arbitrators said in response to the district court's remand order, and treat the arbitrators' award as one for wrongful discharge, there could be no wrongful discharge because Raymond James complied with the termination provision in the contract, which allowed discharge on five days' notice without a showing of just cause. The termination clause also expressly acknowledged that there would be no meaningful damages in the event of a termination (wrongful or otherwise) in view of the transactional nature of the securities industry (in which compensation is largely based on commission).

In any event, Raymond James' compliance with the termination clause was irrelevant because each of the financial advisors voluntarily terminated their relationship with Raymond James after the expiration of a two-month extension of time to close the Richmond office. A voluntary termination is by definition not wrongful.

While judicial restraint is generally a good thing, an affirmance on the three bases the district court relied upon would have resulted in a more meaningful and useful decision.