UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

FREEDOM INVESTORS CORP.,

Petitioner,

v.

ZENAIDA P. GANTAN,

Respondent.

Case No. 17-cv-03914-SK

REPORT AND RECOMMENDATION REGARDING MOTION TO VACATE ARBITRATION AWARD

Regarding Docket No. 1

Petitioner Freedom Investors Corporation moves to vacate an arbitration award, in response to which no opposition was filed. (Dkt. No. 1.) At the hearing on the matter, the Court requested additional briefing on the issue of jurisdiction and service on the parties. (Dkt. No. 12.) Petitioner filed a timely response. (Dkt. Nos. 13, 14.) Prior to the issuance of an order on Petitioner's motion, Respondent Zenaida Gantan appeared and filed miscellaneous pleadings. (Dkt. Nos. 15, 16, 18-20.) The Court requested a consent/declination to proceed before a United States magistrate judge and issued a briefing schedule for Respondent's motion to affirm the arbitration award. (Dkt. No. 21.) On September 7, 2017, Respondent filed a declination to appear before a magistrate judge. (Dkt. No. 23.) Reassignment to a district judge is currently pending. In light of the foregoing, the Court issues this report and recommendation regarding Petitioner's motion to vacate the arbitration award, and RECOMMENDS the District Court DENY the motion for the reasons set forth below.

JURISDICTION AND VENUE

Petitioner asserts federal question jurisdiction (28 U.S.C. § 1331) based on 9 U.S.C. §§ 1 and 10. However, the Federal Arbitration Act ("FAA") at 9 U.S.C. § 1, *et seq.*, bestows no federal jurisdiction; rather, it requires an independent jurisdictional basis over the parties' dispute for

access to a federal forum. *Vaden v. Discover Bank*, 556 U.S. 49, 52-53 (2009); *Luong v. Circuit City*, 368 F.3d 1109, 1110-11 (9th Cir. 2004). Therefore, Petitioner has not met its burden in terms of establishing federal question jurisdiction.

Petitioner also asserts diversity jurisdiction based on 28 U.S.C. § 1332. Specifically, Petitioner is a Wisconsin-based company (Dkt. No. 1-1, ¶ 3), Respondent is a resident of California, and the amount at issue exceeds $75,000. Thus, Petitioner meets the burden of establishing diversity jurisdiction over the parties named in this petition. Venue is appropriate, as provided by 28 U.S.C. § 1391, given that Respondent resides in this district.

ADEQUACY OF SERVICE

According to the FAA, "[i]f the adverse party is a resident of the district within which the award was made, such service shall be made upon the adverse party or his attorney as prescribed by law for service of an action in the same court." 9 U.S.C. § 12. Service of a motion on counsel is permitted where the party is represented, unless the court orders service on the party. Fed.R.Civ.P. 5(b)(1). Service by mail is permitted. *Id.* at 5(b)(2)(C). Here, the petition was properly mailed to Richard Fosher of Oakes & Fosher in St. Louis, counsel for Respondent, on July 12, 2017. Therefore, the Court finds that service upon Respondent was proper. Petitioner also mailed copies of the petition and the court's orders to counsel for Apex Clearing Corporation ("Apex") and the Chief Financial Officer of Merrimac Corporate Securities ("Merrimac"). Had Apex and Merrimac been named in the petition, 9 U.S.C. § 12 would not have been applicable given that these parties do not reside within the district.[1]

BACKGROUND

The underlying action involves a claim by Respondent, Dr. Zenaida Gantan

[1] The Court has concerns that Merrimac is a necessary party in this action because Merrimac shares liability with Petitioner for the arbitration award. The issue of nonjoinder under Rule 19 is "sufficiently important that it can be raised at any stage of the proceedings – even *sua sponte*." *Republic of Philippines v. Pimentel*, 553 U.S. 851, 861 (2008). The Court asked Petitioner to brief this issue, including service on Merrimac and Apex, but Petitioner failed to address the issue. Nevertheless, the Court has determined that that the issue is moot given the recommendation below.

("Respondent"), a widow and resident of Brentwood, California, who runs a home for dementia patients. (Dkt. 1-2 (Statement of Claim), p. 5.) Respondent filed an arbitration claim with the Financial Industry Regulatory Authority ("FINRA") Code of Arbitration Procedure. (*Id.*) Respondent asserts that broker Chad Thompson, a representative of Merrimac Corporate Securities in Florida, "churned" her IRA – implementing a highly speculative investment strategy, excessively trading accounts to generate commissions, and leveraging the account on margin. (*Id.*, pp. 6-7, 11.) Stephen Pizzuti was the registered principal for Merrimac responsible for supervising Mr. Thompson. (*Id.*, p. 7) Respondent asserts that Freedom is the successor to Merrimac. More specifically, she argues that there was a *de facto* merger between Freedom and Merrimac. (*Id.*, p. 15.)

In its petition, Freedom argues that it is not the successor to Merrimac, but that it is home for a number of registered representatives who used to work for the now defunct Merrimac, which had more than 70 representatives. (Dkt. No. 1, p. 13.) Freedom also claims that Mr. Thompson never registered with Freedom and that Respondent's account was never registered with Freedom. (*Id.*) Further, Mr. Pizzuti was never a registered principal with Freedom, although he applied for registration with Freedom. (*Id.*, p. 12.) There were discussions between Freedom and Mr. Pizzuti to open an independent office of supervisory jurisdiction ("OSJ"), during which Freedom made it clear that it did not want to purchase Mr. Pizzuti's clients or be a successor. (Dkt. No. 1-1, ¶¶ 10-12.) In May of 2014, Freedom entered into an independent OSJ licensee agreement with Mr. Pizzuti, the terms of which provided that all accounts of Mr. Pizzuti remained the property of Mr. Pizzuti. (*Id.*, ¶ 13-14.) There was no agreement with Merrimac. (*Id.*, ¶ 15.)

According to the arbitration award, both Mr. Pizzuti and Mr. Thompson initially made *pro se* appearances in the arbitration. (Dkt. No. 1-2 (Arbitrator's Award), pp. 37-38.) Mr. Pizzuti filed for bankruptcy protection under the United States Bankruptcy Code, which stayed the claims against him. (*Id.*) Mr. Pizzuti was subsequently dismissed from the matter. (*Id.*) Mr. Thompson likewise filed for bankruptcy; the claims against him are indefinitely stayed. (*Id.*, p. 38.)

Apex is a brokerage firm that, like Freedom, was determined by the panel to be a successor to Merrimac. (Dkt. No. 1-2, p. 38.) The petition does not identify the role or conduct of Apex in

the circumstances leading to the arbitration.

The arbitration panel found that Apex was liable to Respondent for $31,000 in compensatory damages, $43,700 in attorneys' fees, and $5,163 in costs; and that Freedom and Merrimac were jointly and severally liable for $210,487 in compensatory damages and $5,162 in costs. The panel denied the request for punitive damages. (*Id.*, pp. 38-39.)

On July 11, 2017, Petitioner filed this request to vacate the arbitrators' award, which was unopposed. The matter was heard on August 21, 2017. On August 29, 2017, Respondent filed a cross-claim for confirmation of the arbitrator's award. (Dkt. No. 19.) The Court makes no recommendation on its merits, here.

DISCUSSION

Petitioner seeks to vacate the arbitration award on two grounds: (1) 9 U.S.C. § 10(a)(3) for arbitrator misconduct and (2) 9 U.S.C. § 10(a)(4) for arbitrator abuse of power. Although the statutory grounds for review of an arbitration award appear broad, they are narrowly construed. *Oxford Health Plans, LLC v. Sutter*, 133 S.Ct. 2064, 2068-69 (2013). The FAA does not permit parties to expand the scope of judicial review beyond the statutory scope set forth in 9 U.S.C. §10 (vacatur) or §11 (modification). "The burden of establishing grounds for vacating an arbitration award is on the party seeking it." *U.S. Life Ins. Co. v. Superior Nat. Ins. Co.*, 591 F.3d 1167, 1173 (9th Cir. 2010). As provided below, Petitioner has not met its burden.

A. The Petitioner fails to provide an adequate basis for vacatur based on 9 U.S.C. § 10(a)(3).

Freedom's first argument is based on section 10(a)(3) which allows the district court to vacate an award:

> where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause show, or in refusing to hear evidence pertinent and material to the controversy; or of any misbehavior by which the rights may have been prejudice.

9 U.S.C. § 10(a)(3).

In support, Freedom claims that it was deprived of the right to review and select arbitrators in violation of the FINRA arbitration process to ensure objective and impartial determinations, as permitted under FINRA Rule 13408. Rule 13408 requires each potential arbitrator to learn of and

disclose "any circumstances which might preclude the arbitrator from rendering an objective and impartial determination in the proceeding." Rule 13408(a). Freedom argues that by the time it was brought into the claim, the arbitration panel members had already been selected and that Freedom had never been provided with a list of proposed arbitrators to note its preferences. (Dkt. No. 1-1, ¶¶ 5-6.)

While Petitioner argues section 10(a)(3) of the FAA, Rule 13408(a) dovetails more appropriately with section 10(a)(2), which provides that a court may vacate an award "where there was evident partiality or corruption in the arbitrators or either of them." 9 U.S.C. § 10(a)(2). To show evident partiality, a party moving for vacatur "must establish specific facts indicating actual bias toward or against a party or show that [an arbitrator] failed to disclose to the parties information that creates '[a] reasonable impression of bias.'" *Lagstein v. Certain Underwriters at Lloyd's London*, 607 F.3d 634, 645-46 (9th Cir. 2010) (quoting *Woods v. Saturn Distribution Corp.*, 78 F.3d 424, 427 (9th Cir. 1996)). Further, a "reasonable impression of bias sufficiently establishes evident partiality because the integrity of the process by which arbitrators are chosen is at issue in nondisclosure cases." *Woods*, 78 F.3d at 427.

"The burden of proving facts which establish a reasonable impression of partiality rests squarely on the party challenging the award." *Sheet Metal Workers Int'l Ass'n Local Union No. 420 v. Kinney Air Cond. Co.*, 756 F.2d 742, 745-46 (9th Cir. 1985). However, Freedom does not claim that any one of the arbitrators failed to make disclosures mandated by FINRA or that one or more arbitrators lacked impartiality or qualifications. Rather, Freedom claims that it did not get an opportunity to review qualifications and select the arbitrators. (Dkt. 1, p. 7.) There is no record of Freedom's challenge to the arbitrator selection process. To the contrary, Freedom signed a submission agreement on January 12, 2016 with the FINRA Office of Dispute Resolution, agreeing to submit to the arbitration panel. (Dkt. 1-2, p. 36.) Clearly, as of January 2016, Freedom was willing to proceed with the existing panel of arbitrators.

Freedom failed to demonstrate evident partiality or evident corruption within the meaning of section 10(a)(2). Likewise, Freedom failed to demonstrate a violation of section 10(a)(3). Freedom failed to point to specific misconduct or misbehavior on the part of the arbitrators to

support vacatur. Because Freedom failed to meet its burden, the Court recommends that the District Court DENY the petition to vacate the arbitration award based on section 10(a)(3).

B. Freedom failed to establish that the panel exceeded its powers pursuant to section 10(a)(4).

Freedom claims that the "arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award on the subject matter was not made." 9 U.S.C. § 10(a)(4). This claim is based on two arguments: (1) that the arbitrators exceeded their powers pursuant to section 10(a)(4) or exemplified "manifest disregard of the law" by finding that Freedom was a successor to Merrimac, and (2) that the award was completely irrational.

1. Petitioner has not established that the award issued by the panel is "completely irrational."

An award is completely irrational only where the arbitration decision fails to draw its essence from the agreement." *Lagstein,* 607 F.3d at 642. This is an extremely narrow standard. *Bosack v. Soward,* 586 F.3d 1096, 1106 (9th Cir. 2009). "An arbitration award draws its essence from the agreement if the award is derived from the agreement, viewed in light of the agreement's language and context, as well as other indications of the parties' intentions." *Lagstein,* 607 F.3d at 642; *Bosack,* 586 F.3d at 1106. "[T]he question is whether the award is irrational with respect to the contract, not whether the panel's findings of fact are correct and internally inconsistent." *Bosack,* 586 F.3d at 1106.

In its statement of facts about the arbitration process, Petitioner comments that the award "seems to be based on the notion that Respondent had a 'perfect market return'" and that the panel never held that actual "churning" of the Respondent's IRA took place. (Dkt. No. 1, p. 7.) An arbitrator's award "may be made without explanation of the reasons and without a complete record of their proceedings[.]" *Biller v. Toyota Motor Corp.,* 668 F.3d 655, 666 (9th Cir. 2012). Given that arbitrators need not state the reasons for their awards unless the agreement provides, the panel's failure to provide a reasoned award is not error. Other than the foregoing, the Petitioner makes no argument that meaningfully relies upon the irrationality aspect of section 10(a)(4). Rather, the arguments are directed to whether the panel exceeded its powers by manifest disregard for the law.

2. Petitioner failed to establish manifest disregard for the law.

An arbitration award cannot be vacated or modified because the arbitrator's findings are not supported by substantial evidence or the arbitrator's conclusions of law are erroneous. *Hall Street Assoc., LLC v. Mattel, Inc.*, 552 U.S. 576, 579-81 (2008); *Bosack*, 586 F.3d at 1102. "Arbitrators 'exceed their powers…when the award is 'completely irrational' or exhibits a 'manifest disregard of law.'" *Lagstein*, 607 F.3d at 641 (citing *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 997 (9th Cir. 2003)). "It is not enough … to show that the panel committed an error – or even a serious error.'" *Id.* at 642. "'Manifest disregard of the law' means something more than just an error in law or a failure on the part of the arbitrators to understand or apply the law.' To vacate an arbitration award on this ground, 'it must be clear from the record that the arbitrators recognized the applicable law and then ignored it.'" *Id.* (citations omitted). "There must be some evidence in the record, other than the result, that the arbitrators were aware of the law and intentionally disregarded it." *Bosak*, 586 F.3d at 1104.

Here, Petitioner asserts that the panel of arbitrators showed manifest disregard for the law because they determined that Freedom is a successor in interest to Merrimac. The "record" presented by Freedom for the Court to review consists of the first amended statement of claim, the answer, and the award. There is no reference to a specific location in the record where the panel acknowledged the law and subsequently chose to ignore it. Rather, in the award, the panel acknowledges that at the conclusion of Respondent's case in chief, Apex and Freedom orally moved for dismissal of the claims. (Dkt. 1-2, p. 38.) After which, "[t]he Panel denied the motion based on the credible evidence that Apex and Freedom were successors." (*Id.*) The panel's decision does not exhibit manifest disregard of the law. Instead, the decision acknowledges the need to make a determination on the issue of whether Freedom was a successor, and the arbitrators ruled in favor of Respondent based on credible evidence.

This Court may not question the award because this is not a case where there has been manifest disregard of the law. This Court's function is not to evaluate the merits of the action *de novo*. The Petitioner did not establish that the panel was aware of the law and intentionally disregarded it. The panel did not ignore the law; instead, the panel applied the law to the facts and

ruled in favor of Respondent. Accordingly, Petitioner's argument of manifest disregard for the law fails.

CONCLUSION

For the reasons stated above, the Court RECOMMENDS that the District Court DENY Petitioner's motion to vacate the arbitration. Any party may serve and file specific written objections to this recommendation within fourteen days after being served with a copy. See 28 U.S.C. § 636(b)(1)(C); Fed.R.Civ.P. 72(b); Civil L.R. 72-3. Failure to file objections within the specified time may waive the right to appeal the District Court's order.

IT IS SO ORDERED.

Dated: September 7, 2017

SALLIE KIM
United States Magistrate Judge

United States District Court
Northern District of California