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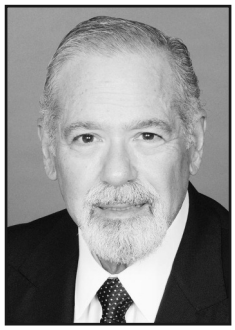
SELECTING PARTY ARBITRATORS



Richard Chernick

It is common in U.S. based commercial arbitrations with tripartite panels that the parties each select one arbitrator and the selected arbitrators then choose a third. The typical clause in an arbitration agreement might provide: "Each party shall select an arbitrator and they shall select the third [or the chair]." This is obviously an important step in the process, and it is fraught with risks and ethical land mines.[1]

Determining the Status of the Party Arbitrators. The first issue one confronts when reading such a clause is whether the parties intended the party arbitrators to be neutral or non-neutral.[2] Arbitration clauses rarely express clearly the

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DURAN, DUE PROCESS, AND THE CLASS ACTION DEVICE

Blaine H. Evanson

On May 29, 2014, the California Supreme Court in *Duran v. U.S. Bank National Association*, No. S200923, unanimously affirmed the reversal of a classwide judgment for plaintiffs in a wage-and-hour misclassification class action that was tried based on an assessment of a statistical sample of class members. *Duran* represents a significant victory for class action defendants in California, as it unanimously rejected as inconsistent with due process and California law attempts by class action plaintiffs to use statistical sampling and other procedural shortcuts to deprive defendants of an opportunity to present individualized defenses. In rejecting use of "the class action procedural device ... to abridge a party's substantive rights," *Duran* brings California class action law closer in line with federal law and recognizes that due process principles reflected in federal class action procedural rules have important implications for similar state procedure.

Brandon J. Stoker

Due Process Principles Imbued in Federal Class Action Procedures

Federal class certification law has undergone dramatic transformation in recent years. The Supreme Court's decision in *Wal-Mart Stores, Inc. v. Dukes* introduced a mandate to engage in "rigorous analysis" during class certification to ensure that a plaintiff "seeking class certification [has] affirmatively demonstrate[d] his compliance" with Rule 23. 131 S. Ct. 2541, 2551 (2011). *Dukes* also condemned "Trial by Formula"—a procedure whereby liability would be determined based on an assessment of the claims of a sample of the class,

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with the results extrapolated across the remainder of the class. *Id*. at 2561. Subsequently, in *Comcast Corp. v. Behrend*, the Court applied the rigorous analysis standard to Rule 23(b)(3)'s predominance requirement, recognizing that causation and the measure of damages must be susceptible to measurement on a classwide basis and observing that "[q]uestions of individual damage calculations" may preclude a finding of predominance by "overwhelm[ing] questions common to the class." 133 S. Ct. 1426, 1433 (2013).

These decisions were animated, in part, by due process principles underlying Rule 23. Although the Court's rejection of "Trial by Formula" in *Dukes* relied on the Rules Enabling Act's prohibition against use of procedural rules to "abridge, enlarge or modify any substantive right" (28 U.S.C. § 2072(b)), that principle reflects a fundamental due process norm that is binding on all courts. Federal class action procedure is "grounded in due process," and the procedural convenience of class treatment cannot displace the "deep-rooted historic tradition that everyone should have his own day in court." *Taylor v. Sturgell*, 553 U.S. 880, 892–93, 901 (2001); see also *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 615 (1997) (class certification should not "sacrifice[ ] procedural fairness"); *Goldberg v. Kelly*, 397 U.S. 254, 267 (1970) ("The fundamental requisite of due process of law is the opportunity to be heard"). This is, in part, because "'[d]ue process requires that there be an opportunity to present every available defense.'" *Lindsey v. Normet*, 405 U.S. 56, 66 (1972) (quoting *Am. Surety Co. v. Baldwin*, 287 U.S. 156, 168 (1932)).

California's Adoption of Federal Due Process Standards in Duran

The California Supreme Court's decision in *Duran* marks an important step in state judicial recognition that due process protections guaranteed by the U.S. Constitution—including the right to be heard in court and present defenses—must factor into state class certification procedures.

The Court followed federal class action law, including *Dukes*, to hold that "the class action procedural device may not be used to abridge a party's substantive rights," including its right to litigate individualized defenses—a precept that "derive[s] from both class action rules and principles of due process." Slip op. at 30–31. It also raised the bar for plaintiffs who seek to prove classwide claims via statistical evidence by requiring courts to analyze proffers of statistical proof with "sufficient rigor," and to "consider *at the certification stage* whether a trial plan has been developed to address" the use of statistical evidence. *Id.* at 27 (emphasis added)

The trial court in *Duran* certified a class of 260 "business banking officers" who claimed they had been misclassified as "exempt" outside salespersons and thus were owed overtime pay. Slip op. at 1–2. The court limited the bench trial to an assessment of an unrepresentative sample of 21 class members (including the two named plaintiffs), and determined that all class members had been misclassified as exempt on the basis of the sample group's testimony. It then extrapolated the average amount of overtime reported by the sample group to enter a $15 million judgment for the entire class. The trial court repeatedly rejected the defendant's attempts to introduce evidence regarding the experiences of class members outside the sample group.

In a unanimous opinion authored by Justice Corrigan, the California Supreme Court rejected this procedure as "profoundly flawed." Slip op. at 2. The Court explained that "[a]lthough courts enjoy great latitude in structuring trials, … any trial must allow for the litigation of affirmative defenses, even in a class action case where the defense touches upon individual issues." *Id*. at 29. The "class action procedural device may not be used to abridge a party's substantive rights," including its right to litigate individualized defenses, a "principle [that] derive[s] from both class action rules and principles of due process." *Id*. at 30–31 (citing *Dukes*, 131 S. Ct. at 2561; *Lindsey*, 405 U.S. at 66; *Philip Morris USA v. Williams*, 549 U.S. 346, 353 (2007)).

"Class certification is appropriate only if...individual questions can be managed with an appropriate trial plan," and any such "class action trial plan, including those involving statistical methods of proof, must allow the defendant to litigate its affirmative defenses" Slip op. at 22, 38. And the Court cautioned that "[s]tatistical methods cannot entirely substitute for common proof." *Id*. Instead, "[t]here must be some glue that binds class members together apart from statistical evidence." *Id.; see also Dukes*, 131 S. Ct. at 2552. Any "statistical plan for managing individual issues must be conducted with sufficient rigor," and "[i]f statistical evidence will comprise part of the proof on class action claims, the court should consider at the certification stage whether a trial plan has been developed to address its use." Slip op. at 27.

Potential Implications of Duran. *Duran* recognizes that "principles of due process" imbued in federal class certification standards and guaranteed by the federal constitution necessarily limit the types of cases that may be

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certified for class treatment under state law. At a minimum, the class action device may not be used to abridge a party's right to litigate individualized defenses. Although the Court indicated that "[d]efenses that raise individual questions about the calculation of *damages* generally do not defeat certification," it emphasized that "a defense in which *liability itself* is predicated on factual questions specific to individual claimants" poses significant manageability challenges that could preclude class certification. *Id*. at 25.

The Court eschewed "a sweeping conclusion as to whether or when sampling should be available as a tool for proving liability" (slip op. at 38), but warned that "[s]tatistical methods cannot entirely substitute for common proof" and emphasized that a "plan for managing individual issues"—including defenses to liability—"must be conducted with sufficient rigor" and should be satisfactorily proven before a class is certified for class treatment. *Id*. at 27. As a practical matter, *Duran* suggests that flawed statistical methods will rarely be sufficient to establish liability.

Duran is a big win for defendants, as it ensures many of the same procedural protections guaranteed by Federal Rule 23 will be available in California state class actions as well. What remains to be seen is whether other federal standards for class certification—including the "rigorous analysis" standard and robust requirements for proving that class claims are susceptible to common proof after *Dukes* and *Comcast*—are likewise incorporated as state procedural law, given that they too are animated by constitutional principles of due process.

Blaine Evanson and Brandon Stoker *are both associates in the Los Angeles office of Gibson, Dunn, & Crutcher LLP, where they practice in the appellate and constitutional law and class actions practice groups. Gibson Dunn represented an* amicus curiae *in* Duran*.*

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might be asked by the party to assess the tactics which will be most persuasive to the chair. (The process of chair selection thus may involve consideration of the likely rapport the party arbitrator will have with the chair.)[7] Any agreement as to *ex parte* communications beyond the first preliminary conference should be documented in the first scheduling order.

Non-neutral arbitrators should never disclose to a party or counsel the substance of any deliberations of the panel. Code of Ethics, Canon X. In *Northwestern National Insurance Company v. Insco, Ltd.* 2011 USDist LEXIS 113626 (SDNY 2011), the court determined it lacked power to remove party-appointed arbitrator but disqualified the attorney who had received and concealed communications from the arbitrator who had disclosed panel deliberations.

Generally, non-neutral party arbitrators are not subject to disqualification (Code of Ethics, Canon X.B), but there are some limits on who is eligible to serve. They often have specific industry knowledge or familiarity with the subject matter of the dispute (factual or legal). They often also have some relationship with the party or counsel. A potential financial interest in the dispute would cause most courts to question a non-neutral arbitrator's ability to ensure a fair hearing. In *Aetna Casualty & Surety Co. v. Grabbert*, 590 A.2d 88, 92 (R.I. 1991), the court found that a contingent fee arrangement between a non-neutral party-appointed arbitrator and the party appointing him was "absolutely improper," but the court denied *vacatur* of the award because it was unanimous.[8] Non-neutral arbitrators who are potential witnesses or partners of counsel or have a present business relationship with a party have also been challenged.[9]

Conclusion. Parties have embraced the party arbitrator process. The ethical pitfalls are easily avoided, and the value of being able to make one appointment unilaterally is unmistakable. Knowing the applicable rules enables counsel to benefit by the selection of a panel of arbitrators well-suited to hear that particular case.

Richard Chernick, Esq. *is an arbitrator and mediator with JAMS in Southern California. He is Vice President and Managing Director of the JAMS arbitration practice. He is a former chair of the ABA Dispute Resolution Section. He can be reached at rchernick@jamsadr.com.*

[7] *See Employer's Insurance of Wausau v. National Union Fire Ins. Co.*, 933 F.2d 1481 (9th Cir. 1991) (rejected a challenge to an award where a non-neutral arbitrator had performed consulting services with counsel on the issues in dispute and ex parte communications had occurred throughout the matter by both party-appointed arbitrators); *Sunkist Soft Drinks, Inc. v. Sunkist Growers*, Inc.,10 F.3d 753 (11th Cir. 1993) (pre- and post- appointment communications between party and party-appointed arbitrator are consistent with the commonplace predisposition of party-appointed non-neutral arbitrators toward the party appointing them and with prevailing ethical rules); *Sphere Drake Ins. Ltd. v. All American Life Ins. Co.*, 307 F.3d 617, 622 (7th Cir. 2002) (rejecting challenge to non-neutral arbitrator who arguably provided incomplete disclosure regarding past representation of a party); *Delta Mine Holding Co. v. AFC Coal Props.*, 280 F.3d 815, 822 (8th Cir. 2001) (when parties have agreed to non-neutral party-appointed arbitrators, the award should not be vacated "unless the objecting party proves that the party arbitrator's partiality prejudicially affected the award").

[8] *See* Alan Scott Rau, *Integrity in Private Judging*, 38 S. TEX. L. REV. 485, 497-514 (1997).

[9] *Metropolitan District Commission v. Connecticut Resources Recovery Authority*, 130 Conn.App. 130, 142, 22 A.3d 651 (2011); *Barcon Associates, Inc. v. Tri-County Asphalt Corp.*, 86 N.J. 179, 430 A.2d 214 (1981) (substantial and ongoing business relationships, including services rendered during the arbitration); *Borst v. Allstate Insurance Company*, 291 Wis.2d 361,