DATE FILED: OCT 17 2018

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

RACHAEL LEIGH KONZ,

Petitioner and Cross-Respondent,

-against-

MORGAN STANLEY SMITH BARNEY, LLC and MORGAN STANLEY SMITH BARNEY FA NOTES HOLDINGS, LLC,

Respondents and Cross-Petitioners.

MEMORANDUM DECISION AND ORDER

18 Civ. 5181 (GBD)

GEORGE B. DANIELS, United States District Judge:

Petitioner and Cross-Respondent Rachael Leigh Konz seeks to vacate an arbitration award entered against her and in favor of Respondents and Cross-Petitioners Morgan Stanley Smith Barney, LLC and Morgan Stanley Smith Barney FA Notes Holdings, LLC (collectively, "MSSB"). (Pet., ECF No. 1.) MSSB opposes the petition and seeks to confirm the award. (ECF No. 27.) Konz's petition is DENIED. MSSB's cross-petition is GRANTED.

I. FACTUAL BACKGROUND

On May 3 and September 17, 2013, Konz signed two promissory notes (the "Notes") in connection with her employment by MSSB. (Pet., Ex. E ("Award"), ECF No. 1-5, at 1.) Each of the Notes also contains an arbitration clause, which provides:

> Any controversy or claim arising out of or in any way relating to this Agreement shall be settled by arbitration in accordance with the rules of the Financial Industry Regulatory Authority ("FINRA") in accordance with the FINRA Code of Arbitration Procedure for Industry Disputes. Any judgment or award entered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

(Pet., Ex. A, ECF No. 1-1, at 8 ¶ 7; Pet., Ex. B, ECF No. 1-2, at 8 ¶ 7.)

On September 1, 2016, MSSB filed a Statement of Claim with FINRA asserting causes of action against Konz stemming from her alleged failure to pay the Notes. (Pet. ¶¶ 6–8; Award at 1.) On November 2, 2016, FINRA sent a memorandum to the parties enclosing a list of ten "chair-qualified public arbitrators" and asked the parties to strike up to four arbitrators from the list and rank the remaining arbitrators. (Pet., Ex. C ("FINRA Mems."), ECF No. 1-3, at 4 (citing FINRA Rule 13806(b)(1)[1]). FINRA consolidated the lists and appointed an arbitrator to hear the parties' dispute. (*See* FINRA Mems. at 4–5; *see also* FINRA Rule 13400(a) (describing FINRA's neutral list selection system).).

On December 6, 2016, Konz filed a Statement of Answer and Counterclaim. (Pet. ¶ 10.) On December 21, 2016, FINRA sent another memorandum to the parties (the "December 21 Memorandum") stating that because Konz "filed a Counterclaim or Third-Party Claim requesting relief of over $100,000 or unspecified damages," the arbitration panel would be expanded from one to three arbitrators.[2] (FINRA Mems. at 52.) The December 21 Memorandum explained that the chair-qualified public arbitrator would remain on the panel, and enclosed lists of public and non-public arbitrators eligible to serve as the other panel members. (*Id.*) FINRA also provided the parties with Arbitrator Disclosure Reports for each potential arbitrator.[3] (*Id.*) The December

[1] MSSB is a FINRA member and Konz is an "associated person" within the meaning of FINRA rules. (Pet. ¶¶ 3–4.) FINRA Rule 13806 governs "a member's claim that an associated person failed to pay a promissory note." FINRA Rule 13806(a).

[2] FINRA Rules provide that once an arbitrator has been appointed, if an associated person files a counterclaim for damages that exceed $100,000 or are unspecified, "the appointed arbitrator will remain on the panel, and will serve as chairperson. In addition, one arbitrator will be selected from the roster of public arbitrators; and one arbitrator will be selected from the roster of non-public arbitrators." FINRA Rules 13806(b)(2), 13806(c)(3).

[3] FINRA Rules define a "public arbitrator" as "a person who is otherwise qualified to serve as an arbitrator, and is not disqualified from service as an arbitrator." FINRA Rule 13100(x). A "non-public arbitrator" is defined as "a person who is otherwise qualified to serve as an arbitrator, and is disqualified from service as a public arbitrator under paragraph (x)" of FINRA Rule 13100. FINRA Rule 13100(r).

21 Memorandum stated that "[e]ach arbitrator's classification as a public/non-public arbitrator is accurate at the time of his or her selection to the list." (*Id.*)

After FINRA conducted a ranking and matching process, two public arbitrators and one non-public arbitrator were appointed to serve on the panel. (Pet. ¶ 16.) The second public arbitrator added to the panel was Paul Mabry. (*Id.*) The Arbitrator Disclosure Report for Mabry reflected that he was a Chief Surveyor at the San Francisco Department of Public Works and had a private practice as a land use attorney. (FINRA Mems. at 74.)

MSSB alleges that on January 31, 2018, FINRA sent a memorandum to the parties attaching an updated Arbitrator Disclosure Report for Mabry, which indicated that he had been hired by Hanson Bridgett LLP ("Hanson Bridgett") as Land Use Counsel in June 2017. (Declaration of Wendy R. Robinson dated July 9, 2018 ("Robinson Decl."), Ex. G, ECF No. 28-7.)

Konz alleges that Mabry's employment at Hanson Bridgett disqualified him from serving as a public arbitrator because "attorney biographies . . . demonstrate that the law firm through which Arbitrator Mabry was employed[] represented individuals and entities that fulfill the disqualification parameters of FINRA Rules" 13100(x)(1), (9) and (10).[4] (Pet. ¶ 43; *see also id.* Ex. G, ECF No. 1-7 (attorney biographies).)

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[4] FINRA Rules 13100(x)(9) and (10) disqualify a person from serving as a public arbitrator if he is "an attorney . . . whose firm derived $50,000 or more, or at least 10 percent of its annual revenue in any single calendar year during the course of the past two calendar years, from" certain sources, including "any entities listed in paragraph (x)(1) and/or . . . persons or entities associated with any of the entities listed in paragraph (x)(1)" or from "individual and/or institutional investors relating to securities matters." The entities listed in FINRA Rule 13100(x)(1) are:

> (A) a broker or a dealer (including a government securities broker or dealer or a municipal securities broker or dealer); or (B) the Commodity Exchange Act or the Commodities Future Trading Commission, or a member of the National Futures Association or the Municipal Securities Rulemaking Board; or (C) an entity that is organized under or registered pursuant to the Securities Exchange Act of 1934, Investment Company

However, MSSB alleges that Konz did not object to Mabry's appointment to the panel after receiving the updated disclosure. (Mem. of Law in Opp'n to Pet. and in Supp. of Cross-Pet. ("Opp'n"), ECF No. 29, at 7.) MSSB further alleges that FINRA did not reclassify Mabry after receiving the updated disclosure. (*Id.*)

The panel conducted a hearing on the parties' dispute on March 19, 2018. (Pet. ¶ 19.) On May 19, 2018, the panel rendered an award against Konz for $1,197,844.69 plus interest and attorney's fees and costs. (Pet. ¶ 20.) The Panel also assessed $1,400 in forum fees to the parties jointly and severally, and $2,800 to Konz alone. (*Id.*; Award at 6.)

Konz seeks to vacate the award pursuant to § 10(a)(4) of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1 *et seq.*, on the grounds that the arbitrators "exceeded their powers," because they were not appointed in accordance with the procedures agreed upon by the parties. (Pet. ¶ 54 (citations omitted).) MSSB argues that the arbitrators were appointed in accordance with the parties' agreement and seeks to confirm the award. (*See* Opp'n.)

II. LEGAL STANDARDS

Under the FAA:

> If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected, as prescribed in Sections 10 and 11 of this title.

9 U.S.C. § 9. "'A party petitioning a federal court to vacate an arbitral award bears the heavy burden of showing that the award falls within a very narrow set of circumstances delineated by the

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Act of 1940, or the Investment Advisers Act of 1940; or (D) a mutual fund or a hedge fund; or (E) an investment adviser.

[FAA]." *NYKCool A.B. v. Pac. Fruit, Inc.*, 507 F. App'x 83, 85 (2d Cir. 2013) (quoting *Duferco Int'l Steel Trading v. T. Klaveness Shipping A/S*, 333 F.3d 383, 388 (2d Cir. 2003)). As relevant here, § 10(a)(4) provides that a district court "may make an order vacating the award . . . where the arbitrators exceeded their powers." 9 U.S.C. § 10(a)(4). However, the Second Circuit has "consistently accorded the narrowest of readings to this provision of law in order to facilitate the purpose underlying arbitration: to provide parties with efficient dispute resolution, thereby obviating the need for protracted litigation." *ReliaStar Life Ins. Co. of N.Y. v. EMC Nat'l Life Co.*, 564 F.3d 81, 85 (2d Cir. 2009) (citations and internal quotation marks omitted). "The focus of [the court's] inquiry in challenges . . . under [§] 10(a)(4) is whether the arbitrators had the power, based on the parties' submissions or the arbitration agreement, to reach a certain issue, *not whether the arbitrators correctly decided that issue*." *Jock v. Sterling Jewelers Inc.*, 646 F.3d 113, 122 (2d Cir. 2011) (citation and internal quotation marks omitted). "If the parties agreed to submit an issue for arbitration, [courts] will uphold a challenged award so long as the arbitrator offers 'a barely colorable justification for the outcome reached.'" *ReliaStar*, 564 F.3d at 86.

III. THE AWARD IS CONFIRMED

Konz argues that, because the "arbitrators were not appointed in accordance with the procedure provided in the parties' agreement, th[is] Court should vacate the award as the arbitrators 'exceeded their powers.'" (Mem. in Supp., ECF No. 2, ¶ 55 (citations omitted).)

In *Avis Rent A Car System, Inc. v. Garage Employees Union*, upon which Konz relies, the parties' agreement provided that the arbitrator was to be selected by the parties from a list prepared by the American Arbitration Association. 791 F.2d 22, 25 (2d Cir. 1986). Instead, the arbitrator was selected by the New York State Mediation Board from its own list. *Id.* The Second Circuit noted that "an award will not be enforced if the arbitrator is not chosen in accordance with the method agreed to by the parties," and found that "the arbitrator had no authority to interpret [the

parties'] agreement, because his appointment did not conform to it." *Id.* However, the Second Circuit noted that a "trivial departure from the contractual method of choosing an arbitrator might not bar enforcement of an award." *Avis*, 791 F.2d at 25.

Other courts have found that situations similar to the one at issue here involve the type of "trivial departure" that *Avis* suggests does not bar enforcement of an award. *Id.* In *Bulko v. Morgan Stanley DW, Inc.*, the parties' agreement called for the arbitration of their dispute in accordance with the rules of the National Association of Securities Dealers ("NASD"), FINRA's predecessor. 450 F.3d 622, 623 (5th Cir. 2006). After an arbitration award was issued, one of the parties moved to vacate the award on the grounds that "the panel acted outside the scope of its authority because [the non-public arbitrator] was not qualified to serve as a non-public arbitrator." *Id.* at 624. The Fifth Circuit rejected this argument, finding that the appointment of the non-public arbitrator was "arguably not a departure from [the parties'] agreement" because the panel was composed of two public arbitrators and a person designated as a non-public arbitrator by the NASD, in accordance with NASD rules. *Id.* at 625. The Fifth Circuit explained that, absent a "specific method-of-selection clause" in the parties' agreement, "determining [an arbitrator's] qualifications and eligibility is a matter best left to the NASD." *Id.* (citing *Howsam v .Dean Witter Reynolds, Inc.*, 537 U.S. 79, 85 (2002)). The Fifth Circuit further found that even if the non-public arbitrator's selection "contradicted the parties agreement, it was, at most, a trivial departure not warranting vacatur." *Bulko*, 450 F.3d at 626 (citations omitted); *see also Stone*, 872 F. Supp. 2d at 439 (finding even if a particular individual "did not qualify as a 'public arbitrator'" under FINRA rules, her participation in a case "did not fall so far outside the parties' agreed-upon arbitration as to require vacatur under [§] 10(a)(4) and . . . constituted harmless error in any event because the three arbitrators rendered a unanimous decision").

Here, as in *Bulko*, the selection of Mabry as an arbitrator was arguably in accordance with the parties' agreement, because that agreement calls for "arbitration in accordance with the rules of the Financial Industry Regulatory Authority." (Pet., Ex. A at 9 ¶ 7.) As discussed above, FINRA Rules called for the appointment of a three-member panel with two public arbitrators and one non-public arbitrator. *See* FINRA Rule 13806. The panel that heard the parties' dispute was composed of individuals that FINRA had determined were qualified to serve in those positions. *See* FINRA Mems. at 52 (noting that FINRA's classification of the individuals named as potential arbitrators on the lists provided to the parties was "accurate at the time of his or her selection to the list"). Because the parties did not have a "specific agreement to the contrary, determining [Mabry's] qualifications and eligibility is a matter left to the [FINRA]." *Bulko*, 450 F.3d at 625. Even if Mabry was not qualified to serve a public arbitrator, his selection was a "trivial departure" from the parties' agreement that did not prejudice Konz because the panel's decision was unanimous. *Avis*, 291 F.3d at 25.

Moreover, when petitioners seek to vacate awards under § 10(a)(2) of the FAA on grounds of "evident partiality or corruption," the Second Circuit has "declined to vacate awards because of undisclosed relationships where the complaining party should have known of the relationship or could have learned of the relationship just as easily before or during the arbitration rather than after it lost its case." *Lucent Techs. Inc. v. Tatung Co.*, 379 F.3d 24, 28 (2d Cir. 2004). Although Konz is seeking vacatur under § 10(a)(4), rather than § 10(a)(2), a similar principle applies here. *See Stone v. Bear, Steans & Co.*, 872 F. Supp. 2d 435, 439 (E.D. Pa. 2012) (finding petitioner "waived any failure-to-disclose-based challenge to the award because he failed to investigate the arbitrators as diligently *before* the arbitration as he did *after* he lost").[5] Konz received Mabry's updated

[5] Konz attempts to distinguish *Stone* because "[h]ere, the issue is not whether the disqualified arbitrator improperly influenced either of the other two arbitrators." (Pet. Reply, ECF No. 31, at 4.) But that argument

disclosure from FINRA more than a month before the arbitration hearing. (*See* Robinson Decl., Ex. G.) Konz provides no argument or explanation as to why she did not investigate the circumstances of Mabry's employment when she received the updated disclosure. Because she "could have learned of" the circumstances of Mabry's employment "just as easily before or during the arbitration rather than after [she] lost [her] case," her belated attempt to object to Mabry's appointment now does not provide grounds for vacatur. *Lucent Techs. Inc.*, 379 F.3d at 28.

Because Konz has not provided a basis to vacate the award, and MSSB's application to confirm the award was made within one year, it must be confirmed under the FAA. *See* 9 U.S.C. § 9.

IV. CONCLUSION

Konz's petition to vacate the arbitration award, (ECF No. 1), is DENIED. MSSB's cross-petition to confirm the award, (ECF No. 27), is GRANTED.

Dated: October 17, 2018
New York, New York

SO ORDERED.

George B. Daniels

GEORGE B. DANIELS
United States District Judge

simply illustrates that Konz's case is *similar* to *Stone*. The petitioner in *Stone*, like Konz, "provided no evidence, or even argument, that [the public arbitrator] improperly influenced or prejudiced either other arbitrator." *Stone*, 872 F. Supp. 2d at 444.