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Ninth Circuit "Monster" ruling: Arbitrator's failure to disclose ownership interest in JAMS warrants vacatur of arbitration award

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In a decision that promises to reverberate through the alternative dispute resolution industry, a panel of the U.S. Court of Appeals for the Ninth Circuit reversed and vacated a district court decision confirming an arbitration award based on the arbitrator's "evident partiality."[1] The Ninth Circuit faulted the arbitrator for failing to disclose that he had a direct ownership interest in JAMS, the administrator of the arbitration in question, and that JAMS had a less-than-trivial ongoing business relationship with the party that had compelled the arbitration and ultimately prevailed in the matter.[2]

The arbitration at issue arose from a dispute over Monster Energy Company's decision to unilaterally terminate a 20-year exclusive distribution agreement with Washington-based distributor Olympic Eagle Distributing 12 years early. The contract permitted without-cause termination upon payment of a severance fee. Monster's termination of Olympic Eagle was a piece of a bigger transaction with another major soft drink company. In fact, Monster terminated most of its distributors, making a few exceptions for those who asserted franchise protection in certain states.[3]

Olympic Eagle attempted to follow in the footsteps of the objecting distributors by rejecting a $2.5 million severance fee and invoking Washington's Franchise Investment Protection Act ("FIPA"), which prohibits termination of franchise agreements absent good cause. Pursuant to an arbitration clause in their contract, Monster served a demand for arbitration administrated by JAMS and filed a federal court action to compel the arbitration. Monster was apparently familiar with this process,

[1] *Monster Energy Co. v. City Beverages, LLC, DBA Olympic Eagle Distributing*, Nos. 17-55813 & 17-56082 (9th Cir. Oct. 22, 2019).

[2] *Id.* at 9.

[3] *Monster Energy Co. v. Olympic Eagle Distributing and King Beverage*, Case No. ED CV 15-00819-RGK (KKx), 2015 WL 12781213, *1 (C.D. Cal. Sept. 29, 2015).

having conducted 97 arbitrations before JAMS in the previous five years. After that motion was granted, the parties selected an arbitrator from a JAMS-provided list of neutrals.[4]

The arbitrator made certain disclosure statements before arbitration, including that "[e]ach JAMS neutral, including me, has an economic interest in the overall financial success of JAMS[,]" and that "given the nature and size of JAMS, the parties should assume that one or more of the other neutrals who practice with JAMS has participated in arbitration, mediation or other dispute resolution proceeding with the parties, counsel or insurers in this case[.]"[5] The arbitrator did not, however, specifically disclose that he had a direct ownership interest in JAMS, nor did JAMS specifically disclose its Monster case load.

After a hearing, the arbitrator largely adopted Monster's arguments, determined that Olympic Eagle did not qualify for protection under FIPA, and awarded Monster attorneys' fees and costs of $3 million. Monster subsequently filed a petition, pursuant to the Federal Arbitration Act ("FAA"), 9 U.S.C. § 9, to confirm the awards in the U.S. District Court for the Central District of California, and Olympic Eagle cross-petitioned to vacate the awards, pursuant 9 U.S.C. § 10.[6]

While confirmation proceedings were pending, Olympic Eagle discovered an article indicating that some JAMS arbitrators are also part-owners of JAMS with a profit interest in JAMS cases. Olympic Eagle also discovered Monster's history of 97 arbitrations administered by JAMS. Outside counsel for JAMS confirmed over the phone that the arbitrator in Olympic Eagle's case was, in fact, a co-owner of JAMS, but JAMS refused to comply with any further requests for information regarding the arbitrator's financial interests in JAMS or Monster's business relationship with JAMS. Olympic Eagle issued a subpoena to JAMS and ultimately filed a motion to compel the subpoena, but the district court confirmed the arbitration awards in favor of Monster; denied Olympic Eagle's cross-petition; and denied, as moot, the motion to compel.

On appeal, a three-judge panel of the Ninth Circuit issued a split decision reversing the district court and vacating the arbitration award and the award of attorneys' fees and costs to Monster. The panel ruled that, because the arbitrator failed to disclose his ownership stake in JAMS, and because JAMS "has done more than trivial business with Monster," the arbitrator's ruling in favor of Monster was tainted with bias sufficient for vacatur under the Federal Arbitration Act, 9 U.S.C. § 10(a)(2).[7]

Two key takeaways arise from the majority's decision. First, the majority confirmed that the FAA clause permitting vacatur of an arbitrator's award based on "evident partiality" has real teeth. The majority cited to *Commonwealth Coatings Corp. v. Cont'l Cas. Co.*,[8] where the Supreme Court held that an arbitration award can be vacated where the arbitrator fails to "disclose to the parties any dealings that might create an impression of possible bias." In a concurrence endorsed by the Ninth Circuit, Justice White stated that an arbitrator should disclose any "substantial interest in a firm

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[4] *Monster Energy Co. v. City Beverages, LLC, DBA Olympic Eagle Distributing* at 4-5.

[5] *Id.* at 6.

[6] *Id.* at 4.

[7] *Id.* at 13.

[8] 393 U.S. 145, 149 (1968).

which has done *more than trivial business* with a party."[9] *Id.* at 151-52 (White, J., concurring). Observing the permeation of arbitration clauses in all aspects of modern life, the majority emphasized that the disclosures made by potential neutrals are crucial to helping parties make informed choices — particularly when arbitration involves "one-off parties" (like Olympic Eagle) facing "repeat players" (like Monster) in unbalanced circumstances.[10] In this case, the arbitrator's ownership interest in JAMS, coupled with the fact that JAMS has a "more than trivial" interest in continuing to do business with Monster, created a circumstance requiring disclosure.[11]

The majority found the general disclosure statement required by the JAMS rules to be insufficient. In this case, where the arbitrator had a right to a portion of profits from all arbitrations due to his ownership interest in JAMS, and where JAMS had administered 97 arbitrations for Monster over the previous five years, the majority found an impression of bias and determined that such information should have been disclosed by the arbitrator before the selection process. The panel found comfort in its observation that state arbitration laws in California, Montana and Arizona, as well as the Revised Uniform Arbitration Act, imposed more-burdensome disclosure obligations upon neutrals.[12]

Second, the panel rejected the argument that Olympic Eagle had waived its evident partiality objection by failing to object to the arbitrator during the selection process.[13] Monster argued that the JAMS general disclosure statement — which disclosed the arbitrator's "economic interest" in JAMS in general terms — gave Olympic Eagle constructive notice of the arbitrator's potential non-neutrality. The panel disagreed, finding that the arbitrator's unexplained "economic interest" was not specific enough for Olympic Eagle to know that the arbitrator was a JAMS co-owner. Indeed, the arbitrator's disclosure expressly likened his interest to that of all JAMS neutrals, in that all JAMS neutrals have an interest in the overall success of JAMS. Further, the majority rejected the notion that the arbitrator's disclosure of arbitration activities adverse to Monster, or the public availability of information pertaining to the number of disputes Monster referred to JAMS, constituted constructive notice.[14] Neither fact revealed that the arbitrator's economic interests in the dispute extended beyond the arbitrations he himself conducted.

Circuit Judge Friedland's dissent can be summarized as "you get what you pay for." Judge Friedland seized upon the disclosures that the arbitrator did make and questioned whether the disclosures required by the majority would make any material difference in the outcome.[15] She observed that when parties willingly forego Article III protections in favor of private arbitration, they give up their constitutional right to completely impartial administration of the law. Arbitrators are paid by the parties and have an inherent economic stake in securing repeat business. As a result, risk of bias is baked into the arbitration industry's structure and "requiring disclosures about the elephant that everyone knows is in the room will [not] address" the disparities inherent in the private arbitration

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[9] *Id.* at 151-52 (White, J., concurring) (emphasis added).

[10] *Monster Energy Co. v. City Beverages, LLC, DBA Olympic Eagle Distributing* at 15.

[11] *Id.* at 13.

[12] *Id.* at 13-14.

[13] *Id.* at 9.

[14] *Id.*

[15] *Id.* at 18 (Friedland, J., dissenting).

system.[16] Oddly, however, Judge Friedland also acknowledged that non-repeat players often have "no choice but to agree to arbitration in order to acquire employment, purchase a product, or obtain a necessary service."[17] This fact undermines her starting premise: that parties to an arbitration have "willingly" forgone their Article III protections.

Judge Friedland further criticized the majority's lack of clarity about how detailed an arbitrator's disclosures must be, and expressed concern that this ruling and the expansion of "evident partiality" will call awards in numerous cases decided by JAMS arbitrators into doubt. She predicted that the majority's ruling will undermine the finality of arbitrations, causing arbitrations to be "re-done" and "endless litigation" aimed at further do-overs, premised on vague claims of evident partiality.[18]

As arbitration continues to infiltrate everyday life, with increasing numbers of cases being tried out of court, parties may not realize that private arbitrators differ from Article III judges, who have life tenure and are subject to stringent financial disclosure laws. The Ninth Circuit's new disclosure standard for arbitrators will have far-reaching effects on parties who need to make informed decisions when selecting neutrals. At a minimum, it should cause parties to take a closer look at their arbitrators in any given case. Businesses should also review their standard arbitration provisions, particularly to the extent they mandate arbitration before JAMS rather than a nonprofit dispute resolution administrator, such as the American Arbitration Association.

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[16] *Id.* at 26 (Friedland, J., dissenting).

[17] *Id.*

[18] *Id.* at 23 (Friedland, J., dissenting).