

10-3847

United States Court of Appeals
for the Second Circuit

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STMICROELECTRONICS, N.V.,
Petitioner-Appellee,

v.

CREDIT SUISSE SECURITIES (USA) LLC,
Respondent-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF APPELLANT

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APPELLANT'S REPLY BRIEF

I. THE AWARD SHOULD BE VACATED FOR ARBITRATOR MISBEHAVIOR.

ST's response on arbitrator misconduct is directed largely at strawmen. It relies heavily on the proposition that CSS has failed to show that Duval exhibited disqualifying bias. But Section 10(a)(3) requires misbehavior and prejudice, not bias, and the impairment of CSS's arbitrator selection right plainly was prejudicial. In no arbitration, let alone a \$400 million matter, would a brokerage firm litigant knowingly select a professional claimant-side expert to serve as the non-public, designated *industry* representative on the arbitration panel.

Nor does CSS contend that FINRA Rule 12405(a) by itself required disclosure of "details about [Duval's] expert engagements, including the legal subjects on which he testified." ST Br. 21–22. What we do contend is that prospective arbitrators must fill out FINRA's Arbitrator Application Booklet with information that does not mislead litigants. JA–388–403. Question 22 in that booklet asks whether the individual has been retained "as an expert or consultant (i) by a broker-dealer ... or (ii) in connection with a claim against a broker dealer ... whether or not the matter proceeded to hearing" and, if so, to "state the names of these broker-dealers." JA–400–01. Duval indisputably did not comply with this requirement.

ST's attempts to evade unambiguous FINRA requirements and the plain meaning of "other misbehavior" in Section 10(a)(3) are premised on an inaccurate presentation of the FAA's *vacatur* standard. This Court need not determine whether the FAA independently required Duval to disclose the one-sided nature of his track record, because FINRA expressly required that very disclosure, in order to enable parties like CSS to make informed decisions whether to accept a proposed arbitrator. When Duval omitted that information and instead provided materially misleading disclosures, he committed "misbehavior" within the meaning of Section 10(a)(3). The statutory remedy is *vacatur*.

When an arbitral body creates specific procedural rules regarding appropriate disclosure, and an arbitrator breaks those rules, the resulting Award is illegitimate. CSS was required to submit to arbitration according to the FINRA Rules, and it was entitled to an arbitration compliant with those Rules.

A. Duval's Own Testimony Proves That His Disclosure Was Misleading, and FINRA Said Nothing to the Contrary.

1. ST contends that "Credit Suisse has offered no evidence that as of 2008, Duval had been retained (including cases in which he did not testify) overwhelmingly by claimants." ST Br. 24. But Duval's sworn testimony in another proceeding establishes the point—and is more credible than his unsworn remarks during this arbitration. In his sworn testimony, Duval acknowledged that his expert appearances comprised a mere "one or two" cases for respondents out of

25-30 engagements. JA-494. By contrast, here Duval's formal disclosure provides only that he had served as an expert for "both sides" and mentions only one engagement for and one against Wachovia Securities. The implications of this balanced language were far from the truth. ST offers no reason to disbelieve Duval's prior testimony.

2. ST tries to excuse Duval's slanted disclosure, citing the Disclosure Checklist in the FINRA Arbitrator's Reference Guide and asserting that "[n]one of the 31 questions listed requires disclosure of the 'facts' Credit Suisse now claims Duval 'omitted.'" ST Br. 22-23. That Checklist, however, is not "further guidance" (*id.* at 22) that supersedes or nullifies the mandatory Disclosure Report. Rather, the Disclosure Report is prepared in advance of the arbitrator's selection for any specific panel and accordingly asks for information—including, in Question 22, about expert witness engagements—unrelated to specific parties. Thereafter, once listed as a potential arbitrator for a particular case, the arbitrator fills out the "Arbitrator Disclosure Checklist," which focuses on relationships to the *parties* to the arbitration (which could not have been disclosed before those parties were identified). See Arbitrator's Reference Guide, *available at* <http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@neutrl/documents/-arbmed/p009423.pdf>, at 21-24 (particularly Questions 27 and 29, calling for confirming and updating the Disclosure Report). Duval's characterization of his

prior expert engagements painted a false portrait, and Duval made no subsequent disclosure to correct that false portrayal.

ST also cites a 2006 FINRA newsletter to argue that FINRA prefers that frequent expert witnesses summarize their experience, rather than fill out the Disclosure Report completely. ST Br. 23. But the newsletter notes that arbitrators must “*at a minimum*” state which side they have represented. FINRA goes on to encourage arbitrators “to provide an *estimate of the number of times* they acted as an expert *for customers, registered representatives or broker-dealers. Including such a statement will alert parties to potential conflicts and prompt them to inquire further, if necessary, as allowed by NASD’s ... Rule 10308(b)(6).*” JA–1848 (emphasis added). Duval’s “summary” statement was neither accurate in general nor did it provide the specific informative estimates suggested by the newsletter cited by ST. In the context of his lopsided career, his disclosure was materially misleading, deceiving CSS into accepting Duval on the panel.

ST also contends that “FINRA squarely rejected” CSS’s recusal motion, implying that FINRA provided a substantive response. ST Br. 25.¹ Instead, the FINRA Director denied CSS’s motion without a word of explanation. JA–577. He

¹ ST’s accusation that CSS waited “over a month” after learning of Duval’s true background before making its motion (ST Br. 12) is directly contradicted by the record. JA–1081. Moreover, the panel was in recess for most of that period. See ST Br. 11 (noting that the hearing adjourned on December 19 and resumed on January 8, when CSS made its motion).

did not “find” that “Duval’s disclosures were unimpeachable” or that “Duval had complied with [FINRA’s] rules.” ST Br. 25–26. Nor is his silence an “interpretation” of the FINRA Rules or a finding that requires any deference by this Court.

B. Duval’s Intent

ST claims that, absent proof of scienter, CSS cannot establish common-law fraud. ST Br. 36–37. While we submit that Duval’s intent to mislead is manifest, ST’s contention is irrelevant: the FAA requires “misbehavior,” not a crime or tort, and CSS has never maintained otherwise. See CSS Br. 25. Instead, CSS’s opening brief cited cases addressing the federal and New York standards for fraud to show that the law recognizes that non-disclosures and half-truths, such as those here, can be just as misleading as affirmative misstatements. Duval’s disclosure is a clear example. There is a world of difference between an arbitrator who is “[r]etained by both sides” and has testified for and against one broker (JA–381) and one who has testified “north of twenty-five times,” only “once or twice for respondents” (JA–494).

Moreover, ST concedes that Duval’s characterizations were deliberate rather than innocently sloppy, saying that his disclosure was intended to “show ... that he had the impartiality required to testify both for and against the same party.” ST Br.

23.² We agree that Duval intended his disclosures to show “impartiality” and balance; the problem is that this was untrue. FINRA requires prospective arbitrators to provide accurate disclosures so that the parties can decide for themselves whether to accept or strike that arbitrator.

C. Parties Are Entitled to Rely on Arbitrator Disclosures.

1. Remarkably, ST argues that it was not Duval’s obligation to portray his background accurately; rather, it was CSS’s obligation to “scrutinize arbitrator disclosures” and independently determine their accuracy. ST Br. 24. ST’s argument directly contradicts what both FINRA Rules and the FAA require. The Code section that ST cites allows, but does not require, parties to “inquire further, if necessary,” after receiving presumptively accurate disclosures. JA–1848. When the disclosures themselves are misleading, suggesting no need for further inquiry, that right is vitiated. ST’s argument that the possibility of independent investigation by litigants excuses misleading mandatory disclosures is entirely unacceptable—especially in a dispute in which ST’s case on the merits rests on its claimed right not only not to inquire about its portfolio but to ignore accurate information in its possession.

² Duval’s website belies ST’s assertion that he lacked motive. ST Br. 37 (citing low arbitrator stipend). Duval points to his arbitration experience to promote his expert witness business: “Being an active arbitrator gives him substantial insight into case possibilities.” See http://www.johnduval.com/-john_duval.htm.

2. Significantly, the core of CSS’s concern—Duval’s extensive undisclosed work as a claimant-side paid expert—occurred in the context of confidential industry arbitrations for which no comprehensive or accurate public or private database exists. Accurate disclosure is thus particularly important in the FINRA context because independent steps to determine the truthfulness of the disclosures—even if litigants were legally required to assume potential deception, which they are not—would inevitably generate somewhat random and incomplete results. Certainly, Duval’s website, which at the time of the arbitration emphasized his “22-year career in the financial services industry” (http://replay.waybackmachine.org/20080509143002/http://www.johnduval.com/john_duval.html), did not serve to correct his Disclosure Report. The sworn transcript, in which Duval admitted that his work was overwhelmingly in favor of claimants and that he could no longer find work as an industry-side witness, was not available in any public database; CSS discovered it only by fortuity before making the recusal motion.

Furthermore, Duval’s own reference to “numerous cases” in which he was retained, but which “didn’t make it to a hearing” (JA–1081), serves to illustrate the incompleteness of the public record. As for the other public source that ST cites (Br. 25), *Highland Capital Management v. Schneider*, Duval there testified on behalf of Highland. 551 F. Supp. 2d 173, 180 (S.D.N.Y. 2008). One published

decision referencing Duval’s testimony on behalf of a venture capital firm would hardly have put CSS on notice that Duval worked almost exclusively for customers against brokers in the non-public FINRA arbitration context. If anything, the *Highland* decision would incorrectly suggest that Duval’s FINRA disclosure was accurate. In short, given the nonexistence of any comprehensive source reflecting the actual experience of prospective FINRA arbitrators, accurate arbitrator disclosure is absolutely critical.

ST faults CSS for not seeking more information about Duval during the hearing. ST Br. 12–13, 25. But it was Duval’s obligation, not CSS’s, to ensure that FINRA’s ongoing disclosure requirements were met. FINRA Rule 12405(b). In any event, by that time it was too late to reject Duval as a potential arbitrator. CSS’s only option was to move for recusal, which it did.

D. “Other Misbehavior” Covers Misleading Disclosures, Especially Those That Violate Arbitral Rules.

1. Informed choice of arbitrators is central to the FINRA arbitration process.

One of the key protections parties enjoy in FINRA arbitration is the right to reject potential arbitrators who they do not wish to have deciding their case.³ No showing of “cause” or likely bias is necessary.⁴

³ ST points out (ST Br. 35 n.12) that peremptory strikes are unavailable in certain circumstances not present here. That merely raises the possibility that a

Thus, ST misses the point by arguing that the “evident partiality” prong of the FAA does not require the disclosure of prior expert engagements. ST Br. 28–31. “Partiality,” as ST itself explains, is limited to relationships with parties to the arbitration and is relevant when the arbitral rules prohibit recusal except for cause. But ST errs in asserting that courts “have held squarely that only § 10(a)(2)’s ‘evident partiality’ provision addresses arbitrator nondisclosure.” *Id.* at 32. As the cases cited by ST show, Section 10(a)(2) addresses non-disclosure only of facts bearing on *partiality*—namely, a relationship with a party, a lawyer, or another arbitrator.

FINRA, however, appropriately requires broader disclosures, and the FAA reaches prejudicial violations of those requirements under a distinct subsection, 10(a)(3). Because a party may strike a proposed FINRA arbitrator simply because it thinks he or she might be unsympathetic to the party’s case, the FINRA Rules require extensive disclosure, including, in Question 22, disclosure of all prior expert retentions. See *Sphere Drake Ins. Ltd. v. All Am. Life Ins. Co.*, 307 F.3d 617, 623 (7th Cir. 2002) (recognizing that “[d]isclosure by a neutral may serve purposes other than flagging potential conflicts”).

violation of the disclosure rules—which always would be misbehavior—might not be prejudicial in different circumstances.

⁴ ST makes much of the point that CSS did not formally accuse Duval of actual bias. ST Br. 2, 34. But the fact that CSS did not formally accuse Duval of bias does not mean that he was unbiased.

For that reason, it is irrelevant whether Duval’s undisclosed engagements would run afoul of the “evident partiality” standard. His one-sided career as an expert witness was of critical importance to CSS in deciding whether to strike and how to rank him. JA–1080. Even if this kind of disclosure would not reveal “evident partiality,” it remains central to the integrity of the arbitral process and is protected by the “other misbehavior” prong of the FAA.

2. The plain meaning of “misbehavior” covers materially misleading disclosures, especially those that breach arbitral rules.

ST strains for reasons why the broad “any other misbehavior” language means something less than it says. But the phrase has a plain meaning that “controls its interpretation.” *Lee v. Bankers Trust Co.*, 166 F.3d 540, 544 (2d Cir. 1999) (citation omitted). And “[w]hen a statute does not define a term, we typically give the phrase its ordinary meaning.” *FCC v. AT&T Inc.*, 562 U.S. —, slip op. 5 (2011).

“Misbehavior” means “improper, inappropriate, or bad behavior.” See Dictionary.com, *available at* <http://dictionary.reference.com/browse/misbehavior>. If non-disclosure of a lengthy course of one-sided expert testimony were “[i]mproper,” “[i]nappropriate,” or good behavior, FINRA would not require prospective arbitrators to fill out questionnaires that elicit those facts. Misleading disclosures that fundamentally distort the arbitrator’s background in breach of FINRA disclosure requirements must qualify as “misbehavior” under the FAA

because they deprive a party of an essential procedural protection for which it has contracted.

Under the rubric of “*ejusdem generis*,” ST invents an arbitrary limitation to suggest that “any” misbehavior is limited to misbehavior concerning “the manner in which arbitrators conduct hearings.” ST Br. 32. But “[*e*]jusdem generis should not ‘be applied to defeat the obvious purpose of the statute or to narrow the targets of Congressional concern.’” *Waterfront Comm’n of New York Harbor v. Elizabeth-Newark Shipping, Inc.*, 164 F.3d 177, 184 (3d Cir. 1998) (quoting *Texas v. United States*, 292 U.S. 522, 534 (1934)). ST offers no reason why Congress would have restricted subsection (a)(3) to misbehavior only *after* the panel is appointed and would exclude even deliberate, outright lies on disclosure forms. For instance, if a potential industry arbitrator had claimed in his disclosure to have worked for 20 years in the securities industry when he in fact spent those years working as a shoe salesman, it is utterly implausible to suppose that such misrepresentation would not constitute misbehavior simply because it did not relate to the conduct of the hearing.

3. The FAA standard is prejudicial “misbehavior.”

Finally, ST distorts the statute in arguing that arbitrator misconduct is not “other misbehavior” unless it makes the hearing itself fundamentally unfair. ST Br. 34–35. The FAA creates no such limitation. Instead, the statute expressly

establishes its own standard, requiring only “prejudice[]” flowing from “misbehavior.” Duval’s misleading characterization of his history as an expert “prejudiced” CSS’s right to strike a proposed decision-maker who made his living testifying against other brokerage firms.

ST theorizes (with no evidence) that CSS knew of Duval’s history and deliberately withheld action on it until late in the proceedings. ST’s insinuation is false. At the same hearing in which CSS made the recusal motion, Pierre Gentin, a Managing Director and CSS’s head of litigation, told the panel that “I can represent to the Panel that we learned about this over the last few days.” JA–1081.

He emphasized that

one thing should be crystal clear: With respect to the Panel members, if we had known that Mr. Duval had testified dozens of times as a paid claimant’s side testifying expert on supervision and other issues against multiple broker dealer firms, we would never have permitted him to sit on this Panel.

JA–1080.⁵

ST provides no authority disputing that misleading disclosures like Duval’s are prejudicial misbehavior warranting *vacatur*, relying instead on cases that are far afield. *Bell Aerospace v. Local 516* says only that the arbitrators need not

⁵ ST also falsely accuses CSS of refusing to “disclose when it had learned that information.” ST Br. 12, 25. Again, CSS disclosed that information during the arbitration. JA–1081. CSS also offered, at the district court, to supplement the arbitration record with additional evidence if needed. If this Court believes that further information is needed, CSS stands prepared to make a more detailed showing on remand.

follow the federal evidence rules as long as proceedings are fundamentally fair; thus, reference to an affidavit not formally in evidence but that “the parties had stipulated was relevant” and of which the objecting party had notice did not warrant *vacatur*. 500 F.2d 921, 923 (2d Cir. 1974). The conduct in *Bowles Financial Group v. Stifel, Nicolaus* also “was within the broad procedural rules of arbitration agreed to by Stifel”; the court emphasized that it “has no power to judicially impose our rules of evidence on an arbitration proceeding.” 22 F.3d 1010, 1013 (10th Cir. 1994).

FINRA places party-selection of arbitrators at the core of the process, and FINRA Rules require candid disclosures. Duval’s non-disclosure prejudiced CSS, by nullifying its right to make an informed peremptory strike.

4. Cases addressing disclosure for bias are irrelevant.

The cases that ST cites to argue that arbitrators may break arbitral rules without undermining the validity of an award are wholly inapposite. See ST Br. 26 (citing *ANR Coal Co. v. Cogentrix N.C., Inc.*, 173 F.3d 493, 499 (4th Cir. 1999); *Positive Software Solutions, Inc. v. New Century Mortg. Corp.*, 476 F.3d 278, 285 n.5 (5th Cir. 2007); *Montez v. Prudential Secs., Inc.*, 260 F.3d 980, 984 (8th Cir. 2001)). None interprets the “misbehavior” branch of the FAA; all address only “evident partiality” and therefore focus on whether a relationship established bias, not whether it should have been disclosed; none involves affirmatively misleading

statements; all found that the non-disclosures at issue did not violate the applicable rules (in *Montez*, “arguably”); and the first two involved AAA arbitrations that limited peremptory strikes and permitted additional strikes only for cause. *ANR Coal* emphasized this point, rejecting an approach under which “an arbitration award could be vacated due to an arbitrator’s failure to disclose a *trivial* fact even though that fact, if known prior to the arbitration, *would not have enabled the losing party to have the arbitrator removed for cause.*” 173 F.3d at 500 (emphasis added).⁶

Most of the other cases that ST cites did not address non-disclosures at all, despite ST’s contrary assertions. All considered information that was relevant only to bias and applied only the “evident partiality” standard, not the “misbehavior” prong of Section 10. ST says that *Morelite Construction v. New York City District Council* held that “nondisclosure warrants *vacatur* only when it is ... egregious” (ST Br. 28), but *Morelite* did not involve non-disclosure at all. The plaintiff argued that the arbitrator should have been disqualified because his father was an official of the international union of which the district council party was a member.

⁶ The non-disclosure in *ANR Coal* also was much less significant than that here. One arbitrator had disclosed that his law firm (not the arbitrator himself) had represented Carolina Power, which was not even a party but merely had a contract with a party. 173 F.3d at 496. The disclosure referred to representations “in electrocution cases” but failed to mention that the firm also represented Carolina Power in cases “involving the utility’s right to deliver electric service.” *Id.* The arbitration was a contract dispute not involving either issue.

748 F.2d 81–82, 84 (2d Cir. 1984). ST describes *Reichman v. Creative Real Estate Consultants* the same way (Br. 28), but that case too addressed actual bias (an argument the plaintiff had “disavowed”), not non-disclosure. 476 F. Supp. 1276, 1285 (S.D.N.Y. 1979). Nor did *Ilios Shipping v. American Anthracite* appear to involve an “*undisclosed* business relationship” (ST Br. 28 (emphasis added)). 148 F. Supp. 698, 700 (S.D.N.Y. 1957). The only objection that the court mentioned related to bias, not non-disclosure. *Id.*; see also *Matter of Andros Compania Maritima, S.A.*, 579 F.2d 691, 699 n.11 (2d Cir. 1978) (evaluating whether disclosure was adequate under evident partiality standard).

Next, *Lucent Technologies v. Tatung* involved an arbitrator who had been an expert witness for a party, and the plaintiff argued that the relationship was “so strongly suggestive of bias that it warrants vacatur of the award *even though it was disclosed.*” 379 F.3d 24, 27, 31 (2d Cir. 2004) (emphasis added); *id.* at 27 (“The court found that Luening had in fact disclosed his relationship with Lucent to the AAA”). ST suggests that an expert engagement by a party is “*a fortiori*” more significant than those by non-parties (ST Br. 29–30), but that assertion overlooks the differences in the arbitral appointment process in these two cases. In *Lucent*, the arbitrators were appointed by the parties. 379 F.3d at 31. There could be no expectation that Lucent’s appointee would not have views generally aligned with Lucent. The FINRA process is quite different. There are no party-appointed

arbitrators, and each party may strike up to twelve names (of 30 listed by FINRA) , and for any reason. The fact that a purportedly neutral arbitrator makes a living testifying for claimants is exactly the type of information on which an industry respondent would base a strike.

The one case ST cites that did address non-disclosures, *Transit Casualty v. Trenwick Reinsurance*, is distinguishable for several reasons. First, the plaintiff did not offer the non-disclosure as an independent basis for *vacatur*; it argued only that a relationship, which happened to be undisclosed, showed bias under the “evident partiality” prong. 659 F. Supp. 1346, 1353–54 (S.D.N.Y. 1987). Second, there was no indication that the non-disclosures violated any arbitral rules. Third, the court found that one relationship at issue was “clearly trivial and carries with it no reasonable suggestion” of bias and that the other “would not lead a reasonable person to believe that [the arbitrator] would be evidently partial.” *Id.* Because the relationships were irrelevant, they were not subject to disclosure under the rules.

II. THE AWARD SHOULD BE VACATED BECAUSE THE PANEL DISREGARDED THE LAW.

ST does not dispute that this Circuit recognizes “manifest disregard” as a basis for vacating an arbitral award. See *Stolt-Nielsen SA v. AnimalFeeds Int’l Corp.*, 548 F.3d 85, 94–95 (2d Cir. 2008). ST argues instead that it is rarely appropriate to do so; ST claims it has been applied in only “four cases out of nearly fifty” in which it has been considered (ST Br. 38); but it concedes, as it must, that

this Court has not abdicated the power to order relief when arbitrators palpably disregard clear, controlling law.

This is such a case. The arbitrators awarded nearly half a billion dollars, refusing to apply well-established and dispositive law defining reasonable reliance, including *Modern Settings*, a case that squarely covers both the facts and the law.

A. *Modern Settings* Is Binding Law In This Circuit And Dispositive Of This Case.

A host of cases, cited to the panel, the district court, and this Court, establish the general principle that a plaintiff who complains of deception may not ignore truthful information in its possession or reasonably available to it. See, e.g., *Brown v. E.F. Hutton Group, Inc.*, 991 F.2d 1020, 1031–32 (2d Cir. 1993) (“[a]n investor may not justifiably rely on a misrepresentation if, through minimal diligence, the investor should have discovered the truth”); see also JA–1570–76 (briefing to the arbitrators). Here, the applicable standard is not vaguely defined by case law but was set out in an express contractual obligation of ST to review its trade reports and statements and to provide timely notice of any objections.

Modern Settings definitively establishes that ST’s contractual obligation of timely objection is enforceable and dispositive, notwithstanding the misrepresentations it had received. Where a customer agreement sets out the standard of care required of a customer in reviewing its statements, the courts enforce that agreement—and arbitrators are equally obligated to do so. ST does not contest

either that it received the statements and reports to which it was entitled, or that they were 100% accurate. Instead, it asserts spurious factual distinctions.

In *Modern Settings*, a customer who had deposited cash in a trading account claimed that the defendant's broker had engaged in "unauthorized trading in that account" constituting securities fraud, and also raised a claim sounding in negligence. *Modern Settings*, 936 F.2d at 641–42. The *Modern Settings* broker, despite express representations to his client, failed to close out a position and instead "got Modern Settings more deeply involved" in a particular market, contrary to instructions. *Id.* at 642–43. The district court credited testimony that the defendants' "trading was in direct contravention to [the] orders" of the plaintiff; however, the plaintiff received "monthly account statements detailing the trading" in its account. *Id.* at 645.

In *Modern Settings*, the contractual notice requirement provided:

Reports of the execution of orders and statements of my account shall be conclusive if not objected to in writing within five days and ten days, respectively, after transmittal . . . by mail or otherwise.

936 F.2d at 642. The language of ST's customer agreement was virtually identical.

See CSS Br. 10.

In *Modern Settings*, this Court enforced the customer agreement according to its plain terms and barred the misrepresentation claims—just as the arbitrators here were obliged to do.

B. ST Misrepresents The Record To Suggest *Modern Settings* Is Inapposite.

ST argues that this case falls within exceptions suggested in dictum in *Modern Settings*. This requires a decidedly revisionist approach to the evidence actually presented to the panel.

1. ST Received Voluminous Accurate Information And Was Not Dissuaded From Relying Upon It

The record belies ST’s assertion (Br. 43) that CSS “specifically induced ST” to rely upon emails from Butler and Tzolov “in lieu of mailed statements.” ST does not contest that CSS sent, and that ST received, detailed account statements, trading reports, and “Advent” reports, all of which accurately stated the securities actually purchased for ST’s account. It points to no evidence that CSS did anything to “specifically induce[]” ST to disregard those materials. Many of these accurate disclosures are in the record as examples of the nature and quality of information ST regularly received. See, *e.g.*, JA–253–83 (trade confirmations); JA–284–315 (account statements); JA–316–74 (“Advent” statements). The informal emails sent by Butler and Tzolov—which misrepresented the *names* of the securities, but not other facts—were in addition to the continuous stream of official trade confirmations and formal account statements ST regularly received, and not “in lieu of” anything.

ST's claim (Br. 5, 43) that it could not use the regular documentation because it arrived too late is nonsense. There is no suggestion in the record that the trade confirmations and account statements were sent otherwise than in ordinary course. Moreover, as ST itself states (Br. 4), by the end of 2006 its entire account consisted of unauthorized securities; many of these securities remained in ST's account in August 2007. A glance by ST at any intervening monthly statement would have revealed the unauthorized trading, and a complaint would have led to the unwinding of the trades. Yet ST, a major public company with financially sophisticated persons overseeing its treasury function, apparently failed to check on (or chose to ignore) how its \$400 million was being managed.⁷

ST also argues (Br. 46-47) that *Modern Settings* is inapplicable where an investor had no knowledge of unauthorized trades. Regardless of what any individual officer may have known, here the investor was *ST*, and there is no doubt

⁷ In addition to the ordinary prudence required of any investor, and its contractual obligation, ST was under a clear *statutory* obligation to review its trading records. As an NYSE-listed company, ST had an affirmative duty under the Securities Exchange Act to: “devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that—(i) *transactions are executed in accordance with management’s general or specific authorization*; (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets; (iii) *access to assets is permitted only in accordance with management’s general or specific authorization*; and (iv) *the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences*” 15 U.S.C. 78m(b)(2)(B) (emphases added).

that *ST* had at least imputed knowledge of what was in its account. When it opened its account, *ST* designated a specific employee to receive account information—an assistant to *ST*'s Treasurer. See JA–22. There is no claim that information was not sent *to ST* in the manner it designated, or that the designated person did not receive that information in the ordinary course. Thus, there is no doubt that the securities actually purchased were known *to ST*, even if the individual designated *by ST* to receive that information failed to pay sufficient attention to reconcile its accounts.⁸

2. *ST* Never Provided Timely Objections to the Trades on Which Its Claims Rest.

ST's principal attempted distinction of *Modern Settings* is the claim that it did, in fact, object to unauthorized trades in a timely fashion—in July, August and September of 2007. *ST* Br. 45–46. But this argument, too, relies on misdirection. The “objections”—with one exception—did not direct CSS to reverse any particular trades, but were only general instructions to “keep to the mandate.”⁹

⁸ A corporation acts only through its agents, and it is well established that “that knowledge acquired by an agent acting within the scope of his agency is imputed to his principal and the latter is bound by such knowledge although the information is never actually communicated to it.” *Center v. Hampton Affiliates, Inc.*, 66 N.Y.2d 782, 784 (1985); see also *Henry v. Allen*, 5 E.H. Smith 1, 9, 45 N.E. 355, 357 (N.Y. 1896) (same).

⁹ The exception is an objection made on July 20, 2007, shortly before the market collapse, complaining about the purchase of commercial paper (not unauthorized ARSs). *Id.* This transaction was promptly reversed. See JA–662–63.

And even if repeating a general instruction counted as an objection to an executed trade, the objections on which it relies *were made after months of accurate statements had been disregarded and too late to avoid the market freeze, or even after the markets had frozen.*

ST identifies an August 6, 2007, instruction to attempt to sell \$200 million of its holdings, and to cease purchasing new securities. See JA–1654. ST also relies on an August 7 objection to a further purchase of a particular security in disregard of this instruction (JA–1656), where it reiterated its mandate. CSS did its best to comply, but by then the ARS markets were in distress and it was not possible to liquidate the securities in question. Notably, ST claims (Br. 46) that it noticed this purchase because of a small difference in yield, again showing that ST had both the sophistication and the timely information to review its trading records, if it had chosen to do so.

ST does not discuss its claimed September 5, 2007, objection in any detail. By then, in the face of the collapse of ARS markets for the securities in its account, ST’s instruction to CSS to sell all nonconforming securities “at par plus interests accrued” (JA–1659) was plainly impossible to carry out.

ST imaginatively but inaccurately now contends that those belated objections were timely because every security that is now frozen in its account “first appeared on ST’s July or August 2007 monthly account statement.” ST Br.

46 (citing JA–1721–23, an ST-prepared demonstrative exhibit). This statement is simply false. See JA–1525–29, JA–1556, JA–1565–68 (and account records cited therein). ST seems to be claiming that *continuing to hold* an ARS that had been reported on an earlier statement and was merely held in the account somehow constitutes a “new purchase” that reset the clock for making the contractually-required objection. This is untenable. ST’s claim that it timely objected to the unauthorized trades is false.

C. The Award Is Not Supported By Any Alternative Basis For Relief.

Finally, ST claims (Br. 50) that the Award could find some basis in an alternative theory of liability—contract, fiduciary duty, or failure to supervise. This, again, is misdirection. All of ST’s claims are different ways of complaining about the same conduct: Butler and Tzolov bought things on ST’s behalf that ST had not authorized. Any complaints about that conduct are barred because ST failed to satisfy a clear and unambiguous contractual condition providing, just as in *Modern Settings*, that the validity of all transactions would be “conclusive” absent timely objection. ST was provided with the accurate information to which it was entitled, sent to the person it designated to receive that information. Unless it can show that it complied with the contractual notice requirement, all claims predicated on unauthorized trading and misleading emails are barred.

D. This Court Ought Not Strain to Support A Dubious Award.

ST notes that that arbitrators are not required to provide reasoned decisions, and urges that this Court should affirm if it can find in the record any conceivable basis for the panel's finding.

This is not a case where the parties have consented to have their dispute decided on the basis of industry custom, or a Chancellor's-foot sense of commercial equity. It was the panel's duty to apply the law, for which arbitrators may not substitute their own notions of equity. See *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1767–68 (2010). This Court has noted that where an opinion, “if given, would have strained credulity, the absence of explanation may reinforce the reviewing court's confidence that the arbitrators engaged in manifest disregard.” *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197, 204 (2d Cir. 1998), quoted in *Rich v. Spartis*, 516 F.3d 75, 82 (2d Cir. 2008). Just as it has been recognized that a misstatement of law can “cloud the presumption of validity of the award” (*Porzig v. Dresdner, Kleinwort, Benson, LLC*, 497 F.3d 133, 140–41 (2d Cir. 2007)), so would it be perverse to require a reviewing court to reconsider the record of a lengthy arbitration in an effort to infer a theoretically legitimate basis for an arbitral award that, on its face, is contrary to settled law and indisputable facts.

III. AT A MINIMUM, THE JUDGMENT SHOULD BE CORRECTED TO AVOID DOUBLE RECOVERY.

A. This Issue Is Reviewed De Novo.

CSS raises legal objections to the judgment: whether ST is entitled to post-judgment interest on amounts that it already has received; whether the judgment should reflect an offset for those amounts; and whether CSS is entitled to a credit for interest paid on the securities that it is to receive upon payment of the arbitrators' Award when it is also paying interest on the Award. Like all questions of law, those issues are reviewed de novo.

ST argues (Br. 51) that an abuse of discretion standard applies because these issues were raised on a Rule 59 motion. That is incorrect. *Lora v. O'Heaney*, 602 F.3d 106, 111 (2d Cir. 2010), addressed an untimely motion for reconsideration that did not toll the period for filing a notice of appeal. This Court distinguished “the substantive ruling,” which was not on appeal, from “the determination by the district court whether to reconsider that ruling”—only the latter was subject to an abuse-of-discretion standard. *Id.* Here, the appeal is from the Amended Judgment, issued after the district court denied the Rule 59 motion in part. ST also relies on *Empresa Cubana del Tabaco v. Culbro Corp.*, which characterized as discretionary the decision whether to grant “the kind of relief sought by General Cigar.” 541 F.3d 476, 478 (2d Cir. 2008). But the appellant there sought relief under a statute that made relief discretionary as a substantive matter, not just when it is raised on a

Rule 59 motion. Here, CSS raises legal objections to the judgment itself. Moreover, unlike the typical Rule 59 motion, there is nothing about the proceedings below that would give the district court any better perspective on these issues than this Court has, and therefore no reason to afford it deference.

ST also halfheartedly suggests that all of the issues on the Rule 59 motion were waived. ST Br. 55, 56 n.18. That claim *is* reviewed for abuse of discretion, and the district court denied the motion on the merits, not for waiver.

B. CSS Should Not Be Required to Pay Amounts That ST Already Has Received, or Interest on Those Amounts.

It is telling that ST does not even attempt to defend on the merits the \$75 million overpayment that the Amended Judgment requires, the only purpose of which seems to be to justify awarding interest on amounts already received by ST. The Award requires that CSS repurchase the portfolio from ST, and the Amended Judgment acknowledges that the proceeds from the partial sale of the portfolio properly belong to CSS. Yet it bizarrely requires that CSS first pay that money to ST, and that ST then repay it.

ST argues only that the court lacked power to “modify the Award to discharge nearly \$75 million of [CSS’s] principal obligation.” ST Br. 56. First, that is absurd—the principal obligation of any judgment is reduced to the extent that the judgment creditor receives money in satisfaction of the judgment. Recognizing that, the *Laundry, Dry Cleaning Workers* court issued a judgment in a

reduced amount, without even treating that change as a Section 11 modification. ST suggests (Br. 57) that the \$75 million is irrelevant to CSS's obligation because the money came directly from Deutsche Bank. ST fails to mention that Deutsche Bank paid the \$75 million in exchange for securities that the Award obligates ST to hand over to CSS. Why it should matter who wrote the check that ST received, which plainly constitutes partial satisfaction of the Award, neither ST nor the district court has explained.¹⁰

More consequential is ST's insistence that it continue to be paid interest on the amount it has already received. ST admits that interest serves "to compensate the successful plaintiff for being deprived of access to money" and to avoid "an incentive for defendants to exploit the time value of money." ST Br. 53 (quoting *Air Separation, Inc. v. Underwriters at Lloyd's of London*, 45 F.3d 288, 290 (9th Cir. 1995)). Neither of those rationales applies here: ST is not "deprived of access to money" that Deutsche Bank has already paid it, and delay does not "exploit the time value of money" because the judgment requires that ST pay that money right back to CSS.

¹⁰ ST absurdly claims (Br. 14–15, 52) that CSS "forced" it to accept the Deutsche Bank offer. In fact, the very opposite happened: CSS left the choice to ST, with the perfectly reasonable caveat that if it declined to tender, any subsequent gain or loss on the securities would inure to ST. Apparently, in ST's lexicon, one is "forced" by being given a choice.

Even leaving aside the manifestly inequitable nature of the judgment in this respect, ST’s argument rests on a fundamental flaw. It claims that CSS is seeking modification of the arbitral Award (Br. 52), but this seriously misreads the language of the relevant provision, which awards interest “on *the par value of the portfolio* ... until the award is paid in full.” JA–17 (emphasis added). The Deutsche Bank transaction *reduced the par value of ST’s portfolio by \$153,500,000*. Under the unambiguous language of the Award and ST’s strenuous arguments against any equitable modification, the principal amount on which interest was due should be reduced correspondingly. CSS requested that relief in the district court in the alternative to a reduction equal to the sale proceeds and renews that request here.

C. The Amended Judgment Awards an Improper Double Recovery of Interest.

Finally, ST demands that, after the purchases are rescinded and it recovers its full purchase price, with interest, it should retain the benefits of holding the securities, namely the interest paid by the issuers. ST again relies heavily on the assertion that CSS seeks to modify the Award. But the Award is silent as to post-award interest received on the securities, so a judicial construction of the Award is necessary. ST claims (Br. 59–60) that the Award’s silence shows the arbitrators’ intention that ST receive double interest. We submit, however, that the arbitrators’ offset of *pre*-Award interest is a far better guide to their intention, and produces a

far more equitable result.¹¹ Allowing ST to keep interest on the portfolio is fundamentally inconsistent with the rescissionary logic of the Award.

Respectfully submitted.

Dated: New York, New York
March 14, 2011

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¹¹ ST concocts an imaginary rationale for keeping the interest received on the portfolio that it has always claimed belongs to CSS—and that the award gives to CSS. It speculates that the arbitrators intended this result to make up for the inadequacy of federal post-judgment interest. There are several problems with this hypothesis. First, there was a substantial period between the award and the judgment during which ST would receive 4.64% interest—well above market rates. Second, neither the arbitrators nor the district court may supplement the mandatory, statutory post-judgment interest rate.

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Federal Rule of Appellate Procedure 32(a)(7)(B) because: this brief contains 6,992 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(5) and the type style requirements of Federal Rule of Appellate Procedure 32(a)(6) because this brief has been prepared in a proportionally-spaced typeface using Microsoft Word 2007 in 14-point Times New Roman.

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Second Circuit using the appellate CM/ECF system on March 14, 2011.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

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