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Clarifying the Standard For Determining **Arbitrator Bias**

New decisions take on 'evident partiality.'

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IN AN ARTICLE entitled "'Gotcha Game,'" The National Law Journal reported last year on a "rising tide of challenges to arbitration awards [that] threatens to undermine the system."[1] The article focused on challenges alleging "evident partiality" on the part of an arbitrator, and observed that a "wide jurisdictional disparity regarding what constitutes partiality" was compounding the added time and expense inherent in any judicial challenge to an award.[2] But the last year has brought new clarity to the standard for evident partiality applied by the U.S. Court of Appeals for the Second Circuit and now by state courts in New York. This article traces the evolution of that standard, concluding with two recent cases that clarify the law—the Second Circuit's *Scandinavian Reinsurance Co v. St. Paul Fire & Marine Ins. Co.* opinion[3] and the N.Y. Court of Appeals' decision in *U.S. Electronics Inc. v. Sirius Satellite Radio Inc.*[4]

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More Issues Raised Than Resolved

Section 10(a)(2) of the Federal Arbitration Act (FAA) empowers a federal district court to vacate an arbitration award "where there was evident partiality or corruption in the arbitrators, or either of them."[5] New York state courts also apply the FAA when the dispute affects interstate commerce.[6] Any "jurisdictional disparity" regarding the meaning of evident partiality primarily results from a lack of clear guidance from the U.S. Supreme Court. Its only evident partiality case—*Commonwealth Coatings Corp v. Continental Casualty Co.*, decided in

1968[7]—prompted 40 years of debate on whether the plurality opinion of Justice Hugo Black or the concurring opinion of Justice Byron White should be followed, with most courts concluding that the plurality opinion does not control.[8]

Commonwealth Coatings presented a nondisclosed financial relationship between a neutral arbitrator and the successful party to the arbitration, with "repeated and significant" business lasting over a period of four or five years (but not the year before the arbitration), including "services on the very projects" involved in the arbitration.[9] Six justices agreed that the award should be vacated but did not agree on the reasoning. Justice Black offered "the simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias," stating that arbitrators "not only must be unbiased but also must avoid even the appearance of bias."[10]

Justice White stated that he was "glad to join" Justice Black's opinion, but then declared that "[t]he Court does not decide today that arbitrators are to be held to the standards of judicial decorum of Article III judges, or indeed of any judges "[11] For Justice White, it was "enough for present purposes to hold, as the Court does, that where the arbitrator has a substantial interest in a firm which has done more than trivial business with a party, that fact must be disclosed."[12] Both opinions looked more to recusal standards for federal judges than to the statutory words. As the dissent argued, an "innocent failure to volunteer information" about a relationship does not constitute evident partiality in a case where the award was unanimous and "no claim is made of actual partiality, unfairness, bias or fraud"; "evident partiality" "means what it says: conduct—or at least an attitude or disposition—by the arbitrator favoring one party, rather than the other."[13]

Reasonable Person Standard

In 1984, the Second Circuit adopted a reasonable person standard for evident partiality in *Morelite Constr. Corp v NYC Dist Council Carpenters Benefit Funds*,[14] the court's seminal opinion that has been applied in dozens of cases.[15] Judge Irving Kaufman treated "much of Justice Black's opinion...as dicta," allowing the court to "delineate standards of impartiality on a relatively clean slate."[16] "Mindful of the trade-off between expertise [in the relevant industry] and impartiality, and cognizant of the voluntary nature of submitting to arbitration," the court read "Section 10(b) as requiring a showing of something more than the mere 'appearance of bias' to vacate an arbitration award."[17] But the court could not "countenance the promulgation of a standard of partiality as insurmountable as 'proof of actual bias'—as the literal words of Section 10 might suggest."[18] The court concluded:

> If the standard of "appearance of bias" is too low for the invocation of Section 10 and "proof of actual bias" too high, with what are we left? Profoundly aware of the competing forces that have already been discussed, we hold that "evident partiality" within the meaning of 9 U.S.C. §10 will be found where a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration.[19]

Applying this standard, *Morelite* held that a reasonable person would have to conclude that a *sole* arbitrator, whose father was president of an international union, would be partial to a local of that union that was a party to the arbitration. The court emphasized that it did not "intend that unsuccessful parties to arbitration may have awards set aside by seeking out and finding tenuous relationships between the arbitrator and the successful party."[20]

In *Local 814, International Brotherhood of Teamsters, Chauffeurs, Warehousemen & Helpers of America v. J & B Systems Installers & Moving Inc.*,[21] the court declined to vacate an award where an arbitrator allegedly had, in a separate incident, gone to jail for contempt rather than testify against the father of a party to the arbitration. The court held that while the speculation of a close friendship between the party's father and the arbitrator "might suffice to show 'an appearance of bias' ..it falls short of *Morelite*'s 'reasonable person' standard."[22] The court further observed: "Nor have appellants presented any evidence tending to show that [the arbitrator's] putative partiality prejudiced them."[23]

In *Lucent Technologies Inc. v. Tatung Co*,[24] the Second Circuit held that evident partiality was not shown where an arbitrator disclosed that he had served as an expert witness for Lucent in an unrelated case completed months before the arbitration was commenced, but where the losing party had not received the disclosure form. Judge Wilfred Feinberg stated that the court has

> "not been quick to set aside the results of an arbitration because of an arbitrator's alleged failure to disclose information " In particular, [it 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 the case."[25]

In 2007, the court underscored the burden faced by a petitioner, holding in *Applied Indus., Materials Corp v Ovalar Makine Ticaret Ve Sanayi, A.S.*:[26]

> Unlike a judge, who can be disqualified in any proceeding in which his impartiality *might* reasonably be questioned, ...an arbitrator is disqualified only when a reasonable person, considering all of the circumstances, would *have* to conclude that an arbitrator was partial to one side.

The court stated that

> [a]n arbitrator who knows of a material relationship with a party and fails to disclose it meets *Morelite*'s "evident partiality" standard: A reasonable person would have to conclude that an arbitrator who failed to disclose under such circumstances was partial to one side.[27]

Applied Industrial also addressed whether an arbitrator has a duty to investigate, holding that

> where an arbitrator has reason to believe that a nontrivial conflict of interest might exist, he must (1) investigate the conflict (which may reveal information that must be disclosed...) or (2) disclose his reasons for believing there might be a conflict and his intention not to investigate.[28]

Applied Industrial vacated an award where the chair of the panel—the CEO of multinational holding corporation—became aware that a division of his corporation had business dealings with the parent of one of the parties to the arbitration and he erected a so-called "Chinese wall" to prevent him from learning anything more about such dealings. The losing party to the arbitration determined that the chair's corporation received approximately $275,000 from the business relationship, which the court said was "not a trivial amount"[29] and which the arbitrator (whose vote was decisive to a 2-1 arbitration award) would have uncovered had he investigated the relationship.

Second Circuit's Latest Guidance

On Feb. 3, 2012, the Second Circuit issued its opinion in *Scandinavian Reinsurance*. The challenged relationship was not between an arbitrator and a party. Instead, two members of the panel in the *St. Paul* arbitration did not disclose that they were selected to serve together on a panel in a contemporaneous arbitration (the *Platinum* case); St. Paul's business was related in several ways to Platinum's, and a former employee of both Scandinavian and Platinum testified in both proceedings. The district court had vacated the award;[30] the Second Circuit reversed. In doing so, the court not only reviewed its precedents but also filled in additional details for the reasonable person standard and eliminated some of the "jurisdictional disparity." Specifically, the court stated:

> The evident-partiality standard is, at its core, directed to the question of bias.... It follows that where an undisclosed matter is

New York Law Journal MONDAY, APRIL 2, 2012

not suggestive of bias, vacatur based upon that nondisclosure cannot be warranted under an evident-partiality theory....[31]

But, in ascertaining whether a relationship is "material"—or, to use the terminology of *Applied Industrial*, whether it is "nontrivial"—we think that a court must focus on the question of how strongly that relationship tends to indicate the possibility of bias in favor of or against one party, and not on how closely that relationship appears to relate to the facts of the arbitration....[32]

[W]e do not think it appropriate to vacate an award solely because an arbitrator fails to consistently live up to his or her announced standards for disclosure, or to conform in every instance to the parties' respective expectations regarding disclosure. The nondisclosure does not by itself constitute evident partiality....[33]

Even where an arbitrator fails to abide by arbitral or ethical rules concerning disclosure, such a failure does not, in itself, entitle a losing party to vacatur....[34]

We do not in any way wish to demean the importance of timely and full disclosure by arbitrators. Disclosure not only enhances the actual and apparent fairness of the arbitral process, but it helps to ensure that the process will be final, rather than an extended by proceedings like this one.[35]

In addition, the court adopted the Fourth Circuit's nonexclusive guidelines for evaluating evident partiality:

"(1) the extent and character of the personal interest, pecuniary or otherwise, of the arbitrator in the proceedings; (2) the directness of the relationship between the arbitrator and the party he is alleged to favor; (3) the connection of that relationship to the arbitrator; and (4) the proximity in time between the relationship and the arbitration proceeding."[36]

It also drew on Seventh Circuit precedent for the proposition that "arbitrators [are] not disqualified merely because they acquired relevant knowledge in a previous arbitration";[37] on Ninth Circuit precedent for the proposition that an arbitrator is '"required to disclose only facts indicating that he might reasonably be thought biased *against one litigant and favorable to another*'";[38] and on Fourth Circuit precedent for the proposition that the "'asserted bias'" may not be '"remote, uncertain, or speculative."'[39]

The court ultimately held that the two arbitrators' service in both arbitrations "does not, in itself, suggest they were predisposed to rule in any particular way in the St Paul Arbitration. As a result, their failure to disclose their concurrent service is not indicative of evident partiality."[40]

Court of Appeals Concurs

In *U.S Electronics*, decided Nov. 15, 2011, the New York Court of Appeals "adopt[ed] the Second Circuit's reasonable person standard" and stated that it would "apply it when we are asked, as in this case, to consider the federal evident partiality standard."[41] U.S Electronics challenged an award on the basis that the chairman of the arbitration panel's son, a member of Congress, had "publicly advocated a merger between Sirius and XM Satellite Radio Inc. (XM)" and "was a close political ally of Congressman Darrell Issa, the founder and director of a competitor of U.S. Electronics in radio receiver distribution."[42] The Court held that evident partiality is not shown "premised on attenuated matters and relationships."[43]

That Chairman Sessions' son publicly endorsed the Sirius-XM merger had no impact on the merits of the separate and distinct breach of contract matter Moreover, the purported connection between Chairman Sessions and Congressman Issa through his son's political relationship is too tenuous to impute partiality to the chairman.... This would be a far different case if USE could allude to a personal or business relationship between Chairman Sessions and Congressman Issa; or if his son had a prominent role at Sirius or DEL... However, absent such a showing, these allegations, without more, amount to speculation of bias "[44]

In a word, clarity. New York state courts will now follow the Second Circuit's standard for evident partiality, and *Scandinavian Reinsurance* has made that standard even clearer.

1. Leigh Jones, "'Gotcha Game,'" National Law Journal, Feb 14, 2011 at 1
2. Id at 5
3. __F3d__, No 10-0910-cv, 2012 WL 335772 (2d Cir. Feb 3, 2012).
4. 958 N E 2d 891 (N Y 2011). Sirius' brief included a nationwide survey of the case law on evident partiality, contending there was more concurrence than disagreement among the federal circuits on the standard for evident partiality. 2011 WL 6986868, at *23-52
5. 9 U.S.C §10(a)(2)
6. *Diamond Waterproofing Sys. Inc v 55 Liberty Owners Corp*, 826 N E 2d 802, 803 (N Y 2005)
7. 393 U S 145 (1968)
8. See *Positive Software Solutions Inc v New Century Mortg Corp*, 476 F3d 278, 281-82 (5th Cir 2007) (en banc) (collecting cases)
9. 393 U.S at 146
10. Id at 149-50
11. Id at 150-52.
12. Id at 151-52
13. Id at 152, 154
14. 748 F 2d 79 (2d Cir 1984)
15. See, e g, *Transportes Coal Sea de Venezuela CA v. SMT Shipmanagement & Transp Ltd*, No 05-CV-9029 (KMK), 2007 WL 62715 (S D N Y. Jan 9, 2007) (collecting cases)
16. *Morelite*, 748 F 2d at 83
17. Id. at 83-84.
18. Id at 84
19. Id
20. Id at 85
21. 878 F 2d 38 (2d Cir. 1989) (per curiam)
22. Id at 40.
23. Id
24. 379 F 3d 24 (2d Cir 2004)
25. Id at 28 (citations omitted)
26. 492 F 3d 132, 137 (2d Cir 2007) (citations and internal quotation marks omitted)
27. Id at 137.
28. Id at 138
29. Id. at 139
30. 732 F Supp 2d 293 (S D N.Y. 2010) (Scheindlin, J)
31. 2012 WL 335772, at *9.
32. Id at *11
33. Id at *12.
34. Id at *12 n 22
35. Id at *13 (citing Justice White)
36. Id at *10 (quoting *Three S Del Inc. v Dataquick Info Sys Inc*, 492 F 3d 520, 530 (4th Cir 2007))
37. Id at *13
38. Id at *9 (quoting *Lagstein u Certain Underwriters at Lloyd's, London*, 607 F 3d 634, 646 (9th Cir. 2010)).
39. Id at *8 (quoting *Three S Del*, 492 F.3d at 530)
40. Id. at *1; see also *STMicroelectronics, N V. v Credit Suisse Securities (USA) LLC*, 648 F.3d 68, 74 (2d Cir 2011), which addressed whether an arbitrator's experience as an expert witness would cause him to have a "predisposition" against financial institutions in disputes over account management; the court rejected a challenge to the award under §10(a)(3) of the FAA ("other misbehavior by which the rights of any party have been prejudiced").
41. 958 N.E 2d at 893
42. Id at 892
43. Id at 893.
44. Id at 893-94.