

## Outside Counsel

## Expert Analysis

# Arbitrator Impartiality And the Duty to Disclose

An arbitrator has ethical obligations to maintain the integrity and fairness of the arbitration process, as well as ethical obligations to the parties to an arbitration. An arbitrator's adherence to ethical standards is especially important given the limited circumstances under which courts are authorized to vacate arbitration awards.

The neutrality of an arbitrator is essential to the arbitration process; an arbitrator's lack of impartiality is one of the few bases upon which a court may vacate an arbitral award. Under the Federal Arbitration Act, a court may vacate an arbitration award "where there was evident partiality or corruption in the arbitrators, or either of them...." 9 U.S.C. §10(a)(2). Similarly, under New York law, a court can vacate an arbitration award "if the court finds that the rights of that party were prejudiced by...partiality of an arbitrator appointed as a neutral...." CPLR §7511(b)(1)(ii). In both the state and federal contexts, the party seeking to vacate an arbitral award has the burden of proving the existence of evident partiality on the part of an arbitrator.

### When to Decline to Serve?

An arbitrator's ethical obligation arises as soon as he is invited to serve in a prospective arbitration; he must be fully satisfied that he can serve impartially. If an arbitrator believes that there are or have been dealings or relationships that would prevent him from serving impartially, he must decline the invitation to serve. As obvious examples, if a prospective arbitrator is married to a party, a parent of one of the parties or an owner of one of the corporate parties, the prospective arbitrator must decline.



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Additionally, it is not proper for an arbitrator to claim that, notwithstanding material relationships with one or more of the parties or other non-trivial dealings, he can impartially serve as an arbitrator, even if that is his genuine belief. The subjective good faith of the arbitrator is not the proper test. *Applied Indus. Materials Corp. v. Ovalor Makine Ticaret Ve Sanayi, A.S.*, 492 F.3d 132, 139 (2d Cir. 2007).

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### Duty to Disclose

If a potential arbitrator believes that he can be impartial notwithstanding the existence of one or more arguably relevant relationships or dealings, the issue becomes one of disclosure. In one U.S. Court of Appeals for the Second Circuit case, *Morelite Constr. Corp. v. New York City District Council Carpenters Benefits Funds*, 748 F.2d 79 (2d Cir. 1984), one of the arbitrators was the son of the president of an international union, a district union of which was a party to the arbitration. After the arbitration was completed and an award was rendered, the losing party challenged the award in the U.S. District Court for the Southern District of New York, claiming that the arbitrator was not

impartial and that the award should therefore be vacated. The district court vacated the award, and an appeal was taken to the Second Circuit.

The Second Circuit, following reasoning of the concurring opinion of Justice Byron White in the U.S. Supreme Court case, *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145, 89 S. Ct. 337 (1968), affirmed the vacatur and set forth the standard that evident partiality will be found and an award should be vacated "where a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration." 748 F.2d at 84. "An 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." *Applied Indus.*, 492 F.3d at 137.

In *Morelite*, the court concluded that an "appearance of bias" standard—a strict impartiality standard that is applied to judges—was too low for vacating awards. At the same time, the court concluded that a "proof of actual bias" standard was too high and not required. *Id.* at 83-84.

### Prompt Disclosure Is Essential

Disclosure should be made as early in the arbitration process as possible since prompt disclosure enables the parties to deal with conflict issues early, aids in the selection of arbitrators, and limits potential collateral attacks on arbitral awards by disgruntled parties. *Lucent Techs., Inc. v. Tatung Co.*, 379 F.3d 24, 29 (2d Cir. 2004). Conflicts, once revealed, can be waived. However, a waiver can only be made by the parties once sufficient disclosure has been made; the arbitrator cannot assume or infer a waiver, and parties, obviously, cannot waive conflicts of which they are not aware.

The duty to disclose is ongoing. In the event a conflict arises during the course of an arbitration, or an arbitrator first becomes aware of a pre-existing conflict after the arbitration has already

commenced, a supplemental disclosure should be made.

The parties have a duty to disclose as well. At the commencement of an arbitration, they should disclose the identity of the parties and their principals, anticipated witnesses and counsel appearing on their behalf. In addition, the parties' obligation to disclose is also ongoing. Only with full disclosure by the parties can an arbitrator consider all potential conflicts.

### Duty to Investigate Conflicts

When a prospective arbitrator has reason to believe that a conflict of interest might exist, the arbitrator must make a reasonable effort to further inform himself about the potential conflict even if he is not aware that any conflict in fact exists. For example, if the arbitrator is affiliated with a law firm, the arbitrator needs to conduct a conflicts check through the firm's conflicts data system. Such conflicts checks enable the arbitrator to determine whether, for example, any of the parties, their counsel or any witness appearing in the arbitration is either a client or adverse to a client of the firm, thereby enabling the arbitrator to disclose relevant relationships of which the arbitrator may have been unaware. The investigation may involve inquiries of family members who could have dealings or relationships that would be appropriate to disclose.

For example, in *Applied Industrial*, an arbitrator was the principal of a company that had a business relationship with one of the parties. At the conclusion of the hearing, the arbitrators rendered an award and the losing party sought to vacate the award based on the partiality of the arbitrator and his failure to disclose the relationship. On such basis, the District Court vacated the award. *Applied Indus.*, at 135-136.

On appeal, the Second Circuit affirmed the vacatur, stating: "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." *Id.* at 138 (internal citations omitted). The court explained that the failure to disclose either the non-trivial conflict or the reason for believing there might be a conflict and the arbitrator's intention not to investigate the potential conflict has the potential to mislead parties into believing that no non-trivial conflict exists. "The mere failure to investigate is not, by itself, sufficient to vacate an arbitration award. But, when an arbitrator knows of a potential conflict, a failure to either investigate or disclose an intention not to investigate is indicative of evident partiality." *Id.*

More recently, in *Scandinavian Reins. Co. Ltd. v. St. Paul Fire & Marine Ins. Co.*, 732 F. Supp.2d 293 (SDNY 2010), the disclosure issue did not relate to any relationship between the arbitrators and the parties or their counsel. Rather, two of the arbitrators had been simultaneously serving as arbitrators in another case that involved a common expert witness, similar reinsurance issues and related though not identical parties. *Id.* at 295. The two arbitrators had access to essentially ex parte information regarding the same kind of reinsurance business and could have been influenced by the prior testimony of the common witness.

The court observed that the absence of either a financial interest in the outcome or a direct relationship with a party was not dispositive of the issue of whether a relationship is material. After considering all of the factors collectively, the court concluded that a material conflict of interest existed and vacated the award. *Id.* at 307-08.

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### Adopting Standards?

In a case that is currently on appeal to the New York Court of Appeals, an arbitration was conducted with a panel of three arbitrators, the chair of which had a son in the U.S. House of Representatives. The congressman had made statements or taken steps that concerned issues that were relevant to the arbitration. After the award was rendered, the unsuccessful party sought to have the award vacated based upon the arbitrator's alleged partiality.

Justice Ira Gammerman of the New York State Supreme Court concluded that there was no evidence that the chair knew of his son's actions, nor did he have reason to believe that there was a conflict. Accordingly, the court found that there was no basis for concluding that there was evident partiality. The court relied on the standards set forth in *Morelite* and *Applied Industrial* and denied the motion to vacate the award. See *U.S. Elecs. Inc. v. Sirius Satellite Radio, Inc.*, No. 115867/08, (N.Y. Sup. Ct. July 1, 2009).

On appeal, the Appellate Division, First Department affirmed the denial of the motion to vacate. However, the appellate court, applying a standard deemed too low by the Second Circuit,

went on to state: "it is thus incumbent upon an arbitrator to disclose any relationship which raises even a suggestion of possible bias." *U.S. Elecs. Inc. v. Sirius Satellite Radio, Inc.*, 73 A.D.2d 497, 498 (1st Dept. 2010) (quotations omitted).

Under that standard, the Appellate Division concluded that the arbitrator should have made full disclosure. However, the court further reasoned that, despite the failure to disclose, "petitioner failed to meet its burden of proving by clear and convincing evidence that any impropriety or misconduct of the arbitrator prejudiced its rights or the integrity of the arbitration process or award, since no proof was offered of actual bias or even the appearance of bias on the part of the chairman." *Id.*

Here, the Appellate Division appears to have diverged from the standards set forth by the Second Circuit by suggesting that an arbitrator must disclose any relationship which "raises even a suggestion of possible bias" and by imposing a "clear and convincing evidence" burden of proof of any arbitrator "impropriety or misconduct" since no proof was offered of "actual bias or even the appearance of bias." See *id.*

A decision in *U.S. Electronics, Inc. v. Sirius Satellite Radio, Inc.* should be rendered by the New York Court of Appeals later this year. Stay tuned.