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Disclosures key to avoiding 'evident partiality' challenges

By: Gordon P. Katz and Taylor Han August 31, 2017

Arbitration offers an often quick and cost-effective alternate forum to resolve disputes. However, challenges to arbitration awards can diminish benefits and prolong the dispute resolution process. Through initial disclosures, the arbitrator can reduce the risk of such challenges being brought.

Once an arbitration is over, only a few narrow grounds exist for vacating an arbitration award. One of these is "evident partiality" of the arbitrator.

Evident partiality is a tempting argument to consider for an unsuccessful party to an arbitration. In trying to undo an arbitration loss, a party might search for any connection that an arbitrator had with the case or the other party, in order to argue that there was evident partiality because the arbitrator failed to disclose that connection.

The U.S. Supreme Court last considered the meaning of evident partiality in *Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 393 U.S. 145 (1968), almost five decades ago.

In that case, the arbitrator failed to disclose that he served as a consultant for one of the parties and, although that business relationship was sporadic, the services were "repeated and significant." In a 6-3 decision, the Supreme Court validated the vacating of the arbitration award on the basis of evident partiality.

Justice Hugo Black, writing for the court, compared arbitrators to judges and held that arbitrators "must avoid even the appearance of bias." *Commonwealth Coatings*, 393 U.S. at 150.

Justice Byron White, in a concurring opinion joined by Justice Thurgood Marshall, noted that arbitrators should not be held to the same standards of impartiality as a judge and purported to limit Black's opinion to hold only that a nontrivial business relationship must be disclosed.

Because Black's opinion did not specify which justices joined it, circuit courts have failed to agree on whether that decision was of a majority or plurality of the court.

> *In between the two extremes, the law is unclear. It is possible that a nondisclosure may show evident partiality in the 9th Circuit but not in the 2nd Circuit.*

Circuit split

The law in the circuits since *Commonwealth Coatings* is split. In *Morelite Construction Corp. v. New York City District Council Carpenters Benefit Funds*, 748 F. 2d 79, 83 (2d Cir. 1984), the 2nd Circuit concluded that White and Marshall did not join Black's opinion, making Black's a plurality opinion.

Accordingly, the 2nd Circuit declined to follow Black's "appearance of bias" standard, which it deemed too low a bar to establish evident partiality.

Instead, the 2nd Circuit held that the standard for evident partiality is whether a "reasonable person would conclude that an arbitrator was partial to one party." *Id.* at 84. That standard is lower than requiring a showing of actual bias.

The 1st Circuit and Massachusetts state courts, as well as most other circuits, have followed the 2nd Circuit. See, e.g., *JCI Communications, Inc. v. Int'l Bhd. of Elec. Workers, Local 103*, 324 F.3d 42, 51 (1st Cir. 2003); *City of Newton v. Cummings*, 91 Mass. App. Ct. 1118 (2017).

The 9th Circuit takes a different approach. It has noted that White's opinion spoke of Black's as the "majority opinion," *Schmitz v. Zilveti*, 20 F.3d 1043, 1046 (9th Cir. 1994).

From that, the 9th Circuit adopted an "appearance of bias" standard and further clarified that evident partiality will be found if there is a "reasonable impression of bias."

Although the Supreme Court has not decided an evident partiality case since *Commonwealth Coatings*, two cases have been denied certiorari in recent years.

In *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, a Texas District Court followed the 9th Circuit's standard and vacated the arbitration award. See 337 F. Supp. 2d 862, 885 (N.D. Tex. 2004).

Although the 5th Circuit initially affirmed (see 436 F.3d 495, 501 (5th Cir. 2006)), it reversed en banc, adopting instead the 2nd Circuit's standard. See 476 F.3d 278, 283 (5th Cir. 2007).

The Supreme Court in 2010 also denied certiorari in a 9th Circuit evident partiality case. *Lagstein v. Certain Underwriters at Lloyd's, London*, 607 F.3d 634 (9th Cir. 2010).

Thus, the time is ripe for further Supreme Court clarification.

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Preventing challenges through disclosure

While courts wait for the Supreme Court to speak again on evident partiality, all recognize the importance of pre-arbitration disclosures.

It is, of course, unrealistic for an arbitrator to "provide the parties with his complete and unexpurgated business biography"; it is far better for a potential conflict "[to] be disclosed at the outset" than for it to "come to light after the arbitration, when a suspicious or disgruntled party can seize on it as a pretext for invalidating the award." *Commonwealth Coatings*, 393 U.S. at 151 (White, J., concurring).

On either side of the circuit split, a nondisclosure must be "material" in order to show evident partiality, though courts following the 2nd Circuit test require a stronger showing of materiality. See *Lagstein*, 607 F.3d 634, 646 ("Vacatur of an arbitration award is not required simply because an arbitrator failed to disclose a matter of some interest to a party. Instead, Whitehead was required to disclose only facts indicating that he 'might reasonably be thought biased against one litigant and favorable to another.'") (quoting *Commonwealth Coatings*, 393 U.S. at 150); *Applied Indus. Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi, A.S.*, 492 F.3d 132, 137 (2nd Cir. 2007) (holding that there is evident partiality when an arbitrator "knows of a material relationship with a party and fails to disclose it").

Some courts have adopted the following factors to aid the analysis: (1) extent, if any, of financial or personal interest in the arbitration; (2) directness of the relationship between the arbitrator and the party; (3) connection of the relationship to the arbitration; and (4) proximity in time between the relationship and the arbitration. See, e.g., *Consolidated Coal Co. v. Local 1643, United Mine Workers of America*, 48 F.3d 125, 130 (4th Cir. 1995).

Nondisclosures of some connections are easily determined material: direct financial or personal interests in the outcome of the case; direct family relations to a party, counsel or an important witness; and nontrivial business relationships. See *Morelite*, 748 F.2d at 83 (holding that there was evident partiality where the arbitrator's son was the officer of the union that was a party); but see *Consolidated Coal*, 48 F.3d at 130 (holding that there was no evident partiality where the arbitrator's brother was a member of the union that was a party).

On the other hand, nondisclosures of other connections are likely nonmaterial when the connections are "long past, attenuated, or insubstantial."

For example, courts have found no evident partiality when: the arbitrator previously mediated for a party (see *Ploetz v. Morgan Stanley Smith Barney*, LLC, 2017 WL 2303969 (D. Minn. May 25, 2017)); the arbitrator and attorney's social ties consisted of a single social event (see *Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 429 F.3d 640, 644 fn. 4 (6th Cir. 2005)); or two arbitrators had co-owned an airplane (see *Lucent Techs. Inc. v. Tatung Co.*, 379 F.3d 24, 30 (2nd Cir. 2004)).

In between the two extremes, the law is unclear. It is possible that a nondisclosure may show evident partiality in the 9th Circuit but not in the 2nd Circuit.

For example, in *Positive Solutions*, cited above, an arbitrator and a party's counsel were part of a 34-lawyer team in a litigation 10 years before the arbitration. Each signed the same 10 pleadings in the case, but they had never spoken to each other until the arbitration. The 5th Circuit initially found evident partiality when applying the 9th Circuit's standard but reversed en banc when applying the 2nd Circuit's standard.

All arbitrators have a general duty to search for potential conflicts that must be disclosed. Under the 2nd Circuit test, if a potential conflict exists, the arbitrator must then either (1) investigate the conflict, or (2) disclose to the parties the reason for believing a conflict might exist and the intention not to investigate. *Applied Indus. Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi, A.S.*, 492 F.3d 132, 138 (2nd Cir. 2007).

To be safe, an arbitrator, before accepting an assignment, should conduct a thorough conflicts check regarding each party, attorney, co-arbitrator and witness, and disclose any family or business relationships, as well as known nontrivial social ties.

Comprehensive disclosure at the outset is the linchpin to avoiding evident partiality challenges after the arbitration award is delivered.

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