



# CONFLICTS OF INTEREST

## WHAT ARE THEY, AND MUST THEY ALL BE DISCLOSED?

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The FAA sets the rule that an arbitration award may be vacated “where there was evident partiality or corruption in the arbitrators.” 9 U.S.C. Sec. 10(a) (2). We know from *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145, 89 S.Ct. 337, 21 L.E.2d 301 (1968), as reaffirmed by *Positive Software Solutions v. New Century Mortgage Corp.*, 476 F.3d 278 (5th Cir. 2007)<sup>1</sup>, that “evident partiality” as used in Section 10(a)(2) means something more than a mere “appearance of bias”—at least everywhere but the Ninth Circuit. See *Schmitz v. Zilveti*, 20 F.3d 1043 (9th Cir. 1994). We also know that the failure of an arbitrator to make a material disclosure may lead to vacatur of an award on the grounds articulated in Section 10(a)(2). It is left to judges applying the standards, however, to define when an arbitrator’s failure to disclose may lead to the conclusion that there was, indeed, “evident partiality.”

The case law gives at least some guidance on what should be disclosed and how courts treat a failure to disclose. In the non-disclosure area, the seminal case, *Commonwealth Coatings*, *supra*, involved an arbitrator who, over a period of four to five years, ending about a year prior to the arbitration, received about \$12,000 from one of the parties for legal work that included the rendering of services on the very projects involved in the arbitration before him. The award in that case was vacated for the arbitrator’s “evident partiality.” In *Positive Software*, the arbitrator and an attorney for one of the parties had been

two of 34 lawyers who had previously represented the same client seven years earlier in unrelated litigation. That prior litigation involved six different lawsuits in the early 1990s and the common client (Intel) was at the time represented by seven law firms. Although the arbitrator’s name and the attorney’s name appeared on the pleadings in one of the cases, they “never attended or participated in any meetings, telephone calls, hearings, depositions or trials together.” *Id. at 280*. In reversing the decision of the prior panel, the Fifth Circuit, *en banc*, discussed the standard to be applied and concluded, over a vigorous dissent, that *Commonwealth Coatings* required the application of a standard that was more than an “appearance of bias.” To the same effect, see *Morelite Contr. Corp. v. New York City Dist. Council*, 748 F.2d 79, 83-84 (2d Cir. 1984) (“Mindful of the trade-off between expertise and impartiality, and cognizant of the voluntary nature of submitting to arbitration, we read Section 10(b) as requiring a showing of something more than the mere ‘appearance of bias’ to vacate an arbitration award. To do otherwise would be to render this efficient means of dispute resolution ineffective in many commercial settings.”)

Other fact scenarios emphasize the need for an arbitrator to make non-trivial disclosures and to be sure that he or she makes a continuing effort to inform himself or herself of relevant information. Thus, in *Soma Partners v. Northwest Biotherapeutics*, 41 A.D.3d 257, 838 N.Y.S.2d 519, 2007 WL 1746391 (1st Dep’t 2007), the court vacated an arbitration award when the arbitrator failed to disclose that one

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of his colleagues at the law firm (an “of counsel”), through his service as a member of the board of directors of a company called Tedco, knew a witness—a Mr. Powers—listed by one of the parties. Tedco had contractual and investment relationships with another company named Toucan Capital Corp. (“Toucan”). The arbitration involved a dispute over whether one of the parties was entitled to a finder’s fee by reason of an investment made by Toucan. In *Soma Partners*, the court applied the New York State standard for vacatur under CPLR 7511(b) (1)(ii) which permits vacatur on the ground of “the partiality of an arbitrator appointed as a neutral.” A critical fact in *Soma Partners* was that the arbitrator circulated the AAA’s conflicts list at his law firm and learned that his colleague knew Powers prior to the arbitrator’s own clean disclosure and his acceptance of the appointment. In vacating the award, the court explained that the matter of an arbitrator’s impartiality is best left to the parties, but “[t]his can only be achieved if, prior to the commencement of the arbitration, the arbitrator discloses to the parties all facts which might reasonably cause one of them to ask for disqualification...” *Id.* at 520. The court concluded:

*The connection between the arbitrator and Toucan and Powers [the witness] was not so insignificant that he could dispense with disclosure, and therefore the arbitration award must be vacated and a new arbitration conducted.*

*Id.* at 521.

One might draw the conclusion from *Soma Partners* that it’s better not to ask for information. If the arbitrator there did not know of the situation, then his failure to disclose might have been considered in a different light. However, in *Applied Industrial Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi*, 492 F.3d 132 (2d Cir. 2007), the arbitrator, the CEO of a large corporation, learned during the course of the arbitration that one of his company’s subsidiaries did business with the company that was acquiring the plaintiff. The arbitrator disclosed the conflict to the parties but failed to disclose that he had set up an internal firewall that effectively prevented him from learning anything further about the conflict. He did not disclose his decision to set up the firewall. As it turned out, there was more to disclose (which he never learned about). In affirming the district

court’s refusal to confirm the award, the Second Circuit held that there was evident partiality in the arbitrator because he neither investigated a conflict of which he had become aware, nor disclosed his decision not to investigate further. As the court expressed the rule:

*It therefore follows 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 under Commonwealth Coatings) or (2) disclose his reasons for believing there might be a conflict and his intention not to investigate...*

*We emphasize that we are not creating a free-standing duty to investigate. 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.*

*Ovalar*, 492 F.3d at 138 (emphasis in original).

The lesson in *Ovalar* is that an arbitrator would be well-advised to make an investigation, learn the facts and disclose them if need be. If the arbitrator becomes aware of a potential conflict, and then puts his or her head in the sand for the remainder of the case, he or she would also be well-advised to tell the parties that he or she is doing so—and even that might not be good enough. Mere ignorance of a subsequently arising conflict will not suffice.

The district court in *Ovalar* relied in part on Canon II of the Code of Ethics for Arbitrators in Commercial Disputes, effective March 1, 2004<sup>2</sup>. Canon II provides under the heading “An Arbitrator Should Disclose Any Interest or Relationship Likely to Affect Impartiality or Which Might Create an Appearance of Partiality”<sup>3</sup>:

*C. The obligation to disclose interests or relationships described in paragraph A is a continuing duty which requires a person who accepts appointment as an arbitrator to disclose, as soon as practicable, at any stage of the arbitration, any such interests or relationships which may arise, or which are recalled or discovered.*

A recent instructive case comes out of a Texas appellate court. *Alim v. KBR*, 331 S.W.3d 178 (Tex. App. 2011) was an employment case. There, the arbitrator failed to disclose that the employer's party representative had previously appeared before him as a party representative of a related entity in another case. In vacating the award, the Texas court ruled that "A neutral arbitrator exhibits evident partiality if he does not disclose facts that might, to an objective observer, create a reasonable impression of the arbitrator's partiality" citing *Burlington N.R.R. v. TUCO, Inc.* 960 S.W.2d 629, 636 (Tex. 1997). *Alim* at 181. In *Alim*, the arbitrator answered "No" to the following question: "Have any of the party representatives, law firms or parties appeared before you in past arbitration cases?" *Id* at 180. After making that disclosure, and prior to the start of the hearings, the arbitrator supplemented the disclosure as follows: "I have over the years come across Ms. Ungerman and Mr. Graves [the party representative], but in terms of this case, I have absolutely no interest involving Haliburton or anything else...." *Id*. That additional statement was deemed insufficient to alert the parties that Graves had indeed appeared before the arbitrator in past cases and that the arbitrator's prior disclosure was, therefore, inaccurate.

In vacating the award, the appellate court quoted the Texas Supreme Court in *TUCO* that "evident partiality is established from the nondisclosure itself, regardless of whether the nondisclosed information necessarily establishes partiality or bias." *TUCO*, 960 S.W.2d at 636.

In a recent decision, however, the Second Circuit embraced a less rigid standard. There, the panel reversed the district court's vacatur of an award notwithstanding the fact that two of the three arbitrators failed to disclose their simultaneous service in a subsequently filed arbitration that had a common witness and issues that were arguably similar to those they were hearing in the first case.

In *Scandinavian Reinsurance Co. Ltd. v. Saint Paul Fire and Marine Ins. Co.*, Docket No. 10-0910-CV (2d Cir. February 3, 2012), the Second Circuit reversed District Judge Scheindlin's vacatur of an arbitration award. As the Court framed the issue (*Op.* at 2):

*The primary question presented on this appeal is whether the failure of two arbitrators to disclose their concurrent service as arbitrators in another, arguably similar, arbitration constitutes "evident partiality" within the meaning of the [FAA Sec. 10(a)(2)].<sup>4</sup>*

The facts are instructive. In the *St. Paul* arbitration, *St. Paul* had ceded certain of its reinsurance liabilities to Scandanavian. A dispute arose over whether those liabilities were capped in some fashion and whether three experience accounts or only one were contemplated by the parties' retrocessional agreement. *St. Paul* appointed Gentile as its arbitrator. Gentile and Scandanavian's party-appointed arbitrator selected Dessenko as the Chair. Both made disclosures with Dessenko completing a nine-page questionnaire. Included in his responses was "that he had never had any involvement with the subject matter of the dispute, nor did he have any significant professional or personal relationship with any officers, directors, or employees of the parties." *Op.* at 9. Dessenko also acknowledged "the arbitrators' 'ongoing responsibility' to make disclosure if and when they 'become aware of relationships or situations that require additional disclosure.'" *Op.* at 10. Dessenko, in compliance with that statement, in fact made supplemental disclosures in the course of the arbitration although none relating to his later service on a panel with Gentile.

After the *St. Paul* arbitration had begun, a second arbitration ("the *Platinum* arbitration") began. In the *Platinum* arbitration, one of the parties (*Platinum*) appointed Gentile. Again, the two party-appointed arbitrators selected Dessenko as the Chair. The *Platinum* arbitration ended prior to the conclusion of the *St. Paul* arbitration.

Neither Dessenko nor Gentile ever disclosed to the parties in the *St. Paul* arbitration their concurrent service in the *Platinum* arbitration, even though they did disclose to the parties in the *Platinum* arbitration the fact "that they were then serving together as arbitrators in another matter." *Op.* at 14. Moreover, certain issues in the *Platinum* arbitration were arguably related to those being decided in the *St. Paul* arbitration. One of those related to the opera-

tion of experience accounts like those at issue in the *St. Paul* arbitration. In addition, a witness named Hedges, a past employee of both Scandanavian and Platinum, testified in both proceedings. In vacating the award below, the district court observed that Hedges' testimony in the *Platinum* case could be viewed as inconsistent with his testimony later offered in the *St. Paul* arbitration thus conceivably affecting his credibility in the *St. Paul* proceeding. (Op. at 15-16). In deciding to reverse the district court and confirm the award, the Second Circuit explained (Op. at 25):

*The evident-partiality standard is, at its core, directed to the question of bias. Because it was “[not] the purpose of Congress to authorize litigants to submit their cases and controversies” to arbitrators who are “biased against one litigant and favorable to another,” [citing Commonwealth Coatings] the FAA provides for vacatur of arbitral awards whenever it is “evident” that an arbitrator was “partial[ ]” to one of the litigating parties. 9 U.S.C. Sec. 10(a)(2). It follows that where an undisclosed matter is not suggestive of bias, vacatur based upon that nondisclosure cannot be warranted under an evident-partiality theory.*

As the Court further opined (Op. at 27):

*[A]s a general matter, we do not think that the fact that two arbitrators served together in one arbitration at the same time that they served together in another is, without more, evidence that they were predisposed to favor one party over another in either arbitration. The undisclosed matter here was overlapping arbitral service, not a “material relationship with a party.” [citing Ovalar]<sup>5</sup>*

The *St. Paul* case is, quite arguably, a departure from the case law trend evident in such decisions as *Soma Partners*, *Ovalar* and *TUCO*, *supra*, where—as explained in *TUCO*—“evident partiality is established from the nondisclosure itself.” 960 S.W.2d at 636.

There are certain rules that arise from the above cases. First, make all initial disclosures that, to an objective observer, might create an impression of partiality. Note that courts, as in *Alim* above, will

consider an arbitrator to have exhibited “evident partiality” if he or she fails to make an initial disclosure that arguably should have been made.<sup>6</sup> Second, when you do make a disclosure, take care that it is complete and wholly accurate. An inaccurate or false disclosure will lead to special scrutiny as in *Soma Partners* above. Third, do not seek to immunize yourself from your continuing disclosure obligations by walling yourself off from possible sources of conflict information. If you do wall yourself off, at least be sure to disclose to the parties that you are doing so and that it is possible that subsequent events might lead to conflicts that will not come to your attention and, therefore, that you will not be able to disclose. Finally, take your obligation to make ongoing disclosures seriously. While you might “thread the needle” as the two arbitrators did in *St. Paul*, you are tempting vacatur by failing to disclose subsequent assignments involving the same parties, arbitrators or issues that arguably relate to an ongoing case.

## HELPFUL CHECKLISTS

Thankfully, the provider organizations give assistance to potential arbitrators in the conflict checking process. Both the AAA and JAMS have checklists that potential arbitrators complete with questions asking, for example, whether the candidate or his or her family has a significant personal relationship with a party or counsel for a party.

CPR has Model Rules for the Lawyer as Third-Party Neutral. Rule 4.5.4 entitled “Conflicts of Interest” provides specific guidance in the nature of the JAMS and AAA questionnaires. In the international arena the International Bar Association’s Guidelines on Conflicts of Interest in International Arbitration (known as the “IBA Guidelines”) are also quite helpful. They divide potential conflicts into three areas: green (need not be disclosed); orange (need to be disclosed but are waivable by the parties) and red (non-waivable conflicts, although certain “red” conflicts are waivable). The IBA Guidelines’ general rule on disclosure provides in General Principle 3:

*(a) If facts or circumstances exist that may, in the eyes of the parties, give rise to doubts as*



to the arbitrator's impartiality or independence, the arbitration shall disclose such facts or circumstances to the parties, the arbitration institution or other appointing authority...and to the co-arbitrators, if any, prior to accepting his or her appointment or, if thereafter, as soon as he or she learns about them.

\* \* \*

(c) Any doubt as to whether an arbitrator should disclose certain facts or circumstances should be resolved in favour of disclosure.

There are also additional things that all potential arbitrators can do to lessen the odds that they will be accused of evident partiality after rendering an award. One is to make a generic disclosure such as the recent JAMS addition:

12. Do you participate in social networking sites such as Facebook, Twitter, or LinkedIn?

If the arbitrator marked this question, "Yes," it is possible that one of the lawyers or member of a law firm involved in this matter is in some way connected to the Arbitrator through this professional networking application. However, none of these contacts rises to the level of a prior business relationship that might cause a person aware of the facts to reasonably entertain a doubt that the arbitrator would be able to be impartial, unless otherwise noted below.

Or, if you are retired from a law practice, something like the following might be in order: "I retired from the firm of XYZ on January 1, 2007. As a retired partner, I no longer have access to the firm's client database and, therefore, cannot learn whether the firm either currently represents, or may have represented (or acted adversely to), one or both of the parties in the arbitration. I myself have had no personal contact with the parties and am completely impartial and unbiased in the matter." These generic disclosures should be sufficient to pass muster under *Commonwealth Coatings*.

In sum, make all the disclosures that would lead a reasonable objective observer to form an impression that you might be partial or biased. In close cases or, if uncertain, err on the side of disclosure but understand that trivial relationships (such as common memberships in bar associations) need not be disclosed. Know as well that your disclosure obligations are continuing ones and act accordingly. This is, in the last analysis, an exercise in good judgment. ■

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1 *Positive Software* was an *en banc* decision of the Fifth Circuit that reversed a prior decision of one of its panels that had vacated an arbitration award.

2 The Code may be accessed at <http://www.adr.org/sp.asp?id=21958>.

3 Note the Code's use of the higher standard (an appearance of bias) that was generally rejected by *Commonwealth Coatings*.

4 The arbitration was a New York Convention case, but, because hearings were conducted in the United States, the FAA's grounds for vacatur overlapped with those in Article V of the Convention (See *Zeiler v. Deitsch*, 500 F.3d 157.164 (2d Cir. 2007)).

5 Apparently, St. Paul did not press the argument on appeal that Dessenko's favorable vote with Gentile in the *St. Paul* case might have been in consideration for Gentile's appointment of Dessenko as Chair in the *Platinum* arbitration. The Court, however, recognized that special considerations might exist in the party-appointed context, but left any such discussion for another day. (*Op.* at f. 21).

6 But see the statement in Fortas's dissent in *Commonwealth Coatings*, 393 U.S. 145 at 154, "I agree that failure of an arbitrator to volunteer information about business dealings with one party will, *prima facie*, support a claim of partiality or bias. But where there is no suggestion that the nondisclosure was calculated, and where the complaining party disclaims any imputation of partiality, bias, or misconduct, the presumption clearly is overcome."