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Reviewing 'Evident Partiality' After *Scandinavian*

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In the recent decision *Scandinavian Reinsurance Co. Ltd. v. St. Paul Fire & Marine Insurance Co*., 668 F.3d 60 (2d Cir. 2012), the U.S. Court of Appeals for the Second Circuit upheld a reinsurance arbitration award despite claims of evident partiality on the part of members of the arbitral panel.

The court found the failure of two members of the arbitration panel to disclose they concurrently served on an arbitration panel in a similar reinsurance case did not constitute "evident partiality" within the meaning of the Federal Arbitration Act (FAA) sufficient to justify vacatur of the arbitration award.

The opinion not only reaffirms the stringent standard for judicial review of arbitration awards in the Second Circuit, but also raises issues pertaining to the contours of the "evident partiality" standard as it applies to the review of arbitration awards in all jurisdictions.

This article will discuss the *Scandinavian Reinsurance* decision as well as other recent decisions addressing the "evident partiality" standard.

Evident Partiality & *Commonwealth Coatings*

Under Section 10(a)(2) of the FAA, a court can vacate an arbitration award "where there was evident partiality or corruption in the arbitrators, or either of them."

However, what exactly constitutes "evident partiality" is unclear, due in part to a lack of clarity in the seminal case on the subject, *Commonwealth Coatings Corp. v. Continental Casualty Co*., 393 U.S. 145 (1968).

In *Commonwealth Coatings*, the U.S. Supreme Court vacated an arbitration award where the neutral arbitrator, an engineering consultant, failed to disclose he had a "sporadic" business relationship with one of the parties to the arbitration, a construction contractor.

There are three separate opinions in the case: Justice Hugo Black authored an opinion joined by three other justices, Justice Byron White authored a concurring opinion joined by one justice and Justice Abe Fortas authored a dissenting opinion joined by two justices.

In his opinion, Black noted the contractor's dealings with the engineering consultant were

"repeated and significant ... and the relationship even went so far as to include the rendering of services on the very projects involved in the lawsuit."

However, there were no allegations the neutral arbitrator was guilty of actual fraud or bias. Black conceded that, "apart from the undisclosed business relationship," there was no reason to suspect the arbitrator had any improper motives.

Black analogized the ethical standard applicable to arbitrators to those applicable to Article III judges and adopted an "appearance of bias" standard to be applied to arbitrators.

In his concurring opinion, White focused on the business realities surrounding most arbitrations and expressly refused to hold arbitrators to the "standard of judicial decorum of Article III judges, or indeed of any judges."

White stated arbitrators should not be automatically disqualified by a business relationship with the parties to the arbitrations if "both parties are informed of the relationship in advance or if they are unaware of the facts but the relationship is trivial."

Reasoning that arbitrators are often chosen because of their experience with and knowledge of a particular industry, White could "see no reason automatically to disqualify the best-informed and most capable potential arbitrators" on the basis of business relationships that are natural precursors of industry knowledge and experience.

Like Black, White emphasized the importance of disclosure at the outset of the arbitration.

Scandinavian Reinsurance is Consistent with the Second Circuit Standard for Evident Partiality

White's and Black's differing opinions in *Commonwealth Coatings* prompted confusion in the lower courts regarding the proper measure of "evident partiality" in reviewing arbitration awards.

Declaring that Black's opinion was mostly dicta, the Second Circuit propounded its own standard of "evident partiality" in *Morelite Construction Corp. v. NYC Dist. Council Carpenters Benefit Funds*, 748 F.2d 79 (2d Cir. 1984).

Morelite set forth a standard that required more than an appearance of bias and less than actual bias, holding that "evident partiality" will be found "where a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration."

Applying this standard, the court vacated an arbitration award because of a father-son relationship between an arbitrator and a party.

In *Scandinavian Reinsurance*, the Second Circuit applied the "reasonable person"

standard set forth in *Morelite*, vacating Judge Shira Scheindlin's decision overturning the arbitration award.

The underlying arbitration involved a dispute between Scandinavian Reinsurance and St. Paul over the interpretation of a retrocessional agreement. Before the start of the arbitration, the umpire acknowledged, on behalf of the panel, the arbitrators' ongoing duty to make disclosures.

Accordingly, the arbitrators and umpire made numerous additional disclosures throughout the arbitration. In 2009, the panel issued an award against Scandinavian.

While the St. Paul arbitration was ongoing, both St. Paul's arbitrator and the umpire were selected to serve on a panel in another reinsurance arbitration involving PMA Capital Insurance Co. and Platinum Underwriters Bermuda.

St. Paul was not a party to the Platinum arbitration, but St. Paul's business was related to that of Platinum, and Platinum had succeeded St. Paul as PMA's reinsurer.

Moreover, the core contract issue in dispute was the same in both arbitrations. Also, a witness who previously worked for both Scandinavian and Platinum testified in both arbitrations.

Neither St. Paul's arbitrator nor the umpire disclosed his involvement in the Platinum arbitration to the participants in the St. Paul arbitration. When Scandinavian discovered that the arbitrator and umpire had concurrently participated in the Platinum arbitration, Scandinavian filed a suit to vacate the award, arguing that the arbitrator's and umpire's failure to disclose their involvement with the Platinum arbitration showed the arbitrators' evident partiality.

In February 2010, Scheindlin vacated the arbitration award, noting that the arbitrator and umpire failed to disclose their involvement in the Platinum arbitration even though the two arbitrations "were presided over by two common arbitrators, overlapped in time, shared similar issues, involved related parties [and] included ... a common witness."

Scheindlin found that all these factors together amounted to an undisclosed, material conflict of interest and ruled that a reasonable person could conclude the arbitrators were improperly partial to St. Paul.

While Scheindlin purported to be applying the standard set forth in *Morelite*, the standard applied to vacate the arbitration award approximated the "appearance of bias" standard previously rejected by the Second Circuit.

It is thus not surprising that Scheindlin's decision was reversed on appeal.

Applying the "reasonable person" standard set forth in *Morelite*, the Second Circuit steered the focus away from the mere fact of nondisclosure and toward the question of

bias: “[T]he evident-partiality standard is likely to be met [where] an arbitrator fails to disclose a relationship or interest that is strongly suggestive of bias in favor of one of the parties.”

Acknowledging the clear overlap between the arbitrations, the court rejected the argument that the overlap alone was evidence of bias, noting that “the fact that one arbitration resembles another in some respects does not suggest to us that an arbitrator presiding on both is somehow therefore likely to be biased in favor of or against any party.”

Even while upholding the arbitration award, the court stressed the importance of disclosure: “Disclosure not only enhances the actual and apparent fairness of the arbitral process, but it helps ensure that that process will be final, rather than extended by proceedings like this one.”

The Standard for Evident Partiality in Other Jurisdictions

In reaching its decision in *Scandinavian Reinsurance*, the Second Circuit discussed standards for “evident partiality” in other jurisdictions.

The court invoked the standard set forth by the Ninth Circuit in *Lagstein v. Certain Underwriters at Lloyd’s, London*, 607 F.3d 634 (9th Cir. 2010) (stating an arbitrator is only required to disclose facts indicating that the arbitrator might reasonably be biased against one party in favor of another).

Quoting the Fourth Circuit in *Three S. Del Inc. v. DataQuick Info Systems Inc*., 492 F.3d 520 (4th Cir. 2007), the *Scandinavian Reinsurance* court held that a court could consider the following factors in determining whether an undisclosed relationship is indicative of bias:

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.”

In *Trustmark Ins. Co. v. John Hancock Life Ins. Co*., 631 F.3d 869 (7th Cir. 2011), the Seventh Circuit rejected a claim that a party arbitrator had a disqualifying “interest” in an arbitration simply because he had knowledge about the dispute from a prior arbitration between the same parties.

The arbitration agreement between the parties required that all three arbitrators be “disinterested.” Trustmark argued that Hancock’s arbitrator was not disinterested because he had participated in the first arbitration.

The Seventh Circuit rejected Trustmark's arguments, noting that "disinterested" means lacking a financial or other personal stake in the outcome of an arbitration.

The court acknowledged that the arbitrator, and all privately appointed arbitrators, had a reputational interest in getting future arbitration employment, but declined to view this interest as a disqualifying factor and held that the arbitrator was properly disinterested.

Although the decision did not deal with the "evident partiality" standard *per se*, the court cited case law addressing that standard in support of its decision.

Significantly, the decision is similar to *Scandinavian Reinsurance* insofar as it reflects a recognition of the business realities surrounding reinsurance arbitrations.

Trustmark explicitly referenced a key recurring issue in many reinsurance arbitrations: "[P]rivate parties often select arbitrators precisely because they know something about the controversy."

Because of the limited pool of qualified arbitrators who are knowledgeable about reinsurance, in particular, scenarios where arbitrators will sit on panels in related and substantially similar reinsurance disputes will undoubtedly continue to occur.

In contrast to *Scandinavian Reinsurance* and *Trustmark*, there are other recent decisions addressing "evident partiality" which are not so sensitive to the business realities surrounding arbitrations.

In *Dealer Computer Services Inc. v. Michael Motor Co. Inc*., 761 F. Supp.2d 459 (S.D. Tex. 2010), the arbitrator disclosed she had previously participated on an arbitration panel in a dispute involving Dealer Computers. However, the arbitrator failed to disclose the previous dispute involved an identical clause in a similar contract.

According to the Fifth Circuit, evident partiality "may be based on nondisclosure of information by an arbitrator if it involves a significant compromising connection to the parties."

Because the arbitrator had previously signed an opinion relating to the interpretation of the contract provision at issue, the court found that the arbitrator's prior involvement created a reasonable impression that she had prejudged the issues in the second arbitration. The court vacated the award.

In *Amoco D.T. Co. v. Occidental Petroleum Corp*., 343 S.W.3d 837 (Tex. App. Ct. 2011), the court applied an "appearance of bias" standard in vacating an arbitration award in favor of Amoco and Shell Oil Co. on the ground that their party arbitrator failed to disclose that his law firm had represented Shell prior to the arbitration and represented several Amoco-affiliated entities during the pendency of the arbitration.

In contrast to the Second Circuit's analysis in *Scandinavian Reinsurance*, the court stated that "nondisclosure is, without more, sufficient to establish partiality regardless of whether the undisclosed information necessarily proves partiality or bias."

Despite the differing standards applied by the courts addressing the "evident partiality" standard in arbitrations, the one point of agreement which emerges from the case law is the importance of disclosure. Where there is doubt about whether to make a disclosure, an arbitrator should err on the side of caution and fully disclose any known conflicts of interest.

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