Evident Partiality

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Section 10(a)(2) of the Federal Arbitration Act

Under the Federal Arbitration Act, there is no provision for pre-award removal of an arbitrator for alleged bias. Some cases have suggested that allowing challenges during the arbitration 'could have the disadvantage of enmeshing district courts in endless peripheral litigation and ultimately vitiate the very purpose for which arbitration was created'. While a party in a US arbitration must assert an objection to avoid waiving it, he may not and need not immediately go to court to resolve it.

The sole remedy for bias of an arbitrator is set forth in section 10(a)(2) of the Act, which provides that an award may be vacated 'where there was evident partiality or corruption in the arbitrators, or either of them'.

The starting point for any discussion of section 10(a)(2) is the decision of the Supreme Court in *Commonwealth Coatings Corp. v. Continental Cas. Co*., 393 U.S. 145 (1968). There, the Court vacated an arbitration award under Section 10(a)(ii)where the third arbitrator—'the supposedly neutral member of the panel'—had failed to disclose a prior business relationship between himself and one of the parties. The third arbitrator, an engineering consultant, had provided consulting services to the prevailing party in the arbitration, 'involving fees of about $12,000 over a period of four or five years' and included 'the rendering of services on the very projects involved in this lawsuit.'.

There was no majority opinion in Commnwealth Coatings – only a plurality opinion by Justice Black and a concurring opinion by Justice White. Since then, courts have struggled to deduce, from the 'less than pellucid' opinions in Commonwealth Coatings, what standards to apply to claims of evident partiality and failure to disclose.

Morelite Definition of "Evident Partiality"

Regarding evident partiality, writing upon a 'relatively clean slate', the Second Circuit in *Morelite Constr. Corp.* v. *New York City Dist. Council Carpenters Ben. Funds,* 748 F.2d 79 (2d Cir. 1984), concluded that 'the standard of "appearance of bias" is too low for the invocation of section 10, and "proof of actual bias" too high'. The court stated the appropriate standard as follows:

> *[W]e 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. In assessing a given relationship, courts must remain cognizant of peculiar commercial practices and factual variances. Thus, the small size and population of an industry might require a relaxation of judicial scrutiny, while a totally unnecessary relationship between arbitrator and party may heighten it. In this way, we believe that the courts may refrain from threatening the valuable role of private arbitration in the settlement of commercial disputes, and at the same time uphold their responsibility to ensure that fair treatment is afforded those who come before them.*

In *Morelite*, the Court vacated an arbitration award rendered in favor of a union by a sole arbitrator whose father was the president of that union. The court said:

> *[W]ithout knowing more, we are bound by our strong feeling that sons are more often than not loyal to their fathers, partial to their fathers, and biased on behalf of their fathers. We cannot in good conscience allow the entering of an award grounded in what we perceive to be such unfairness.*

Criteria for evaluating claims of bias

Since Morelite, courts in the Second Circuit have developed strict criteria for evaluating claims of alleged bias:

> *To set aside an award for arbitrator partiality, 'the interest or bias . . . must be direct, definite and capable of demonstration rather than remote, uncertain, or speculative'. The appearance of bias does not satisfy the standard of 'evident partiality'. . . . Instead, in evaluating the purported bias of an arbitrator, the courts look at:*
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> 1) *the financial interest the arbitrator has in the proceeding;*
> 2) *the directness of the alleged relationship between the arbitrator and a party to the arbitration proceeding;*
> 3) *and the timing of the relationship with respect to the arbitration proceeding.*

Criteria for evaluating claims of bias

Apart from *Morelite*, only one case in the Second Circuit appears to have vacated an award for evident partiality upon grounds *not* involving a failure to disclose.

In Sun Refining & Marketing Co. v. Statheros Shipping Corp., the district court, in a decision affirmed by the Second Circuit, vacated a maritime arbitration award where it found that:

a) the chairman of the panel was extensively and personally involved in an ongoing arbitration by the company that employed him against the losing party in the arbitration;

b) the chairman and the arbitrator appointed by the prevailing party had allocated arbitration fees unevenly to increase their own fees at the expense of the arbitrator appointed by the losing party.

Requirement of disclosure

For many years after *Commonwealth Coatings*, courts in the Second Circuit were extremely reluctant to vacate arbitration awards based upon the alleged non-disclosure of a relationship with a party.

The first such case was *AIMCOR. v. Ovalar Makine Ticaret Ve Sanayi, A.S.* 492 F.3d 132 (2d Cir. 2007). There, AIMCOR appealed from a district court judgment granting Ovalar's motion to vacate the award. The dispute concerned the distribution of profits from a joint venture in which AIMCOR purchased petroleum coke and transported it to Turkey for distribution there by Ovalar. The parties each appointed arbitrators who, in turn, selected as chairman Charles Fabrikant, President and CEO of Seacor Holdings, a multibillion dollar company with 50 offices in 30 countries. (In addition to being a successful businessman, Fabrikant graduated from Columbia Law School in 1968 and clerked for Justice Harlan, one of the dissenting justices in *Commonwealth Coatings*.)

In September 2003, before hearings started, the arbitrators were advised that AIMCOR was being sold to Oxbow Corporation and that this might be relevant to disclosure. In September 2003, Fabrikant submitted a disclosure statement stating that he 'ha[d] had no personal or business relationship with any of the parties to this proceeding, or their affiliates', and would 'reserve the right to amend or add to this disclosure should future circumstances warrant'

In April 2005, after commencement of hearings in the liability phase of the arbitration, Fabrikant amended his disclosure to advise the parties that SCF, a subsidiary of his company, was discussing with Oxbow a contract for the carriage by barge of petroleum coke, that he was not involved in the discussions and that he did not get involved in day to day operations.

Requirement of disclosure

There was no objection from Ovalar and no further disclosure by Fabrikant. Five months later, in September 2005, the panel issued a 2-1 award in favor of AIMCOR on liability.

Ovalar then hired new lawyers, who retained a consultant to inquire into the relationship between SCF and Oxbow. The consultant spoke to an SCF employee and a tugboat operator and was advised, among other things, that SCF had been providing barges to Oxbow for shipments of petroleum coke for about a year and had been soliciting additional business. Armed with this information, Ovalar's lawyers wrote to the tribunal in November 2005 and asked that Fabrikant withdraw. Fabrikant declined to do so.

He stated that, at the time of his disclosure of the discussions between SCF and Oxbow, he told the president of SCF that he 'wished to know nothing about SCF's conversations or be a party to information about our activities with Oxbow or be consulted concerning any business with them'. He further advised that, after receiving Ovalar's letter, he had confirmed that SCF had chartered barges to Oxbow since December 2004, continued to do so and had received revenues from contracts with Oxbow of '$274,770, approximately one-third of one percent of SCF's revenues and an imperceptible fraction of SEACOR's total business'.

Thereafter, AIMCOR filed an action to confirm the liability award and Ovalar moved to vacate.

Requirement of disclosure

The Second Circuit upheld a district court decision vacating the award, but employed a different standard from the district court for evaluating the conduct of the arbitrator

The Court of Appeals began its analysis by stating the basis for the obligation to disclose, explaining it in terms of the test for evident partiality established in *Morelite*:

> *Failure to disclose a material relationship with a party that is known to the arbitrator is 'evident partiality' because a reasonable person 'would have to conclude' that an arbitrator who failed to make such disclosure was partial to the party with whom he had the relationship.*

Duty to investigate

The court then announced a new ground in the Second Circuit for the vacation of arbitral awards under section 10(a)(2):

> *However, our analysis does not end there. While the presence of actual knowledge of a conflict can be dispositive of the evident partiality test, the absence of actual knowledge is not. Indeed, in Morelite, we did not address the scope of an arbitrator's duty to investigate or disclose potential conflicts of interest. We now conclude that if we are to take seriously Justice White's statement that 'arbitrators are not automatically disqualified by a business relationship with the parties before them if both parties are informed of the relationship in advance, or if they are unaware of the facts but the relationship is trivial,' . . . arbitrators must take steps to ensure that the parties are not misled into believing that no nontrivial conflict exists.* ***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 investigat****e.*
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> *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.***

Decisions since AIMCOR

In subsequent cases, the Second Circuit has refused to vacate arbitral awards based upon arbitrator non-disclosure.

In *Scandinavian Reinsurance Co. Ltd. v. Saint Paul Fire and Marine Ins. Co*., 668 F.3d 60 (2d Cir. 2012), the Second Circuit held that failure of two arbitrators in a reinsurance arbitration to disclose their concurrent service as arbitrators in another, arguably similar, arbitration did not constitute "evident partiality" within meaning of Federal Arbitration Act (FAA).

> *"We conclude that, under the circumstances of this case, the fact of Dassenko's and Gentile's overlapping service as arbitrators in both the Platinum Arbitration and the St. Paul Arbitration does not, in itself, suggest that they were predisposed to rule in any particular way in the St. Paul Arbitration. As a result, their failure to disclose that concurrent service is not indicative of evident partiality. We therefore reverse and remand with instructions to the district court to confirm the award."*

More recently, in *Certain Underwriting Members of Lloyds of London v. Florida, Dept of Financial Services*, 892 F3d 501 (2d Cir. 2018), the Second Circuit **rejected a claim of evident partiality based on the failure of a party appointed arbitrator to disclose close relationships with former and current directors and employees of the party that had appointed him.**

The court held for the first time that a ***different stnadard*** applied to claims of evident partiality on the part of party appointed arbitrators,

> *We respectfully part ways with the district court, and instead **join the circuits that distinguish between party-appointed and neutral arbitrators in considering evident partiality.** This distinction is salient in the reinsurance industry, where an arbitrator's professional acuity is valued over stringent impartiality. It also meshes with our case law and takes into account the FAA, which restricts "evident partiality" as opposed to "partiality" or "appearance of bias."*
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> *That said, a party-appointed arbitrator is still subject to some baseline limits to partiality. We decline to catalogue all "material relationship[s]" that may bear upon the service of a party-appointed arbitrator.... But it can be said that an undisclosed relationship is material if it violates the arbitration agreement.. In this case, the qualification in the contract is "disinterested," which would be breached if the party-appointed arbitrator had a personal or financial stake in the outcome of the arbitration..... An undisclosed fact is also material, and therefore warrants vacatur, if the party opposing the award can show that the party-appointed arbitrator's partiality had a prejudicial effect on the award*

Takeaways

- Under US law as applied by federal courts in New York, the scope for challenges based on bias is extremely limited. There is no procedure for the pre-award resolution of such challenges to arbitrators. Hence, objections on the ground of alleged bias may loom over an arbitration—a situation that in English law would be considered to exert 'unfair and undue pressure' on the arbitrators. It would be preferable if the FAA required resolution of such challenges at the beginning of a case.

- In the US, the majority of courts will not enforce arbitral institution rules on disclosure or bias and will not vacate awards for the breach of those rules. See e.g. AIMCOR, in which the court held that violation of "appearance of impropriety" standard in the AAA Code of Ethics for Arbitrators did not warrant vacatur of an award. See also. ANR Coal Co., Inc. v. Cogentrix of N.C., Inc., 173 F.3d 493 at 499 (4th Cir. 1999); Merit Ins. Co. v. Leatherby Ins. Co., 714 F.2d 673 at 680-81 (7th Cir. 1983).

- But see *Certain Underwriting Members of Lloyd*s (holding that failure to disclose relationships which may have resulted in the breach of a qualification of disinterestedness could be ground for vacatur.) Is the provision of the SMA Rules that "No Arbitrator shall accept an appointment or sit on a Panel, where the Arbitrator or the Arbitrator's current employer has a direct or indirect interest in the outcome of the arbitration." a qualification of disinterestedness?