Arbitration Nuts & Bolts: Vacating Arbitration Awards ? Part III.B: Evident Partiality (Enforcing the Parties' Expectations of Neutrality)

Introduction

Part III.A of the evident partiality segment of this series discussed the parties' reasonable expectations of neutrality. Today we consider how those expectations are enforced.

?Evident partiality? challenges typically arise out of one of two scenarios. First, there are ?presumed bias? cases in which the arbitrator's relationship to the parties or the controversy would lead a reasonable person to conclude that the arbitrator was biased, even though the challenger cannot prove actual bias. Second, there are evident partiality challenges based on allegations of actual bias. For example, suppose a neutral said on the record during the proceedings prior to deliberations: "Party A, frankly I have distrusted your company's business motives for many years, but hearing your witnesses' testimony has simply confirmed what I've suspected all along.? While the chances of an arbitrator making such a statement (let alone on the record) are exceedingly slim to non-existent, it would provide the basis for an evident partiality challenge (which would probably succeed) based on proof of actual bias.

The difference between ?presumed? and ?actual? bias is simply one of proof. One is based on circumstantial evidence and the other on direct evidence. Our focus will be on ?presumed bias? cases, because they arise with greater frequency. Actual bias is very difficult to prove, and if it or something approaching it can be established, then that proof would in any (or most any) event meet the standards necessary to establish evident partiality.

Enforcement of the Parties' Expectations of Neutrality Through the Disclosure Process

There are three procedural problems with presumed bias cases. First, courts generally cannot entertain an evident partiality challenge until the arbitrators issue a final award and the challenging party makes a timely motion to vacate, and the Federal Arbitration Act does not expressly provide procedures designed to ensure the parties' expectations of neutrality are protected during the arbitrator selection process or any other time prior to a final award. Second, the selection process is the juncture at which the parties' expectations of neutrality are most vulnerable to frustration and the period during which the parties are best positioned to protect those expectations. Third, the arbitrators themselves have the most ready access to the information the parties need to protect their expectations of neutrality.

To protect the parties' expectations of neutrality during the selection process, the United States Supreme Court imposed the now-familiar requirement that arbitrators disclose at the outset of the proceedings non-trivial conflicts of interest (such as ongoing business relationships with one of the parties) and any other relevant information bearing on the arbitrator's ability to meet the parties' expectations of neutrality. See **Commonwealth Coatings Corp. v. Continental Cas. Co**., 393 U.S. 145 (1968). At least two circuits have added to that disclosure requirement an affirmative duty on the part of a neutral arbitrator to investigate when there is reason to believe a nontrivial conflict might exist. See **Applied Materials Indus. Corp. v. Ovalar Makine Ticaret ve Sanayi, A.S**., 492 F.3d 132, 138 (2d Cir. 2007) (2d Cir. 2007); **New Regency Productions, Inc. v. Nippon Herald Films**, 501 F.3d 1101, 1111 (9th Cir. 2007).

A neutral arbitrator's failure to disclose a conflict of interest of which he or she is deemed to have knowledge can result in vacatur of an award on evident partiality grounds without any showing that the arbitrator was actually biased or that the award resulted from bias. Indeed, as the Seventh Circuit observed, if an arbitrator unduly frustrates a party's access to information pertinent to whether he or she has the requisite degree of neutrality, there may be grounds for vacatur based not only on evident partiality, but also on the arbitrator exceeding his or her powers: ?[f]ailure to comply with a[n] [express or implied] contractual requirement designed to facilitate the search for an acceptable neutral might imply that the neutral exceeded his authority, spoiling the award under 9 U.S.C. § 10(a)(4).? **Sphere Drake Ins. Co. v. All American Life Ins. Co**., 307 F.3d 617, 623 (7th Cir. 2002), reh'g denied, Nov. 4, 2002, cert. denied, 538 U.S. 961 (2004).

The flip side of the disclosure rule is that it provides an opportunity for the parties to vet and waive at the outset conflicts of interest that might otherwise provide the basis for a losing party to challenge the award. If the arbitrator discloses a potential conflict, and a party fails to object, that party usually waives its right to challenge a later award based on the disclosed conflict. See, e.g., **Kiernan v. Piper Jaffray Cos**. 137 F.3d 588, 593-94 (8th Cir. 1998); **Cook Indus. v. Itoh & Co.**, 449 F.2d 106, 107-08 (2d Cir. 1971), cert. denied, 405 U.S. 921 (1972).

Early vetting coupled with the waiver rule reduces the risk that time and expense will be invested in a proceeding that yields an award subject to vacatur. Before the parties know the outcome of the arbitration, they are more likely to consider a potential conflict to be trivial and waive it. But if undisclosed and not discovered until after an award has been issued, the losing party may understandably perceive the potential conflict to be more serious than it was, and move to vacate the award. The motion may not be successful, but it may not be utterly frivolous either, and the parties and the court will end up incurring time and money costs.

Disclosure by Appointed Arbitrators

At least in reinsurance arbitrations, appointed arbitrators are generally expected to disclose their relationships with the parties even though they are usually expected to be, at least to some degree, partial to the appointing party. Whether or not these disclosures are required by Commonwealth Coatings is an open question and at least one circuit has suggested the answer is ?no.? See **Winfrey v. Simmons Foods, Inc**., 495 F.3d 549, 552 (8th Cir. 2007).

Because the parties' expectations of party-appointed arbitrator neutrality are not very high (absent contract language or agreed arbitration rules to the contrary), party-appointed arbitrator disclosures will ordinarily not yield anything to support a successful evident partiality challenge. And a party-appointed arbitrator's nondisclosures will generally not deprive the other party of information relevant to arbitrator selection, since appointed arbitrators are unilaterally and privately selected by the appointing party, and the other party generally has no say in matter as long as the arbitrator is otherwise qualified to serve.

But at least one important purpose is arguably served by party-arbitrator disclosure. The information the appointed-arbitrators disclose may be useful to their colleagues ? especially the neutral ? in determining what to make of the positions taken by the arbitrators in deliberations. A failure to disclose that information might, in appropriate circumstances, establish that the arbitrator exceeded his powers under Section 10(a)(4) of the FAA. Cf. Sphere Drake, 307 F.3d at 623 (?We have not been given any reason to think that umpire Huggins wanted more information from [party-appointed arbitrator] Jacks in order to know what to make of Jacks' arguments during deliberations.?); Winfrey, 495 F.3d at 552 ("Simmons presents no evidence indicating that Butler's partiality deceived or misled the other two arbitrators.?).

Asserting Evident Partiality

In presumed bias cases there are typically two scenarios that give rise to a motion to vacate. First, an arbitrator may disclose a conflict of interest that one of the parties considers indicative of evident partiality. Assuming that a party timely objects to the conflict, the arbitrator does not voluntarily step down, the arbitrators make an award adverse to the objecting party, and the party timely moves to vacate, then the objecting party can legitimately challenge the award on evident partiality grounds.

Second, an arbitrator may fail to disclose an actual or potential conflict of interest, which is subsequently discovered by one of the parties who promptly objects. That party may also legitimately move to vacate the award based on evident partiality grounds.

Establishing Evident Partiality: Applicable Standards

Whether the case involves disclosure or nondisclosure, the potential conflict and its surrounding circumstances must be assessed to determine whether the award should be vacated. Defining a workable standard to assess evident partiality challenges is difficult, and perhaps impossible. The circuits have formulated various "tests" running the gamut from ?a reasonable person, considering all the circumstances, would have to conclude? the arbitrator was partial, to a standard which, for all intents and purposes, permits vacatur where the alleged conflict creates an ?appearance of bias.? Compare **Schmitz v. Zilveti**, 20 F.3d 1043, 1047-48 (9th Cir. 1994)

(adopting "reasonable impression of partiality? test which it construed as functional equivalent of ?appearance of bias?) with Ovalar, 492 F.3d at 137-38 ("[A]rbitrator is disqualified only when a reasonable person, considering all of the circumstances, would have to conclude that an arbitrator was partial to one side;? test satisfied where the ?arbitrator knows of a material relationship with a party and fails to disclose it.?); see also Philip J. Loree Jr. & Costas Frangeskides, Arbitration Practice and Procedure in U.S. and U.K. Reinsurance Disputes: Is the Grass any Greener on the Other Side of the Pond?, AIRROC Matters, Vol. 4 No. 1, at 24, 42-43 n.21-22 (Spring 2008) (Part 1) (citing cases) (copy available **here**).

None of these ?tests? is a consistently useful indicator of the outcome of a given case. Reasonable people applying the tests may reach different conclusions based on the same facts, and outcomes may be influenced by fact-dependant policy considerations. The relative strictness or laxity of a test, however, may indicate how predisposed a circuit might be toward granting relief on evident partiality grounds.

But irrespective of how each test may be worded, whether the parties' expectations of neutrality have been thwarted is a significant, underlying, and sometimes unspoken, consideration. For example, as discussed in Part III.A, when the parties use tripartite arbitration without agreeing on whether, and if so, to what extent, the party-appointed must be neutral, disinterested or independent, then a court will likely conclude that the parties expected the party-appointed arbitrators to be non-neutral and (a) conclude vacatur is inappropriate even if the arbitrator would be deemed evidently partial were he or she a neutral; (b) require the challenging party to show prejudice resulting from the evident partiality; or (c) figure into the evident partiality calculus the parties' diminished expectations of partiality. (See Part III.A., **here**, and cases cited.)

One important caveat is that a conflict remains a conflict whether or not it is disclosed, and irrespective of what the arbitrator's subjective state of mind might be. Suppose a neutral arbitrator owned a 25% equity interest in one of the parties, a closed corporation. The neutral discloses the conflict and says his ownership will not affect his ability to act as a neutral. And suppose that the neutral firmly believes what he says despite his rather significant financial interest in the matter over which he is asked to preside. One of the parties objects, the panel rules against the objecting party, and ? although no one can prove or disprove it ? the umpire acts completely impartially and gives the losing party the benefit of every doubt. Under these facts the party challenging the award would have a strong (some might say surefire) motion to vacate under the law of every (or virtually every) circuit.

Conversely, failure to disclose a potential conflict does not provide a basis for an evident partiality challenge unless the potential conflict turns out to be an actual conflict or something awfully close to one. We hedge here because there may be relationships between an arbitrator and a party that are material to the evident partiality calculus, but which, in and of themselves, may not qualify as actual conflicts. The United States Court of Appeals for the Second Circuit indicated that the test for evident partiality can be satisfied where the arbitrator ?knows of a material relationship with a party and fails to disclose it,? because ?[a] reasonable person would have to conclude that an arbitrator who failed to disclose under such circumstances was partial to one side.? See Ovalar, 492 F.3d at 137-38. That suggests to us that the Second Circuit (and perhaps other circuits) will place some weight on the circumstances surrounding the non-disclosure itself in determining whether, based on all of the circumstances, the test for evident partiality is satisfied.

We hope we have provided you with some useful, general information concerning evident partiality. In Part IV. of this series we address Federal Arbitration Act Section 10(a)(3), which authorizes vacatur where a party was prejudiced by an arbitrator's procedural misconduct.