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DISQUALIFYING ARBITRATORS FOR FAILURE TO MAKE COMPLETE DISCLOSURES AFTER *SCANDINAVIAN RE V. ST. PAUL RE: WHAT IS “EVIDENT PARTIALITY”?*

By Keith A. Dotseth

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Following the Southern District of New York’s decision in the *Scandinavian Reinsurance Co., Ltd. v. St Paul Fire & Marine Insurance Company* case,¹ commentators involved in arbitrations around the world vigorously debated whether the decision marked the entry into a new era of full arbitrator disclosures, allowing parties to be fully



Keith A. Dotseth is one of the founding partners of Larson King, LLP. Throughout his career he has devoted his practice to complex civil

litigation and strategic counseling. He has participated in some of the most significant litigation, arbitration and crisis management challenges over the last two decades. Keith is a frequent speaker on reinsurance and insurance topics. He is a Fellow of the American Bar Foundation and is a Vice Chair of the IADC Insurance and Reinsurance Committee

informed of any significant connection the arbitrator had with the potential witnesses or issues likely in dispute. Meanwhile, other commentators charged that the decision was the beginning of the end for the arbitration system, suggesting that requiring such full disclosures, arguably greater than that required of federal court judges, would doom arbitration by foreclosing parties from obtaining arbitrators who were knowledgeable and experienced in the field over which they presided. Needless to say, now that the Second Circuit has reversed the Southern District of New

¹ 732 F. Supp.2d 293 (S.D.N.Y. 2010).

York's decision, *Scandinavian Reinsurance Co., Ltd. v. St Paul Fire & Marine Insurance Company*,² it is possible the hues and cries from both sides of the aisle will again rise up.

Rather than engage in the overwrought debates about whether the decision offers extreme hope or doom, this brief note seeks to offer a straight-forward discussion of what really was decided in the *Scandinavian Re* case and what realistic lessons can be taken from the decision. Viewed from a more tempered lens, the recent pronouncement from the Second Circuit does offer additional guidance for those looking to determine whether a particular arbitrator has demonstrated sufficient "evident partiality" to justify disqualification or possible vacatur of an arbitration award. And, it adds a worthwhile caution for arbitrators to provide a full and fair disclosure of their relevant background.

The Boundaries of "Evident Partiality"

The Federal Arbitration Act (FAA) allows federal district courts to vacate an arbitration award under Section 10(a)(2) "where there was evident partiality or corruption in the arbitrators, or either of them." There are a variety of decisions interpreting this particular portion of the FAA and offering a broad array of different standards that might be applied by a court considering whether to vacate an arbitration award. All of these decisions seek to define what level of misconduct or bias satisfies the notion of "evident partiality." Whether a failure to make a timely or full disclosure can

constitute "evident partiality" is a much more narrow inquiry. But, it has not produced a much more narrow set of standards from the courts.

The United States Supreme Court's *Commonwealth Coatings Corp. v. Continental Casualty Co.*³ decision considered the question of whether a failure of an arbitrator to disclose a financial relationship between himself and the prevailing party was sufficient to justify vacating the arbitration award due to "evident partiality." In that case, the arbitrator had conducted "repeated and significant" business with the prevailing party, including being involved in providing services for one of the specific projects that was a subject of the dispute being arbitrated. The Supreme Court found the failure to disclose the "repeated and significant" financial relationship presented sufficient evidence of "evident partiality" to support vacating the arbitration award under the FAA Section 10(a)(2) standards.

Significantly for the host of courts seeking to interpret the "evident partiality" standard as applied in *Commonwealth*, the decision reached by the Supreme Court was by a vote of six justices, with the court issuing both a plurality opinion and a concurring opinion. As a result, subsequent courts have been left to determine whether the plurality or the concurrent opinions fully describe the basis for the Court's decision.

The differences between the plurality and concurrent opinions are not slight. In the opinion for the plurality, written by Justice Black, the Court declared under

² 2012 WL 335772 (2d Cir. Feb. 3, 2012).

³ 393 U.S. 145 (1968).

Section 10(a)(2) that arbitrators “not only must be unbiased but also must avoid even the appearance of bias.”⁴ The plurality opinion categorically declared that arbitrators are required to “disclose to the parties any dealings that might create an impression of possible bias.”⁵

The concurrence, on the other hand, while supporting the conclusion that the particular failure of the arbitrator to disclose the “repeated and significant” financial relationship justified vacatur of the arbitration award, declined to go so far as the plurality in suggesting that an arbitrator had a broader obligation to avoid the impression of possible bias. The concurrence, written by Justice White, instead stated: “The Court does not decide today that arbitrators are to be held to the standards of judicial decorum of Article III judges, or indeed of any judges.”⁶ Instead, Justice White declared, it was “enough for present purposes to hold, as the Court does, that where the arbitrator has a substantial interest in a firm which has done more than a trivial business with a party, that fact must be disclosed.”⁷

Given that the *Commonwealth* decision was the singular opportunity that the Supreme Court has had to consider whether a failure by an arbitrator to disclose a potentially concerning relationship with one of the parties was sufficient to establish “evident partiality,” federal courts have reached varying interpretations of this issue. While some courts have given effect to the plurality opinion, requiring arbitrators to make

disclosures of any relationship that would raise an impression of possible bias, others have declined to adopt the plurality, declaring that the concurring opinion was the controlling decision.

One of the most frequently cited decisions adopting the concurring opinion approach from *Commonwealth* is the Second Circuit’s decision in *Morelite Constr. Corp. v. NYC Dist. Council Carpenters Benefit Funds*.⁸ In *Morelite*, the Second Circuit stated that vacatur on grounds of “evident partiality” required something more than “the mere ‘appearance of bias’,” as suggested by the plurality opinion in *Commonwealth*, but also could not “countenance the promulgation of a standard of partiality as insurmountable as ‘proof of actual bias’ – as the literal words of Section 10 might suggest.”⁹ Instead, *Morelite* declared:

If the standard of “appearance of bias” is too low for the invocation of Section 10 and “proof of actual bias” is too high, with what are we left? Profoundly aware of the competing forces that have already been discussed [including the trade-off between expertise in the relevant industry and pure impartiality], we hold that “evident partiality” within the meaning of 9 U.S.C. Section 10 will be found where a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration.¹⁰

⁴ *Id.* at 150.

⁵ *Id.* at 149.

⁶ *Id.* at 151-152.

⁷ *Id.*

⁸ 748 F.2d 79 (2d Cir. 1984).

⁹ *Id.* at 84.

¹⁰ *Id.*

While offering a compromise approach, the “reasonable person” standard has left much room for debate and disagreement.

It is within this background that the United States District Court and the Second Circuit considered the facts presented by *Scandinavian Re* and the failure of those arbitrators to make a full and complete disclosure of their relationships with the parties, witnesses and issues. Regardless of which side of the dispute one might take, there can be no doubt that the courts’ consideration of the particular facts arising in the *Scandinavian Re* arbitration present some opportunities for further enlightenment on this issue.

Facts Arising in *Scandinavian Re* and the District Court Ruling

The *Scandinavian Re* dispute arose from the undisclosed involvement of arbitrators in two different, simultaneous arbitrations involving a common witness, two common arbitrators and similar issues. St Paul Reinsurance Company, Ltd. and St. Paul Re, Ltd. filed a demand for arbitration against Scandinavian Reinsurance Company, Ltd. seeking to recover losses arising from a stop loss retrocessional agreement. After arbitrators were selected to preside over the arbitration, the arbitrators made detailed disclosures of their involvement with the parties, counsel for the parties and each other. In addition, each of the arbitrators recognized an obligation to make ongoing disclosures.

Meanwhile, while the St. Paul Re arbitration was underway, a separate arbitration was demanded by Platinum

Underwriters Bermuda, Ltd., a reported successor in interest to St. Paul Re, against another reinsurer, PMA Capital. In the second-initiated arbitration by Platinum, there were many commonalities with the prior St. Paul Re proceeding. In particular:

The same arbitrator was appointed by Platinum and St. Paul Re; The same umpire was selected in the two proceedings; A past employee of Platinum testified in both proceedings; Many of the legal issues being considered were the same.

Added to these similarities was the fact that Platinum, St. Paul Re and their affiliates, had many close, financial relationships during all relevant times.

Although the arbitrators in the St. Paul Re initiated proceeding, including the two arbitrators who were also involved in the Platinum arbitration, continued throughout the proceeding to make ongoing disclosures of connection they had with the parties, counsel or issues, neither of the arbitrators mentioned anything about the fact that they were simultaneously involved in the Platinum arbitration with the same witness and same legal issues.

Shortly after the arbitration panel issued an award in favor of St. Paul Re, Scandinavian Re learned for the first time that the two arbitrators were simultaneously serving in the Platinum arbitration but failed to disclose this concurrent service. Scandinavian Re filed a petition to vacate the award pursuant to Section 10(a)(2) of the FAA, citing “evident partiality.”

The District Court held that the arbitrators' participation in the second arbitration was, in the particular circumstances of the case, a material conflict of interest that should have been disclosed, notwithstanding the arbitrators' alleged good faith belief that they would not be influenced by any information learned during the other arbitration.¹¹ The Court found that St. Paul Re and Platinum had a "substantial relationship" and that, by participating in the two arbitrations that overlapped in time, shared similar issues, involved related parties and included a common witness, the arbitrators placed themselves in a position where they could receive ex parte information, be influenced by credibility determinations made regarding the single, common witness, and influence each other's thinking and deliberations on the common issues. It further held that the failure to make appropriate disclosures had deprived Scandinavian Re of the opportunity to object to the arbitrators' simultaneous service. Finally, the Court concluded that the arbitrators' affirmative declarations that they in good faith believed they could remain impartial was not relevant since "evident partiality" was judged based on an objective standard and the arbitrators had an obligation to make the disclosures. The Court, thus, vacated the arbitration award, directing the parties to submit the dispute to a newly formed panel.

This decision, alleged by some as marking a new "high water mark" for the obligations of arbitrators to make full and complete disclosures, provoked much debate and discussion within various

arbitration communities. Some declared the decision as a welcomed reaffirmation of Justice Black's description of the obligations of arbitrators to be mindful of the appearance of bias. On the other hand, other commentators declared that the standards of disclosure endorsed by the District Court would force parties to only use arbitrators that had no possible connection with the parties or issues, thus stripping arbitration of the benefit of arbitrators who had extensive experience within the relevant industry.

Second Circuit Ruling: New Clarity?

Against this swirling background, the Second Circuit considered the appeal taken of the District Court's decision. The Second Circuit concluded that the arbitrators' overlapping service did "not, in itself, suggest that they were predisposed to rule in any particular way in the St. Paul arbitration," and that their failure to disclose this overlapping service could not, therefore, constitute evident partiality on its own. As a result, it overturned the District Court decision and reinstated the arbitration award. *Scandinavian Reinsurance Co. v. St. Paul Fire & Marine Ins. Co.*¹²

To establish "evident partiality," the Second Circuit adopted as a nonexclusive list, the following guideposts:

The extent and character of the personal interest, pecuniary or otherwise, of the arbitrator in the proceedings; The directness of the relationship between the arbitrator and the party he is

¹¹ 732 F. Supp.2d 293 (S.D.N.Y. 2010).

¹² 2012 WL 335772.

alleged to favor; The connection of that relationship to the arbitrator; and The proximity in time between the relationship and the arbitration proceeding.¹³

This list, which the Second Circuit openly adopted from the Fourth Circuit, provides needed additional guidance for future proceedings considering “evident partiality” in general, whether involving a failure of disclosure or not.

In reaching its result, the Second Circuit also offered several insights into how it intended to apply the “evident partiality” standard to allegations of a failure to make adequate disclosures. In regard the question of whether a disclosure, by itself, could support a claim of “evident partiality,” the Court stated:

The evident-partiality standard is, at its core, directed to the question of bias 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.¹⁴

Emphasizing that the Court’s focus was more on the nature of the relationship that was not disclosed than the fact that the alleged relationship had not been disclosed, the Court stated:

[W]e do not think it appropriate to vacate an award solely because an arbitrator fails to consistently live up to his or her announced standards for

disclosure, or to conform in every instance to the parties’ respective expectations regarding disclosure. The nondisclosure does not by itself constitute evident partiality.¹⁵

And, added for good measure:

Even where an arbitrator fails to abide by arbitral or ethical rules concerning disclosure, such a failure does not, in itself entitle a losing party to vacatur.¹⁶

In reaching its result, the Second Circuit seems to indicate that the focus of its “evident partiality” analysis would be on the alleged relationships (disclosed or not) and would not greatly concern itself with the mere fact that the relationship had not been previously disclosed.

It is important, however, to note that the Second Circuit was not entirely dismissive of the significance of full disclosures by arbitrators or the possible relevance of a failure to fully disclose a relationship might have on an “evident partiality” analysis. For example, in regards to the importance of full disclosure, the Court stated:

We do not in any way wish to demean the importance of timely and full disclosure by arbitrators. Disclosure not only enhances the actual and apparent fairness of the arbitral process, but it helps to ensure that the process will be final,

¹³ *Id.* at *10.

¹⁴ *Id.* at *9.

¹⁵ *Id.* at *12.

¹⁶ *Id.* at n. 22.

rather than extended by proceedings like this one.¹⁷

In addition, the Court underscored that arbitrators are still “required to disclose . . . facts indicating that he might reasonably be thought biased against one litigant and favorable to another.”¹⁸

“Evident Partiality” and Full Disclosures After *Scandinavian Re*

Now that the Second Circuit has seemingly declared a failure by an arbitrator to make a full disclosure is not, by itself, sufficient to support a finding of “evident partiality,” does this spell an end to exhaustive disclosures by arbitrators? For a variety of reasons, parties should still demand and expect full and timely disclosures by arbitrators.

First, and perhaps most important to recognize, it would seem to be an over-reading of *Scandinavian Re* to conclude that an arbitrators’ failure to make a timely and full disclosure should have absolutely no impact on a court’s analysis of “evident partiality.” Although the Court states that nondisclosure by itself does not constitute “evident partiality,” it also does expressly take pains to warn arbitrators of the importance of full disclosure to the “actual and apparent fairness of the arbitral process.” Moreover, the Court is clear that whether a relationship is “material” or “nontrivial” depends on considerations such as how strongly the relationship tends to indicate the possibility of bias in favor of or against one party. It seems obvious,

therefore, that the failure of timely and full disclosure of a relationship, which can impact actual or the appearance of fairness to one party, might in certain circumstances support a finding of “evident partiality” under the Second Circuit standards. In other words, even if a failure to disclose, by itself, did not support a finding of “evident partiality,” this does not mean that the failure to disclose a questionable relationship *taken together* with a slightly concerning relationship would not be sufficient proof of “evident partiality.”

Second, most arbitration communities have established strong ethical expectations for arbitrators to make full and timely disclosures. These ethical expectations ought to encourage, and to date certainly have encouraged, arbitrators to make full and timely disclosures regardless of the potential impact of the disclosure on a finding of “evident partiality.”

Finally, as the Second Circuit recognized in its opinion, since the obligation to make a full and timely disclosure does have the potential to directly impact the actual and apparent fairness of the arbitral process, it is expected that parties will continue to demand full disclosure by arbitrators and will be less and less likely to turn to arbitrators who routinely fail to make appropriate disclosures. In this sense, the self-policing function of each arbitration community likely would be sufficient to encourage arbitrators to keep making full and timely disclosures.

In the end, regardless of one’s views of the significance of *Scandinavian Re* and the potential impact of arbitrator disclosures to the determination of

¹⁷ *Id.* at *13.

¹⁸ *Id.* at *9.

“evident partiality,” it continues to remain true that nearly all, ethical arbitrators will still voluntarily make timely and full disclosures of all relevant relationships they have to the parties, issues, counsel and witnesses. After all, it simply is the right thing to do.

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