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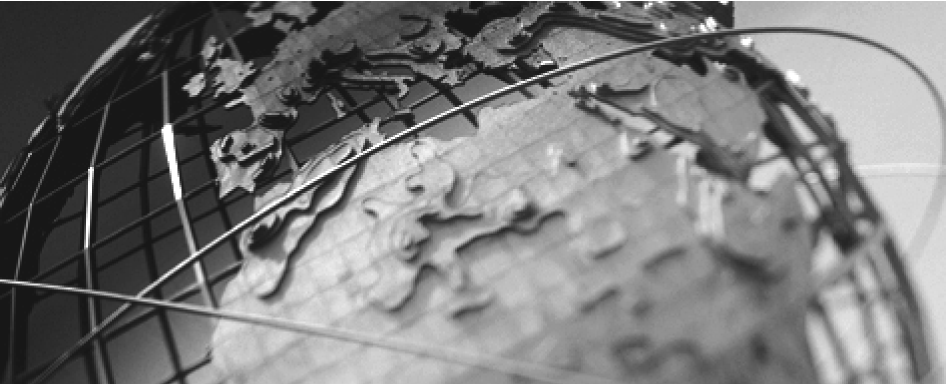

CHALLENGES TO ARBITRATORS IN THE UNITED STATES OF AMERICA

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Federal Arbitration Act

- Federal Arbitration Act - 9 United States Code, Section 1 *et seq.*
- No express reference to challenges to arbitrators.
- Section 10 deals with arbitrators' impartiality in the context of grounds for vacating arbitral awards.
- "Evident impartiality or corruption" are grounds for vacating an arbitral award. Section 10(a)(2).
- There is no provision in the FAA for interlocutory judicial challenges or removal of arbitrators.

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Leading Case: *Commonwealth Coatings Corp. v. Continental Casualty Co.*

- United States Supreme Court – 393 U.S. 1112 (1968).
- 40 years since the U.S. Supreme Court considered the issue of "evident partiality" and vacatur pursuant to Section 10(a)(2) of the Federal Arbitration Act.
- The plurality opinion (Justice Black) found that vacatur was warranted because the arbitrator failed to disclose a recent business relationship with one party.

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Leading Case: *Commonwealth Coatings Corp. v. Continental Casualty Co.*

- The Court stated that arbitrators "must avoid even the appearance of bias."
- In the concurring opinion, Justice White joined by Justice Marshall, stated 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." At the same time, the concurring opinion stated that the arbitrator should "err on the side of disclosure."
- Some Federal Circuit Courts view the *Commonwealth Coating* concurring opinion as irreconcilable with the plurality opinion, which has resulted in the development of differing interpretations of the requirement of "evident partiality" by a number of Federal Circuit Courts.

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Fifth Circuit – *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*

- 476 F.3d 278 (5th Cir. 2006)
- Initially, the Court vacated the arbitration award based on the fact that the arbitrator had failed to disclose that seven years earlier he, as counsel, participated in a dispute along with seven other law firms, involving six lawsuits and 34 lawyers, among which there was a lawyer who represented New Century in the Positive Software arbitration.
- On rehearing *en banc*, the Court, relying on Justice White's concurring opinion, held that the arbitral award should not be vacated and announced a "reasonable impression of bias" standard.

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Ninth Circuit – *Schmitz v. Zilveti*

- 20 F.3d 1043 (9th Cir. 1994)
- Arbitrator failed to disclose that his law firm had represented the corporate parent of a party in multiple cases during a 35-year period, with the most recent case ending almost 2 years before the subject arbitration commenced.
- The Court adopted the "reasonable impression of bias" standard.
- Arbitrator's lack of knowledge is not sufficient to preclude a finding of a "reasonable impression of bias." The Court stated that "an arbitrator may have a duty to investigate independent of his . . . duty to disclose."

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Fourth Circuit – *ANR Coal Company, Inc. v. Cogentrix of North Carolina, Inc.*

- 173 F.3d 493 (4th Cir. 1999)
- Adopted four-factor "reasonable person" test for determining "evident partiality":
  - the extent and character of the personal interest, pecuniary or otherwise, of the arbitrator;
  - the directness of the relationship between the arbitrator and the party;
  - the connection of that relationship to the arbitration; and
  - the proximity in time between the relationship and the arbitration.
- Under the Fourth Circuit test, a party does not have to demonstrate that the arbitrator has failed to disclose because of an improper motives.

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Second Circuit – *Applied Industrial Materials Corp. v. Ovalar Makine Ticaret Ve Snayi, A.S.*

- 492 F.3d 132 (2nd Cir. 2007)
- The arbitrator failed to disclose that he had erected a "Chinese Wall" to avoid learning information that could disqualify him from being an arbitrator.
- The Court applied the "reasonable person" standard and vacated the award.

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Second Circuit – *Applied Industrial Materials Corp. v. Ovalar Makine Ticaret Ve Snayi, A.S.*

- "Arbitrators must take steps to ensure that the parties are not misled into believing that no nontrivial conflicts exist. 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 that there might be a conflict and his intention not to investigate."
- "We emphasize that we are not creating a freestanding 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 is indicative of evident partiality."
- "reasonable person looking at an arbitrator's decision not to investigate and his concomitant failure to inform the parties of the 'Chinese Wall,' would conclude that evident partiality existed."

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Scandinavian Reinsurance Company Limited v. St. Paul Fire & Marine Insurance Co.

- 732 F.Supp. 2d 293 (S.D.N.Y. 2010)
- Arbitration award vacated because two arbitrators failed to disclose their overlapping service on another arbitration panel.
- The Court found that the arbitrator's overlapping service created a "material conflict of interest" because there were overlapping issues, shared similar interests, related parties, a common witness.
- The Court stated that the arbitrators' failure to disclose is not excused even if they believed in good faith that they would not be influenced by information they learned in the course of the other arbitration.

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Second Circuit – STMicroelectronics N.V. v. Credit Suisse Securities (USA) LLC

- 2011 WL 2151008 (2nd Cir. 2011)
- After agreeing to an arbitration panel, the investment bank argued that one arbitrator had failed to disclose he had previously acted as an expert witness for customers asserting claims against financial institutions. The arbitrator refused to resign.
- A unanimous award found that Credit Suisse was liable for securities fraud.
- ST Microelectronics sought to confirm the award in federal court in New York under the FAA. Credit Suisse cross-petitioned to vacate the award. The court denied the petition to vacate and confirmed the award.
- Credit Suisse appealed to the Second Circuit and contended, relying on Section 10(a)(3) of the FAA , that the arbitrator had engaged in "other misbehavior" by failing to disclose that he had previously acted "almost exclusively . . . as a witness for customers arbitrating against financial firms." Credit Suisse also argued that the arbitrator had acted improperly by failing to disclose that he had acted for a claimant "on an issue very similar to the one that would determine the arbitration."

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Second Circuit – STMicroelectronics N.V. v. Credit Suisse Securities (USA) LLC

- The Second Circuit rejected Credit Suisse's appeal and affirmed the award. First, the Court concluded that the arbitrator had adequately disclosed his prior engagements pursuant to the FINRA rules. Second, the Court stated that the arbitrator's prior experience addressing legal issues similar to the ones presented in the underlying arbitration had not affected his impartiality.
- Notably, the Second Circuit stated that it is "virtually impossible to find a judge who does not have preconceptions about the law" and "[t]his is all the more true for arbitrators."
- *STMicroelectronics* appears to state that arbitrators must only disclose information required by the rules of the institution administering the arbitration.
- *STMicroelectronics* appears to confirm that arbitrators should not be presumed to be biased merely because they have previously expressed positions on issues raised in an arbitration.

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Conclusions

- The precise standard of impartiality and independence of arbitrators (both domestic and international) remains unsettled under U.S. law.
- Federal Circuit Courts apply different standards to determine what information an arbitrator must disclose and when nondisclosure rises to the level of "evident impartiality."
- Until the U.S. Supreme Court addresses this issue, it is critical for the parties, practitioners and arbitrators to understand that a challenge based on an allegation of evident partiality may be analyzed differently depending on the reviewing court's venue.