AMERICAS

United States

Appeals Court in New York Heightens Standard for Establishing 'Evident Partiality' of a Non-Neutral Party-Appointed Arbitrator

Andrew L. Poplinger
Counsel, Chaffetz Lindsey LLP, New York

In June 2018, the U.S. Second Circuit Court of Appeals held that non-neutral party-appointed arbitrators should not be held to the same standard of independence and impartiality as 'neutral arbitrators'. Therefore, a non-neutral party-appointed arbitrator's failure to disclose his or her relationships with the appointing party will only amount to 'evident partiality' supporting vacatur of an award under section 10(a)(2) of the Federal Arbitration Act if the challenging party shows by clear and convincing evidence that the non-disclosure violates the arbitration agreement or had a prejudicial impact on the award.

Background: The lower court vacates award due to arbitrator's 'evident partiality'

In *Certain Underwriting Members at Lloyd's of London v. Insurance Company of the Americas*, the U.S. District Court for the Southern District of New York vacated a reinsurance arbitration award on the ground of 'evident partiality' under section 10(a)(2) of the Federal Arbitration Act (FAA) based on the respondent's party-appointed arbitrator's failure to disclose its close relationships with the respondent (No. 16-CV-323(VSB), 2017 WL 5508781 (S.D.N.Y. Mar. 31, 2017); the original District Court and subsequent Circuit Court decisions are hereinafter referred to collectively as 'Lloyd's').

Under the FAA, 'evident partiality' on the part of an arbitrator is one of four exclusive statutory grounds for vacating an award governed by the FAA, which is in most cases an award issued by a tribunal seated in the United States. The district court applied the rule established 50 years ago by the U.S. Supreme Court in *Commonwealth Coatings Corp. v. Continental Casualty Company* (393 U.S. 145 (1968)) that an arbitrator's failure to disclose a material relationship with a party could demonstrate 'evident partiality' warranting vacatur of the award.

Here, the respondent's party-appointed arbitrator had failed to disclose what the district court deemed to be 'significant' relationships with the respondent. These included the respondent's former officer, also a witness in the arbitration, serving as chief financial officer of the arbitrator's company, ongoing dealings between respondent and a human resources company of which the arbitrator was president and CEO, and the respondent's former president providing consulting services to the arbitrator's company.

In considering whether these nondisclosures amounted to 'evident partiality', the district court framed the issue as follows:

> The question here is 'whether the facts that were not disclosed suggest a material conflict of interest', such that 'a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration'.

The District Court concluded the undisclosed facts suggested a conflict of interest indicative of partiality, and granted the petitioner's motion to vacate the award.

Importantly, in finding evident partiality, the district court rejected the respondent's argument that impartiality requirements did not apply in 'tripartite industry arbitrations', such as reinsurance arbitrations, where party-appointed arbitrators are drawn from a relatively small community of industry experts and expected to be partisan. Rather, the court found that the party-appointed arbitrator's 'conduct must be considered under the same evident partiality standard as is required in all arbitrations'.

The respondent appealed the decision to the United States Court of Appeals for the Second Circuit.

Decision of the Second Circuit Court of Appeals

On appeal, the Second Circuit Court of Appeals (*Certain Underwriting Members of Lloyd's of London v. Florida Dept. of Fin. Srvs*., 892 F.3d 502 (2d Cir. 2018)) reversed the district court:

> We hold that a party seeking to vacate an award under Section 10(a)(2) must sustain a higher burden to prove evident partiality on the part of an arbitrator who is appointed by a party and who is expected to espouse the view or perspective of the appointing party.

The Second Circuit thus rejected the district court's premise that all arbitrators were subject to the same standards in determining whether the arbitrator's failure to disclose a material relationship with his or her appointing party constituted 'evident partiality'. The court offered two reasons why a higher burden must be met to demonstrate a non-neutral party-appointed arbitrator's 'evident partiality' sufficient to vacate an award.

- First, the court found that the party-appointed arbitrators were not expected or intended to be entirely independent and impartial. Rather, they were 'expected to serve as de facto advocates'. According to the court:

  > [T]he ethos of neutrality that informs the selection of a neutral arbitrator to a tripartite panel does not animate the selection and qualification of arbitrators appointed by the parties.

- Second, the court emphasized that 'arbitration is a creature of contract, and courts must hold parties to their bargain'. The court noted that the FAA's 'evident partiality' standard could therefore be modified and even eliminated by the parties' agreement.

  > [P]arties are free to choose for themselves to what lengths they will go in quest of impartiality,' including various degrees of partiality that inhere in the party-appointment feature.

The court appears to have been particularly focused on this second factor. The court noted that the parties had agreed to several parameters, which were standard in reinsurance arbitrations, and indicated that the parties intended and expected that their party-appointed arbitrators would exercise a degree of partisanship. These included: choosing 'a tripartite panel with party-appointed arbitrators who are "relieved of all judicial formalities and may abstain from following the strict rules of law"', requiring as the 'only contractual qualification' for party-appointed arbitrators that they be 'disinterested' current or former insurance or reinsurance executives, and permitting *ex parte* communications between the party-arbitrators and their appointing party through much of the proceeding. The court further recognized that in the reinsurance industry, in particular, 'an arbitrator's professional acuity is valued over stringent impartiality'. Under these circumstances, the court concluded:

> [E]xpecting of party-appointed arbitrators the same level of institutional impartiality applicable to neutrals would impair the process of self-governing dispute resolution.

The court, however, did not immunize non-neutral party-appointed arbitrators from all 'evident partiality' challenges. Rather, it found that 'a party-appointed arbitrator is still subject to some baseline limits to partiality'. The court broadly identified two circumstances that would warrant vacatur: (1) if the undisclosed relationship violates the arbitration agreement; or (2) the failure to disclose had a prejudicial impact on the award. The court otherwise 'declined to catalogue the "material relationships"' for which a non-neutral party-appointed arbitrator's non-disclosure would warrant vacatur on 'evident partiality' grounds.

Moreover, the showing that the non-disclosure prejudiced the proceeding or the award must be made by 'clear and convincing' evidence. This is a higher standard than the 'preponderance of the evidence', (akin to the 'balance of probabilities'), which is the ordinary standard of proof in civil cases and arbitration in the United States. Thus, the court concluded:

> [I]n the absence of a clear showing that an undisclosed relationship (or the non-disclosure itself) influenced the arbitral proceedings or infected an otherwise-valid award, that award should not be set aside even if a reasonable person (or court) could speculate or infer bias.

The heightened standard established by the court appears difficult to meet. Given that tribunal deliberations are generally strictly confidential, the party challenging the award will in most cases need to demonstrate that the conduct of the arbitrator during the proceeding deprived the challenging party of due process. As a practical matter, it would be even more difficult to make this showing where an award is unanimous.

The court remanded the case to the district court to determine whether the petitioner could demonstrate 'evident partiality' under this heightened standard by showing that the undisclosed relationships between respondent and its party-appointed arbitrator either violated the contractual requirement of disinterestedness or otherwise in fact prejudiced the award.

The impact of the decision where parties intend and expect party-appointed arbitrators to be neutral

It is clear from the Second Circuit's opinion that, where party-appointed arbitrators are expected to be partisan, they are not held to the same standards of independence and impartiality as neutral arbitrators. At times, the court appears to paint with a broad brush, assuming categorically that any arbitrator appointed by a party is a '*de facto* advocate' for that party. The apparent breadth of the court's ruling may be concerning to parties in U.S.-seated arbitrations who, as is generally the case in international arbitrations and in most domestic arbitrations, intend for party-appointed arbitrators to remain independent and neutral.

A reasonable interpretation of the court's opinion, however, is that the heightened standard of 'evident partiality' only applies in those cases where the parties' agreement or applicable custom and practice indicate that the parties intended or reasonably expected party-appointed arbitrators to be non-neutral. Two observations support this interpretation.

- First, the court addressed the question of party-arbitrator neutrality in the context of an *ad hoc* reinsurance arbitration, where parties have traditionally accepted and anticipated that party-appointed arbitrators were non-neutral and partisan. In fact, the respondent specifically argued that party-appointed arbitrators are permitted to be partial in reinsurance arbitrations and other 'tripartite industry arbitrations' where partisanship is expected. And the court recognized that the distinction between party-appointed and neutral arbitrators 'is salient in the reinsurance industry'.
- Second, the court emphasized the contractual nature of arbitration and the parties' ability to choose the applicable standards of impartiality in any given case. In the court's words, a party must meet a higher burden to vacate an award based on the 'evident partiality on the part of an arbitrator who is appointed by a party *and who is expected to espouse the view or perspective of the appointing party*' (emphasis added). A fair reading of this holding is that a heightened standard of 'evident partiality' applies only where the parties intend for their party-appointed arbitrators to be partisan, and therefore expect the party-appointed arbitrators to advance their appointing party's positions.

Under this view, this higher standard for showing 'evident partiality' would not apply where the parties' arbitration agreement requires party-appointed arbitrators to remain neutral and independent. The parties can express this requirement explicitly in the arbitration agreement or by agreeing to arbitrate under procedural rules requiring party-appointed arbitrators to remain impartial and independent. As the court noted in *Lloyd's*, 'parties are free to choose for themselves to what lengths they will go in quest of impartiality'. If, as the court noted, the parties can modify or even eliminate the FAA's 'evident partiality' requirement by agreement, the parties must also have the power to preserve it.

Nevertheless, while there is reason to interpret the *Lloyd's* decision narrowly to apply where the parties intend that party-appointed arbitrators be non-neutral, the court's loose language causes uncertainty. The most prudent course for parties who want an all independent and impartial tribunal is to state so clearly in their agreement, including by adopting institutional or other rules that require arbitrators to be independent and impartial unless otherwise agreed. Even after the Second Circuit's decision in *Lloyd's*, if the parties clearly agree that party-appointed arbitrators are to be neutral, the court should apply traditional notions of independence and impartiality in determining what constitutes 'evident partiality' under the FAA.