Arbitrator Disclosure

Ignorance is not bliss

“On Professional Practice” examines how professional responsibility principles apply to our work. Sharon Press, a member of the Dispute Resolution Magazine editorial board, serves as the “On Professional Practice” editor. We encourage readers to submit ideas for future columns to Sharon Press at sharon.press@mitchellhamline.edu.

Imagine the following scenario: You have been selected to serve as an arbitrator in a business matter involving Artemis Partners and Apollo Corporation. You review the appointment papers and check with your law firm colleagues for potential conflicts, notifying them by email that you have been asked to serve in the case and including the names of the parties, counsel, and identified witnesses. You also run a search of your emails and contacts for the names of the parties, counsel, and identified witnesses.

No potential conflict surfaces, so you complete your notice-of-appointment form with nothing to disclose, and the case moves forward. After you issue the award, however, the losing party’s counsel sends you a letter requesting information regarding payments your law firm received from the parent company of the prevailing party. After you ask your billing company to send you that information, you learn that the prevailing party’s parent company is a long-term client of the firm, with billings of more than $250,000 over the last five years.

What did your partners do to check conflicts when you sent around that email? Did you receive affirmative responses from each of them that conflicts had cleared? Hmmm . . . maybe you received an out-of-office message from one partner and did not follow up? Did you send a second email to your partners to check again for conflicts midway through the case, after you learned that a parent company was involved? Was sending the email around to your partners the best way to check for firm conflicts in the first place? Most important, did you fulfill your ethical obligations to check for potential conflicts — and is your award now in jeopardy of being vacated?

The Code of Ethics for Arbitrators in Commercial Disputes, effective March 1, 2004, (the Code) provides in Canon II(B) that: “[p]ersons who are requested to accept appointment as arbitrators should make a reasonable effort to inform themselves of any interests or relationships described in [the Code].” Some circuit courts have also found this concept to exist within the Federal Arbitration Act Section 10(a)(2), the standard of evident partiality. However, court decisions make clear that whatever the Code means by “making a reasonable effort” to inform oneself under the Code, that is a greater burden than what is required pursuant to FAA 10(a)(2). So there are two separate levels of inquiry: whether a court might vacate an award pursuant to FAA 10(a)(2), and whether an arbitrator fulfilled his or her ethical obligation pursuant to the Code.

In the seminal 1968 US Supreme Court case Commonwealth Coatings Corp. v. Continental Casualty Co, Justice Byron White’s concurrence states that there is “no reason automatically to disqualify the best informed and most capable potential arbitrators” if an arbitrator is “unaware of the facts but the relationship is trivial.” However, embedded in this concurrence is the notion that an award may be vacated if the arbitrator was not aware of the conflict but the relationship is more than trivial. Since the Supreme Court issued its decision in Commonwealth Coatings Corp., circuit courts have been split as to how an arbitrator’s failure to investigate impacts evident partiality.

The Ninth Circuit case of Schmitz v. Zelveti interpreted Commonwealth Coatings as holding that evident partiality can exist even when the arbitrator did not have actual knowledge of the conflict. The issue in Schmitz was that the arbitrator had run a conflict check for the parties in the arbitration and had...
reviewed documents reflecting that one of the parties was owned by a parent company. The arbitrator did not run a conflict check of the parent company. A post-award investigation by the losing party revealed that the arbitrator’s law firm represented the prevailing party’s parent company in at least 19 cases during a 35-year period. The district court confirmed the award, holding that arbitrators are bound to disclose only potential conflicts they are actually aware of. The Ninth Circuit reversed, finding that while “lack of knowledge may prohibit actual bias, it does not always prohibit a reasonable impression of partiality.” And that “a reasonable impression of partiality can form when an actual conflict of interest exists and the lawyer has constructive knowledge of it.” Citing the rules of NASD, the National Association of Securities Dealers (now FINRA, the Financial Industry Regulatory Authority) that were applicable to the case and are similar to Canon II of the Code, the court found that the arbitrator “had a duty to investigate the conflict at issue.” Further, the court stated that “representation of a parent corporation is likely to affect impartiality or may create an appearance of partiality in the lawyer’s representation of or dealing with a subsidiary.” The arbitrator’s “failure to inform the parties to the arbitration resulted in a reasonable impression of partiality under Commonwealth Coatings.”

The Second Circuit has also decided that actual knowledge is not required to vacate an award based on evident partiality. In Applied Industrial Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi, A.S., the court found that the chair acted with evident partiality when he failed to investigate further into a business relationship between his company and one of the parties to the arbitration. The chair of the arbitration panel disclosed that he was aware of a potential business relationship, but after the award on liability was issued, the counsel for the non-prevailing party discovered that a previously existing relationship between the chair’s company and one of the parties to the arbitration also generated approximately $275,000 in revenue. The court “emphasize[d] that [it was] 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.” In this case, the chair failed to investigate the known relationship and failed to disclose to the parties that he was not making that investigation. Thus the Second Circuit articulated a less stringent standard than the Ninth Circuit, namely, that an arbitrator must first be aware of a potential conflict and then fail to investigate for an award to be vacated based on evident partiality.

And then there is the Eleventh Circuit. In Gianelli Money Purchase Plan and Trust v. ADM Investor Services, Inc., the court found that an arbitrator must have actual knowledge of a conflict to display evident partiality. Before the arbitrator in Gianelli joined his law firm, that law firm had frequently represented one of the party’s corporate representatives. Citing earlier precedent in the Eleventh Circuit, the court “rejected the proposition that the arbitrator had a duty to investigate the past contacts to avoid evident partiality.”

These cases highlight that a court may not vacate an award because of evident partiality based on a failure to investigate potential conflicts. However, the Code goes further than FAA 10(a)(2) by placing an affirmative burden on arbitrators to make reasonable efforts to ensure that they are aware of any possible conflicts. Therefore, just because a court may not vacate an award based on evident partiality does not mean the ethical standard of making a reasonable effort to inform oneself pursuant to the Code has been met.

Canon II of the Code details what the arbitrator needs to investigate:

An arbitrator should disclose any interest or relationship likely to affect impartiality or which might create an appearance of partiality.

A. Persons who are requested to serve as arbitrators should, before accepting, disclose:

(1) Any known direct or indirect financial or personal interest in the outcome of the arbitration;

(2) Any known existing or past financial, business, professional or personal relationships which might reasonably affect impartiality or lack of independence in the eyes of any of the
Parties. For example, prospective arbitrators should disclose any such relationships which they personally have with any party or its lawyer, with any co-arbitrator, or with any individual whom they have been told will be a witness. They should also disclose any such relationships involving their families or household members or their current employers, partners, or professional or business associates that can be ascertained by reasonable efforts;

(3) The nature and extent of any prior knowledge they may have of the dispute; and

(4) Any other matters, relationships, or interests which they are obligated to disclose by the agreement of the parties, the rules or practices of an institution, or applicable law regulating arbitrator disclosure.

B. Persons who are requested to accept appointment as arbitrators should make a reasonable effort to inform themselves of any interests or relationships described in paragraph A. (Italics added).

Reflecting back to the hypothetical posed at the beginning of this article, did the arbitrator satisfy her ethical obligations to make a reasonable effort to inform herself of any interests or relationships as provided in Canon II? The arbitrator failed to meet her ethical obligations for two reasons: (1) she failed to run a conflict check once she learned of the parent company; and (2) even if she did run a conflict check of the parent company, she should also have inquired directly with the law firm’s billing company, followed up with any partner who did not reply to her, and confirmed what actions her partners took to check for conflicts.

Section C is clear: the obligation to check for conflicts is a continuing duty throughout the arbitration process. In the hypothetical case, the arbitrator had an ethical duty to make a reasonable effort to investigate whether any conflict existed with the parent company — and failed to do so.

Canon II does not define what constitutes a “reasonable effort.” Therefore, it is up to the individual arbitrator to determine, under the circumstances of the case, what this involves. Reasonable efforts are certainly something more than no effort. An arbitrator, when conducting a conflict check, is obligated to ask, at a minimum, whether the investigation will uncover the interests and relationships identified in Canon II of the Code. If the answer to that question is no, the arbitrator must rethink how to conduct the conflict check.

Whether a court would vacate the award based on evident partiality would depend on the jurisdiction. Based on the case law above, this scenario closely mirrors the Ninth Circuit Schmitz case, and this award probably would be vacated by the Ninth Circuit. The award would probably not be vacated by the Second and Eleventh Circuits, given that the arbitrator did not appear to have any knowledge that the parent company was a firm client. Whatever a court would think about vacating the award, this is a good example of how best practice in investigating potential conflicts can save parties time and cost as well as protect the arbitrator from reputational damage. No one wants to see her name in lights (or on legal blogs or showing up Westlaw searches) for an easily avoidable sticky situation.

Tracey B. Frisch is Senior Counsel for the American Arbitration Association, where she is involved in a variety of legal matters that impact the association. Frisch also serves as an Adjunct Professor at Benjamin N. Cardozo School of Law, supervising law student mediators, and at Pace University Law School, where she teaches Commercial Arbitration Law. Frisch, who is a volunteer mediator for the US District Court for the Southern District of New York and volunteer arbitrator for Manhattan Small Claims Court, has written and spoken on numerous dispute resolution topics. She can be reached at FrischT@adr.org.
Endnotes

1  393 U.S. 145 at 150 (1968).
2  20 F.3d 1043 (9th Cir. 1994).
3  Id. at 1048.
4  Id.
5  Id. at 1049.
6  Id.
7  Id.
8  But see, Certain Underwriting Members of Lloyds of London v. State of Florida, Dept. of Financial Services, 892 F.3d 501 (2d Cir. 2018) (setting forth a lower standard of evident partiality for party-appointed non-neutral arbitrators). While this article is focused on neutral non-party-appointed arbitrators, it should be noted that Canon X (B)(1) places the same obligations on party-appointed non-neutral arbitrators to make a reasonable effort to inform themselves of any interests or relationships and to disclose those interests or relationships. The only difference is that pursuant to Canon X (B)(2) party-appointed non-neutral “arbitrators are not obliged to withdraw [] if requested to do so only by the party who did not appoint them.”
9  492 F.3d 132, (2nd Cir. 2007).
10  Id. at 138.
11  146 F.3d 1309 (11th Cir. 1998).
12  Lifecare International, Inc. v. CD Medical, Inc., 68 F.3d 429 (11th Cir. 1995).
13  Id. at 1312.