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Inside the Locker Room: Recent Judicial Review Of Arbitrator Conduct

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Many reinsurance contracts call for disputes to be resolved by a panel of three arbitrators -- one selected by each party and a third, the umpire, selected by the other two panel members or by other means. Perceived advantages of arbitration over litigation include a measure of control over the dispute resolution process which may emanate from appointment of the parties' own "judges;" adjudication before industry experts, as opposed to generalist judges; a more svelte and efficient process; and, confidentiality. Consistent with those objectives, "[t]he most sought-after arbitrators are prominent and experienced members of the specific business community in which the dispute to be arbitrated arose. Since they are chosen precisely because of their involvement in that community, some degree of overlapping representation and interest invariably results." *Nationwide Mut. Ins. Co. v. Home Ins. Co.,* 429 F.3d 640, 647 (6th Cir. 2005).

For the most part, over the years, disagreements occasioned by a panel member's disclosures to the parties or relationship with a party, counsel or other panel member have been addressed in the manner of a professional sports franchise seeking to suppress media controversy -- in the locker room, behind closed doors. As in other spheres of arbitration practice, however, this decorum has been replaced with an enhanced appetite to expand the discourse to include the courts and, in the process, other members of the reinsurance community. In response, a handful of recent U.S. court decisions addresses disputes concerning the permissible relationships among arbitrators and parties, the disclosures required to afford fairness to participants, and the broader role of courts in policing the arbitration process at large. The purpose of this article is to review three of those decisions -- exemplars of alleged pecuniary interest, non-disclosure, and breach of confidentiality -- and to comment on their possible implications, to the extent that they may alter future behavior and portend other discernable trends.

Recent US Court Decisions

Ario v. Cologne Re

In *Ario*, the Court concluded that a candidate's acceptance of an appointment as umpire in a second unrelated arbitration, during the pendency of the challenged arbitration, did not constitute "evident partiality" under the Federal Arbitration Act (the "FAA"), even though the subject appointment was secured (in part) through the efforts of a party-appointed arbitrator serving in both arbitrations. See FAA at § 10(a)(2); *Ario v. Cologne Reinsurance (Barbados) Ltd.*, No. 1:CV-98-0678, 2009 WL 3818626 (M.D. Pa. Nov. 13, 2009). As a result, it declined to vacate the challenged award.

The Court applied a common iteration of the "reasonable person" test: "In order to show 'evident partiality', the challenging party must show a reasonable person would have to conclude that the arbitrator was partial to the other party to the arbitration." *Id.* *7 (quoting *Kaplan v. First Options of Chicago, Inc.*, 19 F.3d 1503 (3rd Cir. 1994)). The party seeking to vacate the award argued that the appointment gave the umpire an impermissible pecuniary interest, which created an appearance of bias. It also objected based on the timing of the umpire's disclosure of his second appointment -- which was known to him before two interim orders were issued in the first arbitration, but disclosed only after those orders were delivered to the parties.

The Court rejected both arguments, and it confirmed the award. It concluded that "there is no evident partiality from an arbitrator accepting a position in another, unrelated arbitration while the current arbitration is still ongoing, even if that position was partially obtained by the action of a party-appointed arbitrator." *Id.* at *10. The Court further observed that "[r]einsurance is a field sufficiently specialized that those with expertise can be expected to serve on multiple arbitration panels. In these circumstances . . . that arbitrators appoint each other to panels does not *per se* manifest evident partiality or corruption." Id. Finally, the Court rejected the challenge based on the timing of the umpire's disclosure, because the arbitration was still pending, and the parties and the panel had the opportunity, in the Court's parlance, to "deal with the issue."

Scandinavian Re

Just a few months later, in *Scandinavian Re*, a different federal trial court vacated an arbitration award based on "evident partiality," because two arbitrators failed to disclose their simultaneous involvement in two arbitrations involving related corporate entities. See FAA at §10(a)(2). More specifically, they served in two separate arbitrations that overlapped in time, shared similar issues, involved related parties, and included one common witness. *See Scandinavian Reinsurance Co. Ltd. v. St. Paul Fire & Marine Ins. Co.,* No. 09 Civ. 9531 (SAS), 2010 WL 653481 (S.D.N.Y. Feb. 23, 2010). The parties' arbitration agreement required arbitrators to be "disinterested." *See David A. Attisani*, "Panel Selection and Grounds for Disqualification of Arbitrators in Reinsurance Arbitrations," 11 ARIAS-U.S. Quarterly No. 3 (3d Qtr. 2004) (generally, under U.S. law, "[a] 'fair' and 'disinterested' mindset does not … necessarily preclude advocacy of positions. An arbitrator may be predisposed to decide an issue in accordance with closely held personal views on a familiar issue but may nonetheless be considered 'disinterested' if he or she has no personal or financial stake in the outcome").

Applying the same "reasonable person" test of "evident partiality" used in *Ario*, the Court determined that the arbitrators' service constituted a conflict of interest, because they: (1) received information in the first arbitration (a separate dispute between Platinum Underwriters and PMA Capital), which could properly be characterized as *ex parte* communication vis-à-vis the second proceeding; (2) could be influenced in the second arbitration by their own earlier credibility determinations concerning the common witness; and (3) could influence each other's thinking with respect to issues relevant to one or both of the arbitrations. The Court found these undisclosed relationships to be "material", even though neither arbitrator had a financial interest in the outcome of the arbitration or "a direct relationship with a party", and even though they may have believed in good faith that they would not be influenced by the other arbitration. In addition, the failure to disclose their prior participation deprived Scandinavian -- not a party to the first arbitration -- of the opportunity to object to their service or to alter its strategy, including its tactical approach to the common witness. The Court concluded that the arbitrators' "failure to disclose their participation in the [first] arbitration [displayed] evident partiality because the undisclosed relationships involved in the [first] arbitration collectively were material and [the arbitrators] had actual knowledge of those relationships." *Scandinavian Re*, 2010 WL 653481 at *9. As a result, the Court vacated the award, and remanded the matter for arbitration before a replacement panel of arbitrators.

Trustmark

In *Trustmark*, also decided in February 2010, a third federal trial court refused to disqualify a party's appointed arbitrator, who had served as a party arbitrator in a prior, related arbitration between the same parties, which involved different treaties (excess of loss and quota share, respectively). Trustmark sought to disqualify Clarendon's party-appointed arbitrator, because her service as party arbitrator in the prior arbitration: (1) caused her not to be "disinterested," as required by the parties' arbitration agreement; and (2) would inevitably result in a breach of the parties' confidentiality agreement in the prior arbitration. *See Trustmark Ins. Co. v. Clarendon Nat'l Ins. Co.*, No. 09-C-6169, 2010 WL 431592 (N.D. Ill. Feb. 1, 2010).

The Court rejected both arguments, ordered that the second arbitration proceed with Clarendon's party-appointed arbitrator, and seated an umpire selected from Clarendon's list of candidates. The Court concluded, first, that Trustmark's contractual challenge to the arbitrator as insufficiently "disinterested" was premature, in accordance with the well-settled rule that arbitrator bias can only be challenged after an award is issued. *Id.* at *3. The Court noted that Trustmark could not "avoid this outcome by merely

restating the qualification challenge as a breach of contract action." Id. Second, the Court determined that Clarendon's party-appointed arbitrator could perform her function in the pending proceeding without disclosing confidential information relating to the first arbitration, and that Trustmark had failed to adduce evidence to the contrary. The Court cited the "strong presumption" that arbitrators can disregard what they already know, and it observed that there was no evidence that Clarendon's arbitrator had breached, or necessarily would breach, confidentiality. The mere "fear" of a breach -- arising from an arbitrator's access to confidential information in a prior, related arbitration -- was insufficient to enjoin the arbitrator's participation in the second proceeding.

Commentary

These recent decisions (and others not discussed here) reflect the difficulty faced by courts seeking to strike a balance among the competing arbitral aspirations of fairness, expert adjudication, efficiency, and confidentiality. U.S. courts are generally reluctant to interfere with the arbitration process, in large part because interlocutory objections can delay proceedings, compromise confidentiality, deprive the parties of their bargained-for dispute resolution process, and thwart the asserted goals of the FAA. *See, e.g., Marc Rich & Co. v. Transmarine Seaways Corp. of Monrovia*, 443 F. Supp. 386 (S.D.N.Y. 1978) ("a prime objective of arbitration law is to permit a just and expeditious result with a minimum of judicial interference"). Courts must, however, also seek to preserve the integrity of the arbitration process and prevent parties from, in their view, gaming the system. *E.g., Vigorito v. UBS PaineWebber, Inc.,* 557 F. Supp.2d 303, 307-08 (D. Conn. 2008) (confirming arbitration award, because party waived "evident partiality" objection to arbitrator's service by withholding it during pendency of arbitration).

In this connection, it is worth observing that -- subject to context and the specific facts of each case -- challenges are a double-edged sword. They may be viewed as tools needed to preserve the traditional values associated with the industry arbitration process, which have supported its vitality and efficacy over time. On the other hand, it would be naïve to ignore their potential use as a means to obtain leverage or to destabilize a panel perceived to be unfavorably disposed toward the architect of the challenge. As is often the case within the lexicon of legal options, an arbitral challenge is an instrumentality which may be motivated by a variety of interests and concerns, and even blind self-interest can (in some cases) serve the salutary purpose of conforming arbitrator conduct to a more consistent and palatable standard.

Regardless of their motivation, challenges to arbitrators appear (at least, temporarily) to be on the rise, and parties should take steps to protect themselves, particularly in drafting arbitration provisions and confidentiality agreements. The *Trustmark* decision highlights this point. In *Trustmark*, the parties could have precluded service of a single panel member in related arbitrations under their excess of loss and quota share treaties, but they failed (or declined) to do so. As a result, such proposed service did not -- in the abstract -- amount to a *de facto* breach of their confidentiality agreement. *See Trustmark*, 2010 WL 431592 at *4-5. Parties and arbitrators should also be diligent in researching and disclosing arbitrators' relationships with parties, affiliated entities, and witnesses. *See, e.g., Scandinavian Re*, 2010 WL 653481 at **8-9 (vacating award based on simultaneous, undisclosed service on two arbitration panels involving related parties, similar issues, and one common witness).

Timing is another factor to be considered. Courts may be suspicious of challenges made after the complaining party declined to lodge an objection during the arbitration proceedings, only to assert it after an unfavorable award was rendered. A "heads I win, tails you lose" scenario or any attempt to construct one by sitting on an objection will likely be viewed with disfavor by both courts and arbitrators. *See, e.g., Vigorito*, 557 F. Supp.2d at 307-08 ("a party to arbitration cannot waive an objection, staying silent hoping for a favorable outcome, and then lodge the objection in a motion to vacate when the arbitration ends adversely to it"). It may ultimately be difficult, however, to reconcile this suspicion of belated challenges with the well-entrenched line of cases mandating their deferral until an award is issued. *See Trustmark*, 2010 WL 431592 at *3 (rejecting pre-award challenge as "premature" and chiding movant for seeking to avoid that outcome by disguising its objection as a breach of contract claim).

More generally, it is not difficult to understand why courts, parties and reinsurance arbitrators may be struggling to draw lines that will serve as precedential guideposts in this area, when a principal appeal of

arbitrators is their familiarity with the business over which (and the players over whom) they preside. As the U.S. Supreme Court observed, "[i]t is often because they are men of affairs, not apart from but of the marketplace, that they are effective in their adjudicatory function." *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145, 150 (1968) (White, J., concurring). As a result, it can be challenging to discern and extrapolate to other disputes the line seemingly drawn by isolated and fact-intensive court decisions. For example, the conduct highlighted in *Ario* (umpire appointment furthered by party-appointed arbitrator involved in both disputes and disclosed after two awards were issued *does not* manifest "evident partiality") and *Trustmark* (arbitrator could be "disinterested" and trusted not to breach confidentiality agreement, despite service in prior, related arbitration) was tolerated, but the facts of *Scandinavian Re* (failure to disclose involvement in arbitration with related corporate entities *does* display "evident partiality") resulted in a vacatur.

A few principles can, however, be extracted from the recent decisions. First, the courts have always been sensitive to (and highly protective of) the precise terms of the parties' agreement to arbitrate, which provides both the primary source of arbitrators' authority and a set of concrete principles for a Court to enforce and vindicate. *See, e.g., Trustmark*, 2010 WL 431592 at *5 (interpreting arbitration clause to find a "lapse" in the naming of an umpire, which permitted Court to name one). As a result, arbitrator or party conduct that seemingly runs afoul of the parties' arbitration agreement is likely to be policed aggressively.

Second, the Courts will closely scrutinize (at least) four principal factors in attempting to predict whether the outcome of a proceeding might be influenced by circumstances extrinsic to it -- identity of issues, parties, witnesses, and the nature of the relationships among them. When all of these factors are common to multiple proceedings, and the relationships appear to be intimate, a challenge based on an arbitrator's involvement in those proceedings is (in the abstract) more likely to succeed. *See Scandinavian Re*, 2010 WL 653481 at *9 (finding that "undisclosed relationships . . . collectively were material"). Third, there is protection in disclosure, because it gives both parties an opportunity to scrutinize such factors, and the obverse is also true -- any asserted failure to disclose will raise those concerns that accompany one party's inability to interpose appropriate objections. Fourth, notwithstanding the second and third points, the Courts have made it clear that not all relationships among industry arbitrators, parties, or witnesses will be sufficient to render a challenge based on "evident partiality" sustainable. *See Ario*, 2009 WL 3818626; *Commonwealth Coatings Corp.*, 393 U.S. 145. It would, after all, be unfair to disqualify an arbitrator or sustain a challenge based solely on the *raison d'être* of an arbitrator's appointment -- his or her knowledge of the industry and its players.

Although the decisions emanating from the courts over the past five months have not succeeded in etching any bright line legal rule between permissible familiarity and unacceptable intimacy with persons and issues, they do serve as a reminder that falling on the wrong side of this imaginary boundary can have significant financial and other consequences for participants in industry arbitration. One such consequence is the injection of a potent factor into the equation of industry arbitration -- *i.e.*, public scrutiny of a formerly private dispute, when the doors to the locker room are opened to the gaze of third parties. Confidentiality is (and it long has been) one of the chief benefits of arbitration. It is now unclear whether an increase in the number and intensity of public challenges, perhaps further proliferated going forward by more fulsome disclosures from cautious arbitrator candidates, will diminish the stature of industry arbitration as the most popular means of adjudicating reinsurance disputes.

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