PARTIALITY AMONG ARBITRATION PANELISTS[1]

By Robert M. Hall and Paige D. Waters[2]

Reinsurance contracts often call for the resolution of disputes before an arbitration panel consisting of three individuals who are or have been officers of insurance or reinsurance companies. This represents a clear choice in favor of arbitrators with significant experience with insurance and reinsurance matters and, necessarily, the insurance companies and individuals involved in such matters.

This choice has a number of beneficial aspects, such as a high degree of technical expertise with respect to the subject matter, quick grasp of the issues and creativity in fashioning remedies. Use of arbitrators with insurance industry experience also carries with it the possibility of partiality in favor of or against certain individuals, companies or positions. The purpose of this paper is to examine the law pertaining to arbitrator partiality as well as some potential remedies.

I. VACATING AN AWARD UNDER THE FAA

Arbitration awards may be vacated under federal statutory grounds of arbitrator partiality. As arbitrations became more common as a means of resolving disputes, in July 1947, Congress enacted the Federal Arbitration Act ("FAA") addressing the more frequently litigated arbitration issues. The FAA created statutory grounds for vacating an award on, among other things, the basis of arbitrator partiality. Section 10 of the FAA, [3] provides, *inter alia*, that:

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration-

(1) Where the award was procured by corruption, fraud, or undue means.

(2) Where there was evident partiality or corruption in the arbitrators, or either of them.

(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

Section 10(a)(1) of the FAA provides a statutory provision pursuant to which a party may challenge "active partiality".[4] Section 10(a)(2) allows a party to vacate an award for "evident partiality."[5] The purpose of this paper is to provide a detailed discussion of arbitrator partiality.

II. ACTUAL PARTIALITY

There are few reported cases of active partiality. Courts generally are reluctant to infer active partiality just from the size of an award.[6] To set aside a common law arbitration award based upon active partiality, the party "must show by clear, precise and indubitable evidence that he was denied a hearing, or that there was fraud, misconduct, corruption or some other irregularity of this nature on the part of the arbitrator which caused him to render an unjust, inequitable or unconscionable award, the arbitrator being the final judge of both law and fact, his award not being subject to disturbance for a mistake of either." *Bole v. Nationwide Ins. Co.*, 352 A.2d 472, 473 (Pa. Super. 1975) (quoting *Allstate Ins. Co. v. Fiorevanti*., 299 A.2d 585, 589 (Pa. 1973)).

The *Bole* court remanded the case for further factual findings regarding the prior legal representation rendered to the insurer by its chosen arbitrator (*e.g.*, what the legal issues were, when or how often or how regularly they arose, and the extent of the arbitrator's representation.)[(7)] However, on the appeal of *Bole*, the Pennsylvania Supreme Court adopted a *per se* rule that the award should be vacated and the matter remanded for the appointment of a new panel of arbitrators where: (i) the disputed contract requires a "disinterested arbitrator"; and (ii) a party objects to the prior legal representation of a party by an arbitrator.[(8)]

At least one court has interpreted *Bole*:

Our reading of Bole leads us to conclude that a showing of a direct relationship between a party to an arbitration proceeding and a designated arbitrator must be shown, such as the existence of a prior employer-employee or attorney-client relationship, before the requisite partiality of that arbitrator is established . . . . We will not extend such allegations of partiality to an alleged "indirect connection" with a party to an arbitration. To do so would invite any dissatisfied claimant to allege partiality on the part of the opposing party's arbitrator and thus require court supervision of arbitration. This is contrary to the purpose of arbitration.

Land v. State Farm Mutual Ins., 600 A.2d 605, 607 (Pa. 1991). The *Land* court held that a party to an arbitration may seek only limited discovery to determine whether an arbitrator had been employed by the other party to the dispute prior to the Court's dismissal of the party's petition to set aside the arbitration award.[(9)] As a practical matter, such formal discovery attempts to seek too little too late.

Because active partiality is extremely difficult to prove, there are few reported cases vacating an award on such basis. There are, however, many cases where the award was upheld notwithstanding an allegation of active partiality. For example, in *Fort Hill Builders, Inc. v. Nat'l Grange Mut. Ins. Co.*, 866 F.2d 11 (1st Cir. 1989), the defendant challenged the opposing party's arbitrator as biased in the plaintiff's favor because the arbitrator strenuously advocated the plaintiff's position. Moreover, during the defendant's presentation, the arbitrator "adopted an air of blatant indifference, frequently closing his eyes, appearing to be asleep, and just generally ignoring the proceedings. When he did (infrequently) speak, his comments were most often directed criticisms of [defendants'] position, or indications that he already had made up his mind how he would rule, regardless of [defendants'] testimony."[(10)] In *Hill*, these charges were not substantiated, but the court indicated that if proved, such facts would have established active partiality. *See, e.g., Metropolitan Prop. & Cas. Co. v. J.C. Penney Cas. Co.*, 780 F. Supp. 885, 887-888 (D.R.I. 1991) (potential arbitrator's extensive *ex parte* communications with party and evaluation of evidence prior to appointment constituted active partiality); *but see, Tri-City Jewish Center v. Blass Riddick Chilcote*, 440, 512 N.E.2d 363, 366 (Ill. Ct. App. 1978), *appeal denied*, 520 N.E.2d 393 (Ill. 1988) ("too little or excessive damages in itself is insufficient to raise a presumption of fraud, corruption or undue means on the part of the arbitrators"). *See supra* note 3.

III. EVIDENT PARTIALITY

A. Standards of "Evident Partiality"

"Evident partiality" does not rise to the level of active bias and is inferred from the relationship between an arbitrator and a party involved in the arbitration. The courts have articulated several standards of "evident partiality". One of the earlier tests for "evident partiality" addressed the following factors: (1) the arbitrator's financial interest in the arbitration proceeding; (2) the directness of the alleged relationship between the arbitrator and the party to the dispute; and (3) the timing of the relationship. *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145 (1968). In *Commonwealth Coatings*, the United States Supreme Court vacated an arbitration award for "evident partiality" even though there was no evidence of active bias. The Court determined that although the arbitrator did not have a financial interest in the arbitration, the arbitrator had a substantial undisclosed business relationship with one of the parties (*i.e.*, the arbitrator performed services for the party involving significant fees over a period of four to five years, and even performed services related to the dispute being arbitrated).

Another court developed a "reasonable person" standard which is similar to that which is set forth in *Commonwealth Coatings*, but requires that a reasonable person "would have to conclude that an arbitrator was partial to one party to the arbitration". *Morelite Constr. Corp. v. New York City Dist. Council Carpenters Benefit Funds,* 748 F.2d 79 (2d Cir. 1985). The *Morelite* court found evident partiality existed based upon a father-son relationship (*i.e.*, an arbitrator was the son of an officer of an international union whose local union was a party in this arbitration).

Evident partiality also may be found where the circumstances are "powerfully suggestive" of bias. *Merit Ins. Co. v. Leatherby Ins. Co.*, 714 F.2d 673 (7th Cir. 1983), *cert. denied*, 464 U.S. 1009 (1983), *modified*, 728 F.2d 943 (7th Cir. 1984). The *Merit* court refused to vacate an award where one of the arbitrators failed to disclose that he worked for the president of one of the parties fourteen years earlier at a different corporation; these facts were not "powerfully suggestive" of arbitrator bias.

B. **Vacation of Award for "Evident Partiality"**

An arbitrator's failure to disclose a financial interest in the arbitration, a direct relationship with one of the parties, or other facts creating the appearance of partiality may result in the vacation of an award. "The interest or bias must be direct, definite and capable of demonstration rather than remote, uncertain or speculative." *Tamari v. Bache Halsey Stuart, Inc.*, 619 F.2d 1196, 1200 (7th Cir.), *cert. denied*, 449 U.S. 873 (1980) (citations omitted) (quoting *United States Wrestling Federation v. Wrestling Division of the AAU, Inc.*, 605 F.2d 313, 318 (7th Cir. 1979)).

Reported cases offer insight into the sufficiency of evidence offered to establish evident partiality. In *DeBaker v. Shah*, N.W.2d 464 (Wis. Ct. App. 1994), *rev'd,* 533 N.W.2d 464 (Wis. 1995), the court vacated an award under § 10(a)(2) of the FAA where an arbitrator failed to disclose that he had received, during the arbitration proceedings, campaign contributions from several members of a firm representing one of the parties. In *Schmitz v. Zilveti*, 20 F.3d 1043 (9th Cir. 1994), the court vacated an award where the arbitrator failed to disclose a thirty-five year relationship between his law firm and the parent corporation of the defendant in the arbitration. Although the legal representation had ceased almost two years before the arbitration and there was no proof that the arbitrator was aware of his firm's prior legal representation, the court determined that the arbitrator had a duty to investigate and inform the parties to the arbitration of any potential conflict. The arbitrator's failure to do so resulted in "a reasonable impression of impartiality" justifying vacation of the award. *Id.*, 20 F.3d at 1049. *See also Neaman v. Kaiser Found. Hosp.*, 11 Cal. Rptr. 2d 879 (Cal. Ct. App. 1992) (award vacated where neutral arbitrator failed to disclose that he had served as a party-arbitrator for one of the parties); *Gulf Coast Industrial Workers Union v. Exxon Co.*, 70 F.3d 847 (5th Cir. 1995) (arbitrator engaged in misconduct when he misled party to believe certain evidence was admitted and then later refused to consider that evidence); *Iran Aircraft Indus. v. Avco Corp.*, 980 F.2d 141 (2d Cir. 1992) (award vacated where panel advised party not to submit certain evidence because other documentation was acceptable and panel rejected party's claim for lack of proof).

C. **Disclosure and Waiver**

The appearance of partiality may be rebutted by disclosing the facts or relationship prior to the arbitration hearing. If the other party is notified and fails to object, then that party has waived its right to object after the award. An arbitrator should disclose any and all potential conflicts or relationships prior to the arbitrator's appointment; however, failure to do so will not automatically result in vacation of the award. *Sun Refining & Marketing Co. v. Statheros Shipping Corp.*, 761 F.Supp. 293 (S.D.N.Y. 1991), *aff'd without opinion*, 948 F.2d 1277 (2d Cir. 1991). "Full and early disclosure increases the probability that successful attacks on the award for "evident partiality" can be avoided."[(11)] The duty to disclose continues until the award.[(12)]Once a party consents to the choice of an arbitrator knowing the relevant facts and circumstances, that party may not later object to an award based upon "evident partiality". *Astoria Med. Group v. Health Ins. Plan of Greater N.Y.*, 182 N.E.2d 85, 89 (N.Y. 1962).

A party must raise the issue of arbitrator partiality when the party becomes aware of the facts or circumstances which may give rise to the arbitrator's bias. In *Hartford Steam Boiler Inspection & Ins. Co. v. Industrial Risk Insurers*, 1997 WL 94089 (Conn. Super Ct. 1997); a party to the arbitration challenged the opposing party's arbitrator as biased for engaging in *ex parte* communications and failing to disclose them. The challenging party discovered such communications shortly after they had taken place but failing to raise the issue prior to or during the

arbitration hearing. The *Hartford* court, citing *Clisham v. Bd. of Police Commissioners,*[(13)] stated that, "a claim of bias must be raised in a timely manner. . .[t]he failure to raise a claim of disqualification with reasonable promptness after learning the ground for such a claim ordinarily constitute waiver thereof . . ." The court stated that the *ex parte* communications did not warrant vacation of the award for "evident partiality" because they did not involve "facts, issues or evidence relevant to the subject of the arbitration proceedings".[(14)] The court held that the challenging party was not entitled to discovery to substantiate its claims because it had waived its right to raise the issue of partiality.

If counsel becomes aware of a basis for a challenge to an arbitration based on arbitrator partiality before the hearing, he or she faces a difficult choice. An objection must be lodged at that point in the proceedings or it is waived. The objection is likely to offend the arbitrator in question and may create a negative tone for the entire panel. In addition, relatively few pre-hearing challenges are successful.[(15)] As a result, counsel has a significant disincentive to a pre-hearing challenge but likely waives a post-hearing challenge by not objecting earlier.

IV. PHILOSOPHICAL PARTIALITY

In addition to the actual and evident partiality bases addressed in the FAA, some observers of reinsurance arbitrations are concerned about the appointment of "hired guns" who can be counted upon to take a particular position regardless of the actual law or facts applicable. Since such individuals may take their positions for reasons other than active or evident partiality, we have coined the term "philosophical partiality" for such a situation. Although such partiality probably occurs less often than some might imagine, it nonetheless merits examination.

A. Role of Party's Outside Counsel

Some might attribute the presence of philosophical partiality to the efforts of a party's outside counsel in seeking a sympathetic panel. However, it is the duty of outside counsel to zealously represent the interests of his or her client. Such representation includes an effort to control variables, to the extent practical and ethical, which may impact on the outcome of the arbitration. Clearly, one such variable is the composition of the arbitration panel.

In a trial setting, counsel give considerable thought to venue and court in which to try a case. To the extent possible, trial counsel seek a trier of fact who will be open to the position of counsel's client. In a jury trial, this is shaped through *voir dire*. In addition, some courts allow a limited form of judge shopping.

Within the arbitration context, it is hardly unexpected that a party's outside counsel would be highly focused on the composition of the arbitration panel. All counsel seek panelists who have sufficient knowledge, time and intellectual curiosity to deal with the controversy. Most counsel prefer a party arbitrator and umpire who may be sympathetic with their position. A few merely seek hired guns. None of this should be surprising, however, in light of the relatively unstructured fashion in which panels are composed. Outside counsel often spend considerable time and thought in selecting an appropriate party arbitrator. Even more time may be spent on umpire selection. Months may be devoted to the process and in some cases it is necessary to seek impasse resolution from an outside third party or a court.

Blaming outside counsel for the time spent completing a panel misses the point, however. Usually, an impasse in panel completion results from a poorly drafted arbitration clause.[(16)]Outside counsel act at the direction of their client and would not be zealously representing their client if they did not seek a sympathetic panel. Providing more structure to the panel selection process may allow outside counsel to play their proper role while avoiding some of the more protracted battles over panel selection.

B. Posing the Problem

Requiring arbitrators to be experienced insurance industry executives carries with it the potential for philosophical partiality. A prospective panelist often has experience in the area of the insurance or reinsurance business in which the dispute arises. In addition, such individuals may have experience with the nature of the dispute in question. Clearly, both situations are viewed as an advantage given the qualification requirements for most panelists.[(17)]

It is unrealistic, if not undesirable, to expect such individuals to be complete philosophical neutrals. With some individuals and some issues, however, there may be a point at which experience becomes prejudice in favor of a particular result regardless of the facts or contractual language involved in individual disputes. For instance, a request for an award of declaratory judgement expenses sometimes generates a very strong reactions in arbitration panelists which often correlates to an individual's employment background and experience with this issue. It may be argued that individuals who have developed such strong, generalized conclusions about certain issues are philosophically partial with respect to a dispute involving such issues.

When such a person is selected as a party arbitrator, the opposing party faces a significant problem. Absent the active or evident partiality noted above, there is no apparent remedy for philosophical partiality in the FAA. Efforts to convince such an arbitrator to recuse himself may worsen the problem and affect other panelists. The problem becomes worse still if the individual who is philosophically partial becomes umpire. This could occur if one party fails to appoint an arbitrator within the designated time period and the other party selects both arbitrators who select the umpire. It also could occur if one party nominates only philosophically partial umpire candidates and prevails in the selection by lot. If such situations come to pass, the cynic's observation might be true that the arbitration dispute effectively may be decided when the umpire is selected.

It has been the authors' experience that the situation is not nearly as dire as that which might be theorized. The vast majority of arbitrators go to great lengths to examine all the arguments of counsel, remain objective to the parties and do justice to the dispute. However, the relatively unstructured manner in which arbitrators and umpires are selected, combined with the natural tendency of outside counsel to seek a sympathetic panel, can result in some panels which are more philosophically partial than one might desire.

C. An Alternative for Panel Selection

While the current structures for panel selection work relatively well, the selection process may be modified to decrease the ability to achieve a partial panel. For example, it may be feasible for an organization to develop a database of arbitrators and umpire candidates who wish to be part of that database. Candidates would supply the data, including, *e.g.*:

• Education;

• Employment history;

• Professional background;

• Areas of expertise;

• Published articles; and

• Experience (as counsel, party arbitrator and umpire) and training in arbitrations.

Parties in dispute could agree to use the database to select an umpire or an entire panel based on a matching of characteristics which the parties choose for prospective candidates. Software could be programmed to produce a random pattern of candidates with characteristics the parties select. To avoid true conflict or a philosophical interest in the outcome, a surplusage of candidates could be supplied to the parties who could use strikes or ranking to select the panel or the umpire.

Such an approach distinctly improves the fairness of the arbitration process by focusing on the qualifications of panel candidates rather than their view of the particular issue involved. This would produce a pool of candidates less likely to be partial than those the parties or their counsel propose. It also preserves the right to strike certain candidates who, due to interest or conflict, are not desirable participants in a particular arbitration.

It remains to be seen whether any organization in the United States would be interested in building and making available such a database. Doing so, however, would help: (1) reduce the considerable time and effort currently devoted to the selection of arbitration panels in the United States; and (2) avoid those occasional panels which are tinged by partiality.

V. **CONCLUSION**

The FAA allows an aggrieved party to vacate an arbitration award procured by corruption, fraud, or undue means (active partiality) or where a panelist's connection with a party which is strongly suggestive of partiality (evident partiality). If such partiality is revealed to or becomes evident to the aggrieved party prior to the arbitration hearing, the aggrieved party must raise an objection or risk a waiver of the claim to vacate the award under the FAA. This places a heavy burden on the aggrieved party (who already must meet a high standard of partiality proof) to succeed in demonstrating partiality or fail and risk alienating the accused panelist if not the entire panel.

Philosophical partiality can also have a negative impact on the arbitration process but does not appear to be subject to a specific FAA remedy. Absent such a remedy, the reinsurance arbitration process would benefit from a more structured mechanism for panel or umpire selection, facilitated by an independent third party, which would help mitigate those situations in which partiality plays a role in the arbitration process.

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ENDNOTES

1. This article was previously published in Mealey's Reinsurance Reports.

2. Mr. Hall practices insurance and reinsurance law, and is active in both arbitrations and mediations. The views expressed in this article do not represent the opinions of Mr. Hall's clients. Copyright 1997 Robert M. Hall and Paige D. Waters. Comments and questions can be addressed to *robertmhall@erols.com*.

3. 9 U.S.C.A. § 10.

4. 2. The Arbitrator and Administering Institutions, § 28.1.3.2, Active Partiality, 28:7.

5. 3. *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145 (1968) (Undisclosed business relationship).

6. 4. *Id.*

7. 5. 352 A.2d at 475.

8. 6. *Bole v. Nationwide Ins. Co.*, 379 A.2d 1346 (1977).

9. 7. 600 A.2d at 608.

10. 8. The Arbitrator and Administering Institutions, § 28.1.3.2., Active Partiality, 28:7-8.

11. 9. The Arbitrator and Administering Institutions, § 28.2.3.6, A Proposal, 28:28.

12. 10. *Merit*, 714 F.2d 673.

13. 11. 223 Conn. 354 (1992).

14. 12. *Hartford*, 1997 WL 94089, (Conn. Super.) 12.

15. 13. *See* generally R. Douglas Bond and Teresa Snider, Pre-Hearing Disqualification of Arbitrators, Mealey's Lit. Rep. Reinsurance, Vol. 7, Iss. 8 (Aug. 28, 1996) at 20.

16. 14. *See* Robert M. Hall, *When The Other Side Will Not Arbitrate: Judicial Appointment of Umpires and Arbitrators*, Mealey's Lit. Rep.: Reinsurance Vol. 6, Iss. 24 (April 25, 1996). The better arbitration clauses will: (1) allow one party to appoint both arbitrators if the other does not appoint an arbitrator within a certain number of days after the arbitration demand; and (2) require a selection by lots if there is an impasse over the umpire.

17. 15. In a widely quoted concurring opinion in *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145 (1968), Mr. Justice White stated:

The court does not decide today that arbitrators are to be held to the standards of judicial decorum. . . . It is often because they are men of affairs, not apart from but of the marketplace, that they are effective in their adjudicatory function.

Id. at 150.

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