Protecting The Right To Challenge Arbitration Awards Based On "Evident Partiality"

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Binding arbitration can be a more efficient means than litigation of resolving commercial disputes. When handled correctly, arbitration can save time and money. Of course, the efficiencies in dispute resolution gained through arbitration come at a price: by contracting for binding arbitration, companies substantially (and voluntarily) limit their right of appeal. Courts take seriously private parties' agreement to abide by an arbitration panel's decision; they will overturn an award only in extreme circumstances, like when it is procured by fraud or when an arbitrator is clearly biased. This latter ground for invalidating an award – the "evident partiality" of an arbitrator – is one of the few narrow grounds for overturning an award that is codified in the Federal Arbitration Act.

Corporate counsel may know of these principles. But counsel may not be aware of a recent trend in the case law which, through a more aggressive application of the waiver doctrine, has the effect of restricting the right to contest an arbitration award based upon "evident partiality." Fortunately, there are steps that companies can take to protect the right to seek vacatur of an arbitration award due to the "evident partiality" of an arbitrator. Following these steps can also help companies "weed out" potentially partial arbitrators during the arbitrator selection process, which is preferable to the costs and uncertainty associated with seeking to overturn an award.

"Evident Partiality" As A Ground For Vacating An Arbitration Award

The Federal Arbitration Act authorizes courts to vacate an arbitration award "where there was evident partiality or corruption in the arbitrators, or either of them." The right to contest an arbitration award on the ground of bias or "evident partiality" can be waived, however. Federal courts have long held that if a party knows about an arbitrator's potential bias yet fails to object, that party cannot later use "evident partiality" as a ground to seek vacatur of an adverse award. There are two prerequisites to a finding of waiver under these decisions: the party seeking vacatur of the award must (1) have knowledge during the arbitration proceedings of an arbitrator's potential bias and (2) fail to object on bias grounds before the panel rules.

Over the years, the amount that the challenging party must know regarding an arbitrator's potential bias to support a waiver finding has changed. Under the older federal appellate decisions, failure to object would not result in waiver unless the party challenging the award had actual knowledge before the panel ruled of all the facts on which it later relies to establish an arbitrator's "evident partiality." *See, e.g.*, *Middlesex Mutual Ins. Co. v. Levine*, 675 F.2d 1197, 1204 (11th Cir. 1982) (waiver of evident partiality objection "applies only where a party has acted with full knowledge of the facts"). By contrast, two federal courts have recently held that the challenging party's *constructive knowledge* of an arbitrator's potential bias, coupled with its failure to object, results in waiver of the right to contest the award on "evident partiality" grounds.

Recent Federal Appellate Decisions Finding Waiver of "Evident Partiality" Claim

In *Fidelity Federal Bank v. Durga Ma Corp*., 386 F.3d 1306 (9th Cir. 2004), Fidelity and Durga Ma were parties to a contract that contained an arbitration clause. The arbitration clause provided that if a dispute arose each party would select an arbitrator. Those arbitrators would then select a third arbitrator and, together, the three arbitrators would resolve the dispute. Neither Fidelity nor Durga Ma requested a disclosure statement from any arbitrator before or during the arbitration proceedings. The party-appointed arbitrators did not provide disclosure statements, and neither party objected to the arbitrators' failure to provide disclosure statements.

After the arbitrators issued an award in favor of Durga Ma, Fidelity learned that the arbitrator appointed by Durga Ma had family and professional ties to Durga Ma's counsel in the arbitration. Fidelity moved to vacate the arbitration award, arguing that Durga Ma's arbitrator "was evidently partial to Durga Ma based on his failure to disclose [his] personal and business relationships" with Durga Ma's attorneys. *Id.* at 1310. The panel denied Fidelity's motion and Fidelity filed a motion requesting the district court to vacate the award, which the district court denied.

On appeal, the Ninth Circuit affirmed, finding that the arbitration selection process chosen by the parties "put Fidelity on notice that Arbitrator Lieb, who was initially retained and appointed by Durga Ma as a non-neutral party-appointed arbitrator, was likely to have some personal or professional connection to Durga Ma or its attorneys." *Id.* at 1312-13. The court held that because Fidelity had "constructive knowledge" of the arbitrator's potential partiality, yet failed to object to the arbitrator's appointment or his failure to make disclosures until after an award was issued, Fidelity waived its right to challenge the award based on evident partiality. *Id.* at 1313. The court reasoned that application of the waiver doctrine where a party has constructive knowledge of a potential conflict was consistent with the court's policies favoring the finality of arbitration awards and the speedy and cost-effective resolution of disputes.

The Ninth Circuit's holding and rationale in *Fidelity Federal Bank* is entirely consistent with the *JCI Communications* decision issued by the First Circuit in 2003. *JCI Communications, Inc. v. Local 103*, 324 F.3d 42 (1st Cir. 2003). There, the plaintiff sought to vacate an arbitration award, arguing that the arbitrators were biased against it because the arbitrators worked for the plaintiff's business competitors. The court rejected the plaintiff's argument, finding that the arbitrator selection method set forth in the governing contract put the plaintiff "on notice" that the panel would be drawn from members of its own industry and related industries "and so potentially from its competitors." *Id.* at 51. Despite its being put on notice of this risk when it signed the contract, the plaintiff chose not to inquire about the panel members' backgrounds until after the panel rendered its decision. The First Circuit held that under these circumstances, the plaintiff had waived its claim of evident partiality.

Protecting Against A Waiver Finding

The clear message of these recent federal decisions is that parties to arbitration proceedings who fail to take affirmative steps to learn about potential arbitrator bias risk waiving their right to challenge an award based on "evident partiality." Companies involved in arbitration can protect themselves against such a waiver finding by taking two precautionary steps. First, always request disclosure statements during the arbitrator selection process and insist upon compliance with the request. If an arbitrator refuses to provide disclosures about business or social relationships with the parties or their counsel that refusal would be ample grounds for objecting to the arbitrator's participation in the proceedings. Second, object on bias grounds to an arbitrator's participation if the arbitrator's disclosure raises a legitimate concern about his or her ability to decide the issues impartially. If there is something about an arbitrator's background that raises even the appearance of potential partiality, most arbitrators will recuse themselves from the arbitration in response to an objection.

Following these steps will protect against a finding that your company, by its passivity, waived its right to challenge an arbitration award based upon an arbitrator's evident partiality. Moreover, these affirmative steps will assist your company in eliminating potentially partial arbitrators very early in the proceedings during the arbitrator selection process. The information obtained through arbitrators' disclosures will assist you in making informed decisions about who your company does not want sitting on the panel and, at the same time, minimize the risk of an award that is tainted by arbitrator partiality.

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