Architectural Underpinning: Consequences of Violating Provider Rules

By Gerald M. Levine

No arbitration decision is complete without the court acknowledging that public policy favors this form of dispute resolution.[1] The goal finds particular expression in judges' restraint from second-guessing arbitrators' awards.[2] The U.S. Supreme Court has held that "[a] party seeking to vacate an arbitration award must 'clear a high hurdle.'"[3] Even the fact "that a court is convinced [an arbitrator has] committed serious error does not suffice to overturn [an arbitrator's] decision."[4] Neither would it suffice if the court determines it would have decided the matter differently.[5]

> *"If judges agree with challengers at all it happens primarily in those rare circumstances in which arbitrators fail to follow providers' rules, and in particular the disclosure and award writing rules."*

Ordinarily, in talking about vacating an award the focus is on the four theories set forth in section 10(b) of the Federal Arbitration Act (FAA) and (in New York) in section 7511(b) of the Civil Practice Law and Rules (CPLR). The applicability of these theories depends on the particulars of what the arbitrator did or failed to do that warrants vacating an award. An alternative approach that I take here is to focus on arbitrators' acts compelled by rules promulgated by providers rather than statutory labels. If judges agree with challengers at all it happens primarily in those rare circumstances in which arbitrators fail to follow providers' rules, and in particular the disclosure and award writing rules.

One other rule can trigger court intervention. It applies to decisions by providers rather than arbitrators. Because of the privacy of the arbitral proceedings the details of these provider decisions only become known if the request to the provider is denied and the requesting party challenges the decision in court. These decisions either involve disqualification of arbitrators or enforcement of key provisions of the agreement to arbitrate. Efforts to obtain mid-arbitration disqualification have been roundly rebuffed by the courts. Court interventions to challenge arbitrator authority can occur under the right factual circumstances and give courts jurisdiction to second-guess the provider.

In discussing arbitral rules I will refer to the rules of the American Arbitration Association (AAA) as representative of provider rules in general. The disclosure and award writing rules are uniform among the different sets of AAA rules but not always under the same rule number. I use the rule numbers from the Commercial Rules (2013) except where otherwise indicated. The AAA's procedure for deciding party requests to disqualify an arbitrator or for some other action can be found in the AAA Review Standards of the Administrative Review Council.

Vacatur for Not Observing the Disclosure Rule

The most emphasized rule in arbitration literature, drummed into students studying to be arbitrators, is disclosure. Rule 17(a)[6] of the Commercial Arbitration Rules provides

> Any person appointed or to be appointed as an arbitrator, as well as the parties and their representatives, shall disclose to the AAA any circumstance likely to give rise to justifiable doubt as to the arbitrator's impartiality or independence, including any bias or any financial or personal interest in the result of the arbitration or any past or present relationship with the parties or their representatives.

All the major providers have rules on disclosure, and it is also a prominent feature in the American Bar Association/American Arbitration Association Code of Ethics for Arbitrators in Commercial Disputes.[7] Canon II (D) reads "Any doubt as to whether or not disclosure is to be made should be resolved in favor of disclosure."

Two cases illustrate how important it is to make timely and complete disclosure, one from the Supreme Court of Texas (the state's highest court) and the other from the Sixth Circuit. In the Texas case the arbitrator failed to disclose facts that "to an objective observer [might] create a reasonable impression of the arbitrator's partiality."[8] What the arbitrator failed to disclose during the course of the arbitration proceedings was that he had received a "substantial referral from the law firm of a non-neutral co-arbitrator."

The facts in the case before the Sixth Circuit are even more bizarre since the disclosure came nearly five years into the arbitration and after 50 hearing days:

> [Suddenly, it seems] Kowalsky announced to Kinkade that its adversary, David White, and the Whites' advocate on the arbitration panel, Mayer Morganroth,

> had each hired Kowalsky's firm for engagements that were likely to be substantial. Kinkade objected, to no avail. A series of irregularities in the arbitration followed, all of which favored the Whites. Kowalsky eventually entered a $1.4 million award in the Whites' favor.

The district court vacated the award on grounds of the arbitrator's "evident partiality" and the Sixth Circuit affirmed.

These two cases illustrate Justice White's observation that it is far better for a potential conflict of interest "[to] be disclosed at the outset" than for it to "come to light after the arbitration, when a suspicious or disgruntled party can seize on it as a pretext for invalidating the award."[9] Vacatur is granted where it is not possible to overlook the violations of the arbitrator's duty.

The situation is different where a party challenges the arbitrator during the course of the arbitration. Here, the party's remedy (and really its sole remedy!) is found in Rule 18(c) (Disqualification of Arbitrator)[10]:

> Upon objection of a party to the continued service of an arbitrator, or on its own initiative, the AAA shall determine whether the arbitrator should be disqualified under the grounds set out above, and shall inform the parties of its decision, which decision shall be conclusive.

Within the AAA objections to appointed arbitrators are heard by the Administrative Review Council, which is an executive level, administrative decision making authority to resolve certain administrative issues that arise in the AAA's large, complex domestic cases. Although "objections should be raised at the first available opportunity, any party may make an objection to an arbitrator at any time in the arbitration, up to the issuance of the Award or other terminating order."[11]

In a recent decision from the Ninth Circuit the respondent in the arbitration first made a request to the AAA to disqualify the arbitrator, which the AAA denied, then applied to the district court, which granted the application.[12] The district court anchored its reasoning for intervention and disqualification of the arbitrator on concern for the integrity of the process. It held:

> [t]he arbitrator's failure to [disclose his business plans]…gives rise to a reasonable impression of bias. The Court finds that the standard for evident partiality has been met.

The underlying concern was that to wait for the arbitration to be completed only for the court to later determine that the nondisclosure was material would be a costly failure.

The Ninth Circuit disagreed. It was no less concerned with the integrity of the process but framed the issue differently. It held that

> [E]ven if [the arbitrator's] undisclosed activities did create a reasonable impression of partiality, the district court's equitable concern that delays and expenses would result if an arbitration award were vacated is manifestly inadequate to justify a mid-arbitration intervention, regardless of the size and early stage of the arbitration.

The reason for this is that "mid-arbitration intervention and the removal and replacement of an arbitrator [would] have a disruptive effect on proceedings that are supposed to be speedy and efficient."[13]

Assuring the process is not disrupted or slowed down is more important than cost: "[w]e have repeatedly held that financial harm is insufficient to justify collateral review; 'mere cost and delay'…is no different from the injury a party wrongfully denied summary judgment experiences when forced to go to trial, and we have 'consistently rejected…[the] position that the costs of trying massive civil actions render review after final judgment inadequate.'"

Vacatur for Violating the Award Rule

Whether violations exist at all is only determined after arbitrators have concluded their work, when their "contractual powers have lapsed" and they are *functus officio*.[14] The term *functus officio* is a branch of the doctrine of *res judicata* that prevents the reopening of decisions by the tribunal that has finally resolved a matter. It means in arbitration that a matter once decided cannot be reopened before the same arbitrator or panel (that does not sit generally as a judicial panel) that rendered the final decision. It is a "fundamental common law principle that once an arbitrator has made and published a final award his authority is exhausted and…[he or she] can do nothing more in regard to the subject matter of the arbitration."[15]

In contrast to the consequences of violating the disclosure rule, failure to provide clarity or accuracy of the calculation of awards or failure to provide a required explanation under the rule that dictates the form of award (R-46 of the AAA Commercial Rules) is remand to the arbitrator or provider. The court's authority in this circumstance illustrates one of the several exceptions to *functus officio*. R-47(b) of the Construction Industry Arbitration Rules (2015), for example, provides that "[i]n all cases, unless waived by

agreement of the parties, the arbitrator shall provide [i] concise written financial breakdown of any monetary awards and, if there are non-monetary components of the claims or counterclaims, the arbitrator shall include a line item disposition of each non-monetary claim or counterclaim." (There is no counterpart of this rule in the Commercial Rules).

In a recent case from the U.S. District Court for the Southern District of New York the parties did not waive the rule and were therefore entitled to a reasoned award. In writing a bare award the Court concluded that the arbitrator had exceeded his authority: "In sum, this Court concludes that it is authorized to remand this matter to Arbitrator Krol for purposes of issuing a 'reasoned award,' and that the doctrine of *functus officio* presents no impediment to that approach."[16] In his carefully drafted decision Judge Gardephe cited widespread support for this conclusion.[17]

The same conclusion with consequential remand would not happen with awards involving commercial disputes unless the parties had expressly requested a reasoned award "in writing prior to the appointment of the arbitrator or unless the arbitrator determines that a reasoned award is appropriate."[18]

The remedy for failure to write a proper award, however, is generally inconsequential in comparison with other arbitrator violations that support vacatur. It does not require the parties to incur the expense and waste time starting again with another arbitrator. There are exceptions of course that focus on the parties' agreement rather than provider rules. For example, in a Ninth Circuit case the court vacated an arbitration award that failed to provide "findings of fact and conclusions of law" as required by the arbitration agreement. The court held that the FAA "requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms."[19]

Pre-award Intervention

So far I have been discussing primarily post-award motions. I have noted that courts will not disturb provider decisions denying disqualification of arbitrators mid-arbitration because it interferes with the process. Neither will courts entertain suits to address pre-award general objections to the impartiality or expertise of an arbitrator.

The question is, will "our courts enforce the conditions of an arbitral agreement before the arbitral award has been issued when (1) the underlying subject matter of the arbitration involves complex technical and legal issues, (2) the arbitration agreement requires that the arbitrators possess a highly specialized professional background, and (3) the arbitration agreement specifically outlines a precise method to select said arbitrators?"[20]

This is a "narrow, but important, issue." The court explained in *Oakland-Macomb Drain Dist. v. Ric-Man* that intervention is appropriate "when suit is brought…to enforce the key provisions of the agreement to arbitrate—i.e., when the criteria and method for choosing arbitrators are at the heart of the arbitration agreement—then courts will enforce these contractual mandates." In this case, "[t]he AAA's refusal to comply with the arbitration agreement's stated terms robbed the Drainage District of its bargained-for terms, and AAA's repudiation of its obligation cannot be sanctioned by this Court."

Conclusion

Allowing for some overlap the AAA rules are divided into five groups: arbitral process, arbitrator duties, arbitrator power, party duties and obligations, and provider duties. The argument in this article has been that vacatur is limited to egregious violations of arbitrator and provider duties as expressed in their rules. Although mal-, non-, or misfeasance implicating the other rules are the most raised in motions, and thoroughly enjoyable to read, they are rarely (perhaps, never!) persuasive at the appellate level in supporting vacatur.

Endnotes

1. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24, 111 S.Ct. 1647, 114 L.Ed.2d 26 (1991) Congress enacted the FAA in 1925 "to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, and to place arbitration agreements upon the same footing as other contracts."); *United Bhd. of Carpenters & Joiners of Am. v. Tappan Zee Constructors*, LLC, __ F.3d __, 2015 WL 6143213, at *4 (2d Cir. Oct. 20, 2015) ("A court's review of an arbitration award is severely limited so as not to frustrate the twin goals of arbitration, namely, settling disputes efficiently and avoiding long and expensive litigation.").
2. A good example is the Second Circuit's instruction to the district court to confirm the award *in Scandinavian Reinsurance Co. v. Saint Paul Fire & Marine Ins. Co.*, 668 F.3d 60 (2nd Cir. 2012).
3. 559 U.S. at 671.
4. *Tappan Zee Constructors*, 2015 WL 6143213, at *4 (2nd Cir.).
5. *United Steelworkers of America v. Enterprise Wheel and Car Corp.*, 363 U.S. 593, 599, 80 S.Ct. 1358, 4 L.Ed.2d 1424 (1960) ("It is the arbitrator's construction which was bargained for; and so far as the arbitrator's decision concerns construction of the contract, the courts have no business overruling him because their interpretation of the contract is different from his.").
6. The same rule can be found in the Construction Industry Arbitration Rules of the AAA at R-19.
7. The Code became effective March 1, 2004). Disclosure is covered in Canon II ("An arbitrator should disclose any interest or relationship likely to affect impartiality or which might create an appearance of partiality.).
8. *Burlington Northern Ry. v. Tuco Inc.*, 960 S.W.2d 629 (Tex. 1997) ("[A] prospective neutral arbitrator selected by the parties or their representatives exhibits evident partiality if he or she does not disclose facts which might, to an objective observer, create a

reasonable impression of the arbitrator's partiality. We emphasize that this evident partiality is established from the nondisclosure itself, regardless of whether the nondisclosed information necessarily establishes partiality or bias.").

9. *Commonwealth Coatings Corp v. Continental Casualty Co.*, 393 U.S. 145, 151, 89 S.Ct. 337 (White, J., concurring).
10. The same rule can be found in the Construction Industry Arbitration Rules of the AAA at R-20.
11. Review Standards at 2.
12. *In Re Sussex*, 781 F.3d 1065 (9th Cir. 2015) (Decisions amended March 27, 2015) (Mid-arbitration intervention disqualifying the arbitrator reversed.) A petition for certiorari was filed on June 25, 2015.
13. 781 F.3d at 13.
14. *Green v. Ameritech Corp*., 200 F.3d 967, 976-78 (6th Cir. 2000) ("The doctrine of *functus officio* contains several exceptions. This court has noted: '[The] rule [of *functus officio*] was based on the notion that after an arbitrator has rendered an award, his contractual powers have lapsed and he is `*functus officio*.'").
15. *La Vale Plaza, Inc. v. R.s. Noonan, Inc*., 378 F.2d 569 (3rd Cir. 1967).
16. *Tully Construction Company/A.J. Pegno Construction Company, J.V., v. Canam Steel Corporation*, No. 13 Civ. 3037 (PGG) (SDNY March 2, 2015).
17. See *Green v. Ameritech Corp*., *supra* note 14: "This rule [*of functus officio*], however, has its limits. A remand is proper, both at common law and under the federal law of labor arbitration contracts, to clarify an ambiguous award or to require the arbitrator to address an issue submitted to him but not resolved by the award.'" *Industrial Mut. Ass'n Inc. v. Amalgamated Workers, Local No. 383*, 725 F.2d 406, 412 n. 3 (6th Cir.1984)).
18. R-46(b) of the Commercial Arbitration Rules and Mediation Procedures: "[t]he arbitrator need not render a reasoned award unless the parties request such an award in writing prior to appointment of the arbitrator or unless the arbitrator determines that a reasoned award is appropriate."
19. *W. Employers Ins. v. Jefferies & Co.*, 958 F.2d 258, 261 (9th Cir. 1992).
20. *Oakland-Macomb Drain Dist. v. Ric-Man*, 304 Mich. App. 46, 850 N.W.2d 498 (2014).

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