Lifting the Veil on Arbitration Proceedings

Who's Your Arbitrator: Arbitrator Disqualification by the Courts

In the Spring 2016 issue of AIRROC Matters, we featured Part 1 of a multipart arbitration series by Michael Goldstein and Dan Endick titled, "When Courts Peek Under the Arbitral Veil: The Role of the Courts in Managing Your Reinsurance Arbitration." Part 2 was "Lifting the Veil on Arbitration Proceedings: Who's Your Counsel – Disqualification of Counsel by Courts" and it appeared in the Summer 2016 issue. This is Part 3 of the series.

In addition to resignations, disqualification of an arbitrator in a pending arbitration is another remedy that is more frequently sought in the courts. Although not considered the "general rule,"[1] it is difficult to see why more litigants have not attempted to make analogous arguments as they do with resignations. *See, e.g., Ins. Co. of N. Am. v. Pub. Serv. Mut. Ins. Co.,* 609 F.3d 122, 130 (2d Cir. 2010); *WellPoint, Inc. v. John Hancock Life Ins. Co.*, 576 F.3d 643, 647 (7th Cir. 2009). A common request for disqualification asserts that an arbitrator was not disinterested or was not properly selected under the relevant contractual provisions and therefore must be replaced. One might argue that the entire panel should be replaced because there is a potential that the newly-selected arbitrator would be tainted by the two remaining arbitrators. Although this might be a plausible argument, given the case law involving arbitrator disqualification, it seems that the courts generally respect the parties' rights pursuant to contract to select an arbitrator and are hesitant to intervene to disqualify one.

In *Trustmark v. John Hancock*, for example, the plaintiff filed an action attempting to ask the court to declare that an arbitrator was not disinterested and therefore should be disqualified. *Trustmark Ins. Co. v. John Hancock Life Ins. Co. (U.S.A.)*, 631 F.3d 869, 871 (7th Cir. 2011). The District Court found that the arbitrator, who had acted as an arbitrator in a prior arbitration between the parties, was not disinterested because he could have been called as a fact witness about the prior proceedings. *Id.* at 871. The District Court ruled in favor of the plaintiff and granted an injunction to enjoin the arbitration proceeding. *Id.* Additionally, the court found that only a judge could determine what the confidentiality agreement signed by the arbitrators required. *Id.*

The Seventh Circuit reversed, finding that mere knowledge of the prior proceedings was not enough to claim the arbitrator was not disinterested. *Id.* at 873. The court analogized this situation to judges, who often have knowledge of and experience with multiple suits arising from the same issue. *Trustmark,* 631 F.3d at 873. The court found that the District Court erred in concluding that arbitrators could not interpret the confidentiality agreement, as the agreement to arbitrate encompasses all arbitration disputes. *Id.* at 873-74. The appellate court found that the confidentiality agreement was "presumptively within the scope of the reinsurance contracts' comprehensive arbitration clause." *Id.* at 874.

Finding that the arbitrator had no financial stake in the outcome of the proceedings, the court declined to intervene. *Id.* The court noted that although the arbitrator was familiar with the parties, "[n]othing in the parties'

1 A prior article by Michael H. Goldstein and Daniel J. Endick in the Spring 2016 Edition of AIRROC Matters discussed the "general rule" that applies in the event of the death of one arbitrator; see also Marine Products, 977 F.2d at 68.

contract requires arbitrators to arrive with empty heads." *Id.* at 873. Additionally, the court stated that the arbitration panel was entitled to determine the meaning of the confidentiality agreements. *Trustmark*, 631 F.3d at 874-75. "But among the powers of an arbitrator is the power to interpret the written word, and this implies the power to err; an award need not be correct to be enforceable." *Id.* at 874. The court held that as long as "the arbitrators honestly try to carry out the governing agreements," the panel is within its discretion and the court should not intervene. *Id.*

Northwestern National Insurance Co. v. Insco, Ltd. is another instance where the contractual right to select an arbitrator was upheld, in a particularly contentious dispute. Arbitration commenced in June 2009, and the arbitrators made initial disclosures of possible conflicts of interest in February 2010. *Nw. Nat. Ins. Co. v. Insco, Ltd.*, No. 11 CIV. 1124 SAS, 2011 WL 1833303, at *1 (S.D.N.Y. May 12, 2011). The arbitration was "characterized by an ongoing dispute regarding the alleged failure of both party-appointed arbitrators to disclose possible conflicts of interest arising after the organizational meeting." *Id.* This dispute led to a petition to the court in which Insco demanded the resignation of the entire panel "on the basis of evident partiality." *Id.* This request for resignation came after it was revealed that one of Insco's counsel was employed by an insurance company of which Insco's arbitrator was a board member, and the Northwestern arbitrator revealed that she had been appointed as arbitrator in two previous arbitrations that involved Northwestern's counsel's firm. *Id.*

After the demand for resignation, Insco's arbitrator resigned and Insco quickly reappointed a new arbitrator. *Id.* at *2. Northwestern then filed suit, claiming that the defendant did not have the authority to replace the appointed arbitrator. *Nw. Nat. Ins. Co,* 2011 WL 1833303, at *3. It claimed that allowing a party to appoint a new arbitrator, three days before oral argument of a dispositive motion, would allow for manipulation of the arbitration process. *Id.* Insco countered this argument by stating that it had uncovered evidence of partiality and was entitled to replace its party-arbitrator.

The court declined to intervene in the arbitration proceeding because Insco had appointed a replacement arbitrator. *Id.* The court distinguished this scenario from situations where a party refused to appoint a replacement arbitrator and tried to assert the "general rule" that was set forth by the Second Circuit in *Marine Products*. *Id.; Marine Products Exp. Corp. v. M.T. Globe Galaxy*, 977 F.2d 66, 68 (2d Cir. 1992). The fact that there was an alleged lack of impartiality, coupled with the swift action by Insco to appoint a replacement arbitrator, allowed the court to exercise its discretion by not intervening. The court believed that allowing Insco to choose its arbitrator in these circumstances would promote the underlying goals of arbitration. *Id.*

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The Sixth Circuit, in *Savers Property and Casualty Insurance v. National Union Fire Insurance Company of Pittsburgh*, recently also confronted an effort to disqualify an arbitrator mid-proceeding. In that case, a complaint was filed in Michigan state court, but was later removed to federal court, seeking to vacate an award for "evident partiality." *Savers Prop. & Cas. Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 748 F.3d 708, 713 (6th Cir. 2014). After selecting the party-arbitrators, the parties selected an umpire, who at the time of his appointment disclosed that he was a personal friend of National Union's party-arbitrator. *Id.* at 712. Despite this connection, the parties agreed to the umpire's appointment, and the arbitration commenced.

After the panel issued a unanimous "Interim Final Award," the plaintiff, Meadowbrook, filed a supplemental submission pursuant to the award, containing documents needed to calculate the final damages. *Id.* at 713. National Union's arbitrator and the umpire, the two who had disclosed that they were personal friends, rejected the supplemental submission as not responsive to documents that were sought in the Interim Final Award. *Id.* Meadowbrook filed suit in Michigan state court, arguing that the majority showed evident partiality because they rejected the supplemental submission in the absence of Meadowbrook's party-arbitrator. *Id.* at 713-14. Additionally, Meadowbrook argued that National Union's arbitrator was not disinterested, because he was involved in speaking *ex parte* with National Union's counsel during the course of the arbitration. *Savers*, 748 F.3d at 713-14.

In addition to filing a petition with the court, Meadowbrook protested the panel's orders, asserting the same evident partiality arguments; the panel denied all of Meadowbrook's motions. *Id.* at 714. Meadowbrook moved the state court to stay the proceeding "in order to challenge the fundamental fairness of the proceedings." *Id.* at 715. National Union removed the case to federal court on the basis of diversity and the District Court heard the motion by Meadowbrook for injunctive relief. The District Court concluded that injunctive relief was proper because of the high likelihood of irreparable harm that Meadowbrook faced. *Id.* The court found that substantial financial liability could result, and there was a high likelihood that Meadowbrook would succeed in showing a breach of contract with regard to *ex parte* communications between National Union's party-arbitrator and its counsel. *Id.* Accordingly, the court enjoined the arbitration proceedings and National Union appealed.

The Sixth Circuit, however, found that the District Court erred when it entertained an interlocutory attack on an arbitrator's partiality. *Savers*, 748 F.3d at 716. The court found that a determination of whether the arbitrator was disinterested is ripe only after the proceedings have finished. *Id.* In reviewing both the FAA

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and Michigan's arbitration laws, the Sixth Circuit concluded that there were only two stages at which a court may become involved in arbitration proceedings: at the outset and at the conclusion of the dispute. *Id*. at 717. "Between those two stages, however, the laws are largely silent with respect to judicial review." *Id*.

Placing a heavy emphasis on the procedural posture of the case, the court found that, even when there are allegations of impartiality, the court is bound by the FAA. *Id*. at 720. If proceedings are brought before the court, even in the face of an arguably tainted arbitrator, the court will respect the arbitration proceedings and not intervene in an ongoing arbitration proceeding.

Even when not dealing with whether an arbitrator is disinterested, courts seem to be reluctant to impose their authority to disqualify an arbitrator. For instance, in *IRB-Brasil Resseguros S.S. v. National Indemnity Company*, the court specifically acknowledged that its holding and reasoning could cause manipulation of the arbitration process yet respected the parties' right to select their own arbitrator. *IRB-Brasil Resseguros S.A. v. Nat'l Indem. Co.*, No. 11 CIV. 1965 NRB, 2011 WL 5980661, at *4 (S.D.N.Y. Nov. 29, 2011). *IRB* involved three separate arbitrations. *Id*. at *1-2. All three arbitration panels were being selected simultaneously, and one of the proposed umpires, after being stricken by IRB-Brasil, was subsequently appointed as National Indemnity's arbitrator in two of the three proceedings. *Id*. at *2. In order to get appointment of the stricken umpire as its party-arbitrator in the third proceeding, National Indemnity requested that its already appointed arbitrator, who had been in place for more than two years, immediately resign. *Id*. at *4. IRB-Brasil filed a petition with the court seeking an order preventing National Indemnity from changing its party-arbitrator.

IRB-Brasil argued that the original appointment by National Indemnity should be considered final in order to protect the integrity of the arbitration process. *Id*. at *3. In coming to its conclusion, the Southern District of New York distinguished the instant case from *Insurance Company of North America v. Public Service Mutual Insurance Co. IRB-Brasil*, 2011 WL 5980661, at *3. The court found that there was a crucial distinction between the cases: the party whose arbitrator resigned in *Insurance Company of North America* did not nominate a replacement candidate. *Id*. at *4. Instead, the court found that the factual scenario in this case was similar to *Northwestern National Insurance Co. v. Insco, Ltd.*, where the court held that the request to replace a candidate cut against the overall goal of arbitration to have balanced deliberations that produce an outcome acceptable to both parties. *Id*.

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The district court found that because the second arbitration had not begun, the parties were within their rights to appoint their own arbitrators under the arbitration clause of the contract. *Id*. at *5. Even while acknowledging that the process can be manipulated to allow a party to get the arbitrator it wants, the court was unwilling to disturb the contract. "It is commonly accepted that in the tripartite arbitration system, parties are entitled to an arbitrator of their choice to act as a de facto advocate for their position." *Id*. at *4.

A similar result was reached more recently by the Southern District of New York in *Odyssey Reinsurance Co. v. Certain Underwriters at Lloyd's London Syndicate 53*. 1:13-cv-09014-PAC, Slip Op. (S.D.N.Y. Oct. 9, 2015). In that case, the arbitration agreements required that each member of the arbitration panel be an officer of a U.S. authorized insurance or reinsurance company writing workers' compensation business. Prior to the appointment of an umpire, the respondents advised the petitioner, Odyssey, that they were replacing their party-arbitrator. Subsequently, Odyssey determined that the replacement arbitrator was actually an officer of a broker rather than an insurance or reinsurance company. Respondents took the position that he was qualified insofar as his company had "corporate affiliates" that wrote workers' compensation business in the United States. Odyssey subsequently petitioned the court to direct respondents to appoint an arbitrator who meets the qualification requirements in the relevant agreements. The court, however, refused to do so, holding in a handwritten decision that respondents' replacement arbitrator "meets the qualifications" set forth in the agreements. *Id*.

Interestingly, in that same matter, the court *did* eventually intervene to break a deadlock with regard to the appointment of an umpire. Odyssey had taken the position that respondents' proposed candidates were unqualified under the terms of the parties' agreements. The District Court initially refused to intervene, holding by order of June 30, 2014 that "there has not been a breakdown in the process that justifies court intervention." 1:13-cv-09014-PAC, 2014 WL 3058377 (S.D.N.Y. June 30, 2014). On August 26, 2015, however, the Second Circuit reversed, holding that where, as here, there had been a "lapse" in the naming of an umpire, the district court had "not only the authority, but the obligation" to appoint an umpire pursuant to Section 5 of the FAA. 615 Fed. Appx. 22 (2d Cir. 2015). Accordingly, on December 2, 2015, pursuant to the Second Circuit's instructions, the district court appointed an umpire and dismissed the case. 1:13-cv-09014-PAC, Slip. Op. (S.D.N.Y. Dec. 2, 2015).

Indeed, courts will intervene if the actions taken seem intended solely to manipulate the arbitration process. In *AIG vs. Odyssey*, the New York Supreme Court was asked to intervene to solve a dispute that arose when an arbitrator was discharged

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by the party that selected him. *AIG v. Odyssey* Motion Transcripts, p. 6, Index No. 159373/14, February 10, 2015. The parties were involved in three separate arbitration proceedings. *Id.* at 4. Multiple disputes arose between the parties regarding the selection of arbitrators. In one of the proceedings, Odyssey Group sought to replace its arbitrator only a few days before an organizational meeting was held following an adverse ruling in another matter against Odyssey, in which Odyssey's arbitrator was also a panelist. *See* Memorandum of Law In Support of Petition to Compel, p.1, Index No. 159373/14, October 1, 2014. The other disputes surrounded the selection process for the arbitrators pursuant to the written agreements between the parties. AIG filed a motion under Section 5 of the FAA asking the court to intervene. *Id.* at 6.

As to the replacement of Odyssey's arbitrator before the organizational meeting, AIG's main contention was that the replacement of the arbitrator at that time was a "litigation strategy to most effectively manipulate the arbitration process." *AIG v. Odyssey*, Petitioners Reply Memorandum of Law, p. 9, Index No. 159373/14, Oct. 30, 2014. AIG argued that the calculated termination of the Odyssey party-arbitrator was intended to delay and frustrate the arbitration proceedings. AIG argued that Odyssey had no right under the contract to replace its arbitrator and was simply trying do so because they were in a "no man's land of the arbitration prior to the constitution of the panels in each case." Transcripts, p. 9. AIG asked the court to reappoint the arbitrator that Odyssey had terminated.

The court granted AIG's motion, and found that the substitution of Odyssey's party-arbitrator would prejudice AIG. *Id.* at 21. The court found it was proper under Section 5 of the FAA for it to intervene, as the contract did not expressly sanction Odyssey's actions. Additionally, the court found that in this case there was no claim that the appointed arbitrator was lacking impartiality, and stated that "there is no conflict, there's no reason to substitute that is obvious." *Id.* at 17. Holding that there was no evident partiality, the court distinguished cases like *IRB* and *INSCO*, finding that those cases dealt squarely with a claim that the arbitrator was not disinterested. *Id.* at 18-21. The court concluded that allowing a party to take this action would give it the ability to "blow [up] the arbitration" at any point in an attempt to delay the proceedings. *Id.* at 20. Hence, AIG's claim of Odyssey's attempt at deliberate manipulation of the process was vindicated.

The court then turned to the two other disputes between the parties, and found that the contracts in both arbitrations were controlling. Transcripts, p. 22. Both disputes concerned the reselection of arbitrators after an arbitrator, who was serving in both arbitrations, independently resigned. The contracts for the arbitrations stated that a list of potential arbitrators was to be submitted by both parties, and the parties were to work together to select the arbitrator. *Id.* at 23. The court ordered that the parties follow this procedure, and independently submit a list of potential arbitrators, so that the arbitration process could continue. *Id.* at 22-25.

Although a court could be asked to review the qualifications or partiality of an arbitrator, courts seem to comply with the general understanding under Section 5 of the FAA, which explicitly grants the court discretion to appoint an arbitrator only if the contract itself does not state how the arbitrator will be appointed. Courts seem to respect the party's right to choose its own arbitrator, but have become wary of situations that seem only to delay or frustrate the arbitration process.

Although the case law seems very fact-sensitive and based on when and how the parties come before the court, the Supreme Court of New York's decision in *AIG v. Odyssey* put a check on situations that indicate clear manipulation of the process. In those rare instances, although courts are reluctant to intervene, courts may step in to enforce the parties' contract and allow the arbitration to continue.

Conclusion

Courts have recently taken a more proactive role in pending, as opposed to concluded, arbitrations. Most of the litigation activity surrounds the replacement of party arbitrators. Jurisdictions differ as to the courts' authority when exercising their discretion in these situations. Some jurisdictions follow a strict rule that requires an arbitration to start anew, while others will simply appoint a new arbitrator in the middle of the process and require the new arbitrator to be integrated in the midst of an ongoing proceeding.

A growing concern is whether courts, in exercising their authority under Section 5 of the FAA, are inevitably generating more litigation through these decisions. These decisions, while sound and in accordance with the courts' authority, may be missing issues that could result in a heightened level of litigation in subsequent pending arbitrations. Although the goal of arbitration is to avoid litigation, and reach amicable agreements in a less formal setting, there is still uncertainty as to precisely what role the court should be taking in the midst of the arbitration process. While courts seem to respect the contractual rights of the parties, the broad discretion given under Section 5 of the FAA, and the various applications of the "general rule," could be expanding the courts' role, even if their final determination is that they have no authority to intervene in a particular matter. ●

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