ADR news

ETHICS IN ARBITRATION

Vacatur Not Warranted for Undisclosed Trivial Past Association

But Guidance for Other Transactions Is Lacking

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On Jan. 18, 2007, an 11-5 majority of the 5th Circuit reversed itself and, in an eagerly anticipated decision, ruled *en banc* that the "extreme remedy" of vacatur for "evident partiality" under § 10(a)(2) of the Federal Arbitration Act (FAA) is not required by an arbitrator's nondisclosure of a "trivial former business relationship."

The dispute involved in *Positive Software Solutions v. New Century Mortgage Corp. et al.*, No. 04-11432, 2007 WL 111343 (5th Cir., Jan. 18, 2007), arose during negotiations for renewal of a software license agreement. Positive Software alleged that licensee, New Century Mortgage, illegally copied and incorporated its software into a number of other software products. Positive Software then filed a lawsuit in federal court in Texas against New Century alleging various causes of action (including copyright infringement, theft of trade secrets, and breach of contract) and seeking specific performance and preliminary and permanent injunctive relief. The district court granted a preliminary injunction and, pursuant to an arbitration provision in the license agreement, submitted the matter to arbitration under the aegis of the American Arbitration Association.

Using the AAA list-ranking procedures for arbitrator selection, the parties selected Peter Shurn as the sole arbitrator. Shurn signed and returned the Association's standard Notice of Appointment form, which instructed arbitrators to "please disclose any past or present relationship with the parties, their counsel, or potential witnesses, direct or indirect, whether financial, professional, social or any other kind ...." and asked, "Have you had any professional or social relationship with counsel for any party in the proceeding or with the firms for which they work?" Shurn indicated that he had nothing to disclose.

Requiring an award to be vacated for trivial nondisclosures would "seriously jeopardize the finality of arbitration," the majority of the 5th Circuit said in the en banc decision.

After the hearings were completed, Shurn denied all of Positive Software's claims. Positive Software then began to investigate Shurn's background in detail. It discovered that, seven or more years ago, Shurn and his former law firm, Arnold White & Durkee, along with New Century's counsel, Susman Godfrey, had represented Intel in an unrelated patent litigation. One of Susman Godfrey's attorneys in the Positive Software arbitration, Opheila Camina, had been involved in the Intel litigation, which comprised six different lawsuits and the participation of at least 34 attorneys, including Shurn and Camina. Camina's involvement in three Intel lawsuits ended in July 1992. In September 1992, Shurn entered an appearance in two of the Intel lawsuits on which Camina worked, and their names appeared together on the pleadings (her name remained there until June 1993). However, Shurn and Camina never attended or participated in any meetings, telephone calls, hearings, depositions or trials together. Nevertheless, because Shurn never disclosed this information, Positive Software moved to vacate the award on the ground that Shurn was biased.

In September 2004, the district court vacated the award (337 F. Supp.

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2d 862, N.D. Texas 2004), finding that Shurn "failed to disclose a significant prior relationship with New Century's counsel, thus creating an appearance of partiality requiring vacatur." The district court held that "any reasonable lawyer selecting a sole arbitrator ... would have wanted to know that the arbitrator chosen has a prior association with opposing counsel, given the contentious nature of the dispute between the parties and the duration of the prior litigation with which both the arbitrator and opposing counsel were associated."

Initial 5th Circuit Decision

The 5th Circuit initially affirmed (436 F.3d 495, 2006), finding that the prior undisclosed relationship "might have conveyed an impression of possible partiality to a reasonable person," thus rendering entirely irrelevant the fact that Shurn had never actually met or spoke with Camina prior to the arbitration. This decision cited Justice Byron White's concurrence in *Commonwealth Coatings v. Continental Casualty Co.* (393 U.S. 145, 1968), where he stated that parties must be cognizant of "all non-trivial relationships in order to exercise full and fair treatment," and appeared to advocate a rule of full early disclosure. "It is far better that the relationship be disclosed at the outset, when the parties are free to reject the arbitrator or accept him with knowledge of the relationship and continuing faith in his objectivity, than to have the relationship come to light after the arbitration, when a suspicious or disgruntled party can seize on it as a pretext for invalidating the award," wrote Justice White.

Based on this view, the 5th Circuit held that an arbitrator displays evident partiality by his mere failure to disclose facts "that might create a reasonable impression of the arbitrator's partiality"—regardless of whether actual bias was established. The court reasoned that even a trifling nondisclosure prevents the parties from being privy to a potential arbitrator's biases at the outset when they could reject or accept the arbitrator.

Applying this standard, the court found that Shurn should have disclosed his relationship to Camina prior to his appointment by Positive Software. Since Shurn had not done so, the court affirmed the district court's decision, leading New Century to petition for a rehearing *en banc*.

***En Banc* Decision**

The 5th Circuit reversed its prior decision 11-5 and remanded the case to the district court. The majority attempted to provide a slightly different gloss on the concurrence in *Commonwealth Coatings* by opining that Justice White would uphold awards in instances where arbitrators fail to disclose insubstantial or trivial relationships. The majority based this conclusion on White's statement that arbitrators are "not automatically disqualified by a business relationship with the parties before them if ... [the parties] are unaware of the facts but the relationship is trivial."

After reviewing further precedent in light of Justice White's concurrence, the majority held that "in nondisclosure cases, an award may not be vacated because of a trivial or insubstantial prior relationship between the arbitrator and the parties to the proceeding."

Applying the above-quoted standard, the majority found that Shurn's prior business relationship with Camina was trivial and its nondisclosure did not warrant vacatur. "No case we have discovered in research or briefs," the majority wrote, "has come close to vacating an arbitration award for nondisclosure of such a slender connection between the arbitrator and a party's counsel."

The majority recognized that requiring an award to be vacated in situations like the one at bar would "seriously jeopardize the finality of arbitration" because "losing parties would have an incentive to discover the most trivial of relationships, most of which they likely would not have objected to if disclosure had been made." This would lead, the majority predicted, to a proliferation of "expensive satellite litigation over nondisclosure of an arbitrator's 'complete and unexpurgated business biography.'" The majority opinion stated that concluding otherwise would "hold arbitrators to a higher standard than Article III judges," thus robbing arbitration of one of its most attractive features apart from speed and finality—expertise."

The majority concluded by stating "[n]either the FAA nor the Supreme Court, nor predominant case law, nor sound policy countenances vacatur of FAA arbitral awards for nondisclosure by an arbitrator unless it creates a concrete, not speculative impression of bias" and emphasizing that the "draconian remedy of vacatur is only warranted upon nondisclosure that involves a significant compromising relationship."

Practice Tip

The Fifth Circuit granted relief to New Century by viewing Shurn's prior undisclosed relationship as trivial. But the Court offers no useful guidance for arbitrators as to the extent disclosure required in other situations. How close much a party's prior, undisclosed connection be to an arbitrator to warrant vacatur? The Court fails to say either in terms of proximity and/or time.

Until there is definitive guidance at the appellate level, lower courts are likely to disagree on the practical limits of what constitutes a "trivial" prior relationship and base their views on subjective assessment of highly fact-dependent situations.

So where does this leave arbitrators? Right back where we were prior to Positive Software. To avoid the risk of having our awards vacated, we should disclose all prior relationships no matter how trivial we think they might be—whatever they were and whenever they occurred. ■