

CHAPTER 29

IN INTERNATIONAL ARBITRATION, DISCLOSURE RULES AT THE PLACE OF ENFORCEMENT MATTER TOO

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I. Introduction

An increasing number of international disputes are being decided through international arbitration with large amounts of money at stake. A prevailing party may well decide to enforce the award in a jurisdiction that is not the seat of the arbitration, which follows a stricter standard of arbitrator disclosure. What standards of disclosure should an arbitrator follow when being considered for the panel? The ramifications of ignoring this issue or choosing the wrong standard could be devastating.

This chapter¹ discusses this issue in the context of the Revised American Arbitration Association/American Bar Association Code of

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¹ This chapter was motivated, in part, by discussion held at the Symposium on International Commercial Arbitration sponsored by the London Court of International Arbitration, on Nov. 18, 2006, in Washington, D.C. The author also gave a presentation based on an earlier draft of this chapter at the International Commercial Arbitration and Mediation Conference, sponsored by the International Centre for Dispute Resolution (a division of the American Arbitration Association), on Dec. 6, 2006, in Philadelphia.

Ethics for Arbitrators in Commercial Disputes (Code of Ethics) and the International Bar Association (IBA) Guidelines on Conflicts of Interest in Commercial Arbitration (IBA Guidelines), viewed through the recent en banc decision by the 5th Circuit in *Positive Software v. New Century Mortgage Corp.*²

II. The Code of Ethics

The AAA/ABA Code of Ethics³ imposes very stringent disclosure requirements on arbitrators—the most stringent of all such rules this author has seen—and thus could be viewed as the “gold standard” against which all other disclosure standards are measured. Canon I, paragraph A, sets forth the basic obligation of an arbitrator: “An arbitrator has a responsibility not only to the parties but also to the process of arbitration itself and must observe high standards of conduct so that the integrity and fairness of the process will be preserved.”

Canon II enumerates an arbitrator’s disclosure obligation:

(A2) Persons who are requested to serve as arbitrators should, before accepting, disclose any known existing or past financial, professional or personal relationship which might affect impartiality or a lack of independence in the eyes of any of the parties....

(D) Any doubt as to whether or not disclosure is to be made should be resolved in favor of disclosure....

(F) When parties, with knowledge of a person’s interests and relationships, nevertheless desire that person to serve as an arbitrator, that person may properly serve.

Neither Canon II nor any other Code provision sets any time limitation. A relationship subject to disclosure could have occurred at

² 337 F. Supp. 2d 862 (N.D. Tex.), aff’d with modifications, 436 F.3d 495 (5th Cir. 2006), rev’d en banc, 476 F.3d 278 (5th Cir. 2007), cert. denied, 127 S. Ct. 2943 (U.S. 2007). The author previously discussed this decision in P.L. Michaelson, “Vacatur Not Warranted for Undisclosed Trivial Past Association—But Guidance for Other Transactions is Lacking,” 62(1) Disp. Resol. J. 4 (Feb.-April 2007).

³ AAA/ABA Code of Ethics for Arbitrators in Commercial Disputes, revised and effective March 1, 2004.

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any time in the past—last week, six months ago, or 14 years ago. What matters is that the relationship might be perceived, from the perspective of a party as adversely affecting the arbitrator’s impartiality or independence.

III. IBA Guidelines

The IBA Guidelines⁴ treat conflicts very differently and far more leniently than does the Code of Ethics. Section 3 of the General Standards (Part I) states a general view in paragraph (a):

If facts or circumstances exist that may, in the eyes of the parties, give rise to doubts as to the arbitrator’s impartiality or independence, the arbitrator shall disclose such facts or circumstances to the parties, the arbitration institution or other appointing authority ... prior to accepting his or her appointment or, if thereafter, as soon as he or she learns about them.

Paragraph (c), consistent with the Code of Ethics, states: “Any doubt as to whether an arbitrator should disclose certain facts or circumstances should be resolved in favour of disclosure.”

Yet, while ostensibly favoring disclosure, the IBA Guidelines inhibit it through paragraph (c) in the Explanation to General Standard 3, which, without any justification, states: “Unnecessary disclosure sometimes raises an incorrect implication in the minds of the parties that the disclosed circumstances would affect his or her impartiality or independence. Excessive disclosure thus unnecessarily undermines the parties’ confidence in the process.”

The IBA Guidelines divide up conflicts of interest into three lists, specifically the Red, Orange and Green Lists—the colors of the lights on a traffic signal, having connotations similar to what the colors mean to automobile drivers.⁵

⁴ The IBA Guidelines on Conflicts of Interest in International Arbitration were approved May 22, 2004. Judith Gill, “The IBA Conflicts Guidelines—Who’s Using Them and How,” 1(1) *Dispute Resol. Int’l* 58-72 (June 2007), reports on the limited use of the IBA Guidelines in various countries and the associated views of various administering organizations.

⁵ See IBA Guidelines, pt. II, §§ 1-4. The brochure published by the IBA contains a flowchart on pp. 26-27, depicting specific actions to be taken to deal with conflicts in these lists.

The Red List contains two sub-lists: a Non-waivable Red List and a Waivable Red List. If a candidate arbitrator has a conflict in a matter and that conflict is specified on the Non-waivable Red List, then he cannot serve in the matter. These conflicts are so severe and basic that none of them can be waived even if the candidate were so naïve or ignorant to seek its waiver. One example is if the arbitrator represents one of the parties in the arbitration.⁶

The Waivable Red List specifies conflicts which are less severe but still sufficiently serious that they can be waived only if the parties “expressly state their willingness to have such a person act as arbitrator.” The waiver can be written or oral; but, if oral, the waiver must be placed on the record during a hearing, such as through a procedural order.

One example of a waivable conflict is if the arbitrator currently represents one of the parties (or an affiliate of a party) in a matter outside of the arbitration.⁷ Another example that is particularly relevant for English barristers is if the arbitrator is a lawyer in the same law firm as the counsel to one of the parties.⁸

The Orange List provides a non-exhaustive list of less severe conflicts than those in the red list. But these conflicts nevertheless may, in the eyes of the parties, give rise to justifiable doubts as to the arbitrator’s impartiality or independence. In general, a conflict on this list must be disclosed but is simply waived if the parties fail to object to it within 30 days after disclosure. However, conflicts involving prior service of an arbitrator or the arbitrator’s firm to one of the parties in an unrelated matter need only be disclosed if they occurred within the prior three years,⁹ thus creating a three-year “look-back” period.

In contrast, no look-back period exists in the Code of Ethics. If a potentially conflicting relationship involving the arbitrator occurred at any time in the past, it must be disclosed.

Lastly, the Green List contains a non-exhaustive list of those situations “where no appearance of, and no actual, conflict of interest exists from the relevant objective point of view.” Thus these situations need not be disclosed at all. Further, conflicts that occurred outside the three-year look-back period in the Orange List fall into the Green List, and thus also need not be disclosed at all.¹⁰ The IBA Guidelines attempt

⁶ IBA Guidelines, pt. II, Non-waivable Red List, ¶ 1.1.

⁷ IBA Guidelines, pt. II, Waivable Red List, ¶ 2.3.1.

⁸ *Id.* at ¶ 2.3.3.

⁹ IBA Guidelines, pt. I, ¶ 4(a) and Part II, introductory ¶ 3.

¹⁰ IBA Guidelines, pt. II, introductory ¶ 6.

to hedge the matter somewhat by stating: “[T]he three-year period in Orange List ... may be too long in certain circumstances and too short in others.”¹¹

IV. *Positive Software*

Over the years, U.S. courts have repeatedly struggled to broadly and generally define the relationships that reflect “evident partiality” under the Federal Arbitration Act (FAA),¹² both in terms of their temporal and proximal affinity.

Nowhere is this difficulty more evident than in the recent *Positive Software* case. There, the 5th Circuit, sitting en banc, ultimately reversed its initial decision affirming a trial court order vacating an arbitral award in a domestic arbitration conducted under the AAA rules. It found that an arbitrator’s prior relationship with one of the attorneys for the other party was too insignificant to warrant vacatur.

The two 5th Circuit decisions in *Positive Software* provide an interesting prism from which to extrapolate and contemplate the potential risk an arbitrator faces in abiding by a lesser standard of disclosure, such as under the IBA Guidelines, and deciding, consistent with that standard, not to disclose a prior relationship.

The underlying facts in *Positive Software* are rather simple. In essence, the arbitrator some seven years prior to his accepting his appointment as arbitrator, served as counsel in a totally different and unrelated litigation, as did an attorney for one of the parties in the present arbitration. That litigation lasted six years and involved 34 different lawyers associated with seven different law firms. Though the names of the arbitrator and the attorney appeared together on 10 different pleadings, neither person had ever met or conferred with the other. Though the arbitrator’s relationship with that attorney, as the trial court and the 5th Circuit acknowledged, was basically de minimus, he did not disclose the relationship.

Based on that failure, the trial court granted a motion to vacate the arbitral award. The court held that the arbitrator deprived one of the parties of knowing that the arbitrator had a prior association with opposing counsel; hence his conduct reflected “evident partiality.”¹³

¹¹ *Id.* at ¶ 7.

¹² 9 U.S.C. §§ 1-14, specifically § 10(a)(2).

¹³ For further details, see this author’s case note cited in *supra* n. 2.

The 5th Circuit, in its initial decision, conceded that what constitutes “evident partiality” has proved “troublesome,” so it turned for guidance to decisions of other courts, including the U.S. Supreme Court.

The 5th Circuit first cited to the Supreme Court’s 1968 decision in *Commonwealth Coatings Corp. v. Continental Casualty Co.*¹⁴ There, an arbitrator was appointed who previously worked for one of the parties and, in deciding the case, ultimately sided with that party. The losing party challenged the award by claiming that the arbitrator failed to disclose his prior business relationship and this demonstrated “evident partiality” under § 10 of the FAA, warranting vacatur of the award. The Supreme Court agreed.

Quoting from the Supreme Court’s *Commonwealth Coatings* decision, the 5th Circuit stated in the first *Positive Software* decision:

[A]rbitrators are not expected to sever ties with the business world, but nevertheless, it [the Court] must be scrupulous in safeguarding the impartiality of arbitrators, as they have “completely free rein to decide the law as well as the facts and are not subject to appellate review.” As a result, the Court imposed “the simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias.”

The 5th Circuit also noted that Justice Byron White, who wrote a concurring opinion (joined in by Justice Thurgood Marshall), emphasized that “the parties must be cognizant of all non-trivial relationships in order to exercise sound and fair judgment.” Further, it noted that Justice White agreed on a rule of full disclosure, quoting him as follows:

[I]t 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.¹⁵

¹⁴ 393 U.S. 145 (1968).

¹⁵ *Commonwealth Coatings*, *supra* n. 14, 393 U.S. at 151.

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The 5th Circuit's first *Positive Software* decision noted that other federal courts have adopted a much broader standard. It cited *Schmitz v. Zilveti*,¹⁶ which delineated a "reasonable impression of partiality" as the correct standard in non-disclosure cases. The court felt that this standard sufficed because FAA § 10(a)(2) still permits parties to choose their arbitrators intelligently.

Consequently, the 5th Circuit initially affirmed the trial court's judgment, holding that the arbitrator's prior relationship with one of the attorneys for a party to the arbitration, while insignificant, nevertheless warranted vacatur because the arbitrator, by virtue of his nondisclosure, conveyed an "impression of possible partiality to a reasonable person," who might perceive him as having favored one side over the other. Hence, the disfavored party was deprived at the outset from learning of the arbitrator's bias. But if that party had such knowledge about the arbitrator during the appointment process, it could have objectively accepted or rejected the arbitrator.

However, on en banc review, the 5th Circuit, in an 11-5 decision, backed away from the "reasonable impression of bias" test to one requiring the failure to disclose a "significant compromising connection" to the parties. Applying this test, the en banc court found that, under the specific facts at hand, no such connection existed. Accordingly, it reversed its prior ruling. As this author previously noted,¹⁷ the 5th Circuit completely failed to provide any guidance as to what constitutes a significant compromising connection, hence leaving its assessment, both temporally and in terms of affinity, to a case-by-case determination.

V. Extrapolations and Further Thoughts

Now, what would have occurred if the *Positive Software* arbitration were international, with the place of enforcement in Texas and the seat of arbitration in London or another foreign locale where the IBA Guidelines, rather than the Code of Ethics, is followed?

As noted above, under the IBA Guidelines, the fact that an arbitrator previously served as co-counsel with an attorney for one of the parties—as occurred in *Positive Software*—is specifically encompassed within the Green List, regardless of when that service

¹⁶ 20 F.3d 1043 (9th Cir 1994).

¹⁷ See Michaelson, *supra* n. 2.

occurred. As a result, the IBA Guidelines do not require disclosure. The 5th Circuit effectively concurred.

But, what if the relationship was closer than it actually was? Suppose the arbitrator, rather than having been co-counsel with the attorney, previously represented an unrelated party in a dispute involving one of the parties to the arbitration. That relationship falls squarely within the Orange List and hence is subject to a three-year look-back period.¹⁸ Thus, if the representation occurred more than three years prior to the arbitration, it would also escape disclosure.

Would these facts have changed the 5th Circuit's view? We simply do not know. For one thing, we don't know whether in deciding *Positive Software* en banc, the court was persuaded by the timing of the relationship (i.e., that it occurred seven and not three years ago), or the nature (affinity) of the relationship (i.e., that it was rather remote), or both. Thus, it cannot be said with certainty which is more important: that a relationship draws closer or the period of time separating that relationship from the arbitration lessens.

While the IBA Guidelines provide a welcome and sorely needed objective level of disclosure, this author believes that the IBA's rather lenient standards will reduce the likelihood of their adoption by many judicial tribunals before which parties seek to enforce arbitral awards.

Consider the following simple scenario. You are a potential arbitrator in an international arbitration, seated in London involving an American party. Prior to appointment you made a routine inquiry to determine whether your firm previously represented any of the parties to the arbitration. You learned that your firm previously was involved as counsel to one of the parties some five years ago in an unrelated matter; it did relatively little work for that party at the time, and the relationship ended shortly thereafter. Under the IBA Guidelines, because the relationship between the arbitrator's firm and a party was so far in the past, it falls into the Green List. As a result, you decide not to disclose the past representation. You think that the relationship does not warrant disclosure and that it will not be discovered. You would be wrong.

In high-stakes, high-risk commercial arbitration, where significant sums are at stake, counsel for a losing party will invariably explore every possible avenue to find a potential conflict of interest and then, when it finds one, attempt to have an adverse award vacated. Your prior relationship will be discovered.

¹⁸ IBA Guidelines, pt. II, Orange List, ¶ 3.1.2.

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With all the information that is publicly accessible through the Internet, counsel would be likely to uncover much information about the past endeavors of arbitrators who serve on their cases. Counsel for Positive Software found the arbitrator's prior relationship through PACER (an electronic case filing system used by federal courts in the United States). In today's world, it is only a matter of how much time and effort a losing party would expend searching the arbitrator's background. If the losing party is the American firm, it would very likely file a motion to vacate, not in the U.K., but in a U.S. court, where the award would be enforced. That court would not apply the IBA Guidelines vis-à-vis disclosure. It would apply U.S. standards—most likely the far more stringent Code of Ethics.

Moreover, the difficulty exhibited by the 5th Circuit in assessing whether a prior non-disclosed relationship should be vacated—as evidenced by the court's en banc reversal—only highlights the high risk and uncertainty that arbitrators take on when they decide not to disclose prior relationships.

To ensure greater certainty that an award would be enforced in the United States, the level of arbitrator disclosure should be consistent with that required here—not a more lenient standard at the place of arbitration. In the United States, look to the Code of Ethics. Strictly follow them. Disclose prior relationships to the fullest extent possible, regardless of how remote they might have been, whether by affinity or timing.

When an arbitrator's prior remote relationship to counsel or a party in an unrelated matter is fully disclosed as soon as it is discovered, there is a good chance that the parties will waive the conflict. Once waived, the prior relationship is eliminated as a ground of vacatur; thus, that relationship will not be subject to judicial scrutiny. Alternatively, if after disclosure, a party to the arbitration, for whatever reason, objects to the relationship, then the arbitrator could simply withdraw from consideration.

Arbitrators in international arbitration should not rely on their own judgment as to what constitutes a trifling relationship. They should err on the side of disclosing everything, even if doing so requires making a thorough prior investigation to reveal underlying facts, long since forgotten, of the relationship. Reliance on relatively loose disclosure standards readily invites vacatur by U.S. courts.

VI. Conclusion

Therefore, very early on in an international arbitration, a prudent arbitrator must look not only to the governing disclosure requirements at the seat of the arbitration, but to all such requirements in each jurisdiction where the resulting award may be enforced. The arbitrator should set the disclosure requirements for the arbitration to meet the requirements of the jurisdiction with the strictest legal requirements. If the United States is the country of enforcement and the seat of arbitration follows a looser standard, follow the Code of Ethics.¹⁹

¹⁹ Though this chapter focused on differing disclosure standards, by extension, other provisions of applicable rule sets governing an international arbitration may implicate forum-dependent differences between the seat of the arbitration *vis-à-vis* its ultimate place of enforcement or, generally, any time during the arbitration when a national court may be called upon to render assistance. These differences should also be assessed under governing national laws and their impact fully considered sufficiently early in the process by both counsel and the arbitrator(s) alike.