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SECOND CIRCUIT REVIEW

Expert Analysis

2nd Circ. Declines to Review Arbitrator's Undisclosed Relationships

By **Martin Flumenbaum** And **Brad S. Karp**

While neutrality is considered the touchstone of dispute resolution, it is not difficult for advocates to think there might be benefits to having judges with deep connections to the parties or their respective industries. In certain complicated or niche disputes, a judge with industry expertise may be better suited to quickly reach a just outcome. Alternatively, each party might wish to appoint arbitrators to serve as quasi-advocates on the arbitral panel to ensure that their side is fully heard. When confronted with such a situation, it is unsurprising that companies often turn to arbitration, where they are free to negotiate the governing procedures and protections to ensure that any dispute would be resolved efficiently by arbitrators with deep industrial knowledge or familiarity with the parties. But the agreement to use arbitrators with such expertise or connections to the parties creates an additional difficulty: If a party and its appointed arbitrator are deeply connected, do those relationships undermine the arbitration and require the award to be vacated? The Second Circuit recently considered this issue in *Certain Underwriting Members of Lloyds of London* v. *Florida Department of Financial Services,* No. 17-1137-cv, 2018 WL 2727492 (2d Cir. June 7, 2018) (*Certain Underwriting Members*).

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Partial Arbitral Panels

One of the distinguishing features of arbitration is the parties' ability to craft each tribunal according to their needs. The Federal Arbitration Act (the FAA) provides that where the parties' arbitration agreement specifies a method for appointing arbitrators, "such method shall be followed." Arbitration organizations have, in turn, promulgated rules facilitating such appointment. For example, the American Arbitration Association's commercial arbitration rules explicitly allow parties to appoint their arbitrators so long as those

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arbitrators are both independent and impartial. American Arbitration Association, *Commercial Arbitration Rules & Mediation Procedures*, Rule 13(b) (effective 2013) (the AAA rules). The rules further provide that, if parties so desire, they can waive the requirements of independence, impartiality, or both. This rule stands in contrast to Section 10 of the FAA, which allows a court to vacate an arbitration award "where there was evident partiality or corruption in the arbitrators ..." This conflict, between contracting parties' decision to explicitly waive the requirement of impartiality, and the FAA, which empowers courts to overturn awards for "evident partiality," was at the heart of *Certain Underwriting Members*.

The Party-Appointed Arbitrator Gone Awry?

The underlying dispute was not relevant to the court's holding, but bears mentioning. Insurance Company of the Americas (ICA), which was declared insolvent after oral argument and had Florida's Department of Financial Services appointed as receiver, provided insurance services for workers compensation claims. The Underwriting Members of Lloyds of London (the underwriters) provided second and third reinsurance for ICA under a series of treaties that each contained an arbitration provision. Ultimately, ICA requested over $12.5 million from the Underwriters in connection with multiple construction site injuries, claims which the Underwriting Members rejected under a disputed interpretation of the treaties. In response, ICA demanded arbitration to clarify the meaning of the treaties.

The treaties in *Certain Underwriting Members* outlined a tripartite panel: each party was entitled to appoint one member of the panel, so long as the appointed individuals were "active or retired disinterested executive officers of insurance or reinsurance companies or Lloyd's London Underwriters." Those two party-appointed arbitrators would then chose a third, neutral individual to serve as the umpire. The treaty also allowed each side to have ex parte discussions with the arbitrator it had appointed. Clearly, the tripartite system envisioned by the parties did not expect nor require the party-appointed arbitrators to be entirely neutral. It was unclear, however, just how associated with their side they could be.

Before the arbitration began, each member of the panel had an opportunity to disclose all of their connections to either of the parties. ICA's party-appointed arbitrator, Alex Campos, only identified that he had briefly known the chairman of ICA a decade earlier. After a multi-day hearing, ICA prevailed and the panel awarded ICA net damages of over $1.5 million. Soon thereafter, the underwriters moved to vacate the award because they had discovered multiple undisclosed relationships between Campos and ICA. Specifically they argued that, despite Campos identifying only one tenuous connection to ICA, he actually had the following relationships with ICA:

- Campos was president and CEO of Vensure Employee Services (Vensure), which operated out of the same suite at the same address of ICA.
- The treasurer, secretary, and director of ICA was also the CFO of Vensure.
- The president and director of ICA was both a managing general agent of an LLC that consulted for Vensure and ICA and the CFO of another company connected to a Campos affiliate.
- ICA's national claims managers was also the national claims manager of Vensure.
- Vensure's counsel was a director of ICA until 2012,

provided legal services to both, and rented space in the same business center as Vensure and ICA.

See *Certain Underwriting Members at Lloyd's of London* v. *Insurance Company of the Americas*, 16-CV-232 (VSB), 2017 WL 5508781, at *9 (S.D.N.Y. Mar. 31, 2017).

The district court determined that these multiple undisclosed contacts, as well as Campos's choice not to disclose such an overwhelming number of relationships, were significant enough to demonstrate evident partiality and entered an order vacating the award under 9 U.S.C. Section 10(a). *Id.* at *11.

The Second Circuit Upholds the Award

The issue raised to the Second Circuit was a matter of first impression: should the standard for evident partiality be the same for neutral arbitrators as for party-appointed arbitrators? Judge Jacobs, writing for a panel consisting of himself, Judge Raggi and Judge Hall, determined that, where the parties' arbitration agreement contemplates a panel of nonneutral party-appointed arbitrators, federal courts must respect the choice of the parties. In other words, when parties desire arbitrators with expertise and do not require neutrality, even undisclosed relationships with a party are insufficient to authorize a court to vacate the award.

The Second Circuit's decision did not, however, immunize all awards by party-appointed arbitrators. A challenging party may successfully move to vacate an arbitration award if it is able to demonstrate that the party-appointed arbitrator's relationship with their opposition either: violated the requirements laid out in the arbitration agreement; or prejudicially affects the actual award. The Second Circuit's decision recognizes that courts reviewing awards for evident partiality must consider the competing goals of party-appointed arbitration: ensuring transparency and candor to root out bias or fraud while allowing parties to get arbitrators with the expertise and industry connections for which they contracted.

'Certain Underwriting Members' serves as a further reminder that federal courts will not substantively review arbitration procedures when the contractual provisions authorizing the arbitration are clear.

Certain Underwriting Members serves as a further reminder that federal courts will not substantively review arbitration procedures when the contractual provisions authorizing the arbitration are clear. As the Supreme Court recently held with regard to individualized arbitration clauses in the employment context in *Epic Sys. Corp. v. Lewis*, __ U.S. __ (2018), when parties agree to certain arbitration procedures, federal courts tend to respect those contracts. The lesson is clear: when considering an agreement that contains an arbitration provision, especially one that authorizes the use of nonneutral, party-appointed arbitrators, it is essential to consider the potential ramifications before signing, as federal courts offer few remedies later.