PRE-AWARD CHALLENGE TO A PARTY-SELECTED ARBITRATOR

John Pitblado, Esq.
Jorden Burt LLP

May 6, 2010

Typically in arbitration clauses requiring a three-member panel of arbitrators, each party gets to make a unilateral pick of one arbitrator, with some procedure for selecting a third. Questions often arise as to: (1) what extent a party may challenge its opponent's selection of an arbitrator in tri-partite arbitrations; and (2) whether such challenge can or should be made prior to commencement of the arbitration, or whether such challenge must await a petition to vacate a final arbitral award.

Two judges from the same federal court in Illinois, in cases involving the same plaintiff, address these questions quite differently in decisions issued less than two weeks apart. In *Trustmark Ins. Co. v. John Hancock Life Ins. Co.*, No. 09-c-3959 (N.D. Ill. Jan. 21, 2010), the court enjoined an arbitration from proceeding because it found one of the party-selected arbitrators was not qualified to serve on the panel. In *Trustmark Ins. Co. v. Clarendon Nat'l Ins. Co*., No. 09-c-6169 (N.D. Ill. Feb. 1, 2010), the court refused to enjoin the proceeding, and held that a challenge to an arbitrator's ability to serve on the panel would have to await a post-award petition. Both decisions have now been appealed to the Seventh Circuit Court of Appeals. The cases shine a light on some thorny issues that can arise early in an arbitration, and that are helpful to consider both in the drafting of arbitration provisions, and in the arbitrator selection process.

I. Arbitrator Selection Provisions and the FAA

The Federal Arbitration Act does not make any affirmative proscriptions regarding the arbitrator selection process. It only provides guidance in the context of its provisions listing grounds for vacating an arbitration award:

> (1) where the award was procured by corruption, fraud, or undue means;
>
> (2) where there was **evident partiality or corruption in the arbitrators**, or either of them;
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> (3) **where the arbitrators were guilty of** misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other **misbehavior by which the rights of any party have been prejudiced**; or

> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C.A. § 10 (emphasis added).

Thus, the selection process is left to the parties, as defined in their arbitration agreements. These agreements will vary depending on, for example, the size of the panel, the technical expertise or professional designations required of the arbitrators, the arbitral forum, etc. It is typical, in tri-partite arbitrations, that each party selects an arbitrator of its choosing, and then a contractual mechanism provides for the manner in which the "neutral" third or "umpire" is to be chosen.

While much of the focus in the arbitrator selection process is on selecting the "neutral" third (insofar as the "neutral" is often the deciding vote), dispute sometimes arises in connection with the parties' own selected arbitrators. Court rulings on pre-arbitration challenges to party-selected arbitrators differ, and the differing outcomes are usually attributable to the language used in the arbitration provisions. For example, in *Winfrey v. Simmons Foods, Inc*., 495 F.3d 549, 551 -553 (8th Cir. 2007), the Eighth Circuit Court affirmed a district court's denial of a pre-arbitration challenge on partiality grounds, because the nature of a tri-partite arbitration agreement only requires the third arbitrator to be "neutral." As that court stated: "parties to an arbitration choose their method of dispute resolution, and can ask no more impartiality than inheres in the method they have chosen." (citations omitted). "Where the parties have expressly agreed to select partial party arbitrators, the award should be confirmed unless the objecting party proves that the arbitrator's partiality prejudicially affected the award." *Id.* The Court grounded its ruling in the terms of the arbitration provisions:

> The contract provides for a tri-partite arrangement under which each party selects one arbitrator. The contract does not require a party-selected arbitrator to be neutral. It also does not mandate disclosures or provide either party the right to strike the other's appointed arbitrator. Furthermore, the parties signed an addendum to the contract that also contains no neutrality requirement for the party-appointed arbitrators. Tellingly, it designates [the third arbitrator] as the sole 'neutral' arbitrator.

Id.

Thus, it is clear, particularly in a contract that only defines one of the three arbitrators as being "neutral," that parties will typically have great leeway in choosing their own arbitrators. Nevertheless, although the burden of a pre-arbitration challenge to a party-selected arbitrator is higher due to strong federal and state policy favoring arbitration, courts have nevertheless

granted such challenges in certain circumstances. For example, in *Rodriguez v. Windermere Real Estate/Wall Street, Inc*., 175 P.3d 604, 607 - 608 (Wash. App. Ct. 2008), the court denied a motion to compel arbitration with the selected arbitrators, accepting the plaintiff's argument that the selection provisions violated public policy, as embodied in a state statute, which reads in pertinent part as follows: "[a]n arbitrator who has a known, direct, and material interest in the outcome of the arbitration proceeding or a known, existing, and substantial relationship with a party may not serve as a neutral arbitrator." R.C.W.A §7.04A.110. While Washington's statute is ostensibly directed at the selection of "neutral" arbitrators, in the *Windermere* case, the entire selection provision was found to violate public policy because it restricted the selection of all the arbitrators in a tri-partite arbitration to a list of professionals that had an affiliation with the defendant, Windermere. Windermere argued that, notwithstanding the restrictions, both parties had equal input into the selection of the panel in the form of unlimited challenges for cause and one peremptory challenge. However, the court rejected the argument, noting that all potential panelists were members of the Windermere corporate "family" in some fashion and the appeal process for whether a challenge "for cause" could be sustained was decided by a Windermere-affiliated arbitrator.

Thus, despite noting that "Washington law favors arbitration," the court nevertheless found that because Windermere provided the contract, wrote the arbitration procedures, and selected the list of arbitrators from whom *both* parties were to choose, the would-be claimants' selected arbitrators as well as the would-be "neutral" arbitrators were found to "have a known, existing and substantial relationship with the party-franchisee," and thus would not be competent to serve under the requirements of Washington's statute.

While the relative burdens imposed on a party making such a challenge cause the majority of pre-arbitration challenges to a party-selected arbitrator to be unsuccessful, as the two *Trustmark* decisions discussed below demonstrate, there are bases for rulings on either side of the issue that should be considered.

II. The Competing Trustmark Decisions

A. Trustmark v. John Hancock

In the *Hancock* case Trustmark and John Hancock were parties to certain retrocessional reinsurance contracts. After the parties had completed a tri-partite arbitration of a billing dispute under the contracts, dispute again arose between the parties and they began a second arbitration (argued by Trustmark to be related to the first dispute). John Hancock selected as its arbitrator in the second arbitration the same arbitrator it had used in the first arbitration. Trustmark brought an action in federal court, and moved for a preliminary injunction barring the parties from proceeding with the second arbitration with John Hancock's chosen arbitrator on the panel. Trustmark asserted that John Hancock's arbitrator breached the confidentiality agreement that the parties and arbitrators in the first arbitration had signed, by discussing the case with the two new arbitrators. Trustmark also argued that there was an inherent conflict of interest by John

Hancock's arbitrator, who was asked in the second arbitration to interpret the confidentiality agreement to which he was a signatory (and which he allegedly breached), and who was also asked to consider the extent to which issues in the second arbitration had been resolved in the first arbitration.

The court noted the arbitration provisions in the contracts, which mandated arbitration of disputes relating to the interpretation or performance of the contracts, including their "formation or validity, or any transaction." The contract also specified that "arbitrators and their companies must be disinterested in the outcome of the arbitration."

The court found that John Hancock's arbitrator had breached the confidentiality agreement by discussing matters pertaining to the first arbitration with the other panel members in the second arbitration (who were not parties to the confidentiality agreement). Specifically, the court credited evidence showing that in a conference related to the second arbitration, John Hancock's counsel made a point about a disputed issue from the first arbitration, and John Hancock's appointed arbitrator thereafter, in support of John Hancock's position, described his recollections of the first arbitration, and commented with regard to characterizations of certain claims made in the first arbitration. Moreover, in consequence of its finding that John Hancock's arbitrator breached the confidentiality agreement, the court further found that John Hancock's arbitrator violated a court order, in that the previous arbitration award and the confidentiality agreement entered into in connection therewith had been confirmed by the court (the judge perhaps betrays some displeasure with John Hancock's arbitrator in making its *sua sponte* note on this point). The court also relied in part on *Duthie v. Matria Healthcare, Inc.*, 540 F.3d 533 (7th Cir. 2008), which affirmed a pre-award injunction where the arbitration clause did not provide for arbitration of the specific dispute at issue in that case. Interestingly, the decision avoids any discussion of the FAA, and none of its provisions are cited therein.

Thus, despite the procedural burdens facing Trustmark of demonstrating a "likelihood of success on the merits" and irreparable harm necessary to obtaining a preliminary injunction, the court nevertheless agreed with Trustmark and enjoined the proceeding with John Hancock's selected arbitrator. John Hancock appealed the decision to the Seventh Circuit Court of Appeals.

B. Trustmark v. Clarendon

Trustmark brought a similar action against Clarendon Insurance Company, in the same court (but assigned to a different judge), arising from a reinsurance dispute between the parties. The arbitrator selection provision at issue in the *Clarendon* case is different and a bit more elaborate than the one at issue in the *Hancock* case:

> Each party shall appoint an arbitrator within thirty days of being requested to so and the two named shall select a third arbitrator before entering upon the arbitration. If either party refuses or neglects to appoint an arbitrator within the time specified, the other

> party may appoint the second arbitrator. If the two arbitrators fail to agree on a third arbitrator within thirty days of their appointment, each of them shall name three individuals, of whom the other shall decline two, and the choice shall be made by drawing lots. All arbitrators shall be active or retired disinterested officers of insurance or reinsurance companies or Underwriters at Lloyd's, London not under the control of either party to this Agreement.

As in the *Hancock* case, here the parties had also concluded a prior arbitration in which they entered into a confidentiality agreement, along with the arbitrators. In a second arbitration, Clarendon selected the same arbitrator it had selected in the first arbitration, and who was a party to the confidentiality agreement. Trustmark objected, and ultimately filed an action in court, asserting that Clarendon's arbitrator would necessarily breach the confidentiality agreement as service on the panel would require the arbitrator to consider confidential information from the first arbitration into the second, in violation of the confidentiality agreement. The court rejected Trustmark's argument, finding that a *potential future breach* of the confidentiality agreement by Clarendon's arbitrator was not sufficient ground for a preliminary injunction, and that any challenge to an arbitrator's conduct or impartiality must be made post-award. Here the court pointed to the negative inferences to be taken from the FAA, insofar as the timing of a challenge is concerned: "[a]lthough specific powers are enumerated in relation to arbitration agreements, the power to remove an arbitrator on a bias challenge is not listed, while the power to vacate an arbitration award due to arbitrator 'misbehavior' is specifically listed." *Id*. (citing 9 U.S.C. § 10).

Notably, the judge in the *Clarendon* case also addressed the *Hancock* decision, issued days earlier from the same court. The court did not disagree with *Hancock*, and specifically distinguished the case on its facts. Indeed, the court cited the *Hancock* decision for the proposition that there is a "strong presumption . . . that arbitrators can disregard what they already know." It then went on to note that, "[t]he critical difference between this case and *Hancock* is that in *Hancock*, the arbitrator in question had *already* breached a confidentiality agreement and in doing so had 'rebutted the presumption that he could disregard knowledge he already had. . . In the present case, no breach has occurred and so the presumption is still in effect." The court therefore found that Trustmark failed to satisfy the burden of demonstrating a "likelihood of success on the merits" to obtain the injunction it sought.

The court did not address the *Duthie* case cited in the *Hancock* decision, and interestingly did not cite any Seventh Circuit precedent, but rather other non-binding precedent, for the proposition that, "there is little disagreement among courts that . . . allegations of an arbitrator's bias or impartiality cannot be litigated at the pre-award stage." Trustmark appealed this decision to the Seventh Circuit Court of Appeals.

III. Are They Reconcilable?

There are clearly important similarities *and* differences between the two cases. Both cases were brought by Trustmark, but the arbitration provisions at issue are different in each, as is the nature of the underlying disputes involved. Both cases involve a pre-award challenge to a party's selected arbitrator as a result of that arbitrator being a party to a confidentiality agreement from a prior arbitration, but in only one of the cases was an actual breach of the confidentiality agreement demonstrated. It would seem, given the heavy burden of a preliminary injunction, and the FAA's negative inference that any challenge to an arbitrator's "partiality" or "misbehavior" must await post-award proceedings, that the *Clarendon* ruling stands on stronger ground. However, the lack of citation to Seventh Circuit precedent for key principles in the *Clarendon* decision is interesting. Moreover, issues pertaining to the appellate standard of review may impact the treatment of the two cases, as some level of deference will be afforded to both decisions, insofar as they involve findings of fact. It is highly unlikely that both decisions will be overturned. However, there are ample bases for the Seventh Circuit to find the two decisions factually distinguishable, and affirm both. There are also ample bases upon which the court could make a more emphatic pronouncement and reverse one of the decisions, particularly given the relative lack of Seventh Circuit precedent on these issues.

IV. Conclusion

Challenging a party-selected arbitrator in a tri-partite arbitration pre-award raises a number of issues. The two Trustmark cases provide helpful lenses through which to identify some of these issues so as to prevent them from arising from a drafting standpoint, and to deal with them as they come at the dispute stage. And the cases should provide fodder for the Seventh Circuit Court to issue further guidance.

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John Pitblado is an associate with Jorden Burt LLP, resident in its Simsbury, Connecticut office.