SEVENTH CIRCUIT COURT BRINGS DOWN CURTAIN ON PRE-AWARD CHALLENGE TO ARBITRATOR PARTIALITY

by

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In *Trustmark Insurance Company v. John Hancock Life Insurance Company (U.S.A.)*, No. 09-3682 (7th Cir. Jan. 31, 2011), the United States Court of Appeals for the Seventh Circuit reversed a federal district court's order[1] enjoining a party-selected arbitrator from serving in an arbitration, based on issues arising from his participation in a prior arbitration between the same parties.

I. Kick Off

The long-running dispute between Trustmark Insurance Company ("Trustmark") and John Hancock Life Insurance Company ("Hancock") began as a result of a disagreement over billings under certain reinsurance contracts. Those contracts contained broad arbitration provisions requiring that disputes be submitted to a tripartite panel consisting of two party-selected arbitrators, who themselves appoint a third arbitrator to act as umpire.

In 2003, the parties submitted their dispute to arbitration, which resulted in a $366,330 award in favor of Hancock. Hancock's party-selected arbitrator was Mark Gurevitz. At the conclusion of the arbitration, the parties, their counsel, and the arbitrators signed a confidentiality agreement preventing disclosure of the evidence, proceedings, and award. Hancock moved to confirm the award in court, which motion was granted.[2]

Trustmark thereafter refused to pay, arguing that it was entitled to certain offsets that had not been considered in the arbitration. The parties initiated a second arbitration to resolve the dispute. Hancock again selected Mark Gurevitz to serve as its arbitrator. Trustmark named a different arbitrator. The two selected arbitrators chose a neutral third.

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[1] *Trustmark Ins. Co. v. John Hancock Life Ins. Co.*, No. 09-c-3959 (N.D. Ill. Jan. 21, 2010). In a similar case, captioned *Trustmark Ins. Co. v. Clarendon Nat'l Ins. Co.*, No. 09-c-6169 (N.D. Ill. Feb. 1, 2010), a different judge of the same court refused to enjoin an arbitrator from serving on similar partiality grounds alleged by Trustmark, holding that a challenge to an arbitrator's ability to serve on the panel would have to await a post-award petition. Trustmark appealed that decision, which appeal remains pending, but the Seventh Circuit's opinion in *Hancock* likely resolves the *Clarendon* appeal as well, unless Trustmark intends to seek certification for review of the *Hancock* decision with the U.S. Supreme Court. Further discussion of the two trial court decisions appears in a prior Special Focus article, which was posted at www.ReinsuranceFocus.com on May 6, 2010.

[2] The memorandum of decision confirming the first award is captioned *Trustmark Ins. Co. v. John Hancock Life Ins. Co.*, No. 1:04-cv-02649 (N.D. Ill. June 17, 2004).

Trustmark took the position at the outset that the confidentiality agreement prevented any of the evidence, proceedings, or award from the first arbitration from being disclosed in the second. It also asserted that Trustmark's appointment of the same arbitrator was improper, because he would necessarily disclose information from the first arbitration, in violation of the confidentiality agreement. The panel rejected Trustmark's arguments, and ruled that the confidentiality agreement did not preclude the panel from considering information from the first arbitration.

II. Yellow Flag: Unsportsmanlike Conduct

Trustmark thereafter brought the issue to court. The matter was assigned to the same judge who confirmed the first arbitration award. Trustmark alleged that Gurevitz shared information from the prior proceeding with the new panel members in violation of the confidentiality agreement, and sought an injunction preventing his participation on that basis.

After an evidentiary hearing, the court found that Gurevitz breached the confidentiality agreement by discussing matters pertaining to the first arbitration with the other panel members. The court held that Gurevitz was not "disinterested" as required under the arbitration provision because of his knowledge of the first proceeding, which could make him a fact witness in the second proceeding. Moreover, in rather strong language, the court found, *sua sponte*, that Gurevitz also violated the court's order confirming the original award in the prior proceeding, as that order incorporated the confidentiality agreement, which had been made part of the arbitration record presented for confirmation.[3] The court thus enjoined Gurevitz from serving in the second arbitration, and also ruled that the new panel was not entitled to consider the first panel's decision. Hancock appealed.

III. Upon Further Review

Judge Easterbrook authored the Seventh Circuit panel's unanimous decision, which reverses and strongly rebukes the district court's decision, both on the legal issues pertaining to arbitrator selection procedure, and specifically in its factual findings pertaining to Arbitrator Gurevitz.

The Court first pointed out that Trustmark's arguments of "irreparable injury" – a necessary showing under the standard governing the issuance of an injunction – were "frivolous." The Court noted that the only injury that could come by proceeding with an

[3] Given the District Court's ruling that Gurevitz violated the confidentiality agreement which prohibited disclosure of the "award" among other things, query how the amount of the award came to be disclosed to the court originally, which award was published in the court's original memorandum of decision granting Hancock's motion to confirm. Presumably, one of the parties themselves disclosed that information.

arbitration before challenging it in court was the delay involved in awaiting court review. If this were the standard, the Court noted, then every discovery order would cause irreparable injury. Thus, the Court reversed the issuance of the injunction. But it did not stop there.

Perhaps the most compelling aspect of the opinion is the assignment of error to the district court's factual findings pertaining to Gurevitz. Seeking to remove the "cloud" that the district court's ruling left over Gurevitz's reputation, the Court delved into the meaning of the term "disinterested" as used in the context of an adjudicator. The Court cited U.S. Supreme Court precedent on the term as it pertains to judges, as meaning "lacking a financial or other personal stake in the outcome." The court also cited the ARIAS U.S. Practical Guide to Reinsurance Arbitration Procedure (rev. ed. 2004), which it noted also states that "disinterest" means not having a financial stake in the outcome and not being under a party's direct control.

This standard of "disinterest," the Court held, does not prevent the repeat services of an arbitrator, which is a typical and long-standing practice, particularly in the reinsurance industry. The Court noted that Gurevitz, like any privately appointed arbitrator, has a "reputational interest" in not disappointing the party that selected him, as to do otherwise would mean he would likely not be selected by that party again. The Court held that this interest in potential future employment is "endemic to arbitration that permits parties to choose who will decide," and is therefore not a prohibited "interest."

In fact, the Court highlighted the positive value of parties' repeat selection of a particular arbitrator. "[P]rivate parties often select arbitrators precisely *because* they know something about the controversy." Moreover given the requirement of competence, and the relatively low numbers of specialists or experts in some fields who serve as arbitrators, to disallow the practice of repeat selection would frustrate the purposes of arbitration in terms of efficiency and cost-reduction.

The Court also faulted the district court's logic in holding that Gurevitz's knowledge of the prior proceeding constituted a form of prohibited "interest." The Court not-so-subtly noted that "the district judge who resolved this very dispute also entered the order enforcing the 2004 award. If knowing about what happened in 2004 is an impermissible 'interest,' or makes the person a 'fact witness' about what had occurred in 2004, then the district judge should have stepped aside from the current suit. . . . Arbitrator Gurevitz is as 'disinterested' as the district judge himself and just as entitled to participate."

As the court noted, "[k]nowledge acquired in a judicial capacity does not require disqualification. . . . Likewise with knowledge acquired in an arbitration." In fact, parties benefit from an adjudicator with prior knowledge. Barring the introduction of information from one confidential proceeding in another would have the practical effect of preventing the application of preclusion doctrines (which admittedly, given the first panel's ruling, may have been a factor in Trustmark's attempt to seal it off from the second proceeding). There is an obvious efficiency gain as well, in avoiding relitigation of issues that were been decided in a

prior proceeding. Moreover, there is little real risk of broad distribution of what occurred in the first proceeding because of the existence of a confidentiality agreement covering the second proceeding and the fact that the parties to the two proceedings are the same. The confidentiality of the material from the first proceeding therefore will be preserved.

Gurevitz's status as a signatory to the confidentiality agreement did not alter the Court's conclusion, because the second panel ruled that the agreement did not prevent the disclosure of information from the first arbitration in the second proceeding. The Court found error in the district court's ruling that the arbitrators were powerless to interpret the confidentiality agreement. Even though the confidentiality agreement did not itself contain an arbitration clause, the Court held that interpretation of the agreement had properly been undertaken by the second panel (even though one of the panel members was a signatory), because it was ancillary to resolution of the parties' primary dispute, and thus was presumptively within the scope of the broad arbitration provisions. "Arbitrators are entitled to decide for themselves those procedural questions that arise on the way to a final disposition, including the preclusive effect (if any) of an earlier award."

The Court reiterated its previous encapsulation in a 1987 opinion of the standards governing court review of arbitration awards:

> The question for decision by a federal court asked to set aside an arbitration award . . . is not whether the arbitrator or arbitrators erred in interpreting the contract; it is not whether they clearly erred in interpreting the contract; it is not whether they grossly erred in interpreting the contract; it is whether they interpreted the contract.

The Court concluded with one last dig at the district court judge: "when this arbitration resumes, the panel is entitled to follow its own view about the meaning of the confidentiality agreement; it need not knuckle under to the district court's prematurely announced understanding."

IV. Conclusion

In our prior Special Focus article[4] discussing the district court's ruling (along with a companion ruling by a different judge from the same court that went the other way), we noted that there were ample bases upon which the Seventh Circuit Court of Appeals could make an "emphatic pronouncement" and reverse one of the decisions. Perhaps "emphatic" turns out to have been an understatement. There is scant precedent on the issue of partiality of party-selected arbitrators under standard arbitration provision language requiring the selection of

[4] *See* footnote 1, *supra*.

"disinterested" arbitrators. The decision is technically limited in scope as precedent to only those lower federal courts within the Seventh Circuit. Nevertheless, authored by a highly-regarded jurist, clear and pointed in its instruction, the decision will likely become a guiding star on the issue beyond the Seventh Circuit. It also has the broader impact of further supporting the overriding public policy embodied in the Federal Arbitration Act of favoring the arbitration of disputes.

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