New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 247—NO. 37
MONDAY, FEBRUARY 27, 2012

SECOND CIRCUIT REVIEW

Expert Analysis

Court Reaffirms Stringent Showing Required to Overturn Arbitral Award

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This month, we discuss *Scandinavian Reinsurance Co. Ltd.* v. *St. Paul Fire & Marine Insurance Co.*,[1] in which the U.S. Court of Appeals for the Second Circuit overruled a lower court decision vacating an arbitral award. Circuit Judge Robert Sack wrote the court's opinion; he was joined by Circuit Judge Debra Livingston and District of Vermont Judge J. Garvan Murtha, sitting by designation. The court concluded that the circumstances at issue — two members of the arbitral panel failed to disclose that they served together on a panel in another, similar case — were insufficient to support a finding of "evident partiality."

Background

In 1999, Scandinavian and St. Paul entered into a specialized reinsurance contract called a stop-loss retrocessional agreement. The contract essentially was a form of reinsurance that contemplated that St. Paul would pay its premiums not to Scandinavian directly, but instead to an interest-bearing "experience account"; any payments owed St. Paul would come out of the experience account before Scandinavian would be required to expand its own funds.

When St. Paul requested payments of $290 million in 2002, Scandinavian refused. The parties disagreed on two interpretive issues: first, whether there existed a limitation on the amount of risk that Scandinavian had assumed; second, whether there existed one experience account or, as St. Paul argued, there existed one such account for each of the three years covered by the agreement.

In September 2007, St. Paul initiated what the Second Circuit termed the "St. Paul Arbitration." Each party picked one member of the arbitral panel, and a third member was selected as umpire. The arbitrators made numerous disclosures about their past and present employment and their connections to the parties and related entities; they also committed to update these disclosures as required. The disclosures generally revealed tenuous connections between the parties and the arbitrators: for instance, one arbitrator's private equity firm had been retained to assist with the run-off of an insurer that had a potential dispute with St. Paul's parent company. In a more relevant disclosure, another arbitrator stated that he had met one party's witness, "a few times in the past, mainly in Bermuda."[2]

> In the Second Circuit, a relationship is indicative of partiality only if it is one that clearly suggests bias for or against a party.

Unbeknownst to the parties, and undisclosed in the disclosure forms, the arbitrator and the witness had met in Bermuda because that witness had testified about a very similar contract before that arbitrator and another member of the St. Paul Arbitration panel in another arbitration, the "Platinum Arbitration," which involved a party related to St. Paul and a similar stop-loss retrocessional contract.

Notably, the witness had testified in favor of a more literal reading of the contract at issue in the Platinum Arbitration and testified in favor of a less literal reading of the similar contract in the St. Paul Arbitration.

The panel in the St. Paul Arbitration ruled unanimously in favor of St. Paul on issues related to the experience accounts. The two arbitrators who had also served in the Platinum Arbitration were, according to Scandinavian's later allegations, in the 2-1 majority on the more controversial question of whether the agreement limited Scandinavian's liability, ruling in favor of St. Paul.

The District Court Case

Scandinavian discovered that the arbitrators had served together in the Platinum Arbitration when its counsel read that the panel's decision in the other arbitration was vacated by a district court in the Eastern District of Pennsylvania. Thereafter, Scandinavian filed a petition in the Southern District of New York to vacate the St. Paul Arbitration award under the Federal Arbitration Act (FAA). It argued that the arbitrators' concurrent service in the Platinum Arbitration, combined with their failure to disclose this service, demonstrated bias toward St. Paul.

District Judge Shira Scheindlin agreed, holding that the arbitrators' failure to disclose their concurrent service allowed them to make credibility judgments about the common witness and his possibly contradictory testimony, receive ex parte information about the kind of reinsurance contract at issue in the case, and influence more powerfully each other's thinking. Their failure to disclose their prior service had deprived Scandinavian of an opportunity to object to their service on the St. Paul Arbitration panel or adjust its arbitration strategy.

Taken together, the court ruled, these factors showed that the arbitrators' simultaneous service in the two proceedings constituted a material — that is, non-trivial — conflict of interest. Because the arbitrators knew about, but had not disclosed, the material conflict, the court ruled that a reasonable person likely would conclude they were partial to St. Paul. Judge Scheindlin vacated the award and remanded the matter for consideration before a new arbitral panel.[3]

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The Second Circuit Decision

The Second Circuit reversed, holding that the facts did not suggest that a reasonable person likely would conclude that the two arbitrators were biased and that their undisclosed service on the Platinum panel did not suggest they were partial to St. Paul. The panel noted at the outset that jurisdiction existed under the domestic provisions of the FAA because the arbitration award was entered in the United States, and that it would review the district court's factual findings for clear error and its legal conclusions de novo.

The FAA provides that district courts may vacate an arbitral award "where there was evident partiality or corruption in the arbitrators, or either of them."[4] This is a very high standard in the Second Circuit, as the court emphasized in *Applied Industrial Materials Corp.* v. *Ovalar Makine Ticaret Ve Sanayi, A.S.*: "[A]n arbitrator is disqualified only when a reasonable person, considering all the circumstances, would *have* to conclude that an arbitrator was partial to one side."[5] Still, the court acknowledged, partiality can be inferred from indirect evidence, and one circumstance in which the evident-partiality standard may be satisfied is where an arbitrator fails to disclose a relationship or interest that is strongly suggestive of bias in favor of one of the parties.

Quoting a Fourth Circuit case, the court held that a district court should consider, among others, four factors in determining whether an undisclosed relationship creates bias: "(1) the extent and character of the personal interest, pecuniary or otherwise, of the arbitrator in the proceedings; (2) the directness of the relationship between the arbitrator and the party he is alleged to favor; (3) the connection of that relationship to the arbitrator; and (4) the proximity in time between the relationship and the arbitration proceeding."[6]

Addressing the relationship at issue, the court held that the fact that two arbitrators served together in one arbitration concurrently with their service in another was not — standing alone — evidence that they would be predisposed to favor one party. Here, Scandinavian had not raised any facts to suggest that the arbitrators' service in the Platinum Arbitration would make them predisposed to favor St. Paul. The court rejected Scandinavian's ipso facto argument that the court could infer from the arbitral panel's ruling in St. Paul's favor that the arbitrators were biased.

Nor, in the court's view, did the fact that the St. Paul and Platinum arbitrations were similar suggest bias: The fact that a judge presides over two similar cases does not suggest that he or she will be biased in the second. While the alleged source of bias was related closely to the St. Paul Arbitration, the court noted that it was more important to focus on the fact that this source — the arbitrators' participation in a similar case — was not of the kind that normally would suggest bias: "[E]ven if a particular relationship might be thought to be relevant 'to the arbitration at issue,' that relationship will nevertheless not constitute a material conflict of interest if it does not itself tend to show that the arbitrator might be predisposed in favor of one (or more) of the parties."[7]

The court acknowledged that one of the allegedly conflicted arbitrators had been appointed by the claimant in both cases, and that the district court had found extensive relationships between the claimants in the different arbitrations. These facts alone, the court held, did not suggest bias, and there was nothing in the record that suggested that the arbitrator was appointed in the Platinum Arbitration for any reason relating to the St. Paul Arbitration. In short, Scandinavian was unable to point to any special financial or professional incentive that would have arisen from the arbitrators' participation in both arbitrations.

The court held that the fact that two arbitrators served together in one arbitration concurrently with their service in another was not — standing alone — evidence that they would be predisposed to favor one party.

Scandinavian argued that the arbitrators' failure to disclose their participation in the Platinum Arbitration, despite the parties' repeated encouragement that the arbitrators disclose all potential conflicts, suggested bias because the "[a]rbitrators simply could not have continually failed to see what was right in front of their eyes for so long."[8] But the court ruled that nondisclosure of a relationship does not imply that the undisclosed relationship biased the arbitrator. This would be true even if the nondisclosure is in violation of the arbitrator's own standards: While the district court had found that disclosure of numerous less important potential conflicts suggested that bias had motivated the arbitrators not to disclose the Platinum Arbitration, the Second Circuit rejected this view. Allowing Scandinavian to cite disclosure of less important relationships as evidence that the arbitrators intentionally concealed the relationship at issue would inappropriately inject subjectivity into the evident-partiality standard.

The court added that if arbitrators' disclosure of less important relationships were held against them, they might in the future hesitate to disclose such relationships for fear of making it easier for parties to accuse them of bias.

In this case, the court reasoned, it was entirely possible that the arbitrators' failure to disclose was inadvertent, and not motivated by bias. Indeed, the court noted, one arbitrator had failed to disclose another potential conflict until later in the arbitration, explaining that he had thought that he had previously disclosed it.

The court also rejected Scandinavian's argument that it had been harmed strategically in its handling of the arbitration. The FAA provides a district court with an opportunity to overturn an arbitral award where an arbitrator's ruling is based on evident partiality; it does not provide an arbitral party with a right to know an arbitrator's background before an arbitration begins.

The court made a similar point with respect to the other issues Scandinavian raised: The arbitrators may have received ex parte information about the kind of contract at issue, made particular credibility determinations regarding the common witness that they otherwise would not have, and influenced each other's thinking more than they otherwise would have. But the court ruled that these facts did not demonstrate that the arbitrators were biased toward St. Paul and they did not distinguish the case from other cases where judges or arbitrators hear common issues.

The Second Circuit remanded the case to the district court with instructions to deny Scandinavian's petition to vacate the award, grant St. Paul's cross-petition to confirm it and enter an amended judgment accordingly.

Conclusion

The Second Circuit's decision in *Scandinavian* reaffirms the extraordinarily high bar for overturning arbitral awards. Importantly, it also highlights the necessity of demonstrating bias to satisfy the evident-partiality standard: In the Second Circuit, a relationship is indicative of partiality only if it is one that clearly suggests bias for or against a party. While the court acknowledged the importance of continuing disclosure by arbitrators, it made clear that, where an arbitrator's undisclosed relationship does not suggest bias, nondisclosure of that relationship cannot justify overturning the arbitrator's judgment.

1. Docket No. 10-0910-cv, 2012 WL 335772 (2d. Cir. Feb. 3, 2012).

2. Id. at *2.

3. *Scandinavian Reins. Co.* v. *St. Paul Fire & Marine Ins. Co.*, 732 F.Supp.2d 293 (S.D.N.Y. 2010).

4. 9 U.S.C. §10(a)(2).

5. *Scandinavian*, 2012 WL 335772 at *8 (quoting 492 F.3d 132, 137 (2d Cir. 2007)) (emphasis in original) (internal quote marks omitted).

6. Id. at *10 (quoting *Three S Del., Inc.* v. *DataQuick Info. Sys. Inc.*, 492 F.3d 520, 530 (4th Cir.2007)).

7. Id. at *11 (quoting *Scandinavian*, 732 F.Supp.2d at 307).

8. Id. at *12.