

INTERNATIONAL ARBITRATION

Expert Analysis

## Evident Partiality and the Party-Appointed Arbitrator

In previous articles in this column, I have had occasion to commend various decisions of the Court of Appeals for the Second Circuit for their approach to particular issues in the field of arbitration. In this column, I am compelled to criticize a recent decision, which had various arbitrator list-servs abuzz with concern, on the ground that it rests on a fundamental misunderstanding of how arbitration operates in practice. In making this criticism, I am mindful that the reason for this misunderstanding likely lies with the litigants, since it is their responsibility to educate a court as to the practices in the field that is the subject of the particular case.

*Certain Underwriting Members of Lloyds of London v. State of Florida*, 2018 WL 2727492 (2d Cir. June 7, 2018) (*Lloyds*), concerned an appeal of a decision by the district court for the Southern District of New York vacating an arbitration award on the ground of “evident partiality” under Section 10(a) (2) of the Federal Arbitration Act. The district court found “evident partiality” on the part of a party-appointed arbitrator, Alex Campos, because he had failed to disclose certain of his relationships with his appointing party.

By  
**John  
Fellas**



In vacating the award, the district court held that “Campos’s conduct must be considered under the same evident partiality standard as is required in all arbitrations.” In reversing and remanding, the Second Circuit disagreed, saying that a party seeking to establish evident partiality by a “party-appointed” arbitrator had to meet a higher standard than with respect to a “neutral” arbitrator. The reason for this, according to the Second Circuit, is that party-appointed arbitrators, unlike neutrals, “are expected to serve as *de facto* advocates” for their appointing parties, and thus should be held to different ethical standard than neutrals.

Unfortunately, this broad, unqualified dictum—that party-appointed arbitrators are expected serve as advocates (which appears elsewhere in the opinion)—is out of date. While it was once true in the U.S. that the general expectation was that party-appointed arbitrators in domestic cases were partisan,

that ceased to be the case in domestic arbitrations almost 15 years ago, and was never the practice in international arbitrations seated in the U.S. Indeed, the current practice is precisely the reverse of that described by the Second Circuit: Even in domestic arbitrations, the expectation is that a party-appointed arbitrator should be impartial unless the parties agree otherwise.

For reasons of space, this article has a relatively narrow focus. As noted, in *Lloyds*, the Second Circuit held that there were different tests for evident partiality depending on whether an arbitrator is party-appointed or neutral. Space does not permit consideration of the substance of those tests or their application to the facts of the case. Rather, it will focus on a troubling aspect of *Lloyds*—the dicta that party-appointed arbitrators are expected to act as advocates.

The arbitration in *Lloyds* was carried out on an ad hoc basis, meaning that it was not conducted under any particular set of existing arbitration rules, such as those of the American Arbitration Association (AAA), the International Chamber of Commerce (ICC), or JAMS, to name a few.

Instead, in *Lloyds*, the parties’ arbitration clause explicitly set forth the procedural rules governing the arbitration. As a result, notwithstanding

the broad dicta regarding the role of party-appointed arbitrators, the Second Circuit's decision has only a narrow application. It covers only special cases like ad hoc arbitration in the reinsurance industry, the context in which the case arose, and not arbitrations held under the leading arbitration rules, like those of the AAA, ICC or JAMS, among others. Toward the end of this article, I will explain why the case has a narrow application. However, because the broad dicta in the Second Circuit's opinion could be taken out of context in future cases, I also offer some practical advice to arbitrators and parties to guard against unscrupulous behavior.

### The Facts

Reinsurance is insurance for insurance companies. In the reinsurance industry, the term of art for a reinsurance contract is a "treaty." The Insurance Company of the Americas (ICA), which provided workers' compensation insurance policies for professional employment organizations, had purchased from certain Lloyd's underwriters (the "Underwriters") two reinsurance treaties (the "Treaties")—providing coverage for ICA's underlying policies.

ICA made certain claims under the Treaties. The Underwriters denied those claims and a dispute ensued. The Treaties provided that disputes were to be resolved by arbitration, with the procedures for the conduct of the arbitration set forth in the arbitration clause in the Treaties. Article 24 of the Treaties contemplated the use of party-appointed arbitrators: "One Arbitrator shall be chosen by the Reinsured [ICA], the other by the Reinsurer [Underwriters], and an Umpire shall be chosen by the two Arbitrators before they enter upon arbitration, all of whom shall be active or retired *disinterested* executive officers of insurance or rein-

surance companies or Lloyd's London Underwriters" (emphasis added).

ICA commenced arbitration proceedings, appointing arbitrator Campos. After ICA prevailed, the Underwriters petitioned to vacate the arbitration award on various grounds, including "evident partiality" based on Campos's failure to disclose various relationships with ICA. In vacating the award, the district court applied an "evident partiality" test that held party-appointed arbitrators to the same standard as all arbitrators. As noted, the Second Circuit disagreed, asserting there is a higher

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burden to show evident partiality on the part of party-appointed arbitrators than neutral arbitrators because the former are expected to serve as advocates. As support for this claim, the court relied primarily on prior cases, ranging from the decision of *Astoria Medical Grp. v. Health Ins. Plan of Greater NY*, 227 N.Y.S.2d 401 (1962), over 50 years ago, to *Sphere Drake Life Ins. v. All American Life Ins.*, 307 F.3d 617 (7<sup>th</sup> Cir. 2002), over 15 years ago. The court distinguished a Second Circuit case that "suggested" otherwise (*Floradsynth v. Pickholtz*, 750 F.2d 171 (2d Cir. 1984)) on just that ground; it was "only" a "suggest[ion]" and, as a result, "we are not bound by that language today."

### The Code of Ethics

It used to be the case in the U.S. that, in domestic cases, party-appointed arbitrators were, indeed, expected to be partisan. But since March 1, 2004, when the AAA/ABA Code of Ethics for Arbitrators in Commercial Disputes (the Code) went into effect, this practice changed. While the Code is soft law, it was issued by respected organizations, the American Arbitration Association and the American Bar Association, and, as with many professional codes, reflects the general practice in the field, a practice that has become even more established in the 14 years since it became effective.

The Code contains various Canons. Canon IX relates specifically to party-appointed arbitrators, providing that "all three arbitrators are presumed to be neutral and are expected to observe the same standards as the third arbitrator." In other words, a party-appointed arbitrator is subject to the same ethical standards as a neutral arbitrator.

Canon IX goes on to explain the circumstances in which a party-appointed arbitrator may overcome the presumption of neutrality and act in a partisan manner: "[n]otwithstanding this presumption, there are certain types of tripartite arbitration in which it is expected by all parties that the two arbitrators appointed by the parties may be predisposed toward the party appointing them. Those arbitrators, referred to in this Code as 'Canon X arbitrators,' are not to be held to the standards of neutrality and independence applicable to other arbitrators."

According to Canon IX, three main conditions must be met for party-appointed arbitrators to be transformed from neutrals into partisans (i.e. into "Canon X arbitrators"). First, the arbitrators should decide whether or not they are partisan arbitrators by

reference to, among other factors, the arbitration clause, the arbitration rules, and industry practice. Second, if they conclude they can be partisan, they “should so inform the parties and the other arbitrators” and then may act as advocates for their appointing party “unless or until a different determination of their status is made by the parties, any administering institution or the arbitral panel.” Third, until they conclude they can be partisan, they shall be neutral.

What all this means is that parties are entitled to expect party-appointed arbitrators to be neutral unless such arbitrators explicitly inform them otherwise. Even though the Second Circuit referred to the Code in its decision, it took the opposite view of the general practice in the field. It appears that the court was not directed to Canon IX of the Code. In the light of the fact that the Second Circuit viewed the Code to be sufficiently authoritative to cite in its opinion, this was unfortunate. A consideration of Canon IX might have given the court some pause before it made its unqualified declaration that the prevailing practice is that party-appointed arbitrators are “expected” to be advocates.

### The Leading Arbitral Rules

The leading arbitral rules, both in their latest versions and their earlier versions within the last 10 years or so, reflect the general practice that all arbitrators are expected to be neutral. The prominent international arbitration rules generally affirm this without even providing for the possibility that arbitrators may act otherwise. *See, e.g.*, ICDR Rules, Article 13(1) (“Arbitrators acting under these Rules shall be impartial and independent . . .”); ICC Rules, Article 11(a) (same); LCIA Rules, Rule 5.3 (same); CPR Rules for Administered Arbitration of International Disputes,

Rule 7 (same).

In rules that apply more typically in the U.S. domestic context, party-appointed arbitrators are presumed to be impartial and independent unless the parties agree that they may act otherwise. *See, e.g.*, AAA Commercial Rules, Section R-13(b) (party-appointed arbitrators “must meet the standards of Section R-18 with respect to impartiality and independence unless the parties have specifically agreed pursuant to Section R-18(b) that the party-appointed arbitrators are to be non-neutral and need not meet those standards.”); JAMS Comprehensive Arbitration Rules and Procedures, Rule 7(c) (party-appointed arbitrators “shall be neutral and independent of the appointing Party, unless the Parties have agreed that they shall be non-neutral.”)

As noted above, the arbitration in *Lloyds* was not carried out under an existing set of arbitration rules requiring all arbitrators to be impartial and independent. Rather, it was carried out on an ad hoc basis, based on an arbitration clause that merely required the arbitrators to be “disinterested.” (Article 24 of Treaties, quoted above). However, as the Second Circuit noted, this means only that an arbitrator should have no “personal or financial stake in the outcome of the arbitration” (which Campos did not), not that she must be “impartial and independent.” The Second Circuit acknowledged, in fact, that in “the reinsurance industry . . . an arbitrator’s professional acuity is valued over stringent impartiality.”

The fundamental problem with the decision in *Lloyds* is that the Second Circuit was led to confuse the unusual arbitration practices of the reinsurance industry—where arbitrators are not required to be impartial and independent—for the typical practice in arbitration generally, where they are.

### A Narrow Application

However, as I indicated at the beginning of this article, the Second Circuit’s decision has only a narrow application. In the course of its decision, the Second Circuit correctly noted that arbitration is a “creature of contract” and that, as a result, “parties are free to choose for themselves to what lengths they will go in the quest for impartiality.” Thus, even if party-appointed arbitrators were generally expected to be advocates (which as I argue above, they are not), this expectation must be displaced where the parties choose otherwise. And parties choose otherwise when they conduct their arbitrations under rules that require all arbitrators to be “impartial and independent,” as the preeminent arbitration rules provide. In such circumstances, party-appointed arbitrators must be subject to the same test for evident partiality as neutral arbitrators.

However, in the light of the recent decision in *Lloyds*, it might be advisable for parties drafting arbitration clauses for cases seated in the U.S. to consider providing specifically, where that is their intent, that all arbitrators are to be “impartial and independent,” especially in ad hoc arbitrations. It might also be advisable for the presiding arbitrator in a case seated in the U.S. to consider requiring party-appointed arbitrators to affirm in writing that they are independent and impartial. She might do so, in the case of an arbitration under the ICC Rules, by the inclusion of a provision to that effect in the Terms of Reference, since that document is signed by all the arbitrators, or, in cases under other institutional rules, the inclusion of such a provision in the first procedural order, with the requirement that it be signed by all the arbitrators.