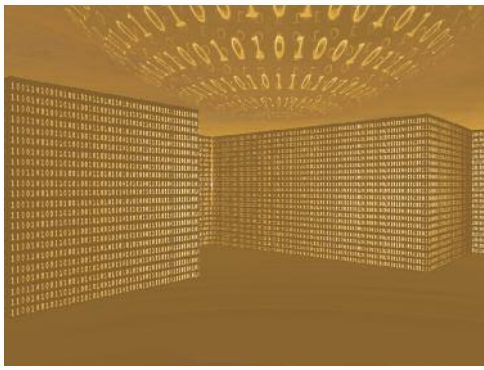
THE ALABAMA LAWYER

MARCH 2016 | VOLUME 77, NUMBER 2



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Shifting the Burden:

Municipal Workers and Establishing Evident Partiality in Alabama Based upon a Failure to Disclose

By Rebecca A. Beers

In Alabama, seeking and obtaining vacatur of an arbitration award just got a little easier. In April 2015, the Alabama Supreme Court broke with the Eleventh Circuit Court of Appeals and joined what the court termed as the "majority" view in setting the standard for what a litigant must establish to meet the "evident partiality" standard under the Federal Arbitration Act and to obtain vacatur in cases where arbitrators have failed to disclose potential ties or relationships with parties to the arbitration and/or their lawyers. While this standard in Alabama was a bit unclear prior to April, in *Municipal Workers Compensation Fund v. Morgan Keegan, et al.*,[1] the Alabama Supreme Court made it clear that, where the forum's rules require it, arbitrators must undertake a thorough conflict check and disclose all conflicts and relationships with the parties and their counsel or the award rendered will be subject to vacatur in post-arbitration proceedings if an undisclosed conflict gives rise to a reasonable impression of partiality, regardless of whether or not the arbitrator had knowledge of the conflict. A litigant in Alabama no longer bears the burden of having to prove that an arbitrator was actually biased or that the arbitrator's failure to disclose a conflict or relationship was knowing and intentional. The burden has shifted to the arbitrator to make a full and fair disclosure of all conflicts and relationships with the litigants and their lawyers.

This article will briefly explain the background of the "evident partiality" standard and an arbitrator's disclosure duties, the competing standards related to conflict non-disclosure cases, the standard that the Alabama Supreme Court set out in *Municipal Workers* and, going forward, what that standard means for arbitrators and litigants in arbitrations in Alabama.

Evident Partiality and The Arbitrator's Duty to Disclose

The Federal Arbitration Act[2] provides four grounds for vacatur of an arbitration award, and the second of those four grounds requires an arbitration award to be vacated "where there was evident partiality or corruption in the arbitrators . . . ."[3] What constitutes "evident partiality" has been the subject of frequent litigation. In 2003, in *Waverlee Homes, Inc. v. McMichael*, the Alabama Supreme Court adopted the "reasonable impression of partiality" standard, stating that to rise to the level of evident partiality, a litigant must establish, through credible, admissible evidence, facts which give "rise to an impression of bias that is direct, definite, and capable of demonstration" rather than a "mere appearance of bias that is remote, uncertain, and speculative."[4] Courts–including Alabama courts–have found that a reasonable impression of an arbitrator's partiality can arise in two contexts: through the arbitrator's conduct and statements (an "actual bias" case) and through the arbitrator's failure to disclose conflicts and relationships with the parties and their counsel (a "nondisclosure" case).

The seminal case discussing an arbitrator's inherent duty to disclose is the United States Supreme Court's opinion in *Commonwealth Coatings Corp. v. Continental Casualty Co.*, in which Justice Hugo Black delivered the majority opinion discussing the balance between preserving the streamlined and cost-effective nature of the arbitration forum and affording the arbitrating litigants the "elementary requirements of impartiality taken for granted in every judicial proceeding."[5] In *Commonwealth Coatings*, the Court reversed the trial court's affirmance of the arbitration award in which the relationship between a litigant and an arbitrator was not disclosed, and the Court observed, "[w]e can perceive no way in which the effectiveness of the arbitration process will be hampered by the simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias."[6] This requirement is founded in the principle that arbitration litigants should be able to select their arbitrators intelligently, which requires full and fair disclosure from the arbitrators.[7] While *Commonwealth Coatings* appears to recognize an independent duty on the part of arbitrators to disclose actual or perceived conflicts to litigants that likely arises out of the Federal Arbitration Act,[8] the Supreme Court and other federal and state courts have also recognized that private arbitration forums have set out their own rules which require arbitrators to discover and disclose actual or perceived conflicts or relationships with litigants and their counsel.[9]

The Duty to Disclose and The Duty to Investigate

It is a well-accepted proposition that, where an arbitrator knows of a conflict or a material relationship with a party or that party's counsel and fails to disclose it, a reasonable person would conclude that that arbitrator was evidently partial and any award rendered would be subject to vacatur. Therefore, while most federal and state courts have recognized that arbitrators bear the burden of disclosing relationships and conflicts that may give rise to an impression of partiality to litigants

and their counsel, distinct differences of opinion arise regarding the relationships and conflicts that must be disclosed. Is an arbitrator required only to disclose known conflicts and relationships? Must the arbitrator undertake the equivalent of a lawyer's "conflict check" to discern relationships that may give rise to an impression of bias of which the arbitrator herself is unaware?

The majority of courts to address situations in which arbitrators have failed to disclose these relationships and potential conflicts have generally determined that the arbitrator's failure to disclose these facts alone–where the facts are non-trivial–may be sufficient, in and of itself, to establish evident partiality warranting vacatur under the Federal Arbitration Act. These cases do not require a litigant to establish that an arbitrator knew of these non-trivial facts and failed to disclose them. Rather, the act of failing to disclose these conflicts and relationships alone may be sufficient–that is, the arbitrator's failure to undertake a reasonable investigation to determine the existence of and then disclose conflicts and relationships may be sufficient to establish evident partiality on its own.[10] These undiscovered and undisclosed conflicts and relationships, however, cannot be trivial and must, on their own, give rise to a direct and definite impression of bias. The seminal opinion in this line of cases is the Ninth Circuit's opinion in *Schmitz v. Zilveti*, in which that court found that the arbitrator's failure to investigate and disclose a particular conflict (where arbitral forum required such an investigation) that gave a reasonable impression of bias constituted evident partiality because the arbitrator had constructive knowledge of the conflict due to the forum's duty to investigate.[11]

In contrast, the Eleventh Circuit has required actual knowledge of these conflicts and relationships in order to warrant vacatur for evident partiality.

In contrast, the Eleventh Circuit has required actual knowledge of these conflicts and relationships in order to warrant vacatur for evident partiality. That is, even if there exists a direct conflict that clearly gives rise to a direct and definite impression of bias, evident partiality is not established and vacatur is not appropriate unless the arbitrator actually knew of this conflict and failed to disclose it to the litigants and their counsel.[12] The Eleventh Circuit has explicitly rejected the Ninth Circuit's "constructive knowledge" theory in *Schmitz* and held that the law in the Eleventh Circuit "is that an arbitration award may be vacated due to the 'evident partiality' of an arbitrator only when either (1) an actual conflict exists, or (2) the arbitrator knows of, but fails to disclose, information which would lead a reasonable person to believe that a potential conflict exists.[13] A later panel of the Ninth Circuit observed that it was "aware of only one court of appeals that has adopted a per se rule that a finding of evident partiality is precluded by an arbitrator's lack of 'actual knowledge of the information upon which [an] alleged conflict was founded,'" and that is the rule adopted in the Eleventh Circuit.[14]

Therefore, while the Eleventh Circuit explicitly requires arbitrators only to disclose relationships and conflicts of which they have actual knowledge in order to avoid a finding of evident partiality, other circuits acknowledge that evident partiality may be established where there exist facts or a conflict that may

give rise to a reasonable impression of bias and the arbitrator failed to investigate and disclose this information, even when the arbitrator may not have had actual knowledge of this information.

Municipal Workers and Alabama's Break With the Eleventh Circuit

Prior to the Alabama Supreme Court's opinion in *Municipal Workers*, the standard of review for nondisclosure cases in Alabama courts was murky and undefined.[15] Only two major decisions discussed the "nondisclosure" brand of "evident partiality" cases. The first–*Waverlee*–was unclear in whether it was a nondisclosure or actual bias case, but it adopted the "reasonable impression of partiality" standard for cases in which vacatur was being sought based upon "evident partiality," relying both upon Eleventh Circuit precedent and also citing the Ninth Circuit's case in *Schmitz*.[16] In the second case–*Lexington Insurance*–the court was interpreting specific provisions of the parties' arbitration agreement relating to the arbitrator selection process.[17] However, in doing so in its discussion of nondisclosure of conflicts, the court again relied upon the Ninth Circuit's *Schmitz* decision.[18] Despite citing both Eleventh Circuit and Ninth Circuit cases that take diametrically opposite views of what constitutes evident partiality in a nondisclosure context, neither *Waverlee* nor *Lexington Insurance* directly addressed what standard Alabama would adopt in nondisclosure cases. The supreme court's opinion in *Municipal Workers* filled that void.

The trial court had found that the arbitrators in question had failed to make disclosures which were required by the arbitral forum but that this nondisclosure did not constitute evident partiality requiring vacatur of the arbitration award.

While it would not have been unreasonable to assume that Alabama would stand with the federal circuit in which it sits, the Alabama Supreme Court in *Municipal Workers*, in somewhat of a surprise, adopted the reasoning of the Ninth Circuit (and other circuits reaching similar conclusions). In *Municipal Workers*, the appellant, Municipal Workers Compensation Fund, argued that the trial court's refusal to vacate the arbitration award at issue should be reversed because, *inter alia*, two arbitrators on the three arbitrator panel had failed to disclose significant information, which for one arbitrator, included the fact that his employer (for which he was a vice president and partner) had business ties to one of the appellees and its counsel.[19] The trial court had found that the arbitrators in question had failed to make disclosures which were required by the arbitral forum but that this nondisclosure did not constitute evident partiality requiring vacatur of the arbitration award.[20] On appeal,

the appellees relied on Eleventh Circuit precedent, asserting that, for the arbitrator whose firm had the undisclosed business ties to the appellee and its counsel, there was no evidence that the arbitrator had actual knowledge of these business ties and then intentionally failed to disclose them.[21] The appellant, Municipal Workers, argued that the arbitrator's failure to disclose these significant business ties, compounded by the fact that the arbitrator was under a duty to investigate and disclose any conflicts pursuant to the rules of the arbitral forum, gave rise to a reasonable impression of partiality which constitutes evident partiality under the FAA, justifying vacatur.[22]

The Alabama Supreme Court reviewed the decisions of both the Ninth Circuit and the Eleventh Circuit, as well as other case law from across the country and its two prior decisions that touched on the issue of arbitrator nondisclosure as a brand of evident partiality under the FAA, and concluded the following:

> We believe the holding in *Schmitz* is the better view and conclude that the "reasonable-impression-of-partiality" standard constituting an "evident partiality" under 9 U.S.C. § 10(a)(2) may be satisfied even though an arbitrator lacks actual knowledge of the facts giving rise to the conflict of interest when the arbitrator was under a duty to investigate in order to discover possible conflicts and failed to do so. In such a situation the arbitrator will be deemed to have constructive knowledge of the conflict of interest, and the failure to disclose the conflict may result in a "reasonable impression of partiality."[23]

In adopting what it characterized as "the majority view in the federal courts," the Alabama Supreme Court spurned the Eleventh Circuit's actual knowledge requirement and found that because the arbitrator at issue had had the duty under the rules of the forum to conduct an investigation into ties with the parties and their counsel and because such a search would have revealed what it termed to be significant ties with one of the parties and its counsel, the facts created a reasonable impression of partiality under its prior standard in *Waverlee* that constituted evident partiality under the FAA.[24] The court found that the arbitrator had constructive knowledge of the conflict, and that fact, combined with the nature of the conflict itself, gave a reasonable impression of partiality.[25] Thus, under *Municipal Workers*, in Alabama, an arbitrator's actual knowledge of a conflict is not required to find evident partiality in an award issued by an arbitrator who has a conflict that gives rise to a reasonable impression of partiality.[26]

Practical Implications of *Municipal Workers*

A federal district court, in relying on Alabama law and vacating an arbitration award, observed the following about the Alabama Supreme Court's opinion in *Municipal Workers*:

> The Supreme Court of Alabama has now firmly joined the courts who find that the purpose of the Federal Arbitration Act can best be satisfied, not by placing on a complaining party the heavy burden of demonstrating actual bias or a knowing nondisclosure, but to place upon applicants for the powerful position of arbitrator the relatively light burden of carefully examining their own backgrounds and revealing all facts that might cause a party to doubt their impartiality. In other words arbitrators must ascertain the relevant facts about their potential impact in the selection procedure in favor of disclosure. The arbitrator does not pass on his own qualifications. The parties do.[27]

This observation makes clear how the burden has shifted in Alabama with regard to arbitrator disclosure after *Municipal Workers*. Now, the burden is on the arbitrator to know the rules of the forum in which he or she is arbitrating and to make all required disclosures, including undertaking a thorough search or conflict check that will reveal any conflicts or business relationships that would implicate a reasonable impression of partiality. The burden is no longer on litigants to demonstrate that the arbitrator had knowledge of any significant conflicts or relationships–rather, litigants must only show that such conflicts or relationships exist and that the arbitrator was under a duty to discover and disclose them.

This decision enables litigants in most arbitrations to choose their arbitrators intelligently and relieves them of the burden of proving that an arbitrator knew of a significant conflict and yet failed to disclose it in seeking vacatur of an arbitration award based on evident partiality.

For litigants and their counsel, this somewhat opens up "evident partiality" challenges to unfavorable arbitration awards. Without the actual knowledge requirement, a litigant can make a strong challenge to an arbitration award if the litigant discovers the existence of an undisclosed relationship that rises to the level of giving a reasonable impression of partiality. To avoid having a favorable arbitration award be susceptible to such a challenge, litigants can conduct their own conflict checks and inquiries on the front end of the arbitration to ensure that the arbitrator has not overlooked or failed to discover a conflict or relationship that could prove to be dangerous in post-arbitration proceedings. Alerting the arbitrator and the other parties to these relationships and potential conflicts prior to the issuance of an arbitration award will serve to save the parties both time and money in avoiding taking an arbitration all the way to an award, only to have it overturned in post-arbitration proceedings because the arbitrator failed to discover and disclose a relationship that a party could have detected on the front end. So, while the burden may now lie with the arbitrator to conduct his or her own investigation to disclose all potential conflicts and relationships, it may be a more prudent course for litigants to shoulder that same burden voluntarily to avoid cost and expense down the road.

Finally, it is still unclear in Alabama whether or not there exists a burden on arbitrators to conduct such an investigation that is independent of any requirements that may exist under the rules of the arbitral forum. As previously noted, the United States Supreme Court in *Commonwealth Coatings* hinted that the FAA may imply such a duty,[28] but subsequent courts have explicitly avoided making such a finding, even when interpreting the FAA.[29] While arbitration forums such as the American Arbitration Association and Financial Institution Regulatory Authority

(FINRA) Dispute Resolution have their own rules and regulations that require arbitrators to conduct their own conflict checks and to disclose any relationships or potential conflicts,[30] many arbitrations in Alabama are private arbitrations that are more informal and without a set of rules and regulations that would impose duties on potential arbitrators to discover and disclose these conflicts. The Alabama Supreme Court's opinion in *Municipal Workers* explicitly stated that actual knowledge of a conflict was not needed "when the arbitrator was under a duty to investigate in order to discover possible conflicts and failed to do so."[31] The court did not find that Alabama arbitrators are under an independent duty to discover conflicts but instead based its holding on the fact that the arbitrator in question was duty-bound to conduct such an investigation and disclose his findings pursuant to the FINRA Dispute Resolution rules which governed the arbitration at issue.[32] Therefore, there may not be an independent duty to investigate and disclose conflicts, and so actual knowledge of a conflict may be required in a nondisclosure case where there are not contractual obligations to investigate and disclose. If litigants would like to arbitrate their claims but would like to choose their arbitrators intelligently, then their counsel, when drafting contracts that provide for private arbitration under Alabama law, should either provide a written duty to investigate and disclose conflicts or incorporate the rules of an arbitral forum that does require conflict investigation and disclosure.

Conclusion

The Alabama Supreme Court's decision to eschew Eleventh Circuit precedent and adopt the Ninth Circuit's standard in arbitrator nondisclosure cases was surprising, yet in line with a majority of courts. The practical implication of *Municipal Workers* is that now, in most cases, arbitrators bear the burden of conducting a thorough conflict check and investigation into potential conflicts and relationships and of disclosing their findings to litigants in arbitration. This decision enables litigants in most arbitrations to choose their arbitrators intelligently and relieves them of the burden of proving that an arbitrator knew of a significant conflict and yet failed to disclose it in seeking vacatur of an arbitration award based on evident partiality. ▲

Endnotes

1. *Municipal Workers Compensation Fund, Inc. v. Morgan Keegan & Co.*, No. 1120532, ____ So. 3d ____, 2015 WL 1524911 (Ala. Apr. 3, 2015). An application for rehearing of this cause was overruled on September 30, 2015.
2. 9 U.S.C. § 1, *et seq.*
3. 9 U.S.C. § 10(a)(2).
4. *Waverlee Homes, Inc. v. McMichael*, 855 So. 2d 493, 508 (Ala. 2003).
5. *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145, 145 (1968).
6. *Id.* at 149.
7. *Id.* at 151 (White. J., concurring) ("And it is far better that the relationship be disclosed at the outset, when the parties are free to reject the arbitrator or accept him with knowledge of the relationship and continuing faith in his objectivity, than to have the relationship come to light after the arbitration, when a suspicious or disgruntled party can seize on it as a pretext for invalidating the award.").
8. *Id.* at 150 ("We cannot believe that it was the purpose of Congress to authorize litigants to submit their cases and controversies to arbitration boards that might reasonably be thought biased against one litigant and favorable to another.").
9. *See id.* at 149 (quoting from the American Arbitration Association's rule requiring arbitrators "to disclose any circumstances likely to create a presumption of bias" or which an arbitrator "believes might disqualify him as an impartial Arbitrator"). *See also, e.g.*, *Schmitz v. Zilveti*, 20 F.3d 1043, 1049 (9th Cir. 1994) ("In this case, Conrad had a duty to investigate the conflict at issue. Section 23(a) & (b) of the NASD Code requires arbitrators to 'make a reasonable effort to inform themselves of any "existing or past financial, business, [or] professional ... relationships [that they or their employer, partners, or business associates may have] that are likely to affect impartiality or might reasonably create an appearance of partiality or bias.'").
10. *See Applied Indus. Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi, A.S.*, 492 F.3d 132, 138 (2d Cir. 2007) (declining to create a free-standing duty to investigate on the part of arbitrators but concluding that "the absence of actual knowledge" of a conflict is not dispositive of evident partiality, requiring arbitrators to investigate potential conflicts or disclose their failure to investigate where the arbitrator

knows that a potential conflict may exist); *ANR Coal Co. v. Cognetrix of N.C., Inc.*, 173 F.3d 493, 499 n.4 (4th Cir. 1999) (declining to impose a duty to investigate upon arbitrators but finding that evident partiality may be established if it can be shown that an arbitrator failed to undertake an investigation where that investigation would have revealed non-trivial facts that demonstrate statutory grounds for vacatur); *Schmitz*, 20 F.3d at 1049 (finding that because the arbitration forum's rules required the arbitrator to make a reasonable effort to inform himself of conflicts and because he failed to disclose a conflict, the arbitrator had constructive knowledge of the conflict, whether or not he had actual knowledge of the relationship, and therefore, the constructive knowledge and the existence of the conflict established evident partiality under *Commonwealth Coatings*).

11. *Schmitz*, 20 F.3d at 1049.
12. *See Univ. Commons-Urbana, Ltd. v. Universal Constructors Inc.*, 304 F.3d 1331, 1341 (11th Cir. 2002) ("As we noted earlier, *Gianelli Money Purchase Plan & Trust* holds that one scenario under which an arbitration award could be vacated would be if 'the arbitrator knows of, but fails to disclose, information which would lead a reasonable person to believe that a potential conflict exists.'. . . This standard can be further distilled into three key elements: (1) the arbitrator must be aware of the facts comprising a potential conflict, (2) the potential conflict must be one that a reasonable person would recognize and (3) the arbitrator must fail to disclose the conflict.) (quoting *Gianelli Money Purchase Plan & Trust v. ADM Investor Servs., Inc.*, 146 F.3d 1309, 1312 (11th Cir. 1998)) (citation omitted).
13. *Gianelli Money Purchase Plan & Trust*, 146 F.3d at 1312 (citations omitted).
14. *New Regency Prods., Inc. v. Nippon Herald Films, Inc.*, 501 F.3d 1101, 1109 (9th Cir. 2007) (quoting *Gianelli Money Purchase Plan & Trust*, 146 F.3d at 1313).
15. Alabama courts rely upon and interpret the FAA in their review of arbitration awards where the facts underlying the arbitration involve interstate commerce and there is a contract requiring arbitration. *See Hereford v. D.R. Horton, Inc.*, 13 So. 3d 375, 379 (Ala. 2009) (finding that arbitration proceedings in Alabama are governed by the FAA where there is a contract calling for arbitration and the contract evidences a transaction involving interstate commerce) (citing *Title Max of Birmingham, Inc. v. Edwards*, 973 So. 2d 1050, 1052 (Ala. 2007)).
16. *Waverlee*, 855 So. 2d at 508.
17. *Lexington Ins. Co. & Chartis, Inc. v. S. Energy Homes, Inc.*, 101 So. 3d 1190, 1205 (Ala. 2012).
18. *Id.*
19. *Municipal Workers*, 2015 WL 1524911, at *5, *21.
20. *Id.* at *5.
21. *Id.* at *22.
22. *Id.*
23. *Id.* at *27 (quoting *Schmitz*, 20 F.3d at 1048-49).
24. *Id.*
25. *Id.* at *28.
26. What is required, however, is that the undisclosed conflict rise to the level of giving a reasonable impression of partiality. In *J. Don Gordon Construction, Inc. v. Brown*, No. 1131129, ____ So. 3d ____, 2015 WL 3537497, at *4-6 (Ala. June 5, 2015), the Alabama Supreme Court addressed a party's challenge to an arbitration award on evident partiality grounds, basing the claim on the fact that the arbitrator had been co-counsel with other lawyers from the firm representing one of the other parties on two separate occasions and had not disclosed that fact to the parties. The Alabama Supreme Court, in noting that the firm in question was large, that the arbitrator had not retained the firm or been retained by them and that the arbitrator had not communicated with the lawyer in question, found that this relationship, despite being undisclosed, did not rise to the level of giving a reasonable impression of partiality, as there was no direct relationship, financial or otherwise, between the arbitrator and counsel for the party. *See id.* at *6. Therefore, despite the nondisclosure, there was no evident partiality.
27. *Mendel v. Morgan Keegan & Co.*, No. 13-AR-1630-S, 2015 WL 3385058, at *7 (N.D. Ala. May 26, 2015). An appeal is pending in this action. *See Morgan Keegan & Co. v. Mendel*, No. 15-12801 (11th Cir. June 23, 2015).
28. *See* note 9 *supra*.
29. *See* note 11 *supra*.
30. Indeed, the court in *Municipal Workers* found that FINRA's rules imposed a duty upon the arbitrator in question to conduct a conflict check and make subsequent disclosures and that the arbitrator had obviously failed to do so. See *Municipal Workers*, 2015 WL 1524911, at *27-28.
31. *Id.* at *27.
32. *Id.*

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