HAS *POSITIVE SOFTWARE* BEEN POSITIVE FOR DISCLOSURE?

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Introduction

Good news for Fifth Circuit arbitrators: the Court has found few undisclosed "compromising connections" significant enough to vacate arbitrators' awards under the Federal Arbitration Act. In fact, since the Court of Appeals' 2008 en banc decision in *Positive Software Solutions v. New Century Mortgage Corp.*, 76 F.3d 278 (5th Cir. 2007) (en banc)("Positive Software II") set the standard, only a few Fifth Circuit decisions have hinted at the kinds of connections that *would* be serious for vacatur, while the vast majority have let awards stand.

The line between "significant" and "trivial" or "insubstantial" undisclosed connections is not any closer to crystal clear. It will never be, particularly where a legal standard is so factually driven. But recent cases do imply disgruntled parties to arbitration digging for undisclosed ties needn't be the ethical arbitrator's bane. "I got ya" isn't the new standard. Rather, the Fifth Circuit is setting precedent against certain kinds of evident partiality arguments and showing how they will approach different kinds of connections—and those that arbitrators should be especially careful to remember and disclose.

Review of Vacatur for Evident Partiality

Section 10 of the Federal Arbitration Act (FAA), codified at 9 U.S.C. § 10, lists a number of grounds for vacating arbitral awards. Among the most hotly contested is "evident partiality" under 10(a)(2). When arbitrators fail to disclose personal and business connections to parties to arbitration, they open themselves to charges of bias.

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There is broad agreement that "evident partiality" should work to make sure arbitrating parties are informed about arbitrator candidates' competence and partiality. *See, e.g.*, *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 135, 151 (1968) (White, concurring) ("[I]t 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"). But judges have also stressed the importance of expertise and finality in arbitration. Vacatur rules shouldn't make arbitrators who are tend to be more knowledgeable and longer serving—and therefore more storied and well networked in their business communities—the riskier choice.

The need to balance has led Courts of Appeals to split slightly where arbitrating parties weren't provided all the possibly relevant information. Courts have read the key precedent, *Commonwealth Coatings v. Continental Casualty Co.*, 393 U.S. 145 (1968), differently. Both the Court's plurality and Justice White filed opinions in that case holding the failure of an arbitrator to disclose $12,000 of sporadic contract work for one of the parties was enough for vacatur. Yet Justice White's concurrence implied a higher standard for undisclosed connections than the Court's plurality. Taking their cue from the plurality, a minority of circuits, including the Ninth, permit vacatur where any connection indicating possible bias isn't disclosed. The majority, however, have held that some undisclosed connections that tend to imply bias will nonetheless be too insignificant to warrant vacatur. It's like a rule of reason. The Fifth Circuit initially took the minority position in so-called *Positive Software I*, 436 F.3d 495 (5th Cir. 2006) but joined the majority after rehearing the case en banc. Fifth Circuit courts therefore have a line to draw: what sort of undisclosed ties are "significant compromising connections to the parties [to arbitration]" warranting vacatur?

A Look at Recent Federal Cases

A Lone Case of Evident Partiality

The Fifth Circuit has come upon the undisclosed connection issue and explicitly applied *Positive Software* II a handful of times since 2008. In only one of those cases, *United Steel Workers AFL-CIO v.*

Murphy Oil USA, *Inc.*, No. 09-7091, 2010 U.S. Dist. LEXIS 78185 (E.D. La. Aug. 2, 2010), did a court unambiguously find evident partiality and vacate an award. This was not a hard case. The arbitrator failed to disclose an ongoing conflict with the very union whose dispute he was arbitrating. He made it clear that he might abuse his position if the union failed to sort things out to his liking. When these issues came to light, the arbitrator refused to recuse himself. Finally—and unsurprisingly—the relevant Arbitration Review Board condemned him for violations of ethical and professional standards even before the federal court's vacatur decision. None but obvious lessons for arbitrators—or any professionals folk, for that matter—to be found here.

In the remaining reported Fifth Circuit cases, the courts did *not* find evident partiality.

Safe Territory

There have been a number of easy cases. Experience with mortgage-backed securities, for instance, did not make an arbitrator evidently partial toward a financial firm, especially given that kind of know-how was needed to understand the dispute being arbitrated. *Morgan Keegan & Co. v. Sturdivant*, No. 3:11cv638-DPJ-FKB, 2012 U.S. Dist. LEXIS 120295 (S.D. Miss. Aug. 24, 2012). Expertise, after all, is one of arbitration's major selling points. Furthermore, when an arbitration agreement provides for just one possible arbitrator, the fact that the same arbitrator presides over subsequent, possibly related arbitrations doesn't warrant vacatur the second time around. *See Adams v. Barnes*, No. 3:09-CV-1860-B, 2010 U.S. Dist. LEXIS 61358 (N.D. Tex. June 17, 2010).

In a couple of less straightforward cases, the courts have shown that some potentially uncomfortable connections will still fall short of warranting vacatur. In *United Forming, Inc. v. FaulknerUSA, LP*, 350 Fed. Appx. 948 (5th Cir. 2009) (per curiam), the Court of Appeals held unequivocally that the fact that an arbitrator's former partner had been an officer of a party's predecessor company and friends with industry peers who worked for a competitor supported at most a "speculative impression of bias." There was no "significant compromising relationship" as required under *Positive Software II*.

In *Halliburton Energy Services v. NL Industries*, 553 F. Supp. 2d 733 (S.D. Tex. 2008), as in *Positive Software* I and II before it, an

arbitrator did not disclose legal professional involvement in earlier litigation against a party to the arbitration. The court dismissed the evidence both as a theory of manifest disregard of procedures—the American Arbitration Association rules, adopted in the case, required disclosure—and as evidence of evident partiality. The court did not delve into the details of the arbitrator's role or involvement, but only emphasized that the standard for vacatur is a high one. There seems to be little to differentiate *Halliburton* from *Positive Software*, which likely accounts for the similarity and brief formulation of the result.

Discovery to Uncover Compromising Connections

A more nuanced case, *InfoBilling, Inc. v. Transaction Clearing, LLC*, No. 5:12-CV-01116, 2013 U.S. Dist. LEXIS 51986 (W.D. Tex. Apr. 10, 2013), fell short of finding evident partiality, but granted the challenging party additional discovery to seek out more evidence of partiality. This arbitrator was politically active, with a position as treasurer for an active political action committee. Neither the fact that the arbitrator had office space in the same building as a co-panelist, nor a donation to that panelist's long-past judicial election campaign, made out a significant connection showing evident partiality. Yet there was evidence that both the arbitrator and his co-panelist attended some fundraising events, and discovery was granted to see whether a more recent, regular, and significant political or personal relationship existed between the panelists through such events. The results of discovery have not yet come before the court.

To be sure, not just any old conspiracy theory gets a losing party discovery. In *Kimco Birmingham, L.P. v. Third Creek, LLC*, No. 3:07-CV-1642-O, 2008 U.S. Dist. LEXIS 112065 (N.D. Tex. July 16, 2008), it was not enough to allege that an arbitrator's visits and "lengthy communications" with "an unknown third party" might have been with a fellow panelist. Marked out names in a produced billing statement and an article from a trade magazine did not impress the magistrate, and the case for evident partiality was dismissed as "frivolous." No more discovery was permitted, and the magistrate recommended the petition to vacate be denied.

It Doesn't Take Much to Waive an Objection

A related line of cases following *Bernstein Seawell & Kove v. Borsarge*, 813 F.2d 726 (5th Cir. 1987) reinforces that parties who don't timely object to revelations of connections waive the right to

use the same information to vacate unfavorable awards. *McVay v. Halliburton Energy Services, Inc.*, 688 F. Supp. 2d 556 (N.D. Tex. 2009), *adopted by* 688 F. Supp. 2d 556 (N.D. Tex. 2009), reiterates that connections disclosed during proceedings—in that case, a social relationship with the son of a party—aren't ammunition to be stockpiled for a vacatur motion; if you don't object, you waive. This is true even when opposing counsel, rather than the arbitrator, actually discloses the connection, as was the case in *Ameser v. Nordstrom, Inc*., 442 Fed. Appx. 967 (5th Cir. 2011) (per curiam). Equivocal or unclear disclosures can apparently also put parties on notice that arbitrators may have unwelcome connections. In *Dealer Computer Services, Inc. v. Michael Motor Co.*, 485 Fed. Appx. 724 (5th Cir. 2012) (per curiam) (mem. op.), an equivocal question mark written on a disclosure form item about previous arbitrations with common experts and parties was enough to require a party object or waive, though the court noted the connection in question wouldn't have been enough even if it were never disclosed.

Conclusion

Disclosure is getting out of hand. What had been a routine duty upon case assignment, with few questions asked, has quickly turned into an offensive tool to vacate awards- or, more importantly, to force settlement. Ironically, the targets are the best arbitrators- that is, the ones with the lengthiest experience and most connections. Much more is at stake than academic issues surrounding "evident partiality". The very use of arbitration as an efficient means of obtaining finality hangs in the balance. Also, one of the hallmarks of arbitration—namely arbitrators with expertise—could be threatened. *Positive Software* II has gone a long way to restore reason to the process. The limited case law demonstrates the very chilling effect it was intended to have: who can know the number of motions to vacate which stayed only as a figment of a trigger-happy losing attorney's mind.