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Like Rodney Dangerfield, *Commonwealth Coatings* "Don't Get No Respect" – and it Shouldn't!

*By George H. Friedman**

Introduction

As reported in the June 18th issue of the *Securities Arbitration Alert*, the Supreme Court of Alabama in a unanimous decision in *J. Don Gordon Construction, Inc. and Western Surety Co. v. Brown*, No. CV-10-901832 (Ala. June 5, 2015), held that a "mere appearance" of arbitrator bias is not enough to satisfy the "evident partiality" ground for vacating an Award under the Federal Arbitration Act ("FAA"). The Court instead embraced a "reasonable impression of partiality" standard.

In so doing, Alabama becomes the latest state or federal circuit to reject the "impression of bias" standard apparently[1] adopted by a plurality holding in *Commonwealth Coatings Corp. v. Continental Casualty Corp.*, 393 U.S. 145, 89 S. Ct. 337 (1968), *reh. den.* 393 U.S. 1112, 89 S. Ct. 848 (1969). At this point, almost fifty years after *Commonwealth Coatings,* few courts cling to the broad arbitrator disclosure standard articulated in *Commonwealth Coatings*.

It's time for SCOTUS to pull the plug[2] on this arcane holding and articulate a clear reasonableness standard; that standard would be applied when a party challenges an Award based on an arbitrator's failure to disclose a relationship with an arbitration participant.

The Federal Arbitration Act

Let's start with the statutory language. FAA section 10(a)(2) states that courts can vacate an Award "where there was *evident partiality* or corruption in the arbitrators, or either of them…" (emphasis added). Attempts to vacate on this ground tend not to deal with allegations of overt bias on the part of an arbitrator, but with an arbitrator's failure to disclose a relationship with someone involved in the arbitration.

The Murky *Commonwealth* Conundrum

Commonwealth involved a construction dispute using the party-appointment method of arbitrator selection. The neutral arbitrator failed to disclose that one of his regular customers was a party to this case. There had not been any dealings, though, in about a year and the Court describes the past dealings as "sporadic" but significant: about

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$12,000 in the prior four or five years (these are 1967 dollars; it would be $86,000 in today's dollars). The losing party challenged the Award based on the arbitrator's nondisclosure. While the district and circuit courts confirmed the Award, the Supreme Court vacated the Award in a plurality holding. The key point articulated in Justice Black's[3] opinion: the mere failure of the Arbitrator to make a disclosure created "an impression of possible bias."

The two concurring Justices, White and Marshall, were "glad to join Brother Black's opinion," but with a caveat. Said Justice White in his concurring opinion, "But it does mean that arbitrators are not automatically disqualified by a business relationship with the parties before them if both parties are informed of the relationship in advance*, or if they are unaware of the facts but the relationship is trivial"* (emphasis added).

The dissenters, Justices Fortas, Harlan, and Stewart, take Justice Black's opinion to task, stating that it "uses this singularly inappropriate case to announce a *per se* rule that in my judgment has no basis in the applicable statute or jurisprudential principles: that, regardless of the agreement between the parties, if an arbitrator has any prior business relationship with one of the parties of which he fails to inform the other party, however innocently, the arbitration award is always subject to being set aside. This is so even where the award is unanimous; where there is no suggestion that the nondisclosure indicates partiality or bias; and where it is conceded that there was in fact no irregularity, unfairness, bias, or partiality."

The Post-*Commonwealth* Rebellion

Commonwealth generally came to be understood to mean the failure of an arbitrator to make a disclosure -- no matter how trivial, and irrespective of whether there is actual bias -- creates an impression of bias such that the Award may be vacated under the "evident partiality" language of FAA section 10(a)(2). Except, the great weight of subsequent case law has rejected *Commonwealth Coatings* and embraced a reasonableness standard.

How can state or federal circuit courts refuse to follow a Supreme Court holding? After all, doesn't the Constitution (Article III, section 1) vest in the Supreme Court "the judicial Power of the United States"? And doesn't the Supremacy Clause (Article VI, paragraph 2) provide that "This Constitution, and the laws of the United States which shall be made in pursuance thereof … shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any State to the contrary notwithstanding"? Lower courts of course *do* have to abide by SCOTUS precedent, but there's the rub: is a plurality decision, complete with multiple caveats by the concurring Justices, a "precedent"? Apparently not.

The Scorecard: Reasonableness wins by TKO

A reasonableness standard has been adopted by the overwhelming majority

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of courts, with *Commonwealth* being rejected expressly by many. What is the reasonableness standard? As articulated in *Morelite Constr. Corp. v New York City District Council,* 748 F.2d 79 (2d Cir. 1984), evident partiality "will be found where a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration." Some other courts so holding:

• *J. Don Gordon Construction, Inc. and Western Surety Co. v. Brown*, No. CV-10-901832 (Ala. June 5, 2015), discussed above. The decision is noteworthy, because this Court has not always warmly embraced arbitration. See *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995).

• *Tenaska Energy, Inc. v. Ponderosa Pine Energy, LLC,* No. 12-0789, 2014 Tex. LEXIS 427 (Texas 2014) ("In short, the standard for evident partiality in *Commonwealth Coatings* and *TUCO* requires vacating an award if an arbitrator fails to disclose facts which might, to an objective observer, create a reasonable impression of the arbitrator's partiality, but information that is trivial will not rise to this level and need not be disclosed").

• *Crouch Constr. Co. v. Causey*, 405 S.C. 155, 747 S.E.2d 482, 488 (2013) ("consistent with the majority of courts, we reject the appearance-of-bias standard and find the approach … requires the party seeking vacatur to 'demonstrate that a reasonable person would have to conclude that an arbitrator was partial to the other party to the arbitration'").

• *U.S. Electronics, Inc. v. Sirius Satellite Radio, Inc.,* 17 N.Y.3d 912 (2011) ("In light of this settled law, we adopt the Second Circuit's reasonable person standard and apply it when we are asked, as in this case, to consider the federal evident partiality standard of 9 USC § 10").

• *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 476 F.3d 278 (5th Cir.) (*en banc*), *cert. den.*, 551 U.S. __ (2007) ("The resulting standard is that in nondisclosure cases, an award may not be vacated because of a trivial or insubstantial prior relationship between the arbitrator and the parties to the proceeding. The 'reasonable impression of bias' standard is thus interpreted practically rather than with utmost rigor…").

• *Nationwide Mutual Ins. Co. v. Home Ins. Co.,* 429 F.3d 640 (6th Cir. 2005) ("[A] majority of the [*Commonwealth Coatings*] Court did not endorse the `appearance of bias' standard set forth in the plurality opinion … a reasonable person would have to conclude that the arbitrator was partial to one party to the arbitration").

• *Univ. Commons-Urbana, Ltd. v. Universal Constructors Inc.,* 304 F.3d 1331 (11th Cir. 2002) (vacatur only if there was nondisclosure of facts creating "a reasonable impression of partiality").

• *ANR Coal Co., Inc. v. Cogentrix of N.C., Inc.,* 173 F.3d 493 (4th Cir. 1999) (burden is on challenger to offer "facts that, alone or taken together, would permit a reasonable person to assume that [the arbitrator] was partial to [the other side]. A trivial relationship, even if undisclosed, will not justify vacatur of an arbitration award").

• *Peoples Sec. Life Ins. Co. v. Monumental Life Ins. Co.,* 991 F.2d 141 (4th Cir. 1993) ("It is well established that a mere appearance of bias is insufficient to demonstrate evident partiality").

• *Merit Ins. Co. v. Leatherby Ins. Co.,* 714 F.2d 673 (7th Cir. 1983) (*Commonwealth Coatings* "provides little guidance because of the inability of a majority of Justices to agree on anything but the result").

• *Ormsbee Dev. Co. v. Grace,* 668 F.2d 1140 (10th Cir. 1982) (must be "clear evidence of impropriety." Also, the relationship "must be direct, definite and capable of demonstration rather than remote, uncertain, or speculative").

And this list is by no means exhaustive (this being a thought piece and not a law review article).

ADR Provider Rules Already There

As a matter of policy, the major ADR providers seemingly track the *Commonwealth Coatings* "impression of bias" standard, strongly encouraging arbitrators to err on the side of disclosure (a view I echo), and warning them that failure to do so may result in their Award being vacated. For example, FINRA's arbitrator training materials[4] instruct arbitrators that it "is important to remember that not every arbitrator disclosure will result in your disqualification, but failing to disclose even a minor conflict may jeopardize your award. When in doubt, arbitrators should always err in favor of disclosure."

Arbitration forum *rules*, however, seem to follow a reasonableness standard. For example, the FINRA *Code of Arbitration Procedure for Customer Disputes* Rule 12405(a) provides "Each potential arbitrator must make a reasonable effort to learn of, and must disclose to the Director, any circumstances which might preclude the arbitrator from rendering an objective and impartial determination in the proceeding..."

AAA's *Commercial Arbitration Rules and Mediation Procedures* state in rule R-17(a) that arbitrators "shall disclose to the AAA any circumstance likely to give rise to justifiable doubt as to the arbitrator's impartiality or independence, including any bias or any financial or personal interest in the result of the arbitration or any past or present relationship with the parties or their representatives." JAMS' *Comprehensive Arbitration Rules & Procedures* Rule 15(h) and CPR's *Administered Arbitration Rules* Rule 7 are similar.

Time to Lay *Commonwealth* to Rest

As far as I can tell, only the Ninth Circuit still applies *Commonwealth* (see *Schmitz v. Zilveti,* 20 F.3d 1043 (9th Cir. 1994)). Although there hardly

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seems to be a major split to resolve, I still think SCOTUS should administer a *coup de grâce* to the *Commonwealth* standard. First, the Ninth Circuit is an important one. Second, although the "impression" standard won't be applied in most jurisdictions, that won't stop challenges to awards based on it. Last, judicial economy and respect for arbitration demand no less. Rodney would want it that way.

ENDNOTES

[1] Read on for why I say "apparently."

[2] Sooner or later, there will be another petition for *cert.* in an arbitrator nondisclosure case.

[3] That Justice Black authored this arbitration-unfriendly opinion is not surprising. He, along with Justice Douglas and Chief Justice Warren, joined the majority in the arbitration-unfriendly *Wilko v. Swan*, 346 U.S. 427 (1953), and came together again 15 years later in Commonwealth Coatings.

[4] See *Your Duty to Disclose* (May 2015), available at http://www.finra.org/sites/default/files/FINRA-Duty-to-Disclose-Training-May-2015.pdf (visited June 21, 2015).