Contact: Maria Cilenti - Director of Legislative Affairs - mcilenti@nycbar.org - (212) 382-6655

REPORT ON LEGISLATION BY THE COMMITTEE ON ARBITRATION

A.7002-A **M. of A. Titone**
S.5798 **Sen. Fuschillo**

AN ACT to amend the civil practice law and rules, in relation to grounds for vacating an arbitration award on the basis of partiality of the arbitrator.

THIS BILL IS OPPOSED

The legislation before the New York State Legislature, A.7002-A/S.5798 (the "Bill"), proposes to amend Section 7511 of the civil practice law and rules to permit vacatur of an arbitration award upon application by a party "where the arbitrator has been affiliated in any way with any party to the arbitration, or any of its subsidiaries or affiliates; or where the arbitrator has a financial interest, directly or indirectly, in any party or in the outcome of the arbitration." The impartiality of arbitrators is fundamental to a fair arbitration hearing and an important public policy which the Arbitration Committee fully supports.

Some concerns have been expressed, particularly by trial counsel, regarding whether more controls need to be imposed on arbitrators in the disclosure area to ensure impartiality and transparency. Although the concern is laudable, the Bill does not advance increasing arbitrator impartiality. Instead, the Bill would inject confusion and uncertainty into the arbitration process. New York courts and their limited resources could be faced with an increase in cases where parties would prolong the arbitration process by encouraging vacatur motions under this over-broadly and vague provision. Such outcomes would seriously undermine the important role that arbitration plays in dispute resolution in New York with no offsetting benefits.

The Arbitration Committee opposes the Bill on three primary grounds:

1. The proposed terms of the Bill are over-broad and vague;

2. The Bill undermines parties' freedom to select arbitrators and venue;

3. The Bill is contrary to the comprehensive approach set forth in the Revised Uniform Arbitration Act (RUAA), an important advance in the law of arbitration that sets forth better and more complete arbitration procedures to meet modern needs.

A. The Bill Is Overbroad and Vague

The Bill provides for vacatur of an award by an arbitrator who "has been affiliated in any way" with a party, its subsidiaries, or affiliates, or has a "direct or indirect financial interest" in a party or in the outcome of a dispute. Both of these key phrases are detrimentally overbroad and vague.

The meaning of the phrase "affiliated in any way" is simply unclear and could reach a staggeringly broad number of relationships. For example, would it include any social media connections, such as LinkedIn, Facebook, Listservs? Would common membership in a large national fraternal organization or in a bar association suffice? Giving no insight into what sort of relationships would be affected, whether professional or personal, the Bill is highly vulnerable to a "void for vagueness" challenge. As the New York Court of Appeals wrote last year, "[i]t has long been settled that 'civil as well as penal statutes can be tested for vagueness under the due process clause.'" Matter of Kaur v New York State Urban Dev. Corp., 2010 NY Slip Op 5601, 11 (N.Y. 2010) (quoting Montgomery v. Daniels, 38 NY2d 41, 58 (1975)). The Court explained that "[d]ue process requires that a statute be sufficiently definite 'so that individuals of ordinary intelligence are not forced to guess at the meaning of statutory terms.'" Id. (quoting Foss v. City of Rochester, 65 NY2d 247, 253 (1985)).

Moreover, the high degree of speculation surrounding the meaning of "affiliated in any way" would likely require courts to interpret the phrase on a case-by-case basis. Such a situation would inevitably lead to a high level of unpredictability and undermine the finality of arbitration, one of its bedrock features. This uncertainty and likely increase in the number of challenges to arbitration awards also will increase the burden on New York's courts at a time when their resources are severely strained.

The Bill's restriction on arbitrators holding a "financial interest, directly or indirectly, in any party or in the outcome of the arbitration" similarly injects an uncertainty into the arbitration process. By way of example, given that most pension or educational funds today include investments in a variety of mutual funds, which in turn own shares in dozens of publicly traded companies, any arbitrator with a 401(k) – let alone a larger portfolio of investments – risks having his or her award vacated on the basis of an indirect interest in a publicly-held corporate party. Again, it is a laudable public policy position to restrict arbitrators from serving in disputes where their direct financial interests would compromise their impartiality. However, phrasing in the Bill goes far beyond this goal and effectively disqualifies all arbitrators with any form of arguable "direct or indirect financial interest" in a party or the dispute, regardless of any disclosure or any determination by the parties of the arbitrator's impartiality.

B. The Bill Interferes With Parties' Freedom to Select Arbitrators and Venue

No one disputes that arbitrators need to disclose relationships and dealings that could affect their impartiality. New York courts have interpreted the current text of CPLR 7511(b)(ii), which provides for vacatur of an arbitration award in the case of "partiality of an arbitrator appointed as a neutral," to require arbitrators to disclose any facts impacting his or her impartiality. Based upon

these disclosures, a party may object to the arbitrator or, by failing to object at the time of disclosure, waive any objection. See Siegel v. Lewis, 40 N.Y.2d 687, 690 (1976) ("assent by a party to the choice of an arbitrator in the face of that party's knowledge of a relationship between the other side and the arbitrator is a waiver of his right to object. And, '[since] waiver is a matter of intention * * * the touchstone * * * is the knowledge, actual or constructive, in the complaining party of the tainted relationship or interest of the arbitrator'") (quoting Matter of Milliken Woolens, 11 A.D.2d 166, 168-169 (1st Dep't 1960)).

However, the Bill uses the guise of disclosure to effectively restrict parties' freedom to select arbitrators, and indirectly New York as a venue for their arbitration, by interjecting high levels of uncertainty into the arbitration process. Specifically, passage of the Bill would create confusion about whether the statute replaces well-settled legal principles that allow arbitrators to render binding arbitration awards after disclosures have been made and any objections waived - a result that would undermine the viability of the arbitration process in New York. This would likely lead parties to select other venues, even for matters involving New York disputes and parties. For example, under the Bill, not only would an arbitrator be put to the task of investigating the holdings of every investment fund in which he or she is invested, as noted above, but even if such an investigation is undertaken and disclosure of an indirect interest is made without any party objections, it is not clear under the language of the Bill whether an award would nevertheless be subject to attack.

Moreover, the Bill would run contrary to the vast body of well-reasoned case law developed under the Federal Arbitration Act ("FAA") that also allows for parties to waive objections after arbitrators have made their disclosures without jeopardizing the arbitration award. AAOT Foreign Econ. Ass'n (VO) Technostroyexport v. International Dev. & Trade Servs., 139 F.3d 980, 982 (2d Cir. 1998) ("The settled law of this circuit precludes attacks on the qualifications of arbitrators on grounds previously known but not raised until after an award has been rendered."); Nordell Int'l Resources v. Triton Indon., 1993 U.S. App. LEXIS 19616, *20 (9th Cir. July 23, 1993) ("As a general rule, a party must object to an arbitrator's partiality at the arbitration hearing before such an objection will be considered by the federal courts."), citing Apperson v. Fleet Carrier Corp., 879 F.2d 1344, 1358-59 (6th Cir.), cert. denied, 493 U.S. 809 (1989); Ft. Hill Builders, Inc. v. National Grange Mut. Ins. Co., 866 F.2d 11, 13 (1st Cir. 1989) ("absent exceptional circumstances, we will not entertain a claim of personal bias where it could have been raised at the arbitration proceedings but was not.").

Finally, the Bill would make New York an anomaly concerning arbitrator disclosure in comparison to the majority of other States by completely ignoring the parties' freedom to waive objections after arbitrators have made their disclosures without jeopardizing the arbitration award. See, e.g., Dornbirer v. Kaiser Foundation Health Plan, Inc., 166 Cal. App. 4th 831, 846 (Cal. App. 4th Dist. 2008) (party waived right to disqualify arbitrator by failing to object at time of disclosure); Edward D. Jones & Co. v. Schwartz, 969 S.W.2d 788, 797 (Mo. Ct. App. 1998) (party waived objection to arbitrator's "evident partiality" by failing to make such objection during hearing); Burlington N. R.R. v. TUCO, 960 S.W.2d 629, 637 n. 9 (Tex. 1997) ("a party who learns of a conflict before the arbitrator issues his or her decision must promptly object to avoid waiving the complaint"); Thomas v. Howard, 51 N.C. App. 350, 353 (N.C. Ct. App. 1981) (disability of an arbitrator is waived if the complaining party had prior knowledge of it).

C. The Bill Ignores Guidance Provided By RUAA

Finally, the Bill overlooks the comprehensive approach provided in the 2000 Revised Uniform Arbitration Act (RUAA) on this very issue of ensuring arbitrator impartiality through disclosures.[1] Within the past 5 years, both the New York Senate and Assembly have had before them proposed RUAA bills for enactment.[2] Adoption of the RUAA would enhance New York as a center for arbitration by providing an arbitration statute that is uniform and accurately reflects mainstream arbitration practices and law.[3]

The RUAA contains a detailed section on "Disclosure by Arbitrator" (Section 12). Under this Section, the RUAA requires broad disclosure by arbitrators and thus addresses the public policy issues surrounding the importance of transparency and impartiality in arbitration. For example, Section 12 requires disclosure of:

- "a financial or personal interest in the outcome of the arbitration proceeding";
- "an existing or past relationship with any of the parties to the agreement to arbitrate or the arbitration proceeding, their counsel or representatives, a witness, or another arbitrators;" and
- "any known facts that a reasonable person would consider likely to affect the impartiality of the arbitrator in the arbitration proceeding."

Unlike the Bill, the RUAA also appropriately takes into account the parties' acceptance of an arbitrator after making the requisite disclosures, unless the party asserts "timely objections."[4] In

---

[1] The RUAA revises the Uniform Arbitration Act of 1956 ("UAA") that had been adopted in 49 states. The RUAA reflects new developments in arbitration law and is a product of the Uniform Law Commission (ULC, also known as the National Conference of Commissioners on Uniform State Laws), established in 1892, that provides states with non-partisan, well-conceived and well-drafted legislation that brings clarity and stability to critical areas of state statutory law. It is endorsed by the American Bar Association, American Arbitration Association and others groups in the arbitration field.

[2] Senate Bill 4148 and Assembly Bill 7826.

[3] *See* Report on the Revised Uniform Arbitration Act (December 9, 2005) (New York City Bar Association Committee on Arbitration, New York State Bar Association Committee on the CPLR, New York County Lawyers Association Committee on Arbitration & ADR, New York State Bar Association Committee on ADR, New York State Bar Association Commercial and Federal Litigation Section) (attached).

[4] **SECTION 12. DISCLOSURE BY ARBITRATOR.**

(a) Before accepting appointment, an individual who is requested to serve as an arbitrator, after making a reasonable inquiry, shall disclose to all parties to the agreement to arbitrate and arbitration proceeding and to any other arbitrators any known facts that a reasonable person would consider likely to affect the impartiality of the arbitrator in the arbitration proceeding, including:

(1) a financial or personal interest in the outcome of the arbitration proceeding; and

(2) an existing or past relationship with any of the parties to the agreement to arbitrate or the arbitration proceeding, their counsel or representatives, a witness, or another arbitrators.

other words, the RUAA encourages both broad disclosure by arbitrators and broad party autonomy in their selection of arbitrators and venue. By contrast, the Bill does not further either goal. To the extent the legislature is not inclined to consider adoption of the entire RUAA at this time, the Arbitration Committee urges at a minimum that it adopt Section 12 of the RUAA in its entirety to address any concerns surrounding arbitrator impartiality and disclosures.

Based on the foregoing, the Arbitration Committee of the New York City Bar Association opposes this legislation.

Respectfully,

Committee on Arbitration[5]
By: Kathleen Scanlon, Chair

December 2011

(b) An arbitrator has a continuing obligation to disclose to all parties to the agreement to arbitrate and arbitration proceeding and to any other arbitrators any facts that the arbitrator learns after accepting appointment which a reasonable person would consider likely to affect the impartiality of the arbitrator.

(c) If an arbitrator discloses a fact required by subsection (a) or (b) to be disclosed and a party timely objects to the appointment or continued service of the arbitrator based upon the fact disclosed, the objection may be a ground under Section 23(a)(2) for vacating an award made by the arbitrator.

(d) If the arbitrator did not disclose a fact as required by subsection (a) or (b), upon timely objection by a party, the court under Section 23(a)(2) may vacate an award.

(e) An arbitrator appointed as a neutral arbitrator who does not disclose a known, direct, and material interest in the outcome of the arbitration proceeding or a known, existing, and substantial relationship with a party is presumed to act with evident partiality under Section 23(a)(2).

(f) If the parties to an arbitration proceeding agree to the procedures of an arbitration organization or any other procedures for challenges to arbitrators before an award is made, substantial compliance with those procedures is a condition precedent to a [motion] to vacate an award on that ground under Section 23(a)(2).

[5] This report was prepared by Arthur D. Felsenfeld, Olivier P. André, Jennifer Cabrera, and Michael J. Crane.