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MAJOR CHANGE IN "EVIDENT PARTIALITY" VACATUR STANDARD

Positive Software Solutions, Inc. v. New Century Mortgage Corporation
2007 U.S.App.LEXIS 1012 (5th Cir. January 18, 2007).

The eighty-six-page award in this seven-day arbitration (administered by AAA) was reinstated by an *en banc* decision by the Fifth Circuit after a panel of that court had vacated the award based on evident partiality due to arbitrator non-disclosure.[2] Ten of the sixteen judges hearing the appeal *en banc* joined in the opinion written by Chief Judge Edith H. Jones. Judges Reavley, Wiener, Garza, Benavides, and Stewart dissented with an opinion written by Judge Reavley and Judge Wiener specially concurring with Judge Reavley's dissent.

The federal district court for the Northern District of Texas, Judge David C. Godbey, had vacated the arbitration award for evident partiality because of the sole neutral arbitrator's failure to disclose his co-counsel status in extended Intel-Cyrix patent litigation (1990-96) with counsel for New Century in this arbitration.[3] Judge Godbey relied on *Commonwealth Coatings Corp. v. Continental Cas. Co.*, for "the simple requirement that arbitrators disclose to parties any dealings that *might* create an *impression* of *possible* bias."[4] Judge Godbey distinguished the evident

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[1]Nothing in *The Arbitration Newsletter* is presented as or should be relied on as legal advice to clients or prospective clients. The sole purpose of *The Arbitration Newsletter* is to inform generally. The application of the comments in *The Arbitration Newsletter* to specific questions and cases should be discussed with the reader's independent legal counsel.

[2]*See Positive Software Solutions, Inc. v. New Century Mortgage Corporation*, 2007 U.S.App.LEXIS 1012 (5th Cir. January 18, 2007).

[3]*See Positive Software Solutions, Inc. v. New Century Mortgage Corporation*, 337 F.Supp.2d 862 (N.D.Tex.2004)(Opinion by Godbey).

[4]393 U.S. 145, 149, 21 L.Ed.2d 301, 89 S.Ct. 337 (1968) (emphasis added).

partiality standard for arbitrator non-disclosure cases from actual bias cases.[5] He cited three reasons why "a more lenient standard in nondisclosure cases is appropriate": (1) "it is consistent with *Commonwealth Coatings*"; (2) "it is consistent with the policies of the *Federal Arbitration Act*"; and (3) "the fact of the nondisclosure itself may create an appearance of bias, even when the underlying facts themselves would not support a finding of actual bias."[6] Judge Godbey was also impressed with the repeated instructions and warnings from AAA to the arbitrator to disclose "any existing or past financial, business, professional, family, or social relationships";[7] that "every disclosure, no matter how insignificant should be communicated to the parties";[8] and to "err in favor of disclosing it [any prior or present business connection with one of the parties] to the parties."[9] It is the parties who decide the significance *vel non* of the arbitrator's disclosure, not the arbitrator, and according to Judge Godbey the question is "would a reasonable lawyer in Positive Software's position have wanted to know about the Arbitrator's role in the Intel Litigation before selecting an arbitrator."[10]

The Fifth Circuit initially agreed with Judge Godbey and upheld his vacatur decision.[11] But upon *en banc* rehearing and supplemental briefing, the Fifth Circuit reversed its panel decision and reversed Judge Godbey's vacatur judgment.[12]

The Fifth Circuit has for the first time tackled what it believes *Commonwealth Coatings* says about 9 U.S.C. §10(a)(2) and its "evident partiality" standard for vacatur of arbitration awards. First, the court applies definitions from *Webster's Ninth New Collegiate Dictionary* 430 (1985) to 9 U.S.C. §10(a)(2) and concludes that the vacatur standard is "clearly evident" bias, what it calls "the straight forward interpretation."[13] Second, the court acknowledges that its panel decision interpreted 9 U.S.C. §10(a)(2) in light of *Commonwealth Coatings* and agrees that

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[5]337 F.Supp.2d at 881.

[6]337 F.Supp.2d at 882-883.

[7]337 F.Supp.2d at 884 (*Code of Ethics for Arbitrators in Commercial Disputes*).

[8]337 F.Supp.2d at 884 (*Disclosure and Challenge of an Arbitrator*).

[9]337 F.Supp.2d at 884 (*Guide to Commercial Arbitrators*).

[10]337 F.Supp.2d at 885.

[11]*Positive Software Solutions, Inc. v. New Century Mortgage Corporation*, 436 F.3d 495 (5th Cir. 2006) (Opinion by Judge Reavley, joined by Garza and Benavides). All of whom dissented from the *en banc* decision at 2007 U.S.App.LEXIS 1012 (January 18, 2007).

[12]The matter has been remanded for further proceedings in the federal district court because of Positive Software's other grounds for vacatur not considered by the court. 2007 U.S.App.LEXIS 1012 at *5 and *23.

[13]2007 U.S.App.LEXIS 1012 at *7.

what the Supreme Court meant in *Commonwealth Coatings* "is a critical issue."[14] Third, the court then attempts to harmonize Justice Black's opinion for the Supreme Court with Justice White's concurrence in *Commonwealth Coatings*.[15] Fourth, the court then decides to follow Justice White's concurrence which the court interprets as a "significantly qualified" concurrence that "is based on a narrower ground than Justice Black's opinion, and it [Justice White's concurrence] becomes the Court's effective *ratio decidendi*."[16] This means 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" and results in the "reasonable impression of bias" standard being "interpreted practically rather than with utmost rigor."[17] Fifth, the court finally looks at the prior co-counsel relationship between the arbitrator and counsel for New Century and concludes it is "a slender connection,"[18] nothing similar to the relationships in *Commonwealth Coatings*.[19]

To vacate the award in this case, the court concludes would (1) "seriously jeopardize the finality of arbitration,"[20] (2) "would hold arbitrators to a higher ethical standard than federal Article III judges,"[21] and (3) "would rob arbitration of one of its most attractive features...-[arbitrator] expertise."[22]

This new Fifth Circuit vacatur standard for the "evident partiality" of 9 U.S.C. §10(a)(2) requires "a concrete, not speculative impression of bias" or "a significant compromising relationship."[23]

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[14]2007 U.S.App.LEXIS 1012 at *7-8 (court observes that *Commonwealth Coatings* "is not pellucid," a conclusion to which Judge Reavley responds in the dissent).

[15]2007 U.S.App.LEXIS 1012 at *8-20.

[16]2007 U.S.App.LEXIS 1012 at *11.

[17]2007 U.S.App.LEXIS 1012 at *16.

[18]2007 U.S.App.LEXIS 1012 at *17.

[19]2007 U.S.App.LEXIS 1012 at *20.

[20]2007 U.S.App.LEXIS 1012 at *20-21.

[21]2007 U.S.App.LEXIS 1012 at *21.

[22]2007 U.S.App.LEXIS 1012 at *23.

[23]*Id.*

LESSONS FROM THE 5TH CIRCUIT'S *POSITIVE SOFTWARE* OPINION

1. Watch the certiorari history on this case especially based on Judge Reavley's dissent and Judge Wiener's concurrence with the dissent!

2. Watch for what Texas state courts do with FAA vacatur appeals, especially in view of the Texas Supreme Court's holdings in *Burlington Northern R.R. Co. v. TUCO*, Inc., 960 S.W.2d 629 (Tex.1997) and *Mariner Financial Group, Inc. v. Bossley*, 79 S.W.3d 30 (Tex.2002).

3. Parties should continue to insist on their right to full and complete disclosures by potential arbitrators. Arbitration is a creature of the parties' agreement and no arbitration agreement should surrender the parties' right to select their arbitrator.

4. Watch your arbitration clause drafting to make sure you specify how your arbitrator will be selected, who will select your arbitrator, and what code of ethics will be applicable to your arbitrator.

5. When in doubt about what to disclose, the potential arbitrator should disclose. The decision about what is trivial or insignificant is not for the potential arbitrator but for the parties.

6. The disclosure obligation never stops for the arbitrator regardless of when during the arbitration process the question arises.

ARBITRATOR DECIDES STATUTE OF LIMITATIONS QUESTION NOT THE COURT

O'Keefe Architects, Inc. v. CED Construction Partners, Ltd.
2006 Fla.LEXIS 2420 (Fla.2006)

A statute of limitations defense created by the arbitration agreement in a standard AIA arbitration clause is for the arbitrator not the court to determine, the Florida Supreme Court has recently decided.[24] The arbitration clause in question specifically included a restricted statute of limitations bar.[25]

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[24]"Because the Florida Arbitration Code allows parties to agree to arbitrate any controversy, the question of whether a dispute is subject to arbitration is a matter of contract interpretation. We hold that a broad agreement to arbitrate includes determining defenses to an otherwise arbitrable claim, including the statute of limitations." 2006 Fla.LEXIS 2420, *2, *16-17.

[25]"A demand for arbitration shall be made within a reasonable time after the claim, dispute or other matter in question has arisen. In no event shall the demand for arbitration be made after the date when institution of legal or equitable proceedings based on such claim,

Applying the Florida Arbitration Code ("FAC"),[26] not the Federal Arbitration Act ("FAA"), the Court affirmed the lower appellate court and the trial court in compelling the completion of the arbitration and staying the trial court litigation.[27] Interstate commerce may have been involved in this project but the parties agreed that the FAC applied in this case.[28]

Although applying the FAC, the Florida Supreme Court discussed the FAA because "both the FAC and the FAA require the court to compel arbitration if it finds that a valid arbitration agreement exists and are silent on the issue of who should decide statute of limitations issues."[29] The Court relied on *Howsam v. Dean Witter Reynolds, Inc.*[30] for the proposition that "questions of arbitrability" do not include "allegations of waiver, delay, or a like defense to arbitrability." In Florida a statute of limitations defense will be a matter for the arbitrator not the Court to decide and, therefore, not a "gateway" question or "question of arbitrability" as the term "arbitrability" is used by the U.S. Supreme Court.[31]

LESSONS FROM *O'KEEFE*

1. Make sure that your arbitration clause clearly and explicitly gives the arbitrator authority to decide questions of "arbitrability" if you want the least amount of court intervention in your arbitration.[32]

2. Pay special attention to the description of claims to be arbitrated when drafting or examining the arbitration clause. The broadest possible terms should be used in drafting if you want all disputes and all defenses heard by the arbitrator rather than the court.

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dispute or other matter in question would be barred by the applicable statutes of limitations." 2006 Fla.LEXIS 2420, *4.

[26]*Id.* at *6.

[27]*Id.* at *4-5.

[28]*Id*. at *6.

[29]*Id.* at *10 fn6.

[30] 537 U.S. 70, 84, 123 S.Ct. 588, 154 L.Ed.2d 491 (2002).

[31]*Id*. at *10-12.

[32]"Arbitration clauses are creatures of contract. As a result, courts look to the intent of the parties as manifested in the contract to determine whether an arbitration clause compels arbitration of a particular issue." 2006 Fla.LEXIS 2420, *8; also citing *Howsam*, 537 U.S. 79, 85 (A "question of arbitrability" is "an issue for judicial determination [u]nless the parties clearly and unmistakably provide otherwise.").

3. Trial courts that do not want to lose a case to arbitration may want to broaden the scope of what the pertinent arbitration law allows the court to consider. In prosecuting your motions to compel make sure you have carefully researched what the trial court can and cannot do in the particular circumstances of your immediate motion to compel.[33]

4. If you want a particular arbitration law to apply, put it in your arbitration clause. Trial courts do not like to settle this disputed issue and probably shouldn't thereby leaving the issue to the arbitrator. State in your arbitration clause which arbitration law you want to apply.

RETROACTIVE SCOPE OF ARBITRABLE CLAIMS (*In re Brookshire Brothers, Ltd.*)

The employer (Brookshire Brothers, Ltd.) instituted an arbitration agreement for its Texas nonsubscriber (Workers' Compensation) employee claims "beginning August 29, 2005 (the 'Effective Date')."[34] The new arbitration policy was delivered to the Brookshire employees on or about December 15, 2005. An employee in a Carthage, Texas store suffered an injury while working on July 21, 2004. The employee required "numerous medical consultations" and worked no more after October 28, 2005 but remained eligible for medical and disability benefits. The injured employee was sent notice of the new arbitration policy sometime in January, 2006.[35]

The trial court denied Brookshire's motion to compel arbitration. The Texarkana Court of Appeals denied Brookshire's petition for writ of mandamus on (1) scope and (2) procedural unconscionability grounds.

The injury occurred at a time when Brookshire had no arbitration policy in place.[36] The arbitration agreement did not specifically include claims arising prior to the effective date of the

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[33]The Florida Supreme Court in *O'Keefe* carefully set out the three issues the trial court "must consider" in ruling on a motion to compel arbitration of a dispute" under the FAC and decided that the arbitrator not the court should determine the status of the statute of limitations defense. 2006 Fla.LEXIS 2420, *7-17.

[34]*In re Brookshire Brothers, Ltd.*, 2006 Texas LEXIS 6178, *6 (Tex.App. - Texarkana, *original proceeding*).

[35]*Id*. at *4.

[36]The court concluded from this that the employee had a "vested right to litigate an accrued claim." *Id*. at *10-11.

new policy.[37] Any construction of the scope language had to be construed strictly against Brookshire, the drafter.[38] The ordinary and customary meanings of "will cover" and "arising out of" the employment relationship, as used in the arbitration policy, "was meant to apply only to future events."[39] Even a Brookshire designated representative testified that the company never intended the arbitration policy to apply to claims occurring prior to August 29, 2005.[40]

Although the employee argued both procedural and substantive unconscionability,[41] the appellate court only considered the employee's procedural unconscionability point. If the arbitration agreement applied retroactively, the at-will employee would have only two options at the time the arbitration policy was announced: (1) accept arbitration and lose her accrued right to litigate; or (2) quit her job and lose her medical and disability benefits. Although the employee had not yet filed suit when the arbitration policy was adopted unilaterally by her employer, the court found that the employee "had taken action to institute the legal process and had notified Brookshire of her intention to pursue legal action on the dispute before receiving the arbitration policy."[42] In light of the "entire atmosphere in which the [arbitration] policy was made," the court found the arbitration policy "procedurally unconscionable."

WHAT WE LEARN FROM
In Re Brookshire Brothers, Ltd.

1. If an employer wants a newly adopted arbitration policy to apply retroactively to c claims that have already accrued, then spell it out in the policy.

2. If an employer wants a newly adopted arbitration policy to apply retroactively to claims that have already accrued, then make sure the claims to be arbitrated include the prior accrued claims.

3. If an employer wants a newly adopted arbitration policy to apply retroactively to claims that have already accrued, then make sure that the at-will employee does

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[37] *Id*. at *6.

[38] *Id*. at *7.

[39] *Id*. at *9-10.

[40] *Id*. at *12.

[41] *See In re Palm Harbor Homes, Inc.* 2006 Tex.LEXIS 529, *12, 49 Tex.Sup.J. 711 (Tex. 2006, original proceeding) for definition of substantive unconscionability; *see In re Halliburton*, 80 S.W.3d 566, 571 (Tex.2002) ("...(1) procedural unconscionability, which refers to the circumstances surrounding the adoption of the arbitration provision, and (2) substantive unconscionability, which refers to the fairness of the arbitration provision itself.")

[42] *Id*. at *17 (*citing Wilcox v. Valero Refining Co.*, 256 F.Supp.2d 687 (S.D.Tex.2003)).

not have to give up accrued medical, disability or any other benefits if the at-will employee chooses not to accept the arbitration policy by continued employment.

4. If an employer wants a newly adopted arbitration policy to apply retroactively to claims that have already accrued, then make sure that the arbitration required doesn't interfere with the at-will employee's prior invocation of the "machinery of the justice system."[43]

5. If an employer wants a newly adopted arbitration policy to apply retroactively to claims that have already accrued, then make sure the arbitration policy is adopted in such a way that it will not be seen by a court to be "oppressive or unreasonable" to the at-will employee who has no bargaining ability."[44]

ABOUT WHITAKER, CHALK, SWINDLE AND SAWYER, L.L.P.

Whitaker, Chalk, Swindle and Sawyer, L.L.P. attorneys and counselors have been serving clients in domestic and international transactions and civil disputes since 1978. See our website at www.whitakerchalk.com for more information about the firm and its lawyers.

John Allen Chalk, Sr., editor of *The Arbitration Newsletter*, has served as an arbitrator in more than two hundred thirty (230) domestic and international arbitrations involving business, commercial, healthcare, employment, insurance, franchise, real estate, oil and gas, partnership, torts, and other issues. Mr. Chalk also serves as a mediator for disputes in all these areas.

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[43] *Id.* at *16 (*citing Wilcox v. Valero Refining Co.*).

[44] *Id.* at *17.