The Arbitration Newsletter

(Published by Whitaker Chalk Swindle & Schwartz PLLC)
(John Allen Chalk, Sr., Editor)

June, 2014

****

The Arbitration Newsletter is published periodically by Whitaker Chalk Swindle & Schwartz PLLC, Fort Worth, Texas to explore the rapidly developing law and practice of commercial arbitration both in the U.S. and other countries.[1]

****

"REASONABLE IMPRESSION OF PARTIALITY" – ALIVE AND WELL IN TEXAS FOR "EVIDENT PARTIALITY" FAA VACATUR

Tenaska Energy, Inc., et al. v. Ponderosa Pine Energy, LLC 2014 WL 2139215 (Tex. May 23, 2014)[2]

In a non-administered, FAA-governed, AAA Commercial Arbitration Rules-guided, three-neutrals (two party-appointed) arbitrator panel, baseball arbitration[3] about breach of representations and warranties claims arising out of a Cleburne, Texas power plant sale,[4] a majority of the panel selected the Buyer's proposed damages of $125 million and issued a majority arbitration award on May 7, 2007.[5] Buyer ("Ponderosa" or "Buyer") was represented in the arbitration by Nixon Peabody LLP, New York, New York, and Buyer appointed Samuel A. Stern ("Stern") as its party-appointed but neutral arbitrator. At the time of Arbitrator Stern's appointment and throughout the arbitration, he had relationships and interests with Nixon Peabody and the Nixon Peabody lawyers who represented the Buyer in the arbitration.

The Seller ("Tenaska" or "Seller") filed its motion to vacate the majority award based on "evident partiality" in the 191st Judicial District Court, Dallas, County, Gina Slaughter, Judge Presiding.[6] Approximately five hundred exhibits[7] were introduced, depositions of two Nixon

---

[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] Opinion not yet released for publication and, therefore subject to revision or withdrawal.

[3] Seller proposed $1.25 million and Buyer proposed $125 million to the panel who had to choose one or the other of the two claim amounts.

[4] 2014 WL 2139215, *1 ("Tenaska Energy, Inc., Tenaska Energy Holdings, LLC, Tenaska Cleburne, LLC, Continental Energy Services, Inc., and Illinova Generating Co. (collectively Tenaska) sold their interests in a power plant in Cleburne, Texas to Ponderosa Pine Energy, LLC (Ponderosa).").

[5] The arbitration panel consisted of Buyer-appointed Samuel A. Stern (a Washington, D.C. lawyer), Seller-appointed Thomas S. Fraser, and as chair the late James A. Baker, retired justice of the Texas Supreme Court. Justice Baker and Mr. Stern chose the Buyer's baseball claim amount of $125 million.

[6] *Ponderosa Pine Energy, LLC v. Tenaska Energy, Inc.*, 376 S.W.3d 358, 362 (Tex.Civ.App. – Dallas 2012, rev'ed and remanded, 2014 WL 2139215) (Buyer filed its petition to confirm the award the day the twenty-three page award was issued – May 7, 2007.).

Peabody lawyers and Arbitrator Stern were taken, and expert testimony from both sides on "evident partiality" given in the trial court motions hearing that occurred in December 2007.[8] Twenty-seven months after the December 2007 hearing in a ten-page opinion, the trial court denied Buyer's motion to confirm, granted the Seller's motion to vacate, ordered the parties to submit their dispute to a new arbitration panel, and later issued separate findings of fact and conclusions of law.[9]

The trial court granted the motion to vacate based on Arbitrator Stern's evident partiality in his failure to fully disclose his business relationships, interests, and contacts with Nixon Peabody and his failure to fully disclose information about one of the four arbitrations in which he had been party-appointed by Nixon Peabody (which had been disclosed by Stern).[10] The trial court denied the Seller's motion to vacate based on 9 U.S.C. §§10(a)(1) ("corruption, fraud, or undue means"); 10(a)(4) ("exceeded their powers"), and the common law ground of "manifest disregard."[11]

But the Texas Fifth Court of Appeals (Dallas) reversed the trial court's order and confirmed the award.[12] Justice Lang wrote the opinion for the Dallas Court of Appeals finding that Seller's failure to object at the time of Stern's initial and supplemental disclosures waived Seller's evident partiality objection.[13] Justice Lang concluded that "the information Stern provided to the parties was sufficient to place them on notice of the facts giving rise to what they now argue is a reasonable possibility of partiality."[14]

The Texas Supreme Court had little difficulty in reversing the Dallas Court of Appeals and reinstating the trial court's vacation of the award and requiring a new arbitration with new arbitrators.[15] The Supreme Court reaffirmed its allegiance to *Commonwealth Coatings*[16] as recognized and followed in *TUCO*[17] and *Bossley*.[18] We now have in Texas an "evident partiality" trilogy – *TUCO*, *Bossley*, and *Tenaska* – that has adopted, without alteration, the *Commonwealth Coatings* "appearance-of-bias" test for "evident partiality."[19] The Court also refused to find waiver as had the Dallas Court of Appeals because Tenaska could not waive what it did not know until after the award had been issued.[20]

---

[7] Dallas Court of Appeals reported "more than 400 exhibits" in the trial court motions hearing. 376 S.W.3d at 363. Texas Supreme Court reports "the parties admitted almost 500 exhibits" in the trial court motions hearing. 2014 WL 2139215, *2.

[8] *Ponderosa Pine*, 376 S.W.3d at 363 (Seller hired an international private investigation firm to investigate Stern within a month of the issuance of the arbitration award.).

[9] 376 S.W.3d at 367 fn 6; 2014 WL 2139215, *6—7.

[10] 2014 WL 2139215, *6—7.

[11] 376 S.W.3d at 366.

[12] 376 S.W.3d at 360.

[13] 376 S.W.3d at 370—372.

[14] 376 S.W.3d at 372.

[15] 2014 WL 2139215, *10.

[16] *Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 393 U.S. 145, 89 S.Ct. 337, 21 L.Ed.2d 201 (1968).

[17] *Burlington Northern Railroad Co. v. TUCO Inc.*, 960 S.W.3d 629 (Tex.1997).

[18] *Mariner Fin. Grp., Inc. v. Bossley*, 79 S.W.3d 30 (Tex.2002).

[19] 2014 WL 2139215, *6 ("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."), *citing Commonwealth Coatings* and *TUCO*.

[20] 2014 WL 2139215, *8—9.

The Texas Supreme Court was not troubled by the fact that this was a "partial disclosure" case.[21] The Buyer argued that Arbitrator Stern had disclosed every "relationship"[22] he had with the parties and their law firms. The Court refused to accept the Buyer's "reformulation" of the *Commonweath Coatings* test explaining that such a revised test "would serve to encourage partial disclosures" and ignored "the test for evident partiality [that] asks whether the undisclosed 'information' might convey an impression of the arbitrator's partiality to an objective observer."[23] The Court made it clear that it was "the parties" who should make the decision about the arbitrator's partiality and, therefore, the parties need full, not partial, disclosure as soon as possible and always before any award is issued.[24]

Surprisingly, both parties urged the Texas Supreme Court to adopt a different evident partiality test. Tenaska requested "an intent-based approach" while Ponderosa urged a "more deferential standard" that called for only setting aside an award if a "reasonable person *would have to conclude* that [the] arbitrator was partial."[25] The Court rejected Tenaska's intentionally misleading test because that would require actual bias or partiality contrary to the "objective" test based on the nondisclosure itself in *Commonwealth Coatings*.[26] The Court also rejected Ponderosa's proposed test borrowed from the Federal Second Circuit explaining that the *Commonwealth Coatings'* "full disclosure" rule, also adopted in *TUCO*, "minimizes the role of the courts" as judges of an arbitrator's impartiality.[27] The Court emphasized that it is the parties who should judge an arbitrator's impartiality and full disclosure offers the parties that informed opportunity.[28]

OBSERVATIONS

1. The Texas Supreme Court, whether interpreting the Texas General Arbitration Act or the Federal Arbitration Act, applies the "appearance-of-bia " standard created by *Commonwealth Coatings* when asked to vacate an arbitration award based on an arbitrator's alleged evident partiality.[29]

2. There was no independent person or entity to manage inquires and objections regarding an arbitrator's disclosures in this arbitration. It was a non-administered arbitration.

3. The *Tenaska* panel's scheduling order contained a waiver of "conflicts of interest and potential conflicts of interest"[30] but said nothing about "disclosures" of "personal interests"

[21] 2014 WL 2139215, *1.
[22] 2014 WL 2139215, *6 and *7.
[23] 2014 WL 2139215, *7.
[24] 2014 WL 2139215, *8 (Quoting *TUCO* to the effect that "it is for the parties to determine, after full disclosure, whether a particular relationship is likely to undermine an arbitrator's impartiality."); *8 ("But such a debate [whether Stern's relationship with Nixon Peabody was like to affect his partiality] is for the parties after a full disclosure—which did not occur here.").
[25] 2014 WL 2139215, *8 (The Second Circuit's test, *quoting Morelilte Constr. Corp. v. N>Y.C. Dist. Council Carpenters Benefit Funds*, 748 F.2d 79, 84 (2d Cir.1984)).
[26] 2014 WL 2139215, *8.
[27] *Id.*
[28] 2014 WL 2139215, *8—9.
[29] 9 U.S.C. §10(a)(2); Tex. Civ. Prac. & Rem. Code §171.088(2)(A).
[30] 2014 WL 2139215, *9.

and "relationships" described in R-16(a) of the AAA Commercial Arbitration Rules quoted by the Court.[31]

4. Neither the panel's scheduling order nor the Court cited the arbitrator's ethical disclosure obligations described in Canon II of the *Code of Ethics for Arbitrators in Commercial Disputes* (1977), although all three panel members were neutrals in this arbitration.

5. In this arbitration the real work of ferreting out what was and was not disclosed and the legal effect of that lack of full disclosure was done by the trial judge of the 191st District Court of Dallas County. But it was done at enormous time and effort costs to the parties and the trial court.

6. There is a vast difference of scope between "conflicts of interest" and "disclosures" of interests and relationships. This distinction was not commented on by the Court.

7. The Texas Supreme Court made no mention of the current split of authorities on the evident partiality standard, which we have discussed in an earlier *Arbitration Newsletter*.[32]

8. Some commentators believe that the Fifth Circuit in *Positive Software*[33] has a different standard for evident partiality than the one applied by the Texas Supreme Court in *Tenaska*. I do not share that opinion and urge the reader to read *Positive Software*.

[31] 2014 WL 2139215, *2.
[32] *The Arbitration Newsletter*, November 2013.
[33] *Positive Software Solutions, Inc. v. New Century Mortg. Corp.*, 476 F.3d 278 (5th Cir.2007).