The Arbitration Newsletter

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(John Allen Chalk, Sr., Editor)

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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]

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ARBITRATOR DISCLOSURES

Ponderosa Pine Energy, LLC v. Tenaska Energy, Inc.
376 S.W.3d 358
(Tex.App. – Dallas August 20, 2012, no pet.)[2]

by John Allen Chalk, Sr.[3]

The same court – Dallas Court of Appeals – that gave us *Karlseng v. Cooke*, 346 S.W.3d 85 (Tex.App. – Dallas 2011, no pet.)[4] has now gone the other way on a different set of facts, reversing a trial court's vacatur, ordering of another arbitration of the dispute before a new panel,[5] and confirmation of an award for approximately $125 million.[6] Although it appears that *Ponderosa Pine Energy* may be subject to a petition for review,[7] its facts are so interesting and instructive for arbitrator disclosures, that comments are appropriate on the Fifth Court of Appeals' decision and opinion.

The parties in the sale of an electric-generating power plant located in Cleburne, Texas, agreed to arbitrate (by "baseball" arbitration)[8] the disputes related to the sale agreement, using

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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] TRAP 53.7(f) motion granted October 2, 2012.

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[4] Reversed the trial court's confirmation of the arbitration award for approximately $22 million, vacated the award, and remanded for further proceedings based on an arbitrator's failure to disclose and the resulting evident partiality.

[5] 376 S.W.3d at 367.

[6] Two different panels of the 5th Court of Appeals heard and decided the *Karlseng* and *Ponderosa* cases: Justices Fitzgerald, Lang-Miers, and Fillmore decided *Karlseng v. Cooke*; and Justices Bridges, Francis, and Lang decided *Ponderosa Pine Energy*.

[7] *See* fn 1, supra.

[8] *Ponderosa* made a $125 million settlement offer and the other side made an aggregate offer of $1.2 million. 376 S.W.3d at 362.

the American Arbitration Association ("AAA") "rules,"[9] with party-appointed arbitrators selecting the third arbitrator but with all three acting as neutrals. The parties expressly agreed in their arbitration clause that the AAA would not administer any arbitration pursuant to their agreement.[10]

Ponderosa Pine Energy, represented by Nixon Peabody, LLP, New York, New York, appointed Samuel A. Stern, Hills & Stern, LLP, Washington, D.C., formerly a partner at Wilmer, Cutler & Pickering, Washington, D.C., as its party-appointed arbitrator. With Stern's appointment, the Nixon Peabody lawyers, attached Stern's 8-page CV.[11] Five weeks later the Nixon Peabody lawyers provided the other parties with Stern's disclosure statement describing Stern's prior contacts with Nixon Peabody, including the Indian company mentioned in his CV for which Stern acted as a representative in a "general discussion" of the services the company offered to Nixon Peabody.[12] The other side requested additional disclosures of Stern regarding his possible relationships or interests with all the other parties to the arbitration but not his Nixon Peabody relationships. Stern replied with a supplemental statement saying he had "no professional or other relationship with the sixteen listed financial institutions and companies connected with the underlying sale.[13] The late retired Texas Supreme Court Justice James A. Baker served as chair of the panel and issued a scheduling order that acknowledged full disclosure of all "conflicts of interest" by the parties and arbitrators and knowing waiver by the parties of "any and all conflicts of interest and/or potential conflicts of interest."[14]

A five-day final hearing resulted in a 2-1 majority award for *Ponderosa Pine Energy* (Thomas S. Fraser, *Tenaska Energy's* party-appointed arbitrator, dissenting). The majority panel awarded the "baseball" amount of $125 million to *Ponderosa*. The 191st Judicial District Court held two days of evidentiary hearings on motions to confirm and vacate with more than 400 exhibits, expert witnesses on "evident partiality," and depositions of Nixon Peabody lawyers and Mr. Stern.[15] The trial court vacated the award[16] based on Stern's failure to fully disclose "all details" of his relationships with Nixon Peabody, including discussions related to the Indian legal services company and one of the previous three arbitrations in which Stern had been party-appointed at the recommendation of Nixon Peabody.[17]

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[9] Opinion does not indicate what AAA "rules" were selected by the parties. Appellees' Brief in the court of appeals suggests that the arbitration was conducted under the AAA's Commercial Arbitration Rules. 376 S.W.3d at 362.
[10] 376 S.W.3d at 360.
[11] Stern's CV mentioned a legal services company headquartered in India with which he was involved. 376 S.W.3d at 361.
[12] 376 S.W.3d at 361-362.
[13] 376 S.W.3d at 362.
[14] *Id.*
[15] 376 S.W.3d at 363.
[16] Twenty-seven months after the evidentiary hearing on the motions to confirm and vacate concluded. 376 S.W.3d at 367.
[17] 376 S.W.3d at 368. The court of appeals opinion contained a detailed discussion and summary of the testimony presented in the trial court hearing on the motions to confirm and vacate including extended recitations of the trial court's findings of fact and conclusions of law at 376 S.W.3d at 367 fn6. 376 S.W.3d at 363-368.

The Dallas Court of Appeals reversed the trial court's vacatur order and confirmed the award saying that the appellees had waived their objection to arbitrator Stern.[18] No petition for review has yet been filed but one is expected in view of the TRAP 53.7(f) motion that was granted on October 2, 2012.

The court of appeals stated the *TUCO* rule that "evident partiality" is established if an arbitrator "does not disclose facts that might, to an objective observer, create a reasonable impression of the arbitrator's partiality."[19] This standard is also described in the court of appeals opinion as failure to disclose facts that constitute "a reasonable possibility of partiality."[20] The court of appeals contrasted the arbitrator's disclosures in *TUCO* with the disclosures by Stern in this case and concluded that as a matter of "the legal effect" of Stern's disclosures, they were sufficient to put the objecting party on notice.[21]

The court of appeals also relied on Justice White's concurrence in *Commonwealth Coatings Corp. v. Cont'l Casualty Co.*, 393 U.S. 149, 89 S.Ct. 337, 21 L.Ed. 2d 301 (1968), regarding the reviewing court's minimal role in the review process of an arbitrator's impartiality and the parties' major role in obtaining the arbitrators they have agreed (in the arbitration agreement) to use.[22] It is the parties, the court said, who must weigh "the competing factors of the arbitrator's knowledge and experience against his potential conflicts."[23]

The court of appeals also tied evident partiality to "the *nondisclosure itself*, regardless of whether the nondisclosed information necessarily establishes partiality or bias."[24] In other words, if the parties agree to arbitrate, as the parties did in this case (in the appellate court's view), "even in the face of facts suggesting possible arbitrator bias or partiality," then waiver operates to bar evident partiality objections after the award is issued.[25] The court of appeals also noted that "an arbitrator cannot be expected to provide parties with all the minute details of every [disclosed] relationship" but then observed that under "TUCO's objective test, the consequences of nondisclosure are directly tied to the materiality of the unrevealed information."[26]

The court of appeals found that the appellees had waived their objection to Mr. Stern by failing to "promptly object in the arbitration proceeding," and certainly by no later than immediately prior to issuance of the award.[27] Once the arbitrator divulges information "sufficient to place [the party] on notice of facts giving rise to what [the party] now contend[s] is a reasonable possibility of partiality," the party that "knows or **has reason to know**" of arbitrator

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[18] 376 S.W.3d at 370-372 ("The question we must decide is whether 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. [citations omitted] Having reviewed the entire record, we conclude it did.").
[19] 376 S.W.3d at 369, citing both *TUCO* (for the TGAA) and *Thomas James Associates, Inc.* (for the FAA).
[20] 376 S.W.3d at 368 (summarizing Ponderosa's view of the appellees' contention) and 371 (quoted from *Kendall Builders Inc. v. Chesson*, 149 S.W.3d 796, 805 (Tex.App. – Austin 2004, pet. denied)).
[21] 376 S.W.3d at 371-372.
[22] 376 S.W.3d at 369-370.
[23] 376 S.W.3d at 370.
[24] 376 S.W3d. at 369; citing *TUCO*, 960 S.W.3d at 636.
[25] 376 S.W.3d at 370; citing *Kendall Buildings*, 149 S.W.3d at 804.
[26] 376 S.W.3d at 370.
[27] 376 S.W.3d at 370.

bias "but remains silent pending the outcome of the arbitration waives the right to complain."[28] Both Texas and federal courts are cited by the court of appeals for the waiver standard of "know or **should have known** of the potential partiality of an arbitrator, but failed to object before the arbitration decision."[29]

OBSERVATIONS

1. Arbitrators have a duty to disclose all facts that **might,** to an objective observer, create a "reasonable impression" of bias, partiality, or lack of independence.

2. The arbitrator's disclosure decision should not be made based on how the arbitrator sees the disclosure in question but on what the "reasonable impression" of an "objective" observer might be.

3. Arbitrator disclosures should be made if the disclosures in question suggest "a reasonable **possibility** of partiality."

4. Although, under Texas law, this disclosure standard is called an "objective" one, at the decision regarding whether to disclose or not, the arbitrator should anticipate review by the parties and by the courts based on possible "impressions" of bias, partiality, or lack of independence.

5. Deciding what is "trivial" and what is "material" requires careful thought and reflection by the arbitrator.

6. Therefore, arbitrators should always resolve the doubt about a potential disclosure by making the disclosure. The arbitrator should always err on the side of disclosure. "When in doubt, disclose!"

7. Arbitrators should never allow others, especially lawyers for the appointing party, to draft or in any way dictate the content of disclosures.

8. Parties, with sufficient disclosures, waive their objections if not timely made prior to the issuance of an arbitration award.

9. Parties have a duty to investigate the disclosures they receive and to do so timely.[30]

10. Arbitrator disclosures and parties' objections to arbitrators are more efficiently handled in administered arbitrations.

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[28] 376 S.W.3d at 371; citing *SkidmoreEnergy, Inc. v. Maxus (U.S.) Exploration Co.*, 345 S.W.3d 672, 684 (Tex.App. – Dallas 2011, pet. denied).

[29] 376 S.W.3d at 371.

[30] *See Dealer Computer Services, Inc. v. Michael Motor Company, Inc.*, 2012 WL 3317809, *3 (5th Cir. Aug. 14, 2012)("Particularly, in light of MMC's **duty to reasonably investigate**, [the arbitrator's] disclosures were sufficient to put MMC on notice."). (Emphasis added).

11. But arbitral institutions must exercise wise judgment when confronted with objections to arbitrators, especially objections that are motivated by improper party motivations or lack of good faith.

12. *Commonwealth Coatings* does not require that arbitrators have no previous knowledge or relationship with arbitration parties or dispute subject matter.

13. *TUCO* does recognize that "the most capable arbitrators are often those persons with extensive experience in the industry, who may naturally have had past dealings with the parties." 960 S.W.3d at 635.

14. Ultimately, arbitration, as a creature of the parties' contract, belongs to the parties who with sufficient disclosure balance the competing goals of arbitrator expertise and impartiality.