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Commentary

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Section 10(a) of the Federal Arbitration Act ("FAA") lists limited grounds on which a federal court may vacate an arbitration award. One of these grounds permits an award to be vacated "where there was evident partiality or corruption in the arbitrators, or either of them." 9 U.S.C. § 10(a)(2).

Thus, after an award is rendered, a party may challenge the validity of the award during confirmation or annulment proceedings based on an arbitrator's lack of impartiality.[1] However, unlike many other jurisdictions, the U.S. courts generally do not entertain judicial challenges to arbitrators made during the arbitration proceedings. An interlocutory judicial removal or replacement of arbitrators is deemed to be an unwarranted intrusion into the ongoing arbitration proceedings.[2] The majority view is that a review of arbitration proceedings "comes at the beginning or the end, but not in the middle."[3] A number of U.S. courts have recognized the possibility of very limited interlocutory judicial intervention in an ongoing arbitration, but would allow it only in "extreme cases."[4]

The standard of "evident partiality" as a ground for vacating an award is not well settled in the United States.[5] The standard has been subject to varying interpretations by U.S. courts, with different circuits adopting different standards. And while the standard itself is not disputed, its application is heavily fact specific, and thus, uncertain.

In a recent decision, the U.S. Court of Appeals for the Ninth Circuit applied the "evident partiality" standard in the context of an interlocutory judicial challenge to an arbitrator.[6] The Ninth Circuit disagreed with the district court's finding of "evident partiality" as well as the appropriateness of judicial removal of an arbitrator from an ongoing arbitration.[7]

Summary

In *In re Sussex*, the Ninth Circuit had to decide whether the sole arbitrator's new business venture – creation of a litigation finance firm for investment purposes – created "evident partiality" on his part.[8] Contrary to the district court, the Ninth Circuit concluded that the arbitrator's failure to disclose his new business activities did not create a "reasonable impression of bias," and thus, the award eventually rendered by the arbitrator would not be subject to annulment on the ground of the arbitrator's "evident partiality" under 9 U.S.C. § 10(a)(2).[9]

In addition, the Ninth Circuit ruled that even a proper finding of "evident partiality" would not have justified the district court's interlocutory removal of the arbitrator.[10] The Court concluded that the district court's order removing the arbitrator from the ongoing arbitration was a clear error as the circumstances did not give rise to an "extreme case" so as to justify judicial intervention in an ongoing arbitration.[11]

In re Sussex illustrates the uncertainties surrounding application of the "evident partiality" standard. The case also confirms that, at least in the Ninth Circuit, an attenuated and purely hypothetical financial interest in the outcome of the case would not create evident partiality, especially where the arbitrator has no relationship with the parties in the dispute or the subject matter of the dispute. This is in line with the understanding that an arbitrator is not required to disclose every matter of some plausible interest to a party.

Specifically, the decision is important in the context of third-party funding. The Ninth Circuit's decision suggests that an arbitrator's involvement in the business of litigation or arbitration financing as such does not amount to an interest in the outcome of a specific case in which the arbitrator has no personal interest, and thus, is insufficient to require the arbitrator's disclosure of such financing activities. It remains to be seen whether other courts take a similar position.

Moreover, *In re Sussex* suggests that even a finding of evident partiality may not justify a court's interlocutory removal of an arbitrator from ongoing arbitration proceedings. The Ninth Circuit stated that even if judicial interference in mid-arbitration were at all permitted, the costs and delay associated with an arbitration that results in an unenforceable award does not constitute the sort of "severe irreparable injury" or "manifest injustice" that could justify such judicial interference.[12] The Court found no occasion to diverge from precedent, consistent with other circuits, of declining to intervene in an ongoing arbitration.

In re Sussex

In re Sussex arose from civil actions filed by hundreds of purchasers of luxury condominium units against the developer and the seller of the condominium project, Turnberry/MGM Grand Towers, LLC and a number of its affiliated companies. The claimants sought rescission of the condominium purchase agreements and money damages on the basis of fraud and other allegations.[13] Two actions that were filed in the district court in Nevada were consolidated, and one action continued in state court. All the condominium purchase agreements at issue included an arbitration clause providing for arbitration of any disputes under the rules of the American Arbitration Association ("AAA"). Thus, the parties were ordered to arbitrate. The AAA appointed Brendan Hare as the sole arbitrator for all three cases.[14]

Turnberry made several requests to the AAA to disqualify arbitrator Hare.[15] The basis for its disqualification request was the arbitrator's recent involvement in a business venture to finance litigation for investment purposes. One month after being appointed as arbitrator, Hare founded Bowdoin Street Capital, a firm that would invest in high-value, high-probability legal claims and litigations, and created a website to attract investors to the firm. Hare participated as a speaker on panels where he spoke about litigation finance and funding. His online LinkedIn profile also indicated that he had recently refocused his practice to concentrate on the emerging field of litigation finance and funding.[16] Turnberry's theory was that a high volume award against Turnberry would enhance Hare's new business, thereby making him partial in the case.

The AAA denied the request for Hare's disqualification.[17] Thereupon, Turnberry turned to the district court and moved to disqualify Hare.[18]

The Decision of the District Court

The U.S. District Court for the District of Nevada granted Turnberry's motion and disqualified arbitrator Hare.[19] Specifically, the court held that, because of Hare's "evident partiality," Turnberry was likely to prevail on a motion to vacate any award rendered by Hare under the FAA, 9 U.S.C. § 10(a)(2), and this justified the court's intervention in an ongoing arbitration.[20]

The court reasoned that undisclosed facts regarding the arbitrator's litigation financing activities suggested he had a financial interest in the outcome of the arbitration because a victory and large financial award against Turnberry would help Hare promote his company, which was designed to generate profits from funding large, potentially profitable litigations.[21] Thus, according to the district court, Hare's new business venture

created a "reasonable impression of bias" sufficient to meet the "evident partiality" standard under 9 U.S.C. § 10(a)(2).[22]

If the award were vacated, which the court predicted, then continuation of the arbitration, according to the court, would be a waste of time and resources, especially considering that the claims involved 385 plaintiffs and the arbitration proceedings were still in the early stages.[23] Thus, the district court concluded that this was the type of "extreme case" that justifies a court's intervention in the arbitration proceedings.[24]

The Decision of the U.S. Court of Appeals for the Ninth Circuit

The U.S. Court of Appeals for the Ninth Circuit vacated the district court's order removing arbitrator Hare. The Ninth Circuit concluded first that the district court incorrectly opined that an award issued by arbitrator Hare would be vacated on the ground of arbitrator impartiality.[25] The Court considered that arbitrator Hare's modest efforts to start a company and to attract investors into litigation financing did not give rise to a reasonable impression that Hare would be partial toward either party. The Court characterized Hare's potential ability to profit from a large award in favor of the claimants to be at best "attenuated" and "insubstantial," particularly given that Hare's business efforts were only just beginning.[26] The Ninth Circuit noted that there was no relationship between Hare and the parties to the dispute. Further, the Court considered it speculative to suggest that Hare could use claimants' success to convince investors to invest in his new business venture. Thus, the Court concluded that the financial relationship in this case was "contingent, attenuated and merely potential" and would not serve as a ground to vacate the eventual award.[27]

Second, the Ninth Circuit noted that, even if Hare's activities created a reasonable impression of partiality, the delays and expenses that would result if the award were vacated were "manifestly inadequate" to justify a mid-arbitration intervention, regardless of the size of the case and the early stages of the arbitration proceedings.[28]

The Court emphasized that judicial intervention in the arbitration proceedings "should be indulged, *if at all*, only in the most extreme cases."[29] The Court also noted that a potential extreme case is one that would cause "severe irreparable injury" from an error that cannot effectively be remedied on appeal from the initial judgment and that would result in "manifest injustice."[30] But the Ninth Circuit observed that the lower federal courts have generally refused to describe what it would take to create extreme circumstances warranting intervention in an ongoing arbitration.[31] The Court concluded that cost and delay alone did not constitute the sort of "severe irreparable injury" or "manifest injustice" that could justify judicial intervention.[32] In sum, the Ninth Circuit decided that the circumstances here were "emphatically not" of the type that could be characterized as "extreme" and that accordingly there was no basis for judicial intervention.[33]

Endnotes

1. Generally, a party must preserve this ground for challenging an award by raising it during the arbitration in accordance with the applicable procedural law or arbitration rules.

2. This is especially so in case of institutional arbitrations where the arbitration institution would have authority to decide on arbitrator challenges during arbitration. But, U.S. courts are reluctant to intervene even if an institutional challenge to the arbitrator is not available.

3. *Blue Cross Blue Shield of Mass., Inc. v. BCS Ins. Co.*, 671 F.3d 635, 638 (7th Cir. 2011).

4. *See Aerojet-General Corp. v. Am. Arbitration Ass'n*, 478 F.2d 248, 251 (9th Cir. 1973).

5. Since the FAA sets forth "evident partiality" only as a standard for annulment of an award, and does not state a standard for interlocutory challenges to arbitrators, the standard for removal of an arbitrator is similarly not well settled in the United States. Generally, a more stringent standard of partiality needs to be demonstrated to vacate an award than to challenge and remove the arbitrator during the arbitration proceedings.

6. *In re Sussex*, No. 14-70158, 2015 U.S. App. LEXIS 1280 (9th Cir. Jan. 27, 2015).

7. *Id.* at *16.

8. *Id.* at *5, *18-19.

9. *Id.* at *7-8, 18-19.

10. *Id.* at *19-20.

11. *Id.* at *20-21.

12. *Id.* at *20 (quoting *Aerojet-General Corp.*, 478 F.2d at 251).

13. *Id.* at *3-4.

14. *Id.* at *4.

15. *Id.* at *5.

16. *Id.*

17. *Id.* at *6.

18. The claimants in the state court action agreed to remove Hare and proceed with a new arbitrator.

19. *Sussex v. Turnberry/MGM Grand Towers, LLC*, No. 2:08-cv-00773-MMD-PAL, 2013 U.S. Dist. LEXIS 181854, at *3, 20-21 (D. Nev. Dec. 31, 2013).

20. *Id.* at *8-9, 12.

21. *Id.* at *16-17.

22. *Id.* at *19.

23. *Id.* at *10-11.

24. *Id.* at *8-9 (relying on *Aerojet-General Corp.*, 478 F.2d at 251).

25. *In re Sussex*, 2015 U.S. App. LEXIS 1280, at *16.

26. *Id.* at *19 (quoting *New Regency Prods., Inc. v. Nippon Herald Films, Inc.*, 501 F.3d 1101, 1110 (9th Cir. 2007)).

27. *Id.* at *19.

28. *Id.* at *19-20.

29. *Id.* at *13 (quoting *Aerojet-General Corp.*, 478 F.2d at 251) (emphasis added).

30. *Id.* at *14 (quoting *Aerojet-General Corp.*, 478 F.2d at 251).

31. *Id.* at *14-15.

32. *Id.* at *20 (quoting *Aerojet-General Corp.*, 478 F.2d at 251).

33. *Id.* ■

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