



ABA FORUM ON THE CONSTRUCTION INDUSTRY

Hot Tip

California's Arbitrator Conflict of Interest Disclosure Standards not Preempted by Federal Arbitration Act and Arbitration Award Vacated for Non-Compliance

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After twenty-three days of arbitration spread over more than five months resulting in an arbitration award of more than \$3.3 million in damages, attorneys fees and costs, a California appellate court affirmed the vacating of the award because the arbitrator had accepted appointment as an arbitrator in another matter at the request of the prevailing party's law firm. *Ovitz v. Shulman*, 133 Cal. App. 4th 830 (2005). The American Arbitration Association's ("AAA") arbitrator disclosure form had not been updated to disclose the arbitrator's willingness to accept additional assignments as a neutral arbitrator from the parties or their lawyers during the pendency of the first arbitration as required by the California Code of Arbitration and the California Ethics Standards for Neutral Arbitrators in Contractual Arbitration. In vacating the arbitration award, the appellate court stated, "[w]e do not mean to suggest that there is any indication that the Arbitrator was in fact unfair. Indeed, we find nothing in the record to suggest such an assertion." *Id.* at 854. Why then upset the arbitration award? Doesn't the court's holding "reflect a mindless adhesion to mere technicalities?" *Id.* Not so ruled the court. The court also ruled that the Federal Arbitration Act ("FAA") did not preempt California's conflict of interest disclosure requirements. As discussed below, the *Shulman* case, decided October 26, 2005, highlights the importance of compliance with state law conflict of interest disclosure requirements applicable to arbitrators.

Factual Background: In *Shulman*, the plaintiff entered into an employment agreement with a joint venture formed to produce a number of films. The employment agreement provided for arbitration before the AAA of any controversy arising out of the agreement. After plaintiff left the joint venture, a dispute arose as to whether plaintiff was terminated for cause or resigned. A subsequent settlement failed to resolve all disputes. The joint venture and related parties filed a demand for arbitration. Plaintiff disputed AAA's jurisdiction and filed a lawsuit asserting claims against the joint venture and related parties (collectively, the "Joint Venture"). Following a ruling by the trial court that the claims against the joint venture were subject to arbitration, the parties agreed to submit to AAA arbitration those claims and the claims against the parties related to the joint venture.

Following twenty-three hearing days conducted over more than five months, the arbitrator awarded the Joint Venture \$1.5 million in damages and more than \$1.8 million in attorneys' fees and costs. When the Joint Venture filed a petition to confirm the award, the plaintiff filed a response and petition to vacate. Plaintiff asserted that the AAA disclosure did

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not satisfy the California disclosure obligation. In short, the arbitrator agreed to serve as a neutral arbitrator in another unrelated matter being handled by another attorney with the law firm representing the Joint Venture and the disclosure form did not indicate that the arbitrator would be willing to accept additional assignments as an arbitrator from the parties or their lawyers. The trial court granted plaintiffs petition to vacate and rejected the joint venture's arguments that (1) the arbitrator had complied with his disclosure obligation, (2) there was a waiver of any objection, and (3) the Federal Arbitration Act preempts the California statute governing vacating an award for an arbitrator's failure to disclose. The court of appeal affirmed the decision to vacate the arbitrator's award.

California's Disclosure Obligations: The California arbitration code specifies those items that must be disclosed to the parties by an arbitrator and requires disclosure within ten calendar days of service of the proposed appointment. *See* Cal. Code Civ. P. § 1281.9 (a)-(b). In addition to statutorily specified matters to be disclosed, the statute requires disclosure of "[a]ny matters required to be disclosed by the ethics standards for neutral arbitrators adopted by the Judicial Council . . ." *Id.* § 1281.9(a)(2). Under Standard 12, an arbitrator is prohibited from accepting or entertaining "offers of employment or new professional relationships as a lawyer, an expert witness or a consultant from a party or a lawyer for a party in the pending arbitration." Standard 12(a) [Appendix to California Rules of Court]. Further, an arbitrator must disclose whether he or she intends to entertain or accept offers from the parties or their lawyers to serve as "as a dispute resolution neutral in another case" and a party may disqualify an arbitrator based on this disclosure. *Id.*(b).

In short, the court found that the AAA disclosure worksheet provided by the arbitrator failed to include a clear disclosure of whether the arbitrator intended to consider offers to serve as an arbitrator in other matters involving the parties or their lawyers. 133 Cal. App. 4th at 841. By statute, "the court shall vacate the [arbitration] award if the court determines . . . [a]n arbitrator making the award . . . failed to disclose within the time required for disclosure a ground for disqualification of which the arbitrator was then aware." Cal. Code Civ. Proc. § 1286.2(a)(6)(A). The court concluded that the arbitrator's failure to disclose his intent to accept other arbitration appointments from the parties or their counsel required that the award be vacated. 133 Cal. App. 4th at 841.

Waiver: The *Shulman* court rejected the Joint Venture's argument that plaintiff failed to formally seek to disqualify the arbitrator on the basis of his initial disclosure. A party may disqualify an arbitrator within fifteen calendar days if an arbitrator fails to provide a disclosure within the specified time period or based on information contained in the disclosure form. Cal. Code Civ. Proc. § 1281.91(a)-(b). The California Code of Arbitration specifies that the right to disqualify an arbitrator is waived if a party fails to act within the fifteen day time period "unless the proposed nominee or appointee makes a material omission or material misrepresentation in his or her disclosure." *Id.* § 1281.91(c). Here, the court ruled that "the Arbitrator's initial disclosure statement contained a material omission: it failed to disclose under standard 12(b) that he intended to entertain other offers of employment from the parties or their attorneys." 133 Cal. App. 4th at 846.

Interestingly, in an unsuccessful motion for reconsideration before the trial court, the Joint Venture submitted a declaration seeking to establish that the plaintiff's counsel knew of the

arbitrator's appointment to the new matter but failed to timely object. According to the Joint Venture's attorneys, during a break in the arbitration proceeding the arbitrator participated in a conference call concerning the new matter involving other attorneys from the Joint Venture's law firm. Plaintiff's counsel purportedly remarked: "What is this, are you guys trying to buy up all of his time?" *Id.* at 847. The trial court declined to consider this information because it did not constitute "new facts" as required to justify reconsideration since the "facts" were available at the time of the hearing on the motion to vacate. In the alternative, the trial court credited the counter declaration from plaintiff's lawyer denying the "new facts." *Id.* at 848. The court of appeal affirmed the trial court's ruling on the failure to meet the reconsideration standard and, in all events, indicated that the credibility determination associated with the dueling declarations would not be "second-guessed on appeal" because it was supported by substantial evidence. *Id.*

FAA Does Not Preempt California's Disclosure Requirements: The FAA and the California Code of Arbitration have different standards for vacating arbitration awards for non-disclosure by an arbitrator. The FAA permits the vacating of an arbitration award only on a showing of "evident partiality" by the arbitrator. 9 U.S.C. § 10(a)(2). As noted by the *Shulman* court, "[w]hen the issue is the arbitrator's failure to disclose, the Ninth Circuit interprets 'evident partiality' to mean that the undisclosed facts must create a 'reasonable impression of partiality.'" 133 Cal. App. 4th at 833. In contrast, the California statutory scheme establishes more of a per se rule: "On a showing that the arbitrator failed to timely disclose a ground for disqualification of which he or she was aware, the California Code of Civil Procedure required the vacating of any award rendered by the arbitrator." *Id.* (citing Cal. Code Civ. Proc. § 1286.2(a)(6)(A)). Since the *Shulman* court found that there was no evidence that arbitrator Cambell Lucas, a retired Justice of the California Supreme Court, was in fact unfair or partial, the Joint Venture hoped to prevail by establishing that the FAA preempted the California Arbitration Code of Arbitration.

The *Shulman* court, however, rejected the argument that the FAA preempted the California Code of Arbitration. First, the court found that the FAA did not fully occupy the field as it relates to arbitration, that the FAA has only limited preemptive effect, and that the FAA provisions concerning vacating arbitration awards only applies to proceedings in federal court and "not state trial courts." 133 Cal. App. 4th at 851-52. Second, the court held that the California arbitration code as it pertains to vacating arbitration awards is not inconsistent with the purpose of the FAA. In that regard, the court noted that section 1286.2(a)(6)(A) "does not undermine the enforceability of arbitration agreements." *Id.* at 853. "Indeed, because it applies to vacating an arbitration award, section 1286.2(a)(6)(A) presupposes that the arbitration agreement has been enforced and the arbitration held. If an award is vacated, the result is not a preclusion of further arbitration, but rather a new arbitration held in accordance with the disclosure requirements." *Id.* Finally, the court found that the application of this section of California's Code of Arbitration was not inconsistent with the parties arbitration agreement. In fact, among other things, the parties sent a letter to AAA indicating that they accepted the arbitrator's appointment "subject to all of the disclosure requirements imposed on [the Arbitrator] by the [AAA] and the California Code of Civil Procedure." *Id.* at 854 (emphasis in original).

Conclusion: The *Shulman* case contains a number of warnings and lessons for parties who arbitrate disputes. First, if the arbitration is conducted pursuant to the law of a jurisdiction with its own rules regarding arbitrator conflict of interest disclosure requirements, careful



adherence to those standards is warranted. In the case of administered arbitrations, the parties may want to ensure that the arbitral forum's conflict disclosure worksheet satisfies the standards of the jurisdiction providing the controlling law. In the event it does not, request that the disclosure be augmented. This is even more important for ad hoc arbitrations when an "out of state" arbitrator might be unfamiliar with the disclosure requirements of local law or simply rely on the parties for the scope of the disclosures. Second, in the event a party seeks to vacate an arbitrator's award for failure to satisfy disclosure requirements, the best practice is to ensure that all available evidence is submitted with the original petition or motion to vacate. Attempts to submit supplemental evidence after the initial denial of a petition to vacate will receive a less receptive audience than when submitted with the original papers especially where the supplemental evidence was available from the outset to the party seeking to vacate the award. Finally, a party who assumes that the FAA preempts state law on disclosure standards does so at his own peril because a court, as in the *Shulman* case, may rule that the FAA does not preempt state law requiring that an arbitration award be vacated for non-compliance with state law disclosure requirements.