

SHOULD PARTIES' DISCLOSURE REQUIREMENTS FOR ARBITRATORS BE HONORED BY COURTS: *POSITIVE SOFTWARE SOLUTIONS, INC. v. NEW CENTURY MORTGAGE CORPORATION*

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I. INTRODUCTION

Arbitration is supposed to be a quick inexpensive way to resolve disputes. It is designed to enable the parties to custom-tailor the means by which their disputes are to be resolved. Congress passed the Federal Arbitration Act to help facilitate arbitration. Congress believed that encouraging arbitration would save the litigants time and expense while relieving congestion at overcrowded courtrooms.

To encourage arbitration, Congress provided for court enforcement of arbitration awards. To streamline the process, Congress envisioned that courts would not generally second-guess arbitration awards. A court may refuse to confirm an arbitration award for any of the following reasons: (1) there has been corruption, fraud or undue means; (2) the award is manifestly contrary to law; (3) the arbitrator engaged in misconduct; (4) there was evident partiality.

Evident partiality can include instances in which an arbitrator fails to disclose significant "information which would lead a reasonable person to believe that a potential conflict exists."¹ Despite this basis for refusal of confirmation, in *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*², the Fifth Circuit Court of Appeals confirmed an arbitration award even though the arbitrator had failed to disclose rather significant facts about his relationship to one of the parties.³ The court believed that it was advancing

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1. Gianelli Money Purchase Plan & Trust v. ADM Investor Servs., Inc., 146 F.3d 1309, 1312 (11th Cir. 1998). See also Merrick T. Rossein & Jennifer Hope, *Disclosure and Disqualification Standards for Neutral Arbitrators: How Far to Cast the Net and What is Sufficient to Vacate Award*, 81 ST. JOHN'S L. REV. 203 (2007).

2. *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 476 F.3d 278 (5th Cir.), cert. denied, 127 S. Ct. 2943 (2007).

3. *Id.*

the purpose of the Federal Arbitration Act by limiting second-guessing of arbitration awards.⁴ However, the effect of the award may be to cause people to be less willing to seek arbitration because of concern that the deck is stacked against them.

One reason for the popularity of arbitration is that it permits parties to custom-tailor the means by which their dispute is resolved. In *Positive Software*, the court failed to adequately defer to the rules by which the parties had chosen to resolve their dispute. That is, it did not enforce the rules of the American Arbitration Association. By submitting their dispute to arbitration under the auspices of the American Arbitration Association, the parties agreed to abide by the rules of the AAA. Those rules include disclosure requirements for arbitrators. By refusing to vacate an arbitration award where the arbitrator has intentionally failed to disclose a material question to a party or to counsel or a financial interest for which disclosure was requested, the court is undermining the agreement of the parties and is actually discouraging resort to arbitration.⁵

II. *POSITIVE SOFTWARE*

Positive Software involved a dispute between Positive Software, which licensed some loan software to New Century, and New Century, which used telemarketing and computer generated calls to identify borrowers.⁶ New Century agreed not to copy or reverse engineer the software.⁷ In violation of that agreement, New Century allegedly began trying to copy or reverse engineer the software.⁸

Ultimately, the District Court issued an injunction and a protective order based on a finding that New Century had copied the software.⁹ Then, pursuant to the parties' agreement, the Court submitted the matter to arbitration under the procedures of the American Arbitration Association.¹⁰ Peter Shurn was selected as the arbitrator.¹¹ He issued an opinion holding that there was no misappropriation of trade secrets, infringement of copyrights nor breach of

4. *Id.*

5. See Howard L. Wieder, *Subversion of ADR: Nondisclosure of Ties by Appointed and Aspiring Arbitrators*, QUEENS BAR BULLETIN (Queens Co. Bar Ass'n, Jamaica, N.Y.), December 2007, at 1.

6. *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 337 F.Supp.2d 862 (N.D. Tex. 2004).

7. *Id.* at 866.

8. *Id.*

9. *Id.*

10. *Id.* at 879.

11. *Positive Software v. New Century Mortgage Corp.*, 476 F.3d 278, 280 (5th Cir. 2007).

contract or any fraud. He ordered Positive Software to recover nothing on its claims and awarded New Century \$11,500 on its counterclaims and \$1.5 million in attorney's fees.¹²

Because the arbitrator's decision diverged so widely from the decision of the district court, Positive Software conducted a detailed investigation of Shurn's background. Positive Software also seems to have been taken aback by the disdain with which the arbitrator characterized its claim: "It involves a saga of how failure to renew an \$86,100 software license has led to a claim for \$500,000,000 in damages in this arbitration, and for \$38,000,000,000 in Federal Court."¹³ It discovered that in a patent litigation, brought on behalf of Intel against Cyrix, Shurn, while a member of the Arnold White & Durkee law firm in Houston, had acted as co-counsel with the Susman Godfrey law firm of Houston. Ophelia Camiña had been a member of the Susman Godfrey team also representing Intel. That litigation was unrelated to the dispute between Positive Software and New Century. Camiña was one of the Susman Godfrey attorneys representing New Century in the *Positive Software* litigation.

The federal district court also found that Susman Godfrey and Shurn's law firm of twenty years, Arnold White, had represented Intel in protracted litigations for several years.¹⁴ Susman Godfrey had handled four related Intel actions, Arnold White had handled five, and the two firms had acted as co-counsel in three different matters.¹⁵ Lawyers from both firms frequently signed pleadings on Intel's behalf, listing both firms as counsel of record.¹⁶

The evidence further demonstrated that Camiña, New Century's co-lead arbitration counsel, and Shurn, a member of Arnold White, were major players in the several litigations. Camiña was counsel of record in three Intel matters, and Shurn handled two Intel cases. For nearly a year, Shurn and Camiña personally represented Intel in one of the several cases, *Cyrix v. Intel*. Their names appeared side-by-side on ten different pleadings—two of which were signed by Shurn himself. The only witness testimony that New Century proffered, in opposition to Positive Software's motion to vacate, was the four-page affidavit of Camiña, which the district court largely dismissed as not credible. The district court gave no credence to Camiña's insistence that her involvement in the Intel litigations "ceased" in June 1992, two months before

12. *Id.*

13. *Positive Software v. New Century Mortgage Corp.*, 476 F.3d 278, 289 (Reavley, J., dissenting) (quoting *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 337 F. Supp. 2d 882 n.23 (N.D. Tex. 2004)).

14. *Positive Software*, 337 F.Supp.2d at 878.

15. *Id.*

16. *See* Petition for Writ of Certiorari, *Positive Software*, 2007 WL 1093508 (No. 06–1352).

Shurn himself got involved in the various litigations, since her claim was betrayed by pleadings plainly revealing her and name and that of Shurn, side-by-side, as late as June 1993. Tellingly, New Century never submitted an affidavit from Stephen Susman—or any other Susman Godfrey lawyer—disclaiming a professional or personal relationship with Shurn.

The AAA procedures required that arbitrators disclose “‘any circumstance likely to affect impartiality or create an appearance of partiality,’ so that parties may rely on the integrity of the selection process for arbitrators.”¹⁷ The AAA rules also required that he disclose any relationship between himself and the parties or their counsel.¹⁸ Shurn signed a statement saying that “he had nothing to disclose of past relationship with the parties or

17. *Positive Software*, 476 F.3d at 285 n.5.

18. Following are some of the key disclosure requirements as set forth in the District Court opinion in *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 337 F. Supp. 2d 862, 884 (N. D. Tex. 2004):

Q. Are arbitrators obligated to make disclosures?

A. Arbitrators must disclose *any relationship* between themselves and a party representative, or a witness. The AAA's rules require that neutral arbitrators be impartial, and that the parties have confidence in their impartiality. The rules require every neutral arbitrator “to disclose to the AAA any circumstances likely to affect his or her impartiality, including any bias or any financial or personal interest in the result of the arbitration or *any past or present relationship with the parties or their representatives.*” This is also dealt with in the AAA's Code of Ethics for Commercial Arbitrators.

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Q. Are there any general principles regarding disclosures?

A. Yes. They are as follows:

1. *Every disclosure, no matter how insignificant should be communicated to the parties.*
2. If information received from the arbitrator or another source seems vague or incomplete, further inquiries should be made to gather pertinent facts for transmittal to the parties.

.....

5. ***Arbitrator had a case in which the arbitrator was a party or counsel before [with] one who is now a party or counsel*** (emphasis added).

3. AAA, Guide to Commercial Arbitrators, provides in relevant part:

If you discover, upon being asked to serve, some prior or present business connection with one of the parties and the contact is so close as to be disqualifying, you should decline to serve. Not every business relationship casts doubt on an arbitrator's impartiality. Often, it is enough for an arbitrator to disclose the connection before accepting the appointment. Arbitrators are advised, whenever a question as to such potentially disqualifying information arises, to ***err in favor of disclosing it to the parties.***

their counsel, ‘direct or indirect, whether financial, professional, social or of any other kind.’”¹⁹ When Shurn was appointed, he was asked whether he had “any professional or social relationship with counsel for any party in this proceeding or the firms for which they work?” He checked: “I have nothing to disclose.”²⁰ He also signed a statement that he would act in accordance with the rules of the AAA.²¹

Positive Software sought additional disclosure regarding Shurn’s relationship to the Susman Godfrey firm. However, the District Court denied the motion on the ground that there were already sufficient facts to require that the arbitration award be vacated in accordance with the Supreme Court decision in *Commonwealth Coatings Corp. v. Continental Cas. Co.*²² The District Court vacated the arbitration award after finding that Shurn had failed to disclose “a significant prior relationship with New Century’s counsel.” The court found that this created an appearance of partiality, which required vacatur.²³

The Court of Appeals for the Fifth Circuit reversed the District Court decision.²⁴ It held that the “evident partiality” standard requires a greater showing than mere appearance of bias. The Court of Appeals cited Justice White’s concurring opinion to the effect that “failure to disclose a trivial former business relationship does not require vacatur of the award.”²⁵ It added that the relationship between Shurn and The Susman Godfrey law firm was “trivial” and “insubstantial.” It concluded that even if Shurn had been an Article III judge, vacating the award would not have been required because the failure to disclose did not create the “impression of possible bias.”²⁶

As an alternative basis for its decision, the majority in *Positive Software* threw in a single paragraph explaining that even if the arbitrators were required to disclose dealings that might create the impression of possible bias, that standard was not breached because the stale contacts between Shurn and Camiña were “tangential and limited” and therefore they did not require disclosure.²⁷ Although this issue was not decided by the Court in *Commonwealth Coatings*, as more fully discussed below, the court should not

19. *Id.* at 290.

20. *Id.* at 879.

21. *Id.*

22. 393 U.S. 145 (1968).

23. *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 337 F. Supp. 2d 862, 865 (N.D. Tex. 2004).

24. 476 F.3d 278 (5th Cir. 2007).

25. *Id.* at 283.

26. *Id.* at 284–85.

27. *Id.*

have substituted its judgment for that of the parties as to what disclosure was required of the arbitrators.

Judge Reavley, who authored the dissent joined by judges Wiener, Garza, Benavides and Stewart, argued that the principle of *stare decisis* required that the Court of Appeals adhere to the precedent established by the Supreme Court in *Commonwealth Coatings*. The dissent argued that six justices adhered to the “appearance of bias” standard for disclosure by arbitrators of prior relationships.²⁸ Justice Reavley also argued that the majority had failed to distinguish between the requirement that judges should fully disclose prior relationships when they are being selected and the conditions that will disqualify an arbitrator after selection.²⁹

In an opinion specially concurring with Judge Reavley’s dissent, Judge Weiner argued that in federal court it is the judicial system and the judges who act as the gatekeepers to exclude the appearance of favoritism by judges, whereas in arbitration it is the parties themselves who serve that role. He argued that parties are deprived of the opportunity to be fully informed and to make intelligent decisions about who should serve as arbitrator in their case if the arbitrators decide for themselves what information to disclose and what to conceal. He wrote:

For the system to enjoy credibility, each potential arbitrator absolutely must disclose every relationship with the parties and counsel, no matter how minimal or insignificant the aspiring arbitrator might deem it to be. It is not the prerogative of a candidate to choose, but the prerogative of the parties alone to decide such significance. And that cannot be done with any degree of comfort absent full disclosure.³⁰

III. SUPREME COURT PRECEDENT: *COMMONWEALTH COATINGS*

The majority and dissent in *Positive Software* strongly disagreed as to whether the decision of the Supreme Court in *Commonwealth Coatings Corp. v. Continental Casualty Co.*³¹ required vacatur of the arbitration award. The majority relied on the fact that *Commonwealth Coatings Corp.* was a “plurality plus” opinion. The opinion of the Court written by Justice Black found that an arbitrator’s failure to disclose close financial ties to the prime

28. *Id.* at 286–87.

29. *Id.* at 287–88.

30. *Id.* at 294 (Judge Weiner specially concurring in Judge Reavley’s dissent).

31. 393 U.S. 145 (1968).

contractor, one of the parties to the arbitration proceeding, warranted vacating the arbitration decree.³² Justice Black stated that even though there was no indication that the arbitrator was biased, arbitrators must “disclose to the parties any dealings that might create an impression of possible bias.”³³ The majority in *Positive Software* argued, however, that the concurring opinion of Justice White, in which Justice Marshall joined, did not go nearly so far.³⁴ The majority argued that most courts that have read Justice White’s concurrence have concluded that an arbitration award should not be overturned based on a mere appearance of bias standard.³⁵ The dissent argued that the court was bound by the precedent of *Commonwealth Coatings*.³⁶

To analyze the scope of the precedent of *Commonwealth Coatings*, it is necessary to analyze the precedential effect of a court opinion in which there is no one opinion that garners the votes of a majority of the justices. The Supreme Court has held in *Marks v. United States*³⁷ that when no single opinion receives the assent of five justices, “the holding of the Court may be viewed as that position taken by those Members who concurred in the judgment on the narrowest grounds.”³⁸ Several courts of appeals have explained that “the *Marks* rule is applicable only where ‘one opinion can be meaningfully regarded as ‘narrower than another’ and can ‘represent a common denominator of the Court’s reasoning.’”³⁹

The majority in *Positive Software* is correct that the concurrence in *Commonwealth Coatings* does not join the majority in holding that the appearance of partiality is sufficient to warrant overturning an arbitration decree. Justice White stated that arbitrators are not Article III judges and should not be held to the same standards as Article III judges.⁴⁰ He added that arbitrators “are not automatically disqualified by a business relationship with

32. *Positive Software*, 476 F.3d at 282.

33. *Id.*

34. *Id.*

35. *Id.* at 282, citing, *Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 429 F.3d 640, 644 n.5 (6th Cir. 2005); *ANR Coral Co., Inc. v. Cogentrix of N.C., Inc.*, 173 F.3d 493, 499–500 & n.3 (4th Cir. 1999) (courts have given Justice White’s concurrence particular weight and have held that “an arbitrators’ failure to reveal facts may be relevant in determining evident partiality under 9 U.S.C. § 10(a)(2), but that mere nondisclosure does not in itself justify vacatur”);

36. *Positive Software*, 476 F.3d at 286 (Reavley, J., dissenting).

37. 430 U.S. 188 (1977).

38. *Id.* at 193.

39. *United States v. Rodriguez-Preciado*, 399 F.3d 1118, 1140 (9th Cir. 2005) (quoting *Anker Energy Corp. v. Consolidation Coal Co.*, 177 F.3d 161, 170 (3rd Cir. 1999)).

40. *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145, 150–51 (1968) (White, J., concurring).

the parties before them if both parties are informed of the relationship in advance, or if they are unaware of the facts but the relationship is trivial.”⁴¹

The majority in *Positive Software* held that the relationship between the neutral arbitrator and the prime contractor was trivial or insubstantial and consequently, the arbitration award should not be overturned. In *Commonwealth Coatings* the prime contractor had repeatedly used the services of the neutral arbitrator over a period of four or five years and had earned fees of about \$12,000.⁴² The arbitrator had even rendered legal services on the projects that were involved in the lawsuit.⁴³ Neither the contractor (respondent) nor the arbitrator revealed their relationship. The third arbitrator was not asked about his business connections with the parties.⁴⁴ There was no agreement between the parties mandating any sort of disclosure by the arbitrators.⁴⁵ The petitioner ultimately challenged the award. The Supreme Court vacated the decree. The majority in *Positive Software* held that the fact that the arbitrator, Shurn, and one of the counsel for New Century, Camiña, had worked for Intel several years earlier on an unrelated case was trivial and did not warrant vacating the arbitration award.⁴⁶ The majority added that even if arbitrators are required to “disclose any dealings that might create an impression of possible bias . . . we cannot find the standard breached in this case.”⁴⁷

The principal problem with the majority opinion in *Positive Software* is its failure to come to grips with the fact that the parties agreed to be bound by the Rules of the AAA, which include their mandatory disclosure rules for arbitrators. Justice White in his concurring opinion in *Commonwealth Coatings* stated that the parties are in the best position to judge how the arbitration process should be designed.⁴⁸ Furthermore, they are better informed of prevailing ethical standards than is the court.⁴⁹

Following the command of *Marks* we need to look to the holding of the court, which is the narrowest one in which a majority of justices join. A majority of justices in *Commonwealth Coatings* clearly supported the appearance of bias standard for disclosure by arbitrators if that was the

41. *Id.* at 150.

42. *Id.* at 146.

43. *Id.*

44. *Id.* at 152.

45. See Brief of Petitioner-Appellant at 7–9, *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145 (1968), No.14 1968 WL 129387.

46. *Commonwealth Coatings*, 393 U.S. at 146.

47. *Id.*

48. *Id.* at 151 (White, J., concurring).

49. *Id.*

standard agreed to by the parties. In particular, the plurality opinion relied on the appearance of bias standard. The concurrence of Justice White rejected that approach but instead relied on the fact that the arbitrator had a substantial interest in a firm, which had done more than trivial business with a party, and that relationship should have been disclosed and was not. Justice White also stated that the parties should be the architect of the process by which their dispute is resolved. Thus, there were probably six justices who would have applied the appearance of bias standard if that was the standard agreed to by the parties. However, as stated above, there was no mandatory disclosure rule for an arbitrator which was agreed to by the parties in *Commonwealth Coatings*. Consequently, Justice Whites' statements on that subject are *dicta*. Because *dictum* does not become part of the binding precedent of a case even when articulated in a majority opinion, it cannot become part of the binding precedent when it is found in a concurring opinion where the opinion of the court consists of a plurality decision. Nonetheless, because there seemingly were six justices who would have applied the appearance of bias standard if the parties had agreed to it, that is certainly persuasive authority to which the court in *Positive Software* paid insufficient heed.⁵⁰

IV. THE PARTIES SHOULD BE ABLE TO DECIDE FOR THEMSELVES WHAT DISCLOSURE IS REQUIRED OF THEIR ARBITRATORS

A. The Federal Arbitration Act Does Not Preempt the Parties Agreed Upon Disclosure Rules for Selecting Arbitrators to Resolve Their Dispute

When it provided specific bases upon which a court could overturn an arbitration decision in the Federal Arbitration Act (FAA), Congress neither expressly nor impliedly sought to preempt state contract law that would enforce the parties agreed upon disclosure requirements for selecting arbitrators. The Supreme Court has stated that “There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate.”⁵¹ Therefore, the Court of Appeals in *Positive Software* should have honored the chosen means of enforcing the dispute that meant refusing to confirm an arbitration award where the arbitrator blatantly

50. See Howard L. Wieder, *Subversion of ADR: Nondisclosure of Ties by Appointed and Aspiring Arbitrators*, QUEENS BAR BULLETIN (Queens Co. Bar Ass'n, Jamaica, N.Y.), December 2007, at 2.
51. Volt Info. Sci. v. Leland Stanford Jr. Univ., 489 U.S. 468, 476 (1989).

ignored the disclosure regimen required by the AAA, which had been selected by the parties.

First, it is clear that under state contract law, the parties' entire agreement, including the means chosen for enforcement is binding. If a state were to claim that a contract which otherwise expressed the intent of the parties could not be enforced because it constituted an agreement to arbitrate, then the FAA would preempt and demand that the agreement be enforced.⁵² However, in the FAA, Congress did not seek to alter the substantive agreement of the parties or the procedural rules which they had agreed upon to resolve their dispute. The FAA does not dictate that arbitrations be subject to any specific procedural rules other than those agreed to by the parties.⁵³ The FAA sought to establish a body of federal law for arbitration agreements subject to the act, whereby disputes as to arbitrability should be resolved in favor of arbitration. However, as the California Supreme Court made clear in *Cronus Investments, Inc. v. Concierge Services*,⁵⁴ "the FAA's purpose is not to provide special status for arbitration agreements, but only to make arbitration agreements as enforceable as other contracts, but not more so . . . [i]n accord with this purpose, the high court has stated that state contract rules generally govern the construction of arbitration agreements. [T]he federal policy is simply to ensure the enforceability, according to their terms of private agreements to arbitrate."⁵⁵

A Congressional statute can preempt state law, including private contract law, if the statute specifically provides for it; if there was an intent to occupy the field or if there is a specific conflict between the federal and state law. There is nothing in the FAA that specifically provides for preemption. Nor

52. The FAA was passed because at the time some judicial opinions were hostile to enforcing arbitration agreements. S. REP. NO. 536, 68TH CONG., 1ST SESS. 2-3 (1924). See also H.R. REP. NO. 96, 68TH CONG., 1ST SESS., 1-2 (1924); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219-20 (1985).

53. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995); *Tuco Inc v. Burlington Northern R.R. Co.*, 912 S.W.2d 311, 314 (Tex. Civ. App. 1995).

54. 35 Cal.4th 376, 107 P.3d 217, 222, 25 Cal. Rptr. 3d 540 (2005) (quoting *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967)).

55. *Id.* at 384, 107 P.3d at 222, 25 Cal. Rptr. 3d at 546 (quoting *Volt Info. Scis. v. Bd. of Trustees*, 489 U.S. 468, 476 (1989)). However, in *Credit Suisse First Boston v. Grunwald*, 400 F.3d 1119, 1136, 1134 n.20 (9th Cir. 2005), the Ninth Circuit held California's Ethics Standards to be preempted by the Securities Exchange Act of 1934, 15 U.S.C. § 78s(b) because the NASD could not simultaneously comply with both the NASD disclosure rules and the California Ethics Standards for Neutral Arbitrators. The NASD rules allow but do not mandate removal of an arbitrator who fails to make required disclosures, whereas the California Standards (CAL R. Ct., Ethics Standards for Neutral Arbitrators in Contractual Arbitration No. 7(d)) mandate disqualification when an arbitrator has failed to make required disclosures. See also Rossein and Hope, *supra* note 1, at 204-05, 238-39.

is there an intent on the part of Congress to occupy the field.⁵⁶ One might argue that since the FAA provides that courts can vacate an arbitration award when there existed “evident partiality” by the arbitrator, this standard preempts contractual provisions, which require awards to be vacated under the lesser standard when arbitrators appear to be biased. The Supreme Court has rejected such an approach, holding that parties are free to select their own ground rules in arbitration and that the FAA does not preempt their ability to do so:

Just as parties may limit by contract the issues to be arbitrated. . . , so too may they specify by contract the rules under which the arbitration will be conducted. Where parties choose state rules, enforcing those rules is fully consistent with the FAA.⁵⁷

The key question that the majority opinion in *Positive Software* avoided involves the issue of whether the parties can, by agreement, set their own standard for disclosure and then get the court to enforce it by vacating an arbitration award if the arbitrators do not comply⁵⁸. The majority in *Positive Software* stated “whether Shurn’s nondisclosure ran afoul of the AAA rules, however, is not before us and plays no role in applying the federal standard embodied in the FAA.”⁵⁹ This assumes that the parties are not free to set their own disclosure standards or to clarify the meaning of “evident partiality” to suit their own needs.

Courts have split on the issue of whether parties can contract for a heightened standard of review of arbitration awards.⁶⁰ Some courts have held that parties are not free to do so. They have relied principally on three arguments: (1) Congress has specified a uniform standard that parties are not free to alter; (2) the parties would be expanding the scope of federal jurisdiction by contract if they could alter the terms of review of arbitration decisions;⁶¹ and (3) it would undermine the purpose of the FAA to efficiently and speedily enforce arbitration awards if parties could custom-tailor how

56. See *Exxon Shipping Co. v. Baker*, 128 S. Ct. 2605, 2618–19 (2008); *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 255–56 (1984).

57. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995).

58. *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 476 F.3d 278, 279 (5th Cir. 2007).

59. *Id.* at 285.

60. *Compare* *Kyocera Corp v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 994 (9th Cir. 2003); *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 935, (10th Cir. 2001); *ANR Coal Co., Inc. v. Cogentrix of N.C., Inc.*, 173 F.3d 493, 495 (4th Cir. 1999) (failure to comply with AAA disclosure rule does not warrant court refusing to confirm an arbitration award), *with* *Puerto Rico Telephone Co., Inc. v. U.S. Phone Mfg. Corp.*, 427 F.3d 21 (1st Cir. 2005).

61. *Chi. Typographical Union No. 16 v. Chi. Sun-Times, Inc.*, 935 F.2d 1501, 1504–05 (7th Cir. 1991).

courts would review arbitrators' failure to adhere to the disclosure procedures required of them by the parties.

On the other hand, other courts take the view that parties should be permitted to custom-tailor how their dispute is resolved, including the standard of review that courts apply in reviewing the arbitration award. The purpose of the FAA is to streamline dispute resolution by having arbitrators enforce the agreement of the parties. Congress did not seek to obtain speedy resolution of disputes at the expense of undermining the agreement of the parties. Everyone would agree that flipping a coin would be even quicker but would clearly not serve to enforce the agreement of the parties.⁶² Furthermore, parties would be disinclined to have their dispute resolved by arbitration if it meant leaving the result entirely to chance or to the decision of a potentially biased arbitrator.

B. Congress Has Not Specified a Uniform Standard for Resolving Arbitration Disputes That Cannot Be Altered by the Parties

Section 10 of the FAA states that courts can vacate an arbitration award:

- (1) Where the award was procured by corruption, fraud, or undue means.
- (2) Where there was evident partiality or corruption in the arbitrators, or either of them.
- (3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.
- (4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.⁶³

The statute does not directly address the problem of arbitrators failing to meet a disclosure requirement. As discussed above, the Supreme Court decision in *Commonwealth Coatings* makes clear that an arbitrator's failure to comply with a disclosure requirement can provide the basis for vacating an arbitration decree. The Supreme Court derived the statutory basis for vacatur

62. *Puerto Rico Telephone Co. Inc.*, 427 F.3d at 30–31.

63. 9 U.S.C. § 10 (2006).

from the “evident partiality” language of subsection (2) and procuring an award by “undue means” from subsection (1). Judge Reavley’s dissent in *Positive Software* also notes that an arbitrator who fails to make a significant disclosure may be guilty of “misbehavior by which the rights of any party have been prejudiced” within the meaning of subsection (3).⁶⁴ Since the statute does not by its terms define “evident partiality or corruption” in subsection (2) or define “misconduct” in section (3), the parties should be free to define those terms in the arbitration agreement unless doing so would undermine the policy behind the FAA.

Courts that have held that the parties are not free to alter the standard of review of arbitration decisions tend to focus on the Congressional purpose favoring arbitration of disputes notwithstanding state law to the contrary.⁶⁵ The argument is made that if courts are too quick to vacate arbitration awards, it will undermine the Congressional purpose favoring arbitration of disputes. However, this argument proceeds on the faulty assumption that parties will be less willing to arbitrate if a court will vacate a decree when an arbitrator has blatantly violated the disclosure rules that the parties have agreed to. It also ignores the other major purpose of the FAA, which is to enforce arbitration agreements in accordance with general contract principles. Part and parcel of that policy is to enforce arbitration agreements according to their terms,⁶⁶ which includes enforcing contracts in accordance with the agreement of the parties. The Supreme Court has indicated that the interest in efficiently resolving disputes should not take precedence over enforcing the provisions of the arbitration agreement.⁶⁷ Finally, it seems much more plausible that parties will actually be less willing to arbitrate if the disclosure rules to which they have agreed are not complied with by the arbitrators.

Parties are protected from less than impartial judges by (1) the political process involving the selection of judges; (2) the F.B.I. screening of judicial candidates; (3) the extensive disclosures required of federal and state judges; and (4) 28 U.S.C. § 455,⁶⁸ which provides for disqualification of judges based upon the appearance of bias. On the other hand, the only real protection that parties to arbitration proceeding have against arbitrators who may be less than impartial is their ability to select the arbitrator.⁶⁹ That protection will be

64. *Positive Software*, 476 F.3d at 288 n.4.

65. See *Kyocera Corp v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d at 998; *Bowen*, 254 F.3d at 935.

66. *Volt Info. Scis. v. Bd. of Trustees of Leland*, 489 U.S. 468, 479 (1989).

67. *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985); *Puerto Rico Telephone Co.*, 427 F.3d at 30–31.

68. 28 U.S.C. § 455(a) (2006).

69. See also *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 476 F.3d 278, 290 (Judge Wiener specially concurring in Judge Reavley’s dissent).

undermined if the parties do not personally know the arbitrator unless they can demand extensive disclosure of possible conflicts of interest. For that reason, the American Arbitration Association has an extensive disclosure form that its arbitrators are required to complete.⁷⁰ If an arbitrator completes the form in a materially misleading fashion and then enters an award, the only protection left to an aggrieved party is vacatur of the award.

In cases tried before a court, the parties have a great deal of protection from biased judges and from judges who appear to be less than impartial. First, some potentially biased judges may be screened through the judicial selection process. In addition, federal judges are required to undergo a vigorous screening process. They must undergo an extensive F.B.I. background check. Also, they must be nominated by the president and confirmed by the Senate. State court judges may have to be elected following a judicial campaign. Although voters in state judicial elections often are not familiar with the judicial candidates⁷¹, the campaign process itself weeds out some judges. Furthermore, reporters may unearth background information on judicial candidates, which reveals potential conflicts.

Parties in court proceedings are also protected from conflict by judicial disclosure rules. Federal judges must complete financial disclosure questionnaires.⁷² Many states rules also require disclosure of financial and,

70. *Positive Software* was litigated under the prior version of the AAA's disclosure rules. See *supra* note 16. The AAA has now revised its disclosure rules. See AAA, Commercial Arbitration Rules and Mediation Procedures (including Procedures for Large, Complex Commercial Disputes) Amended and Effective July 1, 2003, Rules R-12 (requiring "party-appointed arbitrators to meet impartiality and independence standards (delineated in R-17) unless the parties agree otherwise;" R-16 (requiring (1) "all arbitrators to disclose circumstances likely to give rise to justifiable doubt as to the arbitrator's impartiality or independence; (2) clarify that the disclosure obligation remains in effect throughout the arbitration; (3) explain that the disclosures made pursuant to the rules are not to be construed as an indication that the arbitrator considers the disclosed circumstances likely to affect his or her impartiality or independence;" R-17 (including additional language outlining an arbitrator's responsibility to be impartial and independent and providing additional bases for disqualification. R-17 also provides that "the AAA may disqualify an arbitrator 'on its own initiative.'" For forms and other arbitrators' requirements on disclosures of financial assets, see qualification Criteria for Admittance to the AAA National Roster of Arbitrators, available at <http://www.adr.org/si.asp?id=4223>.; See also Uniform Application for Securities Industry Registration or Transfer, Disclosure Questions 14A–14M, as required by FINRA (formerly NASD) By-Laws, Art. V, § 2. See also Nat'l Ass'n of Sec. Dealers, Inc. Code of Arb. 10312 (July 19, 2004).

71. See *Republican Party of Minnesota v. White*, 536 U.S. 765 (2002).

72. Pursuant to the Ethics in Government Act of 1978, 5 U.S.C. app. §§ 101–111, federal judges are required to complete financial disclosure form AO 10. In addition, *Ethics Essentials: A Primer for New Judges on Conflicts, Outside Activities and Other Potential Pitfalls* (Committee on Codes of conduct Judicial Conference of the United States) suggests that federal judges complete certain checklists to avoid conflicts of interest: Checklist for Financial Conflicts, form AO-300 (requires judges to "list all companies and organizations in which the judge or a relative has a financial interest"); Checklist for financial conflicts, form AO-301 (requires judges to "list all matters in which

in some instances, other interests such as membership on boards, honoraria and lobbying.⁷³ These disclosure forms enable parties to determine whether to ask the judge to recuse herself or make a motion to disqualify. If a judge fails to disqualify herself, a party can seek to have vacated a decision rendered while the tainted judge sat.⁷⁴ Court decisions are not invariably vacated just because they were rendered while a tainted judge presided. Courts have differed with respect to when a decision must be reversed. Some courts have held that after a trial judge fails to recuse himself, reversal is automatic.⁷⁵ Other courts have held that whether reversal is necessary depends upon the risk that injustice will have occurred and whether the public's confidence in the process has been undermined.⁷⁶ In instances in which courts have held that reversal is not automatic, courts frequently rely on the fact that the appellate court has ample authority to protect the litigants because of the broad scope of appellate review.⁷⁷ Arbitration awards, however, are subject to more narrow review and may be reversed "only in certain limited circumstances." Awards can be reversed based on one of the four statutory grounds set forth above. In addition, some courts will reverse arbitration decrees where an arbitrator has manifestly disregarded the law.⁷⁸ Because arbitration awards are subject to a much narrower scope of review, the parties may reasonably feel that they need to protect themselves by insuring that the arbitrators who hear their case are impartial. For that reason, they should be able to custom-tailor the scope of review so that the decree can be overturned if the arbitrator fails to make required disclosures.

the judge has a disqualifying nonfinancial interest"); and Checklist for Other conflicts, form AO-301 ("requires judges to list all attorneys and/or law firms related to the judge. . . or whose appearance in a matter will otherwise cause the judge to recuse herself.").

73. The reports vary considerably as to the scope of disclosure required. *E.g.*, Arizona Financial Disclosure Statement, ARIZ. REV. STAT. § 38-542 (2008); Connecticut Statement of Financial Interests to be reported, CONN. GEN. STAT. § 51-46a (2008); Delaware Financial Disclosure Report, DEL. CODE ANN. tit 29, § 5813(c) (2008); Illinois Declaration of Economic Interest, ILCS Code of Jud. Conduct, Sup. Ct. Rule 68 (2008); Missouri Financial Interest Statements—Mandatory Filing Requirements, MO. REV. STAT. § 105.483-105.492 (2008); Texas Personal Financial Disclosure, Standards of Conduct, and Conflict of Interest, TEX. GOV'T CODE ANN. § 572.001 (2007); Wisconsin Financial Disclosure, WIS. STAT. § 19.43-19.44 (2008).
74. *See, e.g.*, *Liljeberg v. Health Services Acquisition Corp.*, 486 U.S. 847 (1988).
75. *Mangini v. United States*, 314 F.3d 1158 (9th Cir. 2003); *Preston v. United States*, 923 F.2d 731 (9th Cir. 1991).
76. *See, e.g.*, *Polaroid Corp. v. Eastman Kodak Co.*, 867 F.2d 1415 (1st Cir. 1989).
77. *See, e.g.*, *Selkridge v. United of Omaha Life Ins. Co.*, 360 F.3d 155 (3rd Cir. 2004); *In re Asbestos Litigation*, 977 F.2d 764 (3rd Cir. 1992).
78. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995); *Brabham v. A.G. Edwards & Sons, Inc.*, 376 F.3d 377, 381 (5th Cir. 2004); *Williams v. Cigna Fin. Advisors, Inc.*, 197 F.3d 752, 759 (5th Cir. 1999).

C. The Parties Would Not Be Expanding the Scope of Federal Jurisdiction By Contract If They Agree That Arbitration Awards Can Be Vacated If Arbitrators Make Material Nondisclosures or Misstatements on Disclosure Forms

Some Courts have held that parties are not free to provide for stricter review of arbitration awards than specifically provided for by the FAA because the parties would be expanding the scope of federal jurisdiction over arbitration disputes.⁷⁹ However, as the First Circuit noted in *Puerto Rico Telephone Company, Inc. v. U.S. Phone Manufacturing Corp.*,⁸⁰ permitting heightened review of arbitration awards does not alter the scope of federal jurisdiction over arbitration awards.⁸¹ The FAA itself does not provide an independent basis for review of arbitration decrees.⁸² Courts have jurisdiction to review arbitration decrees only when there is diversity of citizenship or when there is some other independent basis for federal jurisdiction.⁸³

D. Permitting the Parties to Custom-Tailor How Courts Review Arbitrators' Failure to Comply With Disclosure Requirements is Consistent with the Legislative Purpose of the FAA

Being willing to overturn arbitration awards where arbitrators fail to comply with parties' disclosure requirements is not inconsistent with the FAA for two reasons. First, the statutory purpose of the FAA is not to insist on the speedy resolution of disputes at the expense of the agreement of the parties. The Supreme Court has made clear that the efficient resolution of disputes should not take precedence over enforcing the agreement of the parties.⁸⁴

The legislative history of the FAA supports this viewpoint. The starting point for analyzing the statute is the language of the statute itself. The statute conspicuously avoids using the terms "impartiality might reasonably be questioned," which is found in the federal judicial disqualification statute, 28 U.S.C. § 455 (a).⁸⁵ That language has been interpreted by courts to mean that if an objective observer fully apprized of all the relevant facts would

79. *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 994 (9th Cir. 2003) (en banc); *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 935 (10th Cir. 2001).

80. 427 F.3d 21 (1st Cir. 2005).

81. *Id.* at 30–31.

82. *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25 (1983).

83. *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 476 F.3d 278 (5th Cir. 2007).

84. *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985).

85. 28 U.S.C. § 455 (2006).

reasonably question the judge's impartiality, the judge should be disqualified.⁸⁶ This standard has been termed the "appearance of impropriety" rule.⁸⁷ Since the predecessor to 28 U.S.C. § 455 was adopted in 1911 and contained the language of "whenever it appears that a judge . . . is in any way concerned in interest,"⁸⁸ which later morphed into the "impartiality might reasonably be questioned" standard, the logical inference is that when Congress passed the FAA in 1925 and later revised in 1947,⁸⁹ it was aware of the standard for disqualification for judges and chose not to adopt it as a default rule.

However, at issue in *Positive Software* was whether the disclosure requirements agreed to by the parties should be enforced. The legislative history to the FAA makes clear that agreements should be enforced according to the agreement of the parties.⁹⁰ This means not only that the substantive terms should be enforced according to contract principles but that the procedural rules agreed to by the parties, including the disclosure requirements for arbitrators, should be honored.

Second, if disclosure requirements of arbitrators are strictly enforced, parties will be more likely to have their dispute resolved through arbitration. Conversely, if parties lack confidence in the arbitration process, they will be less likely to resort to arbitration and more inclined to stick with the judicial process. The judicial process, however slow and cumbersome it might be, has checks in place, which are designed to maintain public confidence in the process.

E. An Arbitrator's Failure to Make Disclosures Mandated by the Arbitration Agreement May Constitute "Evident Partiality"

Most courts that have considered the issue have refused to find that arbitrators' failure to disclose relationships similar to those in *Positive Software* constitutes "evident partiality." For example, in *Uhl v. Lomatsu Forklift Co., Ltd.*,⁹¹ the court held that the fact that an arbitrator chosen by one of the parties had previously worked on two occasions as co-counsel with plaintiff's attorney did not demonstrate "evident partiality" sufficient to

86. See *In re International Business Machines Corp.*, 618 F.2d 923 (2d Cir. 1980).

87. See *Liljeberg v. Health Services Acquisition Corp.*, 486 U.S. 847, 860–61 (1988).

88. Law of Mar. 3, 1911, ch. 231, § 258, 36 Stat. 1161, derived from Act of Mar. 3, 1821, ch. 4, § 601, 18 Stat. 98, 105 (1878).

89. Law of July 30, 1947, ch. 392, 61 Stat. 672, derived from Act of Feb. 12, 1925, c. 213, § 10, 43 Stat. 885 (current version at 9 U.S.C. § 10 (2006)).

90. H.R. REP. NO. 96, 68TH CONG. (1st 1924).

91. *Uhl v. Komatsu Forklift Co., Ltd.*, 512 F.3d 294 (6th Cir. 2008).

permit vacation of the arbitration award.⁹² In *Uhl*, the parties differed as to whether the arbitration agreement required disclosure of the relationship between the parties.⁹³ The provision in the arbitration agreement stated that “[p]rior to selecting the neutral arbitrator, the party-selected arbitrators shall disclose to all parties any referral agreements, financial dealings, or other relationships with any of the parties or parties’ attorneys that could in any way be construed as a possible conflict of interest.”⁹⁴

The defendant argued that disclosure of all relationships with counsel was required.⁹⁵ The plaintiff argued that the clause only required disclosure of relationships that could in any way be construed as a possible conflict of interest.⁹⁶ The court decided that it did not need to resolve the party’s disagreement as to contract interpretation.⁹⁷ First, it held that the breach did not constitute fraud in the inducement of a contract in violation of Michigan law.⁹⁸ With respect to the FAA, the party challenging the award only raised the “evident partiality” standard as a basis to vacate the arbitration award.⁹⁹ Based on the decision in *Positive Software* and based on Justice White’s concurrence, the court in *Uhl* held that the failure “to disclose insubstantial relationships” does not warrant vacating an arbitration award based on “evident partiality.”¹⁰⁰

Similarly, in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Lambros*,¹⁰¹ the court held that the fact that years earlier one of the arbitrators had been a fraternity brother of one of the parties was not sufficient to constitute “evident partiality,” requiring vacatur under section 10(a)(2) of the FAA. The court pointed to the defendant’s failure to object to the relationship at any time during the arbitration process as being significant. The court added that the mere prior school relationship itself was “too remote and speculative” to constitute evident partiality. In the course of rejecting other potential bases as being too tenuous to warrant vacatur of the arbitration award, the court noted that in general the mere appearance of bias or partiality is not sufficient

92. *Id.* at 307.

93. *Id.* at 303.

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.* at 304.

98. *Id.*

99. *Id.* at 305.

100. *Id.* at 306 (quoting *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 476 F.3d 278, 281–82 (5th Cir. 2007)).

101. 1 F. Supp. 2d 1337 (M.D. Fla. 1998).

to warrant setting aside an arbitration award.¹⁰² Citing the concurring opinion in *Commonwealth Coatings Corp.*, the court added that if a movant can show that an arbitrator failed to disclose a substantial relationship with a party, “then the less demanding ‘appearance of bias’ standard applies.”

Courts do not uniformly take such a narrow view of “evident partiality.” For example, the Ninth Circuit in *Schmitz v. Zilveti*¹⁰³ held that an arbitrator’s failure to disclose that his law firm had represented the parent corporation of one of the parties on several occasions warranted vacatur of an arbitration award even though the arbitrator did not know at the time of the arbitration of his law firm’s relationship with the parent company. The Court stated that Justice White’s concurrence did not reject the “appearance of bias standard.” It merely recognized that arbitrators operate in a different milieu than do judges. Arbitrators are more likely to have frequent contacts with the parties than judges are. In addition, the issue for arbitrators is disclosure, not recusal. Nonetheless, the court went on to interpret the “appearance of bias” language as requiring a “reasonable impression of partiality.” The court held that the arbitrator’s failure to do an adequate investigation regarding his law firm’s contacts with the parent company of one of the parties created a reasonable impression of partiality. The court added that “[i]f the parties are to be judges of the arbitrators’ partiality, duties to investigate and disclose conflicts must be enforced, even if later a court finds that no actual bias was present.”¹⁰⁴

The real key to *Schmitz* and to *Positive Software* is that the agreement itself specifically requires the disclosure. If the agreement is silent, one can readily surmise that the parties would not have wanted the arbitration award vacated absent a significant disclosure, which would cause reasonable people to question the impartiality of the arbitrator. This explains many decisions where the arbitration agreement does not require disclosure or does not specifically mandate disclosure of particular information. However, where the agreement specifically requires disclosure of particular contacts and the arbitrator then fails to disclose, the arbitration award should be vacated. In the words of Justice White’s concurrence in *Commonwealth Coating*: “The judiciary should minimize its role in arbitration as judge of the arbitrator’s impartiality. That role is best consigned to the parties, who are the architects of their own arbitration process, and are far better informed of the prevailing ethical standards and reputations within their business.”¹⁰⁵ Where the parties

102. *Id.* at 1341–42 (citing *Consolidated Coal Co. v. Local 1643, United Mine Workers of America*, 48 F.3d 125, 129 (4th Cir. 1995)).

103. 20 F.3d 1043 (9th Cir. 1994).

104. *Id.* at 1049 (citing *Close v. Motorists Mut. Ins. Co.*, 486 N.E.2d 1275, 1278–79 (1985)).

105. 393 U.S. at 151 (quoted in *Schmitz*, 20 F.3d at 1049).

have decided that they need certain disclosure from the arbitrator so that they can make an informed decision about that arbitrator, the court should not second-guess that decision. Instead, the court should refuse to confirm the arbitration decree. At a minimum, if an arbitrator has failed to comply with the disclosure requirement agreed to by the parties, a court should apply the “appearance of bias” test as did the court in *Merrill Lynch* in deciding whether to confirm the arbitration award.

V. FAILURE TO DISCLOSE MAY CONSTITUTE ARBITRATOR MISCONDUCT

The dissent in *Positive Software* suggested as an alternative basis for its view that failure by an arbitrator to disclose may constitute arbitrator misconduct under section 10(a)(3) of the Federal Arbitration Act. If it does, then, as suggested by the dissent in *Positive Software*, the arbitration award should be vacated irrespective of whether there appears to be any bias.¹⁰⁶ Most of the current case law construes “arbitrator misconduct” very narrowly. For example in *Andros Compania Maritaima v. Marc Rich & Co., A.G.*,¹⁰⁷ the Second Circuit affirmed the district court judgment confirming an arbitration award notwithstanding the claim of impropriety on the part of an arbitrator in failing to disclose the nature of his relationship with a fellow arbitrator. The court found that despite the appellant’s charge, there was no evidence of an undisclosed personal relationship. Moreover, the fact that they had sat together on 19 arbitrations was a matter of public record. For these reasons the court held that “no clear evidence of impropriety” had been presented.¹⁰⁸ In *Marc Rich*, Andros, the party who received the benefit of the arbitration award, claimed that it had not agreed to the disclosure provisions of the arbitration clause. The court stated that it did “not regard the issue as significant.”¹⁰⁹ Although *Marc Rich* may make sense as a default rule, for the reasons discussed above, it would not if the arbitrator’s non-disclosure clearly contravened the provisions of the arbitration agreement.

At any rate, if an arbitrator has intentionally concealed his connection to one of the parties or to counsel where the arbitration rules clearly demand such disclosure, concealment arguably constitutes fraud that in turn could be

106. *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 476 F.3d 278, 288 n.4 (5th Cir. 2007) (Reavley, J., dissenting).

107. 579 F.2d 691 (2d Cir. 1978).

108. *Id.* at 702.

109. *Id.* at 693 n. 3.

viewed as arbitrator misconduct sufficient to warrant *vacatur* of the arbitration award.¹¹⁰

VI. ECONOMIC EFFICIENCY WILL BE UNDERMINED IF THE PARTIES' DISCLOSURE RULES FOR THEIR ARBITRATORS ARE NOT HONORED

Economic efficiency will be undermined if courts refuse to honor all the terms of arbitration agreements including the disclosure rules that the parties have agreed upon. Economic efficiency is defined as: exploiting resources in such a way that value, as measured by consumers' willingness to pay for goods and services, is maximized.¹¹¹ Assume S agrees to sell widgets to B1 for \$25 per widget. B1 enters into a contract to sell the widgets to B2 for \$30. If S knows that he will have to pay B1's expectation damages of \$30, he will not breach his contract with B1 and sell it to B3 unless B3 is willing to pay more than \$30 per widget. In this fashion, the law of contract damages promotes economic efficiency. The buyer who values the widget the most as measured by his willingness to pay for it will end up with the widget. The theory is that the buyer who is willing to pay the most for it will put the widget to its most productive use. In this way, S is better off and B1 and B2 are no worse off than if S complied with the terms of the original contract. This example assumes that there are no transaction costs incident to forming or enforcing the contract.

If a court refuses to honor the disclosure provisions that the parties have entered into to enforce the terms of their underlying agreement, transaction costs will rise, possibly undermining economic efficiency. For example, in the above example if S knew that an arbitrator would refuse to order her to pay damages for breach of her contract with B1 or would order her to pay damages in too low an amount, she might be inclined to breach even though B3 might be willing to pay \$27 per widget. Thus, if S knew that the arbitrator would order her to pay damages less than \$2 per widget, she would be inclined to sell the widgets to B3. In this example, economic efficiency would be undermined because the widget would end up in the hands of B3 who valued it less than B1.

If a court refuses to honor the disclosure rules, one party may know that a supposedly neutral arbitrator has a hidden bias in his favor. Even if this bias

110. Cf. *Adames v. Velasquez*, 19 Misc. 3d 881, 855 N.Y.S.2d 343 (N.Y. Sup. Ct. Queens Co. Apr. 1, 2008) (suggesting that an arbitrator's failure to disclose may amount to fraud). (Howard L. Wieder, co-author of this article, is law secretary to Judge Markey, the author of the opinion in *Adames*.)

111. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 11–12 (7th ed. 2007).

were not sufficient to demonstrate actual bias, it might be enough to cause S to believe that he could get away with breaching his contract and sell the widgets to B3 for less than B1 valued the widgets. To deal with a court's unwillingness to honor disclosure provisions, B1 would be forced to do expensive research on an arbitrator's contacts with opposing counsel, and with S. These additional transaction costs might be so prohibitive as to discourage B1 from entering in to a contract with S in the first place or would cause B1 to find an alternative dispute resolution mechanism that would impose fewer transaction costs.

Thus, the net effect of refusing to honor disclosure rules may be the exact opposite of what Congress intended: discouraging rather than encouraging resort to arbitration. In *Positive Software*, the parties chose the rules of the AAA to resolve arbitration disputes. Those rules included mandatory disclosure rules for the arbitrators. Confirming the arbitrator's decision when the arbitrator has failed to disclose prior contacts with opposing counsel may cause parties in the future to avoid using arbitration or to do their own expensive research on the arbitrators. Of course, parties may want the benefit of finality even when an arbitrator fails to make significant disclosures required by the rules. In that case, the parties are free to provide that non-disclosure should not be a basis for a court refusing to confirm an arbitration award, and a court should honor that agreement.

The AAA has a significant economic interest in encouraging parties to use their services. By creating disclosure rules for parties who use their services, they save parties the time and expense of having to draft their own disclosure requirements. Nonetheless, when parties agree to have their dispute resolved under AAA rules, they should enjoy the same benefit of arbitrator disclosure as if they had drafted the rules themselves.

Professors Scott and Goetz have argued that courts should be as willing to uphold parties' liquidated damage clauses as they are to uphold other contract provisions.¹¹² They argue that classifying such clauses as penalty clauses and refusing to uphold them when there is no indication that they are unconscionable undermines economic efficiency.¹¹³ They argue that courts should be more willing to enforce damage clauses agreed to by the parties because it would permit parties to avoid the risks of under compensation inherent in contract damage actions.¹¹⁴ Parties are in the best position to know what types of harm they might incur as a result of breach of the agreement.

112. Goetz and Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 Colum. L. Rev. 554 (1977).

113. *Id.* at 591.

114. *Id.* at 591-92.

Consequently, courts should be more inclined to enforce these clauses consistent with the agreement of the parties. Likewise, where the parties have agreed to certain arbitrator disclosure rules, they are in the best position to know of the risks attendant to possible arbitrator bias. Therefore, the courts must enforce those arbitration disclosure rules by refusing to confirm arbitration rules when the arbitrator has violated the disclosure rules agreed to by the parties.

VII. CONCLUSION

When Congress enacted the FAA, it made it clear that it wanted contracts to arbitrate enforced according to the parties' agreement. The parties' agreement includes the disclosure requirements to which the parties have negotiated themselves or to which they have agreed by electing to follow the procedures of an arbitration association such as the AAA. Parties to arbitration lack the protection that court litigants have from potentially biased judges. Consequently, there is a greater need for them to be able to protect themselves. If courts refuse to enforce the parties' disclosure requirements for arbitrators, the net effect may be to discourage resort to arbitration—exactly the opposite of what Congress intended when it passed the FAA.

