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Arbitrator or Private Investigator: Should the Arbitrator's Duty to Disclose Include a Duty To Investigate?

*Abdullah E. Al-Harbi v. Citibank, N.A. and Citibank, A.S.*¹

I. INTRODUCTION

Arbitration and other forms of dispute resolution are replacing courtroom litigation as a means of resolving problems because they are less time consuming, less expensive and promote a friendlier atmosphere. In the case of arbitration, if people are to continue to use arbitration and give arbitrator's decisions credibility, there must be faith that the arbitrator is fair. There must also be a channel to challenge the arbitrator's decision if it was not reached in a fair manner.² This channel is provided statutorily by the Federal Arbitration Act (FAA) which allows a decision to be reversed if the arbitrator displayed partiality to one side or the other in the dispute.³ The Supreme Court held that before the arbitration an arbitrator has a duty to disclose any facts which would appear to make him or her biased.⁴ This Casenote will discuss whether the duty to disclose should also carry with it a duty to investigate for any facts that may cause the arbitrator to appear biased.

II. FACTS AND HOLDING

The parties in this dispute are Abdullah Al-Harbi, a Saudi Arabian citizen, and Citibank A.S., (hereinafter Citibank) a subsidiary of Citibank, and N.A.,⁵ organized under the Czech Republic. Al-Harbi alleges that Citibank defrauded him or breached a fiduciary duty to him in a land transaction in which he became half-owner of a piece of real estate located in the Czech Republic.⁶

1. 85 F.3d 680 (D.C. Cir. 1996).

2. *See*, Federal Arbitration Act, 9 U.S.C. § 10.

3. *Id.*

4. *Commonwealth Coatings Corp. v. Continental Co.*, 393 U.S. 145, 149 (1968).

5. *Al-Harbi*, 85 F.3d at 681.

6. *Id.* In the transaction at hand, Al-Harbi paid \$5,985,000 for half ownership in a piece of property in the Czech Republic. Al-Harbi alleges that as a result of this transaction, he suffered losses of \$7,500,000. *Id.*

In October of 1994, after negotiations were completed, the parties began non-binding mediation before Kenneth Feinberg in London, England.⁷ After reaching no agreement in the mediation, both sides agreed to binding arbitration.⁸ In search of a quick resolution, both sides agreed on Feinberg as the arbitrator.⁹ The parties also agreed upon an arbitration format where after both parties present their cases, the arbitrator chooses one side's settlement figure.¹⁰ Feinberg chose Citibank's figure and added \$500,000 to it, awarding Al-Harbi \$1,100,000.¹¹

Dissatisfied with the arbitrator's award, Al-Harbi brought an action in the United States District Court for the District of Columbia to vacate the arbitration award.¹² The District Court denied vacatur.¹³ Al-Harbi appealed this ruling to the United States Court of Appeals, District of Columbia Circuit.¹⁴

The Court of Appeals reasoned that only Al-Harbi's claims of "manifest disregard of the law" and "evident partiality" were worthy of discussion.¹⁵ Al-Harbi based his "evident partiality" of the arbitrator argument on the fact that Feinberg's former law firm had represented his opponent, Citibank, on issues unrelated to the present dispute between Al-Harbi and Citibank.¹⁶ Al-Harbi stated that Feinberg did not reveal this information to the parties involved, and the Court found that Feinberg had no knowledge of this representation at the time of the arbitration.¹⁷ Al-Harbi asserts that Feinberg had a duty to make an inquiry as to whether or not his former firm ever had any association with either of the parties and to disclose his findings.¹⁸

The Court of Appeals affirmed the District Court's decision to deny vacatur.¹⁹ The Court of Appeals disagreed with Al-Harbi's contention that an arbitrator has a duty of investigation and found no "evident partiality".²⁰ The Court of Appeals held that unless the arbitrator is working under a special code which requires

7. *Id.*

8. *Id.*

9. *Id.* Because of their wish for a quick resolution to the problem, both sides agreed on Feinberg even though he recommended several alternative arbitrators for the sides to choose from. *Id.*

10. *Id.* This is known as the "baseball" format. *Id.*

11. *Id.* at 682. An additional modification to the arbitration was agreed to by both parties. After hearing each side's respective case, the arbitrator could choose one side's number and add or subtract \$500,000 to it. *Id.*

12. *Id.*

13. *Id.* The United States Court of Appeals for the D.C. Circuit does not mention all of the claims Al-Harbi argued to the district court, instead, it addressed only two. *Id.*

14. *Id.*

15. *Id.*

16. *Id.* Al-Harbi's claim of manifest disregard of the law was also denied by the D.C. Court of Appeals. *Id.*

17. *Id.*

18. *Id.* Al-Harbi makes this contention based on the ruling in *Schmitz v. Zilveti*. In *Schmitz*, the Ninth Circuit reversed a district court's judgment upholding an arbitration award where the arbitrator's law firm had represented one of the sides in the past. *Schmitz v. Zilveti*, 20 F.3d 1043 (9th Cir. 1994).

19. *Al-Harbi*, 85 F.3d at 683.

20. *Id.* at 682.

investigation, the arbitrator is under no duty to make an investigation to search for facts which might create an impression of possible bias.²¹

III. LEGAL BACKGROUND

In 1925 Congress passed the United States Arbitration Act (UAA), 9 U.S.C., §§ 1-14, which laid out a comprehensive plan for the arbitration of disputes falling under its umbrella.²² Section 10 allows for vacation of an arbitrator's award where there is evident partiality or corruption by the arbitrator.²³ "Evident partiality" takes a literal meaning: conduct - or at least attitude or disposition - by the arbitrator favoring one party over the other.²⁴ The provisions of the UAA show the intentions of Congress to not only provide for arbitration, but to provide for impartial arbitration.²⁵

Throughout the recent history of this country, participants in the judicial system who could show it was unknown to them that the judge in their case had a close financial relationship with the other party in the controversy would be allowed to challenge that judgment.²⁶ In *Tumey v. State of Ohio*, the Court held that a judgment should be cast aside when there is "the slightest pecuniary interest" by the judge.²⁷

In *Commonwealth Coatings Corp. v. Continental Co.*, the Court stated that in the case of the court system, the pecuniary interest of the judge and its influence on him is a constitutional issue.²⁸ The Court held that there is no basis for refusing to similarly interpret the statutory language which controls arbitration hearings and it provided that an arbitration award can be cast aside on the basis of evident partiality.²⁹

The Court felt that it was even more important to safeguard the impartiality of arbitrators as opposed to judges since arbitrators have complete freedom to decide facts and law and since arbitrators are not subject to the oversight of appellate review.³⁰ The Court found that the arbitration process will not suffer from the additional requirement that arbitrators disclose to the parties involved any dealings that might "create the impression of possible bias." Rather, it will benefit the process because arbitrators are not subject to appellate review.³¹

21. *Id.* at 682-83.

22. *Commonwealth Coatings Corp. v. Continental Co.*, 393 U.S. 145, 146 (1968).

23. *Id.* at 147.

24. *Id.* at 154 (Fortas, J., dissenting).

25. *Id.* at 147.

26. *Id.* at 148.

27. *Tumey v. Ohio*, 273 U.S. 510, 524 (1927).

28. *Commonwealth Coatings*, 393 U.S. at 148.

29. *Id.*

30. *Id.* at 149.

31. *Id.*

While not dispositive of the decision reached in *Commonwealth Coatings*, the Court used section 18 of the Rules of the American Arbitration Association³² and the 33d Canon of Judicial Ethics³³ to help shape its ruling. These two sources are based on the principle that any tribunal permitted to hear cases must be unbiased and also must avoid the appearance of bias. This principle helped the Court in *Commonwealth Coatings* to reach the decision that an arbitrator has a duty to disclose facts which might "create an impression of possible bias."³⁴

The duty owed to a party by arbitrators is similar to the duty owed by judges.³⁵ In *Commonwealth Coatings*, the Court, however, did not hold arbitrators to the same standards of decorum applicable to judges.³⁶ It is because arbitrators are often from the business realm and not the judiciary that they are successful in their positions.³⁷ Because of this, arbitrators should not be automatically disqualified by a business relationship with one of the parties before them if both parties are informed of the relationship in advance or if the parties are unaware of the facts but the relationship is trivial.³⁸ This would accomplish the automatic disqualification of the most informed and capable potential arbitrators.³⁹

In some situations, the arbitrator might reasonably believe the business relationship to be so insubstantial that revealing it would suggest that the arbitrator is easily influenced and not impartial.⁴⁰ The Court in *Commonwealth Coatings*, therefore, arrived at the notion that if the law were to ⁴¹require this disclosure no such view of bias would arise.⁴² It is preferred that relationships between the arbitrator and parties be disclosed from the beginning when the parties may reject or accept the arbitrator or accept the arbitrator with the knowledge of this

32. *Id.* Section 18. "Disclosure by Arbitrator of Disqualification - At the time of receiving his notice of appointment, the prospective Arbitrator is requested to disclose any circumstances likely to create a presumption of bias or which he believes might disqualify him as an impartial Arbitrator. Upon receipt of such information, the Tribunal Clerk shall immediately disclose it to the parties, who if willing to proceed under the circumstances disclosed, shall, in writing, so advise the Tribunal Clerk. If either party declines to waive the presumptive disqualification, the vacancy thus created shall be filed in accordance with the applicable provisions of this Rule." Section 18 the Rules of American Arbitration Association (quoted in *Commonwealth Coatings Corp. v. Continental Co.*, 393 U.S. 145, 149 (1968)).

33. "Social Relations. A judge should, however, in pending or prospective litigation before him be particularly careful to avoid such action as may reasonably tend to awaken the suspicion that his social or business relations or friendships, constitute an element in influencing his judicial conduct." 33d Canon of Judicial Ethics (quoted in *Commonwealth Coatings Corp. v. Continental Co.*, 393 U.S. 145, 149 (1968)).

34. *Commonwealth Coatings*, 393 U.S. at 147-49.

35. *See generally id.* at 147-49.

36. *See generally id.* at 150. (White, B., concurring).

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* at 151.

41. *Id.*

42. *Id.*

relationship, rather than after the arbitration⁴³ when the losing party can use this factor to attempt to invalidate the award.⁴⁴

When the arbitrator discloses such facts which might give rise to an impression of bias, the arbitrator does not have to present his whole business history.⁴⁵ It is enough that where the arbitrator has a substantial interest in a law firm which has conducted more than trivial business transactions with a party, the relationship must be disclosed.⁴⁶ When arbitrators "err on the side of disclosure," it is easy for courts to identify those undisclosed relationships which are not substantial enough to warrant the vacation of an award.⁴⁷

Instead, for a court to overturn an arbitrator's award, the moving party "must show that a reasonable person would conclude that an arbitrator was partial to the other party."⁴⁸ It is established that the mere appearance of bias will not be enough to show evident partiality.⁴⁹ Therefore, the party asserting evident partiality has the burden of proof.⁵⁰ The partiality must be "direct, definite, and capable of demonstration, rather than remote, uncertain, or speculative".⁵¹ This places a heavy burden on the party moving for vacation of the award. The moving party must also establish specific facts which indicate improper motives by the arbitrator.⁵² The policy rationale behind 9 U.S.C. § 10 supports the notion that the standard for nondisclosure cases should be different from the standard applied in actual bias cases.⁵³ In a nondisclosure case, the integrity of the process in which arbitrators are chosen is at issue.⁵⁴ In an actual bias case, the arbitrator has acted with bias when rendering a decision. Thus, if a party is able to show a "reasonable impression of partiality," this will be enough in a nondisclosure case because the policy of § 10(a)(2) instructs parties to choose arbitrators wisely.⁵⁵ The parties are able to choose their arbitrators wisely only when facts which might show potential bias are disclosed.⁵⁶

Although lack of knowledge of disclosable facts may prohibit actual bias, these facts still give a reasonable impression of partiality.⁵⁷ An arbitrator may have a duty to investigate for possible bias independent of the *Commonwealth Coatings* duty to

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.* at 151-52.

47. *Id.* at 152.

48. *Peoples Sec. Life Ins. Co. v. Monumental Life Ins. Co.*, 991 F.2d 141, 146 (4th Cir. 1993).

49. *Health Serv. Management Corp. v. Hughes*, 975 F.2d 1253, 1264 (7th Cir. 1992).

50. *Id.* at 1258.

51. *Id.* at 1264.

52. *Peoples Security*, 991 F.2d at 146.

53. *Schmitz v. Zilveti*, 20 F.3d 1043, 1047 (9th Cir. 1994).

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.* at 1048.

disclose.⁵⁸ Ignoring this duty to investigate could result in a failure to disclose which creates a reasonable impression of partiality under *Commonwealth Coatings*.⁵⁹

IV. INSTANT DECISION

The D.C. Court of Appeals reasoned that Al-Harbi's ability to show evident partiality was dependent on the proposition that the arbitrator had a duty to inquire as to whether or not his former law firm had dealings with either of the parties and a duty to disclose the results of that inquiry.⁶⁰ This court began its analysis of Al-Harbi's evident partiality claim by finding that his reliance on *Schmitz v. Zilveti* was erroneous.⁶¹ The court noted that *Schmitz* was from the Ninth Circuit and held no precedential value in this circuit.⁶² The court distinguished *Schmitz* from the present case on both the facts and the law.⁶³

In *Schmitz*, the arbitrator was running the hearing under the National Association of Securities Dealers ("NASD") code, and in the present case the NASD code did not apply.⁶⁴ The Court also found the facts to be different because in *Schmitz*, the firm the arbitrator worked for still conducted business dealings with one of the parties to the arbitration.⁶⁵ In the present case, the arbitrator had formerly worked for a firm which had represented Citibank on matters totally unrelated to the present arbitration.⁶⁶

Next, in order to determine whether a duty to investigate underlies an arbitrator's duty to disclose facts which could "create an impression of possible bias,"⁶⁷ the D.C. Court of Appeals looked to the reasoning of two cases which resulted in the same conclusion: A district court decision in their circuit, *Overseas Private Inv. Corp. v. Anaconda Co. ("OPIC")*,⁶⁸ and *Peoples Sec. Life Ins. Co. v. Monumental Life Ins. Co.*⁶⁹

58. *Id.*

59. *Id.*

60. *Al-Harbi*, 85 F.3d at 682.

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.* The NASD code requires arbitrators to make an investigation of their relationship to the parties involved to uncover any relevant information. *Id.*

65. *Id.* In *Schmitz*, the arbitrator of the proceedings worked for a law firm that had represented a subsidiary of one of the parties in nineteen cases over thirty-five years, the most recent of which occurred twenty-one months before the arbitration. *Id.*

66. *Id.* at 683. The D.C. Court of Appeals recognized that in the present case, the arbitrator's only continued connection with his former firm was an interest in receivables, none of which were generated by the parties in the present arbitration. *Id.*

67. *Commonwealth Coatings*, 393 U.S. at 149.

68. 418 F.Supp. 107 (D.D.C. 1976).

69. 991 F.2d 141 (4th Cir. 1993). The facts in *Peoples Security* are more analogous to the ones in the present case. In that case, the arbitrator worked in the New York offices of the LeBoeuf law firm. An attorney named James Nolan signed the initial complaint on behalf of one of the parties to the

In *OPIC*, the district court held that where no reasonable person could find the arbitrator "to have known any potentially prejudicial information" before rendering the decision, there was no reason to conclude the arbitrator displayed evident partiality.⁷⁰

The D.C. Court of Appeals found *Peoples Security Life Ins. Co. v. Monumental Life Ins. Co.* to be very similar on a factual basis to the present case.⁷¹ Although the Fourth Circuit did not specifically address the arbitrator's duty to disclose and its relationship with a duty of investigate, the Fourth Circuit stated that the party asserting evident partiality has the burden of proof.⁷² The Fourth Circuit went on to say that the "alleged partiality must be direct, definite, and capable of demonstration rather than remote, uncertain or speculative".⁷³

In the present case, the D.C. Court of Appeals adopts the position of the Fourth Circuit, holding that the burden on a party for vacation of an arbitration award on the grounds of evident partiality is great and that the party must establish specific facts that point to improper motives by the arbitrator.⁷⁴ Because of this high standard for vacatur, the court affirmed the district court's denial of vacating the arbitration award.⁷⁵

In a concurring opinion, Judge Silberman agreed with the majority's holding that an arbitrator has no duty to investigate past employer's client lists in an effort to find disclosable information absent such governing rules as the NASD guidelines.⁷⁶ In Judge Silberman's opinion, this would only increase the costs of the arbitration.⁷⁷ Judge Silberman disagreed with the reasoning in the present case. The absence of a duty to investigate cannot be explained by the burden of proof on the party seeking to vacate the decision.⁷⁸ Rather, Silberman believed that if there was a duty to investigate, the burden of proof could be met by showing that the arbitrator failed to make the investigation.⁷⁹

arbitration under review in *Peoples Security*. This party then had a different firm represent them. While the arbitration was going on, Nolan joined the LeBoeuf Washington offices. The arbitrator did not know Nolan personally, much less that he had joined the firm. The losing party claimed this connection caused evident partiality by the arbitrator. *Id.* at 143-45.

70. *OPIC*, 418 F.Supp. at 112.

71. *Peoples Security*, 991 F.2d at 141.

72. *Id.* at 146 (quoting *Florasmith Inc. v. Pickholz*, 750 F.2d 171, 173-74 (2nd Cir. 1984)).

73. *Id.*

74. *Al-Harbi*, 85 F.3d at 683.

75. *Id.*

76. *Id.* at 684.

77. *Id.*

78. *Id.*

79. *Id.*

V. COMMENT

The D.C. Circuit Court in *Al-Harbi v. Citibank*⁸⁰ had two paths it could follow when determining if there was a duty to investigate. One path was expressed by the Ninth Circuit in *Schmitz* when it stated that there is evident partiality when undisclosed facts show "a reasonable impression of partiality."⁸¹ In such cases "actual partiality of the arbitrator is not required."⁸² Thus, although the arbitrator had no present knowledge of information, the duty to investigate would result in acquiring this knowledge and making it available for disclosure.

The D.C. Circuit could also choose the approach laid out by the Fourth Circuit in *Peoples Security*. In the Fourth Circuit, evident partiality is shown by establishing "specific facts that indicate improper motives" by the arbitrator.⁸³ Accordingly, the rationale is that a duty to investigate is not necessary because there is a heavy burden placed on the moving party to show improper motives on the part of the arbitrator.⁸⁴ If the arbitrator had no present knowledge of "bias" but had to investigate to gain this knowledge, there could be no improper motive displayed by the arbitrator.⁸⁵

In comparing these two approaches, it is best to look to the purposes behind the Federal Arbitration Act (FAA) and *Commonwealth Coatings*'s decision. In the FAA, Congress desired to create impartial arbitrations.⁸⁶ In *Commonwealth Coatings*, the Court found the duty of disclosure necessary to avoid even the appearance of bias in arbitration.⁸⁷ The Ninth Circuit's approach in *Schmitz* appears on its face to best achieve these purposes.

Under *Schmitz*, it is only necessary to show a reasonable impression of impartiality.⁸⁸ The court held that an arbitrator ignoring a duty to investigate could possibly lead to a failure to disclose which would create a reasonable impression of partiality.⁸⁹ By not investigating former clients, present firm's clients, former firm's clients, and the two parties' associations to these people; an arbitrator may not find hidden ties that would create an impression of bias because the relations would not be disclosed, even if nominal. This duty to investigate, however, would increase the cost of arbitration⁹⁰ and the time involved to hold the arbitration.

This approach is consistent with the ideas behind the *Commonwealth Coatings*'s duty to disclose, plus it adds the additional duty to investigate requirement which increases the burden on the arbitrator and the parties involved.

80. *Al-Harbi*, 85 F.3d 680.

81. *Schmitz*, 20 F.3d at 1046.

82. *Id.*

83. *Peoples Security*, 991 F.2d at 146.

84. *Id.*

85. See *Al-Harbi*, 85 F.3d at 683.

86. *Commonwealth Coatings*, 393 U.S. at 147.

87. *Id.* at 150.

88. *Schmitz*, 20 F.3d at 1048.

89. *Id.*

90. *Al-Harbi*, 85 F.3d at 684.

On its face, the *Peoples Security* approach of "direct and definite" partiality rather than the "remote and speculative" test of *Schmitz*⁹¹ does not seem to be in line with the *Commonwealth Coating's* decision or the FAA. A closer look, however, reveals that the "direct and definite" test for evident partiality takes a common sense approach and works just as well without adding additional time or cost to the arbitration. With the *Commonwealth Coating's* ruling, an arbitrator has a duty to disclose any facts which create an impression of bias.⁹² If an arbitrator or the arbitrator's firm has had dealings with either of the two parties and knows at the present time of this association, then the arbitrator must disclose these facts or be in violation of the *Commonwealth Coating's* duty.⁹³ If an arbitrator were to fail to disclose facts of which he or she was aware before arbitration, this would appear to be an improper motive under the *Peoples Security* test for evident partiality.⁹⁴

Under the Fourth Circuit approach where no duty to investigate exists, when an arbitrator that has no knowledge of any "bias" facts and doesn't disclose them because they are either so attenuated the arbitrator cannot know of them without investigation or because they have not happened at the beginning of the arbitration, common sense dictates that there can be no bias by the arbitrator because if an arbitrator has no knowledge of "bias" facts without investigation, how can the arbitrator be biased by them? Similarly, if events that look like bias do not happen until after the arbitration, the arbitration has not been affected. Using the Ninth Circuit's approach would allow a court to find a "reasonable impression of partiality"⁹⁵ in these two scenarios when in fact it did not exist.

Following the Ninth Circuit approach would not give the public more trust and confidence in the arbitration system, as the policy behind the FAA and *Commonwealth Coating's* holding seems to promote. Instead, because there was no real partiality displayed on the part of the arbitrator without a duty to investigate, the public will view the losing party to an arbitration as "clutching at straws in an attempt to avoid the results" of an unfavorable decision.⁹⁶ In turn, this will cause the public to lose confidence in binding arbitration because a decision may be overturned on evident partiality grounds if the duty to investigate is not performed⁹⁷ or is not performed satisfactorily. In addition, the increased costs⁹⁸ incurred by the arbitrator in making these investigations will be reflected in the cost of the arbitration to the two parties involved. Also, another advantage of arbitration, faster resolution of disputes, will suffer a blow. Undoubtedly, much time will be added to the arbitration process while the arbitrator searches through countless personal client

91. *Id.* at 683.

92. *Commonwealth Coatings*, 393 U.S. at 149.

93. *Id.*

94. See *Peoples Security*, 991 F.2d at 146.

95. *Schmitz*, 20 F.3d at 1048.

96. *Commonwealth Coatings*, 393 U.S. at 153 (Fortas, J., dissenting).

97. *Schmitz*, 20 F.3d at 1048.

98. *Al-Harbi*, 85 F.3d at 684.

lists, client lists of present and former firms, plus the backgrounds of the two parties to the arbitration in search of any possible grounds for an evident partiality claim.

VI. CONCLUSION

In choosing to follow the common sense approach of the Fourth Circuit, the D.C. Circuit developed a test which serves two purposes: (1) keeping arbitrations impartial and (2) reinforcing the public's faith in the arbitration process. At the same time, the test does not add any unnecessary costs or burdens to the arbitrator, the parties involved, or the arbitration proceeding itself.

R. TRAVIS JACOBS