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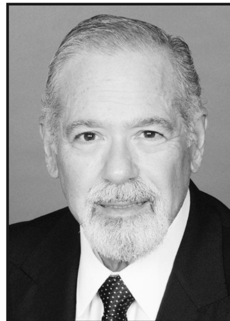
SELECTING PARTY ARBITRATORS


Richard Chernick

It is common in U.S. based commercial arbitrations with tripartite panels that the parties each select one arbitrator and the selected arbitrators then choose a third. The typical clause in an arbitration agreement might provide: "Each party shall select an arbitrator and they shall select the third [or the chair]." This is obviously an important step in the process, and it is fraught with risks and ethical land mines.[1]

Determining the Status of the Party Arbitrators. The first issue one confronts when reading such a clause is whether the parties intended the party arbitrators to be neutral or non-neutral.[2] Arbitration clauses rarely express clearly the

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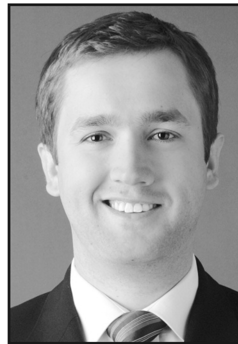
DURAN, DUE PROCESS, AND THE CLASS ACTION DEVICE


Blaine H. Evanson

On May 29, 2014, the California Supreme Court in *Duran v. U.S. Bank National Association*, No. S200923, unanimously affirmed the reversal of a classwide judgment for plaintiffs in a wage-and-hour misclassification class action that was tried based on an assessment of a statistical sample of class members. *Duran* represents a significant victory for class action defendants in California, as it unanimously rejected as inconsistent with due process and California law attempts by class action plaintiffs to use statistical sampling and other procedural shortcuts to deprive defendants of an opportunity to present individualized defenses. In rejecting use of "the class action procedural device ... to abridge a party's substantive rights," *Duran* brings California class action law closer in line with federal law and recognizes that due process principles reflected in federal class action procedural rules have important implications for similar state procedure.

Brandon J. Stoker

Due Process Principles Imbued in Federal Class Action Procedures

Federal class certification law has undergone dramatic transformation in recent years. The Supreme Court's decision in *Wal-Mart Stores, Inc. v. Dukes* introduced a mandate to engage in "rigorous analysis" during class certification to ensure that a plaintiff "seeking class certification [has] affirmatively demonstrate[d] his compliance" with Rule 23. 131 S. Ct. 2541, 2551 (2011). *Dukes* also condemned "Trial by Formula"—a procedure whereby liability would be determined based on an assessment of the claims of a sample of the class,

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Selecting Party Arbitrators…continued from Page 1

intent of the drafters, and parol evidence is usually unavailable or unhelpful. The rules of arbitral institutions ease this likely ambiguity in clause drafting by providing that unless there is a clearly expressed intent that the party arbitrators are to be non-neutral, they are presumed to be neutral. AAA Commercial Arbitration Rules R-13, R-18, JAMS Comprehensive Arbitration Rules and Procedures, Rule 7(c).[3] One clue in some clauses is a reference to the chair as the "umpire," which is an indication that the party arbitrators are intended to be non-neutral. Reference to the chair as the "neutral arbitrator" would carry the same implication.

When a party arbitrator is first contacted it is expected that counsel will discuss with the candidate his or her status; counsel will often consult with the client on this subject and sometimes with the other side. If there is a consensus, the neutrality or non-neutrality can be determined at that point; if there is disagreement, the practice is for both sides to proceed as if the party arbitrators are neutral until the panel or the arbitral institution is able to resolve the issue. Code of Ethics, Canon IX.

Communications with party arbitrators at this stage of the proceedings are conducted *ex parte*, as allowed by the Code of Ethics, Canon IX. Parties are free to discuss with the candidate his or her experience, suitability to serve, availability, possible disclosures, fee requirements and general knowledge of the subject matter of the dispute or the industry or the technology or the area of law involved. They may also discuss the selection of the chair and the names and qualifications of possible candidates for chair. They may not discuss the substance of the issues in dispute or the candidate's views about any disputed issue of fact or law. Code of Ethics, Canon III.

These discussions usually occur by telephone but can be conducted in person. They are usually only between outside counsel and the candidate, but a party representative will sometimes participate. Some arbitrators will not meet in person for this interview process, some will not meet with a party and some put strict time limits on the interview process in order to control the scope of the discussion. On occasion, a candidate will express a preference for a joint interview with both sides present or will make a recording of the meeting in order to document what was discussed.[4]

The Disclosure Process. Party arbitrators, whatever their status, are required to make disclosures to the parties once the appointment has been made. A party may disqualify a neutral party arbitrator based on these disclosures but may not seek to disqualify a non-neutral party arbitrator. The disclosures a non-neutral party arbitrator makes are informational only, primarily for the benefit of the chair and the other participants.

The College of Commercial Arbitrators' *Guide to Best Practices in Commercial Arbitration* says the following about disclosures:

Generally, an impartial arbitrator is one who is open-minded and neither biased in favor of nor prejudiced against a particular party or its case. An independent arbitrator is one who has no close financial, personal, or professional relationship with a party and will not profit from the arbitration's resolution. *See generally*, International Bar Association (IBA) Rules of Ethics for International Arbitrators, Art. 3(1) (1987). Although codes and statutes such as the revised AAA/ABA Code and the RUAA do not clearly delineate the differences between these concepts, they do identify the general factors that neutral arbitrators should consider in determining whether they are impartial and independent. Both the AAA/ABA Code and the RUAA emphasize that in making such determinations, arbitrators should consider any financial or personal interest in the

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[1] JAMS recommends the following:

Within 15 days after the commencement of arbitration, each party shall select one person to act as arbitrator, and the two so selected shall select a third arbitrator within 30 days of the commencement of the arbitration. If the arbitrators selected by the parties are unable or fail to agree upon the third arbitrator within the allotted time, the third arbitrator shall be appointed by JAMS in accordance with its rules. All arbitrators shall serve as neutral, independent and impartial arbitrators.

Alternately, to avoid the party arbitrators knowing who appointed them, the clause might provide:

Each party shall communicate its choice of a party-appointed arbitrator only to the JAMS Case Manager in charge of the filing. Neither party is to inform any of the arbitrators which of the parties may have appointed them.
See also JAMS International Rules Model Clause and Submission Agreement.

[2] These are the terms used by the Code of Ethics for Arbitrators in Commercial Disputes (AAA/ABA Code, 2003) ("Code of Ethics") which sets out the generally accepted standards of ethical conduct for commercial arbitrators, including standards relating to appointment, disclosure, and disqualification of arbitrators. The Code also addresses the procedure the parties must follow in communicating with candidates for appointment as party arbitrators and ascertaining whether the party arbitrators will be neutral or non-neutral. Code of Ethics, Canon III.B(4).

[3] In international practice, the party arbitrators are always neutral and independent of the parties who appointed them. *See*, e.g., *IBA Guidelines on Conflicts of Interest in International Arbitration*, Part I (1) General Principles; *IBA Rules of Ethics for International Arbitrators*, Rule 1.

[4] It is not inappropriate to reimburse a candidate for actual travel costs to attend an interview; it is less clear whether the candidate may be reimbursed for his or her time.

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outcome of the arbitration and any past or existing relationship with any of the parties, their lawyers, witnesses, or the other arbitrators. See *Code of Ethics*, Canon II(A); RUAA §§ 11(b), 12(a).

Guide to Best Practices in Commercial Arbitration at 9-10 (3d Ed.).

Selecting a Party Arbitrator. The value of a party-selected arbitrator, whether neutral or non-neutral, is that the party may unilaterally appoint someone with expertise in the subject matter of the dispute or special knowledge of the industry or the technology involved, or special expertise in an area of the law or with the arbitration process. Non-neutral party arbitrators are likely to have some additional or more direct connection with the subject matter of the dispute or special knowledge of the parties or the industry. Industries that continue to use non-neutral arbitrators routinely, such as insurance or maritime, routinely appoint arbitrators based on their industry or subject matter experience and their familiarity with the arbitration process.

The agreement to use party arbitrators usually directs the process for selecting the chair. It is most common for the party arbitrators to select the chair, with or without the participation of the parties. Usually party arbitrators consult with the parties who appointed them about the suitability of candidates for that position. *See* Code of Ethics, Canon III.B(2). This process is rarely defined in the arbitration clause other than to say that "the party arbitrators shall select the chair." *See* n.1, *supra*. Some party arbitrators believe that such language gives them the discretion to make a selection without consulting the party, and certainly without the party exercising actual control over the selection process. Most party arbitrators regard the process as a collaborative one. Some party arbitrators regard themselves as mere intermediaries for the party that appointed them. This issue is usually addressed as part of the process of interviewing and selecting the party arbitrator.

The delicate balance between the concept of neutrality and the role of the neutral party arbitrator requires that the neutral arbitrator candidate be familiar with the selection process and be comfortable with the limits of *ex parte* communications prior to the appointment of the panel and thereafter proceeding as a fully independent arbitrator. Chairs of tripartite arbitrations are sensitive to the possibility that a neutral party arbitrator sometimes does not completely embrace the concept of neutrality. In that circumstance, it is likely that the chair will discount the input of the "neutral" arbitrator; were that to occur, the party who appointed that arbitrator might be adversely affected. Thus, it is important to select a neutral arbitrator who understands and is capable of fulfilling that unique role.

Compensating Party Arbitrators. Arbitrators are free to set the terms of their professional services.[5] Rates and terms of compensation vary considerably among arbitrators. Typically arbitrators also require reimbursement for reasonable and necessary travel expenses (and sometimes travel time). Some arbitrators also charge a cancellation fee when a hearing is continued or cancelled within a prescribed period prior to the hearing and where those days cannot be rebooked by the arbitrator. These arrangements should be disclosed and agreed upon prior to appointment where the parties are dealing directly with the arbitrator or through the institution in administered cases.[6] (It is common for arbitral institution to require disclosure of the terms of arbitrators' compensation in cases they administer.) Usually arrangements are also made for advance deposit of fees and expenses.

Neutral party arbitrators are most often paid through the administering institution although the parties can agree to direct billing and payment as an exception to the "no *ex parte* contact" rule. Non-neutral party arbitrators are most commonly paid directly by the party who appointed them.

Ethical Conduct of the Non-Neutral Party Arbitrator. Non-neutral arbitrators have the same obligation as the neutral arbitrator to provide the parties with a fundamentally fair hearing. Thus, although non-neutral arbitrators may be "predisposed" to the side that appointed them, they must act fairly to both sides. Code of Ethics, Canon X. For example, the non-neutral arbitrator should not interfere with an orderly arbitration process or with the presentation of a party's case and should refrain from conducting "cross-examination" of the other side's witnesses, as distinguished from asking questions that were not answered in a witness' testimony.

The Unique Role of Non-Neutral Party Arbitrators. In addition to the functions performed by neutral party arbitrators, non-neutral party arbitrators are often expected to communicate *ex parte* with their parties prior to the hearing on such issues as how to effectively frame the issues, legal theories, presentation of witnesses and other evidence and appropriate expert testimony. The non-neutral party arbitrator

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[5] Many international arbitral institutions set the compensation of arbitrators without regard to their customary rates of compensation, such as the International Chamber of Commerce and the Japan Commercial Arbitration Association. All domestic providers permit arbitrators to set their own terms of compensation.

[6] Absent extraordinary circumstances, arbitrators should not request increases in the basis of their compensation during the course of a proceeding. Code of Ethics, Canon VII.B(3).

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certified for class treatment under state law. At a minimum, the class action device may not be used to abridge a party's right to litigate individualized defenses. Although the Court indicated that "[d]efenses that raise individual questions about the calculation of *damages* generally do not defeat certification," it emphasized that "a defense in which *liability itself* is predicated on factual questions specific to individual claimants" poses significant manageability challenges that could preclude class certification. *Id*. at 25.

The Court eschewed "a sweeping conclusion as to whether or when sampling should be available as a tool for proving liability" (slip op. at 38), but warned that "[s]tatistical methods cannot entirely substitute for common proof" and emphasized that a "plan for managing individual issues"—including defenses to liability—"must be conducted with sufficient rigor" and should be satisfactorily proven before a class is certified for class treatment. *Id*. at 27. As a practical matter, *Duran* suggests that flawed statistical methods will rarely be sufficient to establish liability.

Duran is a big win for defendants, as it ensures many of the same procedural protections guaranteed by Federal Rule 23 will be available in California state class actions as well. What remains to be seen is whether other federal standards for class certification—including the "rigorous analysis" standard and robust requirements for proving that class claims are susceptible to common proof after *Dukes* and *Comcast*—are likewise incorporated as state procedural law, given that they too are animated by constitutional principles of due process.

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might be asked by the party to assess the tactics which will be most persuasive to the chair. (The process of chair selection thus may involve consideration of the likely rapport the party arbitrator will have with the chair.)[7] Any agreement as to *ex parte* communications beyond the first preliminary conference should be documented in the first scheduling order.

Non-neutral arbitrators should never disclose to a party or counsel the substance of any deliberations of the panel. Code of Ethics, Canon X. In *Northwestern National Insurance Company v. Insco, Ltd.* 2011 USDist LEXIS 113626 (SDNY 2011), the court determined it lacked power to remove party-appointed arbitrator but disqualified the attorney who had received and concealed communications from the arbitrator who had disclosed panel deliberations.

Generally, non-neutral party arbitrators are not subject to disqualification (Code of Ethics, Canon X.B), but there are some limits on who is eligible to serve. They often have specific industry knowledge or familiarity with the subject matter of the dispute (factual or legal). They often also have some relationship with the party or counsel. A potential financial interest in the dispute would cause most courts to question a non-neutral arbitrator's ability to ensure a fair hearing. In *Aetna Casualty & Surety Co. v. Grabbert*, 590 A.2d 88, 92 (R.I. 1991), the court found that a contingent fee arrangement between a non-neutral party-appointed arbitrator and the party appointing him was "absolutely improper," but the court denied *vacatur* of the award because it was unanimous.[8] Non-neutral arbitrators who are potential witnesses or partners of counsel or have a present business relationship with a party have also been challenged.[9]

Conclusion. Parties have embraced the party arbitrator process. The ethical pitfalls are easily avoided, and the value of being able to make one appointment unilaterally is unmistakable. Knowing the applicable rules enables counsel to benefit by the selection of a panel of arbitrators well-suited to hear that particular case.

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[7] *See Employer's Insurance of Wausau v. National Union Fire Ins. Co.*, 933 F.2d 1481 (9th Cir. 1991) (rejected a challenge to an award where a non-neutral arbitrator had performed consulting services with counsel on the issues in dispute and ex parte communications had occurred throughout the matter by both party-appointed arbitrators); *Sunkist Soft Drinks, Inc. v. Sunkist Growers*, Inc.,10 F.3d 753 (11th Cir. 1993) (pre- and post- appointment communications between party and party-appointed arbitrator are consistent with the commonplace predisposition of party-appointed non-neutral arbitrators toward the party appointing them and with prevailing ethical rules); *Sphere Drake Ins. Ltd. v. All American Life Ins. Co.*, 307 F.3d 617, 622 (7th Cir. 2002) (rejecting challenge to non-neutral arbitrator who arguably provided incomplete disclosure regarding past representation of a party); *Delta Mine Holding Co. v. AFC Coal Props.*, 280 F.3d 815, 822 (8th Cir. 2001) (when parties have agreed to non-neutral party-appointed arbitrators, the award should not be vacated "unless the objecting party proves that the party arbitrator's partiality prejudicially affected the award").

[8] *See* Alan Scott Rau, *Integrity in Private Judging*, 38 S. TEX. L. REV. 485, 497-514 (1997).

[9] *Metropolitan District Commission v. Connecticut Resources Recovery Authority*, 130 Conn.App. 130, 142, 22 A.3d 651 (2011); *Barcon Associates, Inc. v. Tri-County Asphalt Corp.*, 86 N.J. 179, 430 A.2d 214 (1981) (substantial and ongoing business relationships, including services rendered during the arbitration); *Borst v. Allstate Insurance Company*, 291 Wis.2d 361,