Pre-Hearing Removal of Arbitrators

Due to Failure to Meet Contractual Qualification Requirements

By

Robert M. Hall

Mr. Hall is an attorney, a former law firm partner, a former insurance and reinsurance executive and acts as an insurance consultant as well as an arbitrator of insurance and reinsurance disputes and as an expert witness. He is a veteran of over175 arbitration panels and is certified as an arbitrator and umpire by ARIAS - US. The views expressed in this article are those of the author and do not reflect the views of his clients. *Mr. Hall has authored over 100 articles and they may be viewed at his website: robertmhall.com.*

I. Introduction

While arbitration was intended to produce a more rapid resolution of disputes, it is increasingly common to take a year of more of intense negotiation to complete a three-member panel. In some cases, this results from disputes over whether or not party arbitrators or umpire candidates meet the requirements of the arbitration clause such as: (1) disinterested party; (2) current or former senior officer of an insurer or reinsurer; or (3) experience in a specified line of business.

Clearly, the party raising the objection to an arbitrator wishes to resolve such issues before the arbitration rather than raise them after the fact and if successful, start the arbitration process over again. Some might speculate that the opposing party could purposely select individuals questionably qualified under the arbitration clause criteria in order to generate disputes that delay a final resolution as long as humanly possible. Whatever the motives of the parties, the recent case *John Hancock Life Ins. Co. v. Emplrs. Reassurance Corp.*, 2016 U.S. Dist. LEXIS 80592 (D. Mass.) was an emphatic ruling that the qualifications of an arbitrator under the arbitration clause cannot be challenged until after the arbitration is complete. The purpose of this article is to explore selected case law on point.

II. Case Law Which Prohibits Removal

In *John Hancock Life Ins. Co. v Emplrs. Reassurance Corp., supra,* the reinsurer appointed as its party arbitrator an individual who worked for an insurer that became affiliated with the cedent after the party arbitrator had moved on. In addition, that insurer was no longer affiliated with the cedent. The arbitration clause prohibited current or former employees of either party or affiliates or subsidiaries thereof. The cedent asked the court to prohibit the reinsurer from using as a party arbitrator the former employee of the cedent's former affiliate. The court stated the cedent's argument as follows:

> [Cedent's] request for removal is premised upon [the cedent's] contention that the FAA grants courts a limited authority to remove party-appointed arbitrators prior to the issuance of the arbitration award. [Cedent] acknowledges that there is a general rule

> baring judicial removal of party-appointed arbitrators prior to the conclusion of the arbitration. [Cedent] argues, however, that the prohibition on judicial intervention is limited to pre-award challenges regarding the bias of arbitrators. In [cedent's] view, there is an exception permitting pre-award judicial removal of an arbitrator where removal is based upon "[the] arbitrator's failure to meet the criteria specified in the arbitration agreement."[1]

The court found no basis for such an exception in the language of the Federal Arbitration Act and then considered the cedent's policy arguments:

> In the absence of statutory language supporting the alleged distinction between bias-based challenges and qualifications-based challenges, cedent relies upon policy arguing that "addressing the threshold issue of [] [the arbitrator's] eligibility at this juncture promotes the goals of speed and efficiency that arbitrations and the FAA are supposed to foster." The policy aims of the FAA, however, neither support pre-award judicial interference into arbitrator appointments as a general matter nor support creating a separate rule based upon the nature of the challenge to the arbitrator. In interpreting the FAA, courts can draw critical guidance from the fact that "Congress' clear intent [with the FAA was] to move the parties to an arbitral disputes out of court and into arbitration as quickly and as easily as possible."[2]

With respect to case law, the *John Hancock* court stated: "This Court agrees with the reasoning of the Fifth Circuit, Second Circuit and multiple district courts that have rejected the argument that courts have jurisdiction to remove an arbitrator pre-award simply because the challenge is the arbitrator invokes a qualification set out in the arbitration agreement."[3]

One of the cases relied upon by the *John Hancock* court was *Aviall, Inc. v. Ryder Sys.*, 110 F.3d 892 (2nd Cir. 1997). In this case, the parent spun off a subsidiary and in an agreement dealing with pension-related assets, the parent and subsidiary agreed to arbitration before KPMG which was the outside auditor for both parent and subsidiary before the spin off but only for the parent thereafter. KPMG declined a request to withdraw from the arbitration based on its relationship with the parent.

The *Aviall* court regarded it as settled law that a party cannot attack the qualifications or partiality of an arbitrator until after the award. Moreover, the subsidiary was aware of KMG's relationship with the parent at the time the relevant agreement was executed as well as the possibility that the subsidiary would not have such a relationship in the future. Finally, the fact that KPMG supplied some assistance to the parent during the early stages of the arbitration does not supersede the lack of authority of a court to remove an arbitrator prior to the arbitration award.

Another case relied upon by the *John Hancock* court is *Gulf Guar. Life Ins. Co. v. Conn. Gen. Life Ins. Co.*, 304 F.3d 476 (5th Cir. 2002). The arbitration clause at issue required an executive of a life insurance company but the arbitrator appointed by the cedent was an executive of a reinsurance

company. The reinsurer challenged this appointment and the district court upheld the challenge. On appeal, the court of appeals reversed citing extensively to *Aviall, supra,* to the effect that there is no authority under the FAA to remove an arbitrator prior to the arbitration award. The court also cited favorably a district court case[4] in which the court observed that the courts injecting themselves into the arbitrator selection process would result in endless delays in a process designed to be expeditious. The court of appeals observed:

> We agree with this assessment by that district court of the danger prior to issuance of an arbitral award in allowing courts to adjudicate a challenge such as that made by the [reinsurer] to [the arbitrator's] qualifications to serve, based on whether [the arbitrator] is the executive of a reinsurer or an insurer pursuant to the terms of the arbitration agreement. We conclude, therefore, that the dispute regarding [the arbitrator's] qualification to serve, although framed as a request to the court to enforce the arbitration agreement by its terms, is not the type of challenge that the district court was authorized to adjudicate pursuant to the FAA prior to issuance of an arbitral award.[5]

The sale of a business provided the backdrop for *Smith v. American Arbitration Ass'n,* 233 F.3d 502 (7th Cir. 2000). Pursuant to an arbitration clause, the buyer filed an action with the American Arbitration Association that provided a list of 15 potential arbitrators that included 14 men and one woman for strikes and ranking. The one woman was one of the people struck by the seller. The buyer filed an action for breach of contract against the seller and the AAA for failure to ensure gender diversity and sought to preliminarily enjoin the arbitration. The court dismissed these claims stating:

> So viewed, however, [the buyer's] claim against [the seller] is premature. The time to challenge an arbitration, on whatever grounds, including bias, is when the arbitration is completed and an award rendered. To allow a party to bring an independent suit to enjoin the arbitration is inconsistent with fundamental procedural principles that apply with even greater force to an arbitration than to conventional litigation.[6]

In *Trustmark Ins. Co. v. Clarendon Nat'l Ins. Co.*, 2010 U.S. Dist. LEXIS 8078 (N.D. Ill.) the cedent objected to the reinsurer's party arbitrator on the basis that she was not "disinterested" as required by the arbitration clause. (The basis for this allegation is not evident from the opinion.) The court dismissed this action following *Smith, supra.*

In *Insurance Co. of N. Am. v. Pennant Ins. Co.,* 1998 U.S. Dist. LEXIS 2466 (E.D. Pa), the cedent challenged the qualifications of the reinsurer's party arbitrator arguing that he had never been a senior officer of an insurer or reinsurer. The court dismissed the action following *Aviall, supra*, observing that a pre-hearing determination of arbitrator qualifications "could have the advantage of preventing a needless expenditure of time and money if the arbitrator is indeed unqualified. Nevertheless, such a determination could have the disadvantage of enmeshing district courts in endless peripheral litigation and ultimately vitiate the very purpose for which arbitration was created."[7]

III. Case Law Which Allows Removal

The arbitration clause in *B/E Aero, Inc. v. Jet Aviation St. Louis, Inc.* 2001 U.S. Dist. LEXIS 73621 (S.D. N.Y.) required the arbitrators be business people knowledgeable in the aircraft industry. One party challenged the arbitrator appointed by the other party as well as the neutral appointed by the AAA for failure to meet these qualifications. While acknowledging *Aviall, supra,* as the general rule in the second circuit, the court analogized this instant situation to a failure of the parties to proceed with arbitration pursuant to § 4 of the FAA due to a disagreement over the operation of the arbitration clause. On this basis, the court considered the qualifications of the party arbitrator and neutral and found them to meet the requirement of the arbitration clause.

Jefferson-Pilot Ins. Co. v. Leafre Reinsurance Co., 2000 U.S. Dist. LEXIS (N.D. Ill.) involved an arbitration clause in a treaty that required that arbitrators be current or former officers of life or health insurers with experience in reinsurance. The AAA offered a list of possible arbitrators and the cedent rejected all of them. The AAA appointed three arbitrators from this list and the cedent objected that none of them were current or former officers of life or health insurers. The cedent asked that the arbitration with the AAA-appointed arbitrators be enjoined and to order that a new panel be appointed that complied with the arbitration clause. At issue in this case was the reinsurer's motion to dismiss.

The *Jefferson-Pilot* court acknowledged the general rule that allegations of arbitrator bias cannot be addressed until after the hearing. However, the court denied the motion to dismiss treating the issue as one of enforcing the contract:

> The question is whether a party who challenges the arbitrator's qualifications - -just like a party who challenges bias - - must wait until the post award stage to complain. I do not think that this is necessary. Here, [the cedent] does not ask this court to undertake the difficult task of determining whether an arbitrator is impermissibly biased. [The cedent] merely asks that he (sic) be entitled to a benefit explicitly conferred by a provision of an agreement negotiated . . . between two sophisticated parties. The Federal Arbitration Act clearly states that contractual provisions for the appointment of an arbitrator "shall be followed."[8]

Oakland-Macomb Interceptor Drain Dist. v. Ric-Man Constr., Inc., 304 Mich. App. 46 (Ct.App. Mich. 2014) involved a construction contract with very specific arbitration procedures and criteria for arbitrators. When a dispute arose, the parties could not agree on a panel and the AAA selected an arbitration panel to which the plaintiff in this matter objected. The plaintiff filed suit against the counter party and the AAA to enforce the arbitration clause. The court characterized that status of case law as follows:

> Other courts that have looked at this narrow, but important, issue have made the following distinction, which informs our analysis: Courts will not entertain suits to

> address preaward (sic) general objections to the impartiality or expertise of an arbitrator but when suit is brought, as here, to enforce the key provisions of the agreement to arbitrate – *i.e.* when the criteria and method for choosing arbitrators are at the heart of the arbitration agreement – then courts will enforce these contractual mandates. To rule otherwise would essentially rewrite the parties' contract and rob the objecting party of this key contractual right to have a panel with the specialized qualifications necessary to make an informed arbitral ruling – which goes to the precise purpose and reason to arbitrate such technically and legally complex claims.[9]

The court went on to uphold the plaintiff's challenge holding:

> Accordingly a party may petition a court for relief before an arbitral award has been made if (1) the arbitration agreement explicitly specifies detailed qualifications the arbitrator must possess, and (2) the third-party administrator fails to appoint an arbitrator that meets these specified qualifications. Therefore, a court may issue an "order, pursuant to § 4 of the FAA, requiring that the arbitration proceeding conform to the terms of the arbitration agreement entered into by the parties."[10]

IV. Comments

Clearly, the majority rule is that there is no authority under the Federal Arbitration Act to remove an arbitrator on a qualifications basis prior to the conclusion of the arbitration. The minority rule is that arbitrator qualification criteria can be enforced under the FAA as part the courts' authority to enforce arbitration agreements.

It is discouraging that under the majority rule, arbitrator qualifications contained in an arbitration clause are unenforceable until after the arbitration is complete. This provides considerable advantage to those who would disregard these contractual requirements or would use the threat of disregarding them as a means of delay or as leverage in negotiations over panel composition. Perhaps using the example of *Oakland-Macomb Interceptor Drain Dist. v. Ric-Man Constr., Inc., supra,* a remedy might be to make contractually the arbitration clause and the arbitrator qualifications therein a critical part of the contract for the courts to enforce.

ENDNOTES

1 2016 U.S. Dist. LEXIS (D. Mass.) *8 (internal citations omitted).
2 *Id.* *16 (internal citations omitted).
3 *Id.* *13 – 14.
4 *Rich & Co. v. Transmarine Seaways Corp.* 443 F. Supp. 386 (S.D.N.Y. 1995).
5 304 F.3d 476 at 492.
6 233 F. 3d 502 (7th Cir. 2000) (internal citations omitted).
7 1998 U.S. Dist. Lexis 2456 *5.

[8] 2000 U.S. Dist. LEXIS 22645 *5-6.

[9] 304 Mich. App. 46 at 48.

[10] *Id.* at 57-8 (emphasis in the original).