Lifting the Veil on Arbitration Proceedings

Who's Your Counsel: Disqualification of Counsel by Courts

In the Spring 2016 issue of AIRROC Matters, we featured Part 1 of a multipart arbitration series by Michael Goldstein and Dan Endick titled, "When Courts Peek Under the Arbitral Veil: the Role of the Courts in Managing Your Reinsurance Arbitration". The following article is Part 2, "Who's Your Counsel." The final article in the series – Part 3 – will appear in a subsequent issue of AM, titled, "Who's Your Arbitrator."

Much less common, but noteworthy nonetheless, are decisions resulting in disqualification of arbitration counsel mid-arbitration. Similar to disqualification motions for arbitrators, the typical motion concerns possible conflicts of interest or inappropriate communications with the panel. Different from arbitrator disqualification, however, is the fact that courts have expressly stated that arbitration panels are not empowered to decide issues concerning attorney disqualification.

For instance, in *Munich Reinsurance Am., Inc. v. ACE Prop. & Cas. Ins. Co.*, the court was presented with the issue of whether disqualification of an attorney was a matter for the arbitration panel or the court. *Munich Reinsurance Am., Inc. v. ACE Prop. & Cas. Ins. Co.*, 500 F. Supp. 2d 272, 274 (S.D.N.Y. 2007). There, a formal demand for arbitration was issued in January 2006. The respective party-arbitrators were selected in September 2006, but the parties were unable to agree on an umpire. *Id.* at 273. During a dispute as to how to select the umpire, ACE demanded that Saul Ewing, counsel for Munich, withdraw as counsel. *Id.* ACE argued that Saul Ewing had represented ACE in a prior matter and had potentially prejudicial information. *Id.* ACE filed a motion

to disqualify Saul Ewing as counsel for Munich in the Pennsylvania Court of Common Pleas and Munich filed a petition for the appointment of an umpire pursuant to the agreement in the Southern District of New York. *Id.*

The Southern District of New York denied the petition for appointment of an umpire, holding that it would not appoint an umpire while a disqualification motion was pending before the Pennsylvania Court of Common Pleas. Id. at 275. Critical to the Southern District's analysis was the question of whether the disqualification could simply be decided in the arbitration once an umpire had been appointed, as Munich contended. The Southern District disagreed, reasoning that, while arbitration is a favored form of dispute resolution, the scope of review that is permitted to arbitrators is limited to matters that the parties intended to arbitrate. Id. at 274. The court thus concluded that: "disqualification of an attorney for an alleged conflict of interest, is a substantive matter for the courts and not arbitrators." Id. at 275. Therefore, the court held that the disqualification motion was properly before the Pennsylvania Court of Common Pleas, meaning that appointment of an umpire by the court while such motion was pending would not be appropriate. Accordingly, the Southern District denied Munich's petition and dismissed the action.

The facts of *Munich* were very straightforward. There was simply a claim that the attorney representing an adverse party had confidential information by virtue of having previously represented the moving party, and therefore should be disqualified under ordinary conflict of interest rules. While the ruling in *Munich* seems straightforward, another case arose in the Southern District of New York where a court was asked to review actions by a law firm that did not trigger conflict of interest rules. Instead, the claim was that a law firm should be disqualified for violating arbitration and legal ethics rules.

In *Northwestern National Insurance Co. v. Insco, Ltd.*, a unique dispute arose as to the ethical behavior of counsel representing Insco, as well as the ethical behavior of a party arbitrator. *Nw. Nat. Ins. Co. v. Insco, Ltd.*, No. 11 CIV. 1124 SAS, 2011 WL 4552997, at *1 (S.D.N.Y. Oct. 3, 2011). This decision provided one of the more explicit, if not salacious, peeks behind the curtain of confidential arbitration proceedings ever published in public court filings and decisions. Northwestern commenced arbitration against Insco for amounts owed under a reinsurance agreement. *Id.*

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Pursuant to the agreement, both parties selected an arbitrator and a neutral umpire was selected by a lottery. *Id.* In addition to party-arbitrators, both parties were represented by law firms for all arbitration and litigation related matters.

In Fall 2010, a year after the arbitration began, Insco's party-arbitrator, Arbitrator A, informed Insco's counsel that he was concerned about the close relationship between Northwestern's party-arbitrator, Arbitrator B, and its counsel. *Id.* These expressed concerns continued through February 2011 when Arbitrator A finally shared private e-mail communications between the panel members with Insco's counsel. *Nw. Nat. Ins. Co. v. Insco, Ltd.,* 2011 WL 4552997, at *2. A large portion of the e-mails concerned Arbitrator B's frustration with Insco's questioning of her impartiality. *Id.* Upon receipt of the emails, Insco sent a letter to Northwestern demanding that the entire arbitration panel resign because of "evident partiality," and Arbitrator A immediately resigned. *Id.*

Upon request from Insco's attorney, Arbitrator A produced 182 pages of internal panel e-mails, claiming the emails "demonstrate that [Arbitrator B] was under the control of [Northwestern] and its counsel." *Id.* After receipt and review of the emails, Insco and Northwestern engaged in numerous, rather heated communications, most of which centered on the partiality of Arbitrator B. During these communications, Northwestern was unaware that Insco had in its possession any intra-panel communications.

Northwestern finally learned that Arbitrator A had shared internal panel e-mails with Insco's counsel when Northwestern filed a petition with the court to appoint an arbitrator in Arbitrator A's place. In Insco's response to the petition, it submitted a declaration that referenced and attached intra-panel e-mails. *Nw. Nat. Ins. Co. v. Insco, Ltd.*, 2011 WL 4552997, at *2. Northwestern asserted that the possession of these e-mails constituted misconduct by Insco, but a motion was not immediately made.

After Northwestern's petition to appoint a replacement for Arbitrator A was denied, Insco appointed a new arbitrator, and the arbitration continued. *Id.* at *3. At the first organizational meeting following the denial of the petition, concerns were again raised regarding one party's possession of the intra-panel e-mails. When the umpire expressed concern that Insco's possession of private e-mails was a "massive violation," Insco agreed to produce the e-mails to the arbitration panel and Northwestern. *Id.*

The panel reviewed their e-mails and found that the "release by [Arbitrator A] of intra-panel communications was highly inappropriate." *Id.* Despite this finding, the panel issued an interim order on June 10, 2011, stating that

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it would continue to decide the issues presented in the arbitration. *Id.*

The panel ordered all parties to destroy all documents surrounding the private communications, and the arbitration continued. *Id*. at *4. After Northwestern's summary judgment motion was denied by the panel on July 19, 2011, Northwestern filed a motion to reopen its case and disqualify Insco's counsel from representing Insco.

The Southern District of New York first found that matters of attorney discipline and disqualification were outside of the jurisdiction of arbitration panels. *Nw. Nat. Ins. Co. v. Insco, Ltd.*, 2011 WL 4552997, at *4. Although the court found that the FAA represented "a liberal federal policy favoring arbitration," it determined that there were compelling reasons for the court to entertain a motion for attorney disqualification. *Id.* at *5 (internal quotation marks omitted). The court concluded that attorney disqualification required application of substantive state law and insurance arbitrators are selected merely for their expertise within the industry. *Id.* A panel, the court reasoned, should not be expected to have a thorough understanding of the standards of conduct within the legal profession. *Id.* Additionally, the court found that even if the arbitrators were qualified to resolve attorney disqualification, they had expressly refused to do so in this matter, further warranting judicial intervention. *Id.* at *6.

After determining that there was an issue to be decided by the court, the district court found that the actions taken by Insco's counsel were a serious breach of both arbitral guidelines and ethics rules. *Id.* The court found that, although not binding on the parties, the ARIAS Code of Conduct expressly prohibited arbitrators from informing the parties of the contents of panel deliberations. *Nw. Nat. Ins. Co. v. Insco, Ltd.,* 2011 WL 4552997, at *6. The court agreed that the actions taken by Insco's counsel were in violation of both the arbitral guidelines and the New York State Rules of Professional Conduct. The court further found Insco's argument that its actions were justified because of Arbitrator B's alleged partiality to be unavailing. *Id.* at *7-8.

The court then granted Northwestern's motion to disqualify Insco's counsel, finding that the disclosure of the e-mails "tended to taint the proceedings." *Id.* at *10. Although disqualification of counsel is a "drastic measure," the court found that the integral role that electronic communications play in arbitration proceedings warranted disqualification in this case. *Id.* at *8, *10. "Allowing parties to obtain confidential panel deliberations would provide an unfair advantage in the legal proceedings and have a chilling effect on the ability of arbitrators to communicate freely." *Id.* at *10.

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After the October 3, 2011 order from the district court disqualifying Insco's counsel, Insco attempted to overturn the order by filing multiple motions with the court. First, Insco filed a motion for reconsideration, claiming that the court overlooked key facts and that the court's conclusions about the relationship between Arbitrator A and Insco's counsel were factually incorrect. *Nw. Nat. Ins. Co. v. Insco, Ltd.,* No. 11 CIV. 1124 SAS, 2011 WL 5574953, at *1 (S.D.N.Y. Nov. 15, 2011). The court denied reconsideration, finding that Insco could not show that the court had overlooked any evidence. *Id.* at *2. Acknowledging that the facts of this case were *sui generis*, the court stated, as it did in its October 3, 2011 order disqualifying Insco's counsel, that there was no precedent holding that a court cannot sanction attorneys for unethical behavior in an arbitration proceeding. *Id.*

The district court further concluded that reconsideration was not warranted to prevent manifest injustice. *Id.* at *3. Although Insco argued that the ARIAS Code of Ethics arbitral guidelines applied only to arbitrators and the parties, and not the party's counsel, the court concluded that the guidelines helped establish what actions were off-limits. *Id.* The fact that counsel took actions that cut against the ARIAS guidelines, coupled with the clear violation of professional ethics rules, allowed the court to step in to "preserve the integrity of the adversary process." *Id.* (citing *Hempstead Video, Inc. v. Inc. Vill. of Valley Stream*, 409 F.3d 127, 132 (2d Cir. 2005)). Accordingly, the district court denied Insco's motion for reconsideration.

Denial of reconsideration, however, did not prevent Insco from again attempting to have Insco's counsel reappointed as counsel. Insco promptly filed a motion to stay the arbitration, claiming that the order disqualifying Insco's counsel would likely be overturned on appeal, and the disqualification of counsel imposed a severe hardship on Insco. *Nw. Nat. Ins. Co. v. Insco, Ltd.,* 866 F. Supp. 2d 214, 215 (S.D.N.Y. 2011). While admitting "Insco will suffer some harm in the event that it is required to proceed with the arbitration during the pendency of appeal without its lawyer of choice," the court found that balancing the factors necessary to grant a stay weighed against Insco. *Id.* at 217.

The district court first found that there was no likelihood of success on the merits. Insco argued that this question was novel and could have a chilling effect on private arbitrations. *Id.* at 219. The court disagreed with the premise that a novel issue was enough to show likelihood of success on the merits. Finding that other cases, although dealing with conflicts of interest, have disqualified counsel in the Southern District, the court stated that it was within its "inherent authority to disqualify attorneys for unethical

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behavior that tends to taint a court proceeding." *Id.* at 220.

Turning to the second factor in granting a stay, whether there would be irreparable harm, the court agreed with Insco that disqualification of an attorney has "immediate adverse effect on the client by separating him from counsel of his choice." *Id.* at 221 (citing *Bd. of Ed. of City of New York v. Nyquist*, 590 F.2d 1241, 1246 (2d Cir. 1979)). Insco's relationship with its counsel spanned two decades, and although Insco had signed a retainer for new representation, the court agreed that Insco would face harm with the disqualification. Even in light of this finding, however, the court found that the prejudice to Northwestern, the third factor in consideration of granting a stay, was high. *Nw. Nat. Ins. Co. v. Insco, Ltd.,* 866 F. Supp. 2d at 221. The court reasoned that granting a stay would prevent Northwestern from continuing arbitration proceedings that it initiated, and forcing Northwestern to participate in the arbitration with Insco's counsel would undermine the relief sought by Northwestern in the first place. *Id.*

Finally, the court found that the fourth prong, public interest, did not weigh in favor of granting the stay. *Id.* at 222. Insco argued that the opinion by the court would have a "chilling effect" on arbitrations; the court, however, found that the "holding of the opinion is narrower than Insco argue[d]." *Id.* Instead, the court found that similar factual scenarios would not arise with frequency, and instead, the opinion would cause parties to exercise caution in future arbitrations before they disclose intra-panel e-mails. *Id.* at 223. With the court's denial of the stay of arbitration, Insco lost its last attempt to reappoint its counsel, and precedent was set that could change arbitration proceedings going forward.

Northwestern National Insurance Co. v. Insco, Ltd. presented highly unusual facts that forced the Southern District of New York to exercise its "inherent authority." *Nw. Nat. Ins. Co. v. Insco, Ltd.,* 866 F. Supp. 2d at 220. It is difficult

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to determine how arbitrations going forward will react to this precedent: will the court's prediction that parties will now exercise caution before disclosing intra-panel e-mails be proven correct, or will this opinion result in situations where "arbitrators can no longer speak out and reveal corruption" as Insco argued? *Id.* at 222-23. While there is uncertainty as to future arbitrations, one thing is certain: the Southern District of New York increased its role in arbitrations by setting a precedent that attorneys representing parties in arbitrations are held to the same ethical standards as if they were before the court. The decision made clear that if there is a claim that legal ethics were violated, the court has the inherent power to intervene in the arbitration and sanction or disqualify the law firm.

Conclusion

Courts have recently taken on litigation concerning matters that begin in arbitration. Most of the litigation surrounds the appointment of an arbitrator. Jurisdictions differ as to the courts' authority when exercising their discretion. Some jurisdictions follow a strict rule that forces the arbitration to start anew, while others will simply appoint a new arbitrator in the middle of the hearing and expect the arbitrator to catch up.

A growing concern is whether courts, in exercising their authority under Section 5 of the FAA, are inevitably creating more litigation through their interventionist rulings. These decisions, while sound and in accordance with the court's authority, may be missing issues that could result in motion practice in subsequent arbitrations. Although the goal of arbitration is to avoid litigation, and reach amicable agreements in a less formal setting, there is still uncertainty as to precisely what role the court should be taking in the arbitration process. While courts seem to respect the contractual rights of the parties, the broad discretion given under Section 5 of the FAA, and the various applications of the "general rule," could be expanding the courts' role, even if their final determination is that they have no authority to intervene in a matter.

An additional consideration concerning the courts' role in arbitration is the Southern District of New York's decision to disqualify counsel for actions taken during the arbitration. The court's decision to intervene to disqualify counsel indicates that, although issues as to the construction of the panel may be unclear, issues as to legal ethics will trigger a court's "inherent authority" to assert control over the legal profession.

The *Northwestern National* decision also unveiled the inner machinations of a confidential arbitration where the conduct of counsel and some arbitrators can mar what is intended to a less expensive business-like dispute resolution forum; not an undignified free-for-all ethics-challenged melee. One would hope that the publication of the sordid details of this one arbitration constitutes an object lesson, albeit rare, in avoiding all that can go wrong in an arbitration, and not a stain on the integrity of the entire process. To date the authors are unaware of any similarly unseemly blights on the arbitration process. ●

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