VSM, LLC
JUDGE VICTORIA S. MARKS (Ret.)

January 30, 2017

Senator Keith-Agaran
Chair, Senate Judiciary Committee
Hawaii State Capitol
415 South Beretania Street
Honolulu, HI 96813

RE: STRONG SUPPORT for SB 314 – Relating to Required Disclosures by Arbitrators

Hearing: February 1, 2017.

Dear Chair Keith-Agaran and members of the Senate Judiciary Committee:

I write in STRONG SUPPORT for SB 314. This bill, which seeks to amend portions of HRS §658A-12, is necessary to redress the implications of *Nordic PCL Construction, Inc. v. LPIHGC, LLC,* 136 Hawai`i 29, 358 P.3d 1 (2015) and *Noel Madamba Contracting LLC v. Romero,* 137 Hawai`i 1, 364 P.3d 518 (2015). These two decisions had the effect of re-writing the arbitrator's disclosure statute. As currently written, under HRS §658A-12, a court **may** vacate an arbitration award if an arbitrator failed to disclose a known fact that a reasonable person would consider likely to affect the impartiality of the arbitrator. The Hawaii Supreme Court ruled that an arbitrators nondisclosure of information that a "reasonable person" might find likely to affect the arbitrator's impartiality constitutes "evident partiality" as a matter of law and that a court **must** vacate the arbitrator's decision.

The Hawaii Supreme Court's decisions did not even consider whether there was any actual bias on the part of an arbitrator.

The consequence of these rulings is that arbitrator disclosures are now unnecessarily long, with arbitrators going back decades to reveal any and every iota of usually meaningless information in an effort to address what are unclear requirements, in light of these decisions. For example, if an arbitrator met a lawyer years ago at a Bar Association function and had a passing conversation with the lawyer and that lawyer now represents a party in an arbitration proceeding, is the arbitrator required to disclose that conversation? What happens if the arbitrator doesn't remember the conversation and thus does not disclose it, but another person remembered seeing the lawyer and

the arbitrator in a conversation at the Bar Association function? Will the arbitration award be vacated on the basis of an innocuous conversation that occurred years ago that was not remembered and disclosed?

Another consequence of these rulings is that any party who lost at arbitration now has an incentive to search for any tidbit of information to support a claim that the arbitrator failed to make a disclosure so that they can vacate an award and repeat the arbitration process. The cost effective and timely arbitration hearings that motivated many to select arbitration in the first place has now been significantly eroded.

Certainly, a fact must be “known, direct and material” or a relationship must be “substantial” in order to require a disclosure.

Thus, I urge the Judiciary Committee to adopt this bill.

Very truly yours,

Judge Victoria S. Marks (Ret.)
Co-Chair American Judicature Society
Standing Committee on Civil Justice

Mark D. Bernstein
Attorney at Law
A Law Corporation
P.O. Box 1266
Honolulu, Hawaii 96808

January 30, 2017

Senator Keith-Agaran
Chair, Senate Judiciary Committee
Hawaii State Capitol
415 South Beretania Street
Honolulu, HI 96813

RE: Support for SB 314 – Relating to Required Disclosures by Arbitrators

Hearing: February 1, 2017.

Dear Chair Keith-Agaran and members of the Senate Judiciary Committee:

I wish to offer my support for SB 314 and urge that all the members of the Committee support this important legislation which will correct the Hawaii Supreme Court's mistaken decision to re-write HRS §658A-12(d), which provided that:

(d) If the arbitrator did not disclose a fact as required by subsection (a) or (b), upon timely objection by a party, the court under section 658A-23(a)(2) ***may*** *vacate an award.*

Because of the Supreme Court's decisions *Nordic PCL Construction, Inc. v. LPIHGC, LLC,* 136 Hawai`i 29, 358 P.3d 1 (2015) and *Noel Madamba Contracting LLC v. Romero,* 137 Hawai`i 1, 364 P.3d 518 (2015), HRS §658A-12(d), has been amended to read as follows:

(d) If the arbitrator did not disclose a fact as required by subsection (a) or (b), upon timely objection by a party, the court under section 658A-23(a)(2) ***must*** *vacate an award.*

The Supreme Court's decisions were not based on a determination that the language adopted by the Hawaii Legislature was unconstitutional or in any

other way unlawful. Nor did the Supreme Court determine that the Hawaii Legislature was without the lawful authority to adopt this statute. Instead the Supreme Court decided that the law would be better if the statute said "Must" instead of "May".

While I and many others respectfully disagree with the Hawaii Supreme Court's belief that "must" is better than "may", I am most disturbed by the Supreme Court's view that its lawful authority includes the right and obligation to tinker with constitutional laws passed by the Hawaii Legislature to make them "better", even though that right and obligation belongs the Hawaii Legislature. In addition to the separation of powers issue, the Supreme Court's decision did not make the law better, it made it worse, much worse.

Before the Supreme Court's decision, the impact of an arbitrator's failure to disclose facts that a reasonable person would consider likely to affect the impartiality of the arbitrator had been vested in the judges of the circuit courts. This was and is wise because what a *fact that a reasonable person would consider likely to affect the impartiality of the arbitrator* is not capable of a fixed immutable and timeless definition. It thus presents an impossible challenge for the arbitrator in making his/her disclosure.

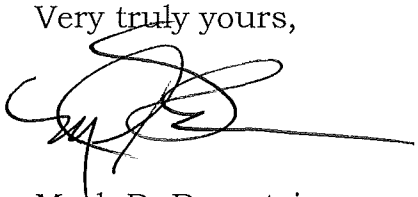
Here is but one of literally hundreds of examples of this challenge. Is the fact that an expert witness in an arbitration appeared as an expert witness 5 years before in a case when the arbitrator was a circuit court judge a *fact that a reasonable person would consider likely to affect the impartiality of the arbitrator*? If it is, just exactly how would the former judge have access to the information throughout his/her post judicial career as an arbitrator? The simple truth is that "blind luck" is the only way this fact gets disclosed.

In addition, the Supreme Court's decision all but compels counsel for the disappointed litigant to challenge the arbitration award on a non-disclosure basis even if counsel believes the decision to have been fair and just. After all, who knows whether the arbitrator's failure to disclose that he/she went to Punahou at the same time as counsel for the prevailing party constitutes a failure to disclose a *fact that a reasonable person would consider likely to affect the impartiality of the arbitrator.*

The language of this bill is designed alleviate such issues and restore control of this issue to the Hawaii Legislature and the judge of the circuit court by requiring that a fact be "known, direct and material" or a relationship "substantial" before disclosure is required and allowing the circuit court to

make the decision rather than have the decision imposed upon it. Accordingly, I strongly support the bill and urge the Committee to adopt it.

Very truly yours,



Mark D. Bernstein

LOU CHANG

MEDIATION • ARBITRATION • NEUTRAL SERVICES

Attorney At Law

The Honorable Gil Keith-Agaran
Chair,
Members of the Senate Judiciary and Labor Committee
State Capitol Bldg. Rm. 221
Honolulu, HI 96813

January 30, 2017

Re: SB 314 Relating to Arbitration

Dear Chair Keith-Agaran and Members of the Senate Judiciary and Labor Committee:

Thank you for the opportunity to submit testimony regarding Senate Bill 314 relating to arbitration.

My professional background is as a civil, business and commercial lawyer in the state of Hawaii since 1973. Over the course of my career, I litigated and arbitrated business, commercial and construction industry matters. Beginning in the 1970s and 1980s, I began serving as an independent and neutral arbitrator of a broad range of civil, business, construction, labor and employment matters. Since 2003, I changed the nature of my professional practice and have been primarily serving as a neutral mediator or arbitrator of such matters.

I strongly urge this committee to approve Senate Bill 314 for the following reasons:

1. Recent decisions by the Hawaii Supreme Court. have caused and created perhaps unintended but severely damaging consequences upon the law and practice of commercial arbitration.

2. As a result of two recent decisions, Nordic PCL Construction, Inc. v. LPIHGC, LLC,[i] (the "Nordic" case) and Noel Madamba Contracting LLC v. Romero,[ii] (the "Madamba" case), the Hawaii Supreme Court has adopted a judicial interpretation of a provision of Hawaii's arbitration statute, HRS Chapter 658A, that has damaged the efficiency, practicality and finality of the arbitration process.

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3. In the two decisions, the Hawaii Supreme Court ruled that an arbitrator's nondisclosure of information that a "reasonable person" might find likely to affect the arbitrator's impartiality constitutes "evident partiality" as a matter of law. Upon finding "evident partiality", the Court ruled that a reviewing court must vacate an arbitrator's decision and award, apparently without determination or consideration as to whether the arbitrator's nondisclosure of information is substantial or material. I note for this committee's attention that the statutory provision interpreted by the Court, HRS section 658-12(d), uses the term "may". The Hawaii Supreme Court concluded however that a reviewing court must vacate an award where there is the mere appearance of bias resulting from an arbitrator's nondisclosure of some relationship, conduct, connection or dealing. The court's ruling requires vacature, a) whether or not the undisclosed information is material or substantial; b) without an opportunity for rebuttal; and c) without a showing of any actual or unfair bias or impact upon the arbitration process.

4. As a practical result, these rulings make commercial arbitration, especially the larger cases, multi-round litigations. The traditional perceived benefits of arbitration as being fast, efficient and final are lost as a consequence. Parties who lose in an arbitration are virtually encouraged to seek judicial vacature by commencing an action and conducting discovery or extensive Google searches in the hopes of finding some element of arbitrator participation or involvement in prior matters that was not disclosed, however insignificant, so as to obtain vacature of the arbitration decision.

5. The rulings encourage unproductive game playing by parties and their advocates to "sandbag" the process. A party or its advocate can hold back knowledge of some prior contact, connection, involvement or relationship that an arbitrator may have had with some party, witness, attorney or other person or entity involved in the case that an arbitrator may have forgotten or failed to disclose. If the party loses in arbitration, they can throw out the arbitration decision and get a "second bite at the apple". Such a result creates more litigation and multiple arbitrations causing the arbitration process to lose one of its primary values, that of providing efficient finality to disputes.

Attached hereto is a copy of a recent article that I have written to provide to details as to the national case law in this area, background information regarding the circumstances of the Nordic and Madamba cases and describing the rulings of the Hawaii Supreme Court and the negative impacts that it has had upon the practice and practicality of arbitration. The article has been accepted for publication in the

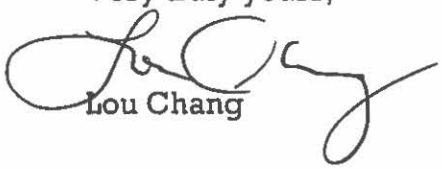
March, 2017 edition of the Hawaii Bar Journal. I respectfully attach it for your committee's review and information.

There are multiple important objectives and goals of a fair and efficient arbitration process and procedure. They include the desire to promote and provide for a fair, just and impartial process, party participation in the selection of a decision maker for their dispute, efficiency and bringing practical finality to party disputes. The rulings of the Hawaii Supreme Court in the Nordic and Madamba cases promotes the appearance of fairness at the expense of other important objectives and goals of fair and just arbitration process. The rulings of the Hawaii Supreme Court in these cases have, in my judgment, placed Hawaii as an outlier, out of the mainstream jurisdiction on this matter.

Senate Bill 314 and the amendment of HRS section 658A-12 seeks to restore and establish an opportunity for rebuttal and a judicial review of claims of arbitrator nondisclosure. The proposed amendment provides for a healthy review of the circumstances regarding an arbitrator's failure to disclose some piece of information and an opportunity to determine whether the circumstances are truly material or significant and caused some actual unfairness before an arbitrator's decision is thrown out. Adoption of the amendment will restore the practicality, fairness, efficiency and finality of commercial arbitration in Hawaii.

Thank you for this opportunity to provide testimony on this matter.

Very truly yours,



Lou Chang

Attachment:

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[i] 136 Hawai'I 29, 358 P. 3d 1 (2015)

[ii] 137 Hawai'i 1, 364 P.3d 518 (2015)

Trouble in the world of Hawaii arbitration due to vacature for arbitrator nondisclosure

By: Lou Chang[1]

When do the undisclosed "dealings" or "relationships" of an arbitrator warrant vacature of an arbitration decision? Section 10 of the Federal Arbitration Act (FAA)[2] provides that an arbitration award may be vacated where it was "procured by corruption, fraud or undue means or (w)here there was evident partiality in the arbitrators"

I. The National Case Law

The seminal case dealing with this issue is the United States Supreme Court case of Commonwealth Coatings Corp. v. Continental Casualty Co. [3] The case involved a construction arbitration which called for a three-person panel. Each party selected an arbitrator and the two arbitrators selected a third neutral arbitrator. The arbitration dispute arose in Puerto Rico, a relatively small community where the advocates, parties and arbitrators appear to have had substantial familiarity with the construction industry and the third arbitrator. The third arbitrator owned a big business in Puerto Rico and served in the preceding five years as a consulting engineer for the general contractor, one of the parties in the arbitration. The business relationship was sporadic, but was repeated and significant involving fees of $12,000 over that span of time. Information regarding this business relationship was not disclosed during the conduct of the arbitration. After the arbitration panel issued a unanimous decision in favor of the general contractor, the losing subcontractor sought to vacate the decision. The lower courts determined that the arbitration decision should be affirmed.

A divided Supreme Court addressed the matter and issued three minority opinions. Justice Black, writing for a plurality of four Justices, reversed the lower courts. The four judge plurality stated:

> We can perceive no way in which the effectiveness of the arbitration process will be hampered by the simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias....
>
> We cannot believe that it was the purpose of Congress to authorize litigants to submit their cases

> and controversies to arbitration boards that might reasonably be thought biased against one litigant and favorable to another.[4]

The plurality decision implicitly requires that a showing be made that undisclosed "dealings" "reasonably be thought" to create an "impression of possible bias".

Justice White and Justice Marshall concurred with the reversal but would require a showing that the undisclosed "relationships" or "interests" be substantial. The White concurring decision recognized that arbitrators are selected by parties because they are often persons "of affairs, not apart from the marketplace, that they are effective in their adjudicatory function."[5] It stated:

> [A]n arbitrator's business relationships may be diverse indeed, involving more or less remote commercial connections with great numbers of people. He cannot be expected to provide the parties with his complete and unexpurgated business biography. But it is enough for present purposes to hold, as the Court does, that where the arbitrator has a substantial interest in a firm which has done more than trivial business with a party, that fact must be disclosed. If arbitrators err on the side of disclosure, as they should, it will not be difficult for courts to identify those undisclosed relationships which are too insubstantial to warrant vacating an award.[6]

Justices Fortas, Harlan and Stewart dissented and supported the position that a showing of "evident partiality" should be subject to a rebuttable presumption. In their dissenting opinion, they noted that the record reflected that the third arbitrator was a "leading and respected consulting engineer" who had performed services for most of the contractors in Puerto Rico and was well known to and personal friends with the petitioner's counsel.[7] Further, the petitioner's counsel indicated that he likely would not have objected to the arbitrator because he knew the arbitrator. The dissent noted:

> I agree that failure of an arbitrator to volunteer information about business dealings with one party will, prima facie, support a claim of partiality or bias. But where there is no suggestion that the

> nondisclosure was calculated, and where the complaining party disclaims any imputation of partiality, bias, or misconduct, the presumption clearly is overcome.
>
> I do not believe that it is either necessary, appropriate, or permissible to rule, as the Court does, that, regardless of the facts, innocent failure to volunteer information constitutes the "evident partiality" necessary under Sec. 10(b) of the Arbitration Act to set aside an award. "Evident partiality" means what it says: conduct—or at least an attitude or disposition—by the arbitrator favoring one party rather than the other.[8]

From this divided decision, four Justices would require that there be a showing the arbitrator's undisclosed information be reasonably found to create an "impression of possible bias". Two Justices would require that the undisclosed dealings or relationships be substantial. Three Justices would require that evident partiality be supported by a showing of conduct favoring one party over another and that the undisclosed information be subject to a rebuttable presumption.

What kind of "dealings' or "relationships" are sufficient to establish an "appearance of possible bias" or "evident partiality" is not defined in the Commonwealth Coatings decision. Since that decision, federal and state courts have struggled to apply its guidance to different factual circumstances.

Recent cases that have found vacature appropriate for arbitrator nondisclosure of prior connections include the following circumstances:

1. Failure to disclose that seven years before the arbitration, the arbitrator and his former law firm were co-counsel in a lengthy litigation matter with law firm and particular lawyer representing winning party in arbitration. [9]
2. Failure to disclose that the arbitrator's law firm had represented the corporate parent of the defendant corporation involved in the arbitration in 19 matters over a 35-year period ending some 21 months before the arbitration. [10]

3. Failure of neutral arbitrator to reveal that he had served as a party-arbitrator for one of the parties. [11]
4. Failure to disclose that the arbitrator had represented investors with similar claims against predecessor-in-interest to respondent. [12]
5. Failure to disclose that, during the arbitration, the arbitrator began work as a senior executive with a production company that was negotiating with an executive of one of the parties to the arbitration to finance and co-produce a motion picture. [13]
6. Failure to disclose an ex parte communication with one of the parties' attorneys regarding the possibility of serving as a mediator in an unrelated action or the arbitrator's eventual appointment as a mediator in the action constituted "evident partiality" [14]
7. Failure to disclose that arbitrator was an official of a non-profit association that previously and presently solicited contributions from the medical institution party during the pendency of the medical malpractice arbitration matter. [15]
8. Failure to disclose arbitrator's law firm's contemporaneous representation of the Commonwealth of Australia, which owned one of the parties to the arbitration, constituted "evident partiality. [16]
9. Party-appointed arbitrator's failure to disclose that he had been employed by the appointing party as its representative and chief negotiator to negotiate the monthly rent for the subject property with the non-appointing party constituted "evident partiality. [17]

Cases that have found vacature not appropriate for arbitrator nondisclosure of prior connections include:

1. Prior service as expert witness for one of the parties does not constitute evident partiality when that service involved matter unrelated to dispute at issue and engagement concluded prior to arbitration. [18]
2. Party's undisclosed campaign contributions to arbitrator's election campaign not evidence of partiality because they are on the public record and because opposing party's lawyers contributed more. [19]
3. Failure to disclose that arbitrator and a party's expert witness were both limited partners in a partnership unrelated to the arbitration. [20]

4. No evident partiality arising from arbitrators' financial dependence on Saturn where arbitrators, like the party in the arbitration matter, were Saturn auto dealers. [21]
5. No duty to disclose employer's prior dealings with a party because the arbitrator did not participate in or have a pecuniary interest in those transactions. [22]
6. Prior service as a pro bono mediator in an unrelated case involving a party's attorney. [23]
7. Party-appointed arbitrator, who had also represented a subsidiary of the appointing party in an unrelated matter four years prior to the arbitration, was not "evidently partial" for failing to disclose his prior involvement with the appointing party. [24]

The developing case law around the country has brought some instructive guidance to determining what kinds of dealings and relationships will be found to constitute evident partiality sufficient to support vacature of an arbitration award under the FAA.

II. The Hawaii Statute

Most states have a state arbitration statute modeled very closely to the FAA. In 2000, the Uniform Laws Commission proposed a newly stated arbitration act called the Revised Uniform Arbitration Act (RUAA). To date, a minority of jurisdictions (18 states plus the District of Columbia) have adopted the RUAA. While the FAA does not contain an explicit provision dealing with arbitrator disclosures, one is contained in section 12 of the RUAA which states, in pertinent part:

> **SECTION 12. DISCLOSURE BY ARBITRATOR.**
> (a) Before accepting appointment, an individual who is requested to serve as an arbitrator, after making a reasonable inquiry, shall disclose to all parties to the agreement to arbitrate and arbitration proceeding and to any other arbitrators <u>any known facts that a reasonable person would consider likely to affect the impartiality of the arbitrator</u> in the arbitration proceeding, including:
> (1) a <u>financial or personal interest in the outcome</u> of the arbitration proceeding; and
> (2) an <u>existing or past relationship with any of the parties to the agreement to arbitrate or the arbitration proceeding, their counsel or representatives, a witness, or another arbitrators</u>.

(d) If the arbitrator did not disclose a fact as required by subsection (a) or (b), upon timely objection by a party, the court under Section 23(a)(2) may vacate an award.
(e) An arbitrator appointed as a neutral arbitrator who does not disclose a known, direct, and material interest in the outcome of the arbitration proceeding or a known, existing, and substantial relationship with a party is presumed to act with evident partiality under Section 23(a)(2).[xxv]
(underscoring added)

Hawaii adopted the RUAA. It is codified in HRS Ch. 658A.

III. Hawaii Supreme Court Decisions

In an apparent case of first impression, the Hawaii Supreme Court adopted a very troubling interpretation of the statutory provisions dealing with arbitrator disclosures. In two recent decisions, Nordic PCL Construction, Inc. v. LPIHGC, LLC,[xxvi] (the "Nordic" case) and Noel Madamba Contracting LLC v. Romero,[xxvii] (the "Madamba" case), the Hawaii Supreme Court has ruled that an arbitrator's nondisclosure of information that a "reasonable person" might find likely to affect the arbitrator's impartiality constitutes "evident partiality" as a matter of law. Upon finding "evident partiality", the Court ruled that a reviewing court must vacate an arbitrator's decision and award, apparently without determination or consideration as to whether the arbitrator's nondisclosure of information is substantial or material.

The Nordic case involved a large, protracted construction deficiency arbitration case. The case involved three large local law firms and entailed 31 days of arbitration hearings. Following the hearings, the arbitrator issued an initial partial award in favor of LPIHGC, LLC, the general contractor, in an amount exceeding $9.8 million. The arbitrator later issued a supplemental award of more than $1.4 million in attorneys' fees and costs to the prevailing party.

Nordic, the subcontractor, unhappy with the large adverse arbitration award challenged the award and sought vacature of the award due to nondisclosure of information by the arbitrator. The case presents very complex factual circumstances and raises multiple legal issues regarding an arbitrator's duty of disclosure under the RUAA, the effect of the arbitrator's partial disclosure, party and counsel knowledge of facts that may raise a duty to inquire and whether the failure to inquire constitutes a waiver of the right to later object.

In Nordic, the losing party asserted as one of its grounds that the arbitrator had not disclosed that attorneys in one of the large law firms representing the party who prevailed in the arbitration had represented a large Hawaiian eleemosenary trust in several prior legal matters and that the arbitrator's role as one of three

trustees of the trust represented by the law firm involved as an advocate in the arbitration should have been disclosed.

The arbitrator was a prominent and frequently utilized retired Circuit Court Judge who previously and at the time of his appointment was serving as a neutral arbitrator and/or mediator on other matters involving all of the law firms involved as advocates in the underlying arbitration and whose role and participation as a trustee of the prominent Hawaiian trust may well have been a matter of public knowledge in the local business and legal community. Complicating the circumstances, a partner of the law firm that represented the party that was seeking to vacate the arbitration award had a brother in law who worked as a vice president for the same Hawaiian trust thus raising the prospect that the arbitrator's role as a trustee of the trust might have been known to the law firm or its client who lost in the underlying arbitration as a factual or legal matter. Further complicating the circumstances, the arbitrator, during the pendency of the arbitration, was requested to and did undertake to serve as a neutral in new matters involving attorneys from the two law firms that were representing the prevailing general contractor in the pending arbitration case. Because the trial court below had not made express findings of fact or conclusions of law, the Hawaii Supreme Court determined that it did not have the proper record from which to rule and thus remanded the matter for the trial court to make findings and conclusions. The results of the remand are presently pending.

The Madamba case was also a construction contract case between homeowners (the Romeros) and their general contractor, Noel Madamba Contracting LLC (Madamba). In the Madamba case, the arbitrator was the same retired judge who was involved in the Nordic case. The arbitrator made a similar general disclosure upon his appointment that when he was a Circuit Court judge, counsels and members of their firms appeared before him and since retirement he served as a neutral in matters for counsels and members of the firms representing the parties in the arbitration. No mention was made in the arbitrator's disclosure relating to the administration and legal review of the arbitrator's personal retirement accounts and that a third party benefits administrator company that managed the arbitrator's personal retirement accounts was deciding to have certain other attorneys from the law firm that represented the homeowners perform legal services to bring the arbitrator's pension plan into compliance with federal and state laws.

Arbitration hearings were conducted in November, 2011. Following the hearings, the arbitrator issued a partial final award in favor of homeowner parties and against the contractor in the amount of $154,476.51 as compensatory damages. Following the arbitrator's issuance of the partial final award, it came to light that the arbitrator's retirement plan administrator had attempted to assign the task of performing the legal review and preparation of amendments needed to bring the arbitrator's pension plan into compliance with federal and state laws to a benefits plan lawyer who was in the same firm as the Romeros' attorney in the arbitration. When this fact became known, the arbitrator's retirement plan file was transferred to

a different law firm. The losing contractor challenged the arbitrator's decision and sought vacature because of alleged insufficient disclosures.

The Court found the timing of discussions concerning the possibility of having the law firm do legal work for the arbitrator relating to his retirement accounts important to its conclusion that significant information that should have been disclosed was not disclosed and constituted a breach of the Hawaii RUAA provisions dealing with arbitrator disclosures. The Hawaii Supreme Court in the "Madamba' case held that an arbitrator's failure to disclose facts relating to a potential future relationship with the law firm that represented one of the parties involved in the arbitration was a fact that a reasonable person would consider likely to affect the impartiality of the arbitrator. It did not matter that no engagement letter had been signed, no legal work was done by the law firm that represented the Romeros in the arbitration and the file was transferred to a different law firm. Upon determining that there was nondisclosure of a fact that a reasonable person would consider likely to affect the impartiality of the arbitrator, the Court ruled that was equivalent to "evident partiality". The Court, interpreting HRS Sec. 658A-12 and HRS Sec. 658A-23 of the Hawaii RUAA, ruled that a reviewing court in such instance must vacate the arbitrator's decision. The Court appears to eliminate any requirement that an "appearance of partiality" be material or substantive, thereby elevating appearance over substance. Its ruling also eliminates the need or opportunity for a party to rebut the significance and materiality of the claimed nondisclosure.

The Hawaii Supreme Court made the following rulings:

- "an arbitrator's impartiality and appearance of impartiality is paramount";
- " ...in the context of neutral arbitrators, "a failure to meet disclosure requirements under HRS § 658A-12(a) or (b) is equivalent to, or constitutes, 'evident partiality' as a matter of law." "(citing the Court's earlier Nordic decision, 136 Hawai'i 29 at 50, 358 P.3d at 22;
- the arbitrator's failure to disclose the possible relationship with another attorney in the firm of one of the arbitration party's attorney "created a reasonable impression of partiality;
- for claims of evident partiality based on a failure to disclose "an arbitrator's nondisclosure of facts showing a potential conflict of interest creates evident partiality warranting vacatur even when no actual bias is present." Daiichi, 103 Hawai'i at 352, 82 P.3d at 438 (quoting Schimitz, 20 F.3d at 1045) underscoring added); and
- even if the relationship at issue is a prospective or future relationship, a failure to disclose may result in a reasonable impression of partiality, and accordingly, a violation of HRS § 658A-12(a) or (b). [xxviii]

III. Impact on the Practice of Arbitration

The Nordic and Madamba cases have turned the world of commercial arbitration in Hawaii into a litigator's haven or hell, depending upon your point of view. Any party who is disappointed by an arbitrator's decision is incentivized, if not required, to engage in an extended internet and media investigative search of the arbitrator's history, background, associations and activities in the hopes of finding some undisclosed factual circumstance that can support a claim that the arbitrator failed to make a needed disclosure and to get the proverbial "second bite at the apple".

Since the Court's issuance of the Nordic and Madamba decisions, additional arbitration disclosure challenges are working their way through the appellate court process. Some asserting as grounds of alleged violative nondisclosure facts such as being listed on a panel of arbitrators maintained by an ADR administering agency along with a partner of an advocate attorney involved in the arbitration, failure to disclose that a witness in an arbitration was involved as an advocate in a prior case, and joint participation in community non-profit organization galas and membership in a community science club. The lack of definition of critical terms such as "dealings", "relationships" "reasonable person" and "likely to affect impartiality" provides great uncertainties and large room for creative argument. Without an opportunity to challenge or rebut the materiality of an item of nondisclosure, the temptation to "take a shot" to vacate an adverse arbitration decision can be irresistable.

The recent rulings introduce some troubling potential malpractice exposure into the process as well. Advocates who fail to thoroughly investigate a potential arbitrator for information concerning potential arbitrator interests, associations, past involvement in cases or relationships may face exposure to a claim of inadequate investigation. An arbitration advocate or a partner or principal of the advocate's firm who might know of a relationship, association or prior connection with the arbitrator who fails to disclose such information to the client or in the course of the arbitration to the agency or parties involved might create an opportunity for the non-client party who loses an arbitration to challenge and overturn an arbitration decision or award that was favorable to the client. If attorney misconduct is found, might that then lead to an action for disgorgement of fees?

These cases appear to assume that the State RUAA statute is applicable rather than the FAA. Unless the parties expressly adopted the Hawaii RUAA as the governing arbitration procedural law, given the broad sweep of the interstate commerce clause, would not the FAA be the appropriate governing statute? Is there preemption over contrary state law? This is apparently one of the issues being presented in a pending certiorari petition to the US Supreme Court in *R.J. Reynolds Tobacco Co. v. Maryland*,[xxix]. It is not yet determined whether the Court will accept the petition.

The ramifications of the Nordic and Madamba cases make arbitrations of any significant size, issue or amount in controversy no longer an efficient, practical or final conflict resolution procedure. The Nordic and Madamba cases resulted in the overturning of arbitration decisions in cases that involved very substantial effort, fees and expenses. In Nordic, attorneys fees and costs alone exceeded a million dollars for just one of the parties. Advocates now are tempted to challenge any adverse arbitration decision through a post award internet and private investigation to dig up some undisclosed or forgotten past, present or future "dealing" or "relationship" of the arbitrator with parties, attorneys, other arbitrators, witnesses, experts, organizations, civic or social groups. Upon doing so, parties can gain vacature, settlement advantage and/or another "bite at the apple".

IV. What Arbitration Practitioners Can Do

Until there is further clarification from the Courts, what can parties and counsels do to maintain the integrity and finality of the arbitration process? Allow me to share some ideas for parties and their counselors and advocates.

A. At the Drafting Stage:

1. Parties can acknowledge in their contract and arbitration agreements that the relationship is one occurring in the course of interstate commerce and specifically adopt the provisions of the Federal Arbitration Act (FAA). (The Nordic and Madamba cases were decided under the Hawaii Revised Uniform Arbitration Act (HRS Ch. 658A), which is arguably now far more restrictive than the FAA.)

2. Parties should carefully review the arbitration rules of any dispute resolution service that they select and adopt as the applicable arbitration procedural rules for the contract. There are important differences in the arbitration rules of the Dispute Prevention and Resolution Inc., American Arbitration Association and JAMS. Note for example, that the rules of the Dispute Prevention and Resolution Inc., the leading Hawaii private dispute resolution agency, provides that unless otherwise noted and agreed by the parties, the provisions of the Hawaii RUAA are deemed the arbitration procedural rules applicable to arbitrations conducted under its rules. Such rule contemplates that parties may expressly agree otherwise.

3. Parties can also consider selecting the forum and jurisdiction of the Federal courts which now appear to be more supportive of the arbitration process as a party selected dispute resolution process.

4. Parties can adopt their own customized rules or adopt selected administrative rules of a dispute resolution agency which provide for a more open and fair arbitrator selection, disclosure and vetting process. For example, Dispute Prevention and Resolution Inc, has adopted a newly revised arbitration

rule 9D dealing with nondisclosure and waiver. That rule provides the following:

> No party shall circumvent the disclosure process by failing to advise DPR of a known, but undisclosed fact or circumstance concerning the Arbitrator that the party believes merits disclosure prior to the confirmation of the Arbitrator and any such failure shall constitute a waiver of that party's right to seek disqualification of the Arbitrator or otherwise attack an Arbitrator's award. Further, no party shall engage substitute counsel, nor name or call a previously undisclosed witness for the purpose of creating a basis to seek the disqualification of an Arbitrator.[xxx]

B. At the Pre-Hearing Stage:

1. Discuss and negotiate a fair disclosure protocol for the matter, such as:

a. Consider the making of an agreement that all parties involved in the arbitration (arbitrator, parties, counsels) share the duty to make good faith disclosures of any past, present or future dealings or relationships regarding the arbitrator that a reasonable person may determine likely to affect the impartiality of the arbitrator or the integrity of the arbitration process.

b. Acknowledge considerations of the desirability of the parties to participate in the selection of the arbitrator(s) from their community with desired or known experience and expertise.

c. Agree to a reasonable time for all parties during a research and investigation phase to thoroughly investigate the business, professional, civic and social history of the arbitrator(s).

d. Agree that after the agreed research and investigation phase, all parties accept the disclosures made and agree that it shall not be grounds for any party to seek vacature due to any subsequently discovered fact, dealing or relationship that could have been discovered during the agreed research and investigation phase.

C. During the Arbitration Process:

Parties and their counsels (and their firms) should refrain from communicating with, soliciting or offering to utilize the arbitrator in any other concurrent or future matter.

V. Conclusion

This aspect of arbitration practice addresses the tension of balancing three objectives: (1) providing for a fair and impartial decision maker, (2) providing for party participation and selection of their desired decision maker with suitable experience and expertise for the matter and (3) assuring reasonable, timely and practical finality of decisions. The Court has emphasized the importance of having the appearance of propriety of the arbitration process to the diminishment of the other desired objectives of arbitration, that of party selection and finality and practicality of the process.

As a practitioner and student of the arbitration process, one hopes that there will be some practical and prompt clarification in this area from the Courts or, if necessary, from the Legislature. Until then, practitioners can consider the suggestions set forth above to try to restore some reason and sensibility to the process.

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[1] Lou Chang, Esq. serves as an independent and neutral mediator and arbitrator for business, commercial, design & construction, labor-management, employment, franchise, real estate, insurance, probate, family business, personal injury and civil disputes.

[2] 9 U.S.C. 1-14

[3] 393 U.S. 145, 89 S. Ct. 337, 21 L. Ed. 301 (1968)

[4] 393 U.S. at pp. 149-150

[5] 393 U.S. at p. 150

[6] 393 U.S. at pp. 151-152

[7] 393 U.S. at pp. 152-153

[8] 393 U.S. at p. 154

[9] Positive Software Solutions, Inc. v. New Century Mortgage Corp., 436 F.3d 495 (5th Cir.2006)

[10] Schmitz v. Zilveti, 20 F.3d 1043, 1044 (9th Cir.1994)

[11] Neaman v. Kaiser Found. Hosp., 11 Cal.Rptr.2d 879 (Ct.App.1992)

[12] Wages v. Smith Barney Harris Upham Co., 937 P.2d 715 (Ariz.Ct.App.1997)

[13] New Regency Prods., Inc. v. Nippon Herald Films, Inc., 501 F.3d 1101 (9th Cir. 2007)

[14] Valrose Maui, Inc. v. Maclyn Morris, Inc., 105 F.Supp.2d 1118, 1124 (D.Haw.2000)

[15] Kay v. Kaiser Foundation Health Plan, Inc., 194 P.3d 1181 (2008)

[16] HSMV Corp. v. ADI Ltd., 72 F.Supp.2d 1122, 1130 (C.D.Cal.1999)
[17] Brennan v. Stewarts' Pharmacies, Ltd., 59 Haw. 207, 223, 579 P.2d 673, 682 (1978)
[18] Lucent Techs. Inc. v. Tatung Co., 379 F.3d 24 (2d Cir.2004)

[19] Freeman v. Pittsburgh Glass Works, LLC, 709 F.3d 240, 254–55 (3d Cir.2013)

[20] Apusento Garden (Guam) Inc. v. Superior Court of Guam, 94 F.3d 1346, 1352 (9th Cir.1996)

[21] Woods v. Saturn Distribution Corp., 78 F.3d 424 (9th Cir.1996)

[22] Casden Park La Brea Retail LLC v. Ross Dress For Less, Inc., 75 Cal.Rptr.3d 763 (Ct.App.2008)

[23] Guseinov v. Burns, 51 Cal.Rptr.3d 903 (Ct.App.2006)

[24] Sphere Drake Ins. Ltd. v. All American Life Ins. Co., 307 F.3d 617, 623 (7th Cir.2002)

[xxv] HRS Sec. 658A-12
[xxvi] 136 Hawai'I 29, 358 P. 3d 1 (2015)
[xxvii] 137 Hawai'i 1, 364 P.3d 518 (2015)
[xxviii] 137 Hawai'i at pp. __; 364 P.3d at pp. 537-539
[xxix] Docket No. 15-1537

[xxx] Arbitration Rules, Procedures & Protocols of Dispute Prevention and Resolution, Inc. In effect September 1, 1995 © 1998, as revised December 31, 2015

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January 31, 2017

The Honorable Gil Keith-Agaran
Chair,
Members of the Senate Judiciary and Labor Committee
State Capitol Bldg. Rm. 221
Honolulu, HI 96813

Re: STRONG SUPPORT for SB 314 – Relating to Required Disclosures by Arbitrators; Hearing: February 1, 2017.

Dear Chair Keith-Agaran and Members of the Senate Judiciary and Labor Committee:

Thank you for the opportunity to submit testimony in STRONG SUPPORT regarding SB 314 relating to arbitration.

I am a member of the Board of Directors of the American Judicature Society, a former Attorney General of the State of Hawaii, a former President of the Hawaii State Bar Association, a former Lawyer Representative to the United States Court of Appeals for the Ninth Circuit, a former Vice-Chair of the Hawaii Supreme Court Rule 19 Committee on Judicial Performance (judicial evaluations), a practicing lawyer for 38 years, and a mediator and arbitrator.

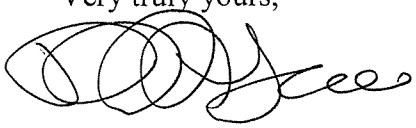
This bill, which seeks to amend portions of HRS §658A-12, is necessary to redress the implications and possible unintended consequences of two recent decisions by the Hawaii Supreme Court in ***Nordic PCL Construction, Inc. v. LPIHGC, LLC***, 136 Hawai`i 29, 358 P.3d 1 (2015) and ***Noel Madamba Contracting LLC v. Romero***, 137 Hawai`i 1, 364 P.3d 518 (2015). These two decisions had the effect of re-writing the arbitrator's disclosure statute. As currently written, under HRS §658A-12, a court **may** vacate an arbitration award if an arbitrator failed to disclose a known fact that a reasonable person would consider likely to affect the impartiality of the arbitrator. The Hawaii Supreme Court cases noted above ruled that an arbitrator's nondisclosure of information that a "reasonable person" might find likely to affect the arbitrator's impartiality constitutes "evident partiality" as a matter of law and that a court **must** vacate the arbitrator's decision.

The bill seeks to return the arbitration process to a rule of reasonableness and proportionality, under the review of a trial court which can determine the facts and then impose relief that is appropriate. Currently, under the recent Hawaii Supreme Court decisions, the arbitration process is fraught with peril for both arbitrators and litigants. If an arbitrator

inadvertently fails to make a disclosure that is later deemed "material," an arbitration award is subject to automatic reversal. If a party loses an arbitration, that party has a great incentive to begin an investigation into the relationships of the arbitrator in the hopes that they can find something, anything, that can be called "material" so that the arbitration award can be vacated and reversed, so that the party gets a second bite at the apple. This creates uncertainty and adds substantially to the cost of arbitration. This bill restores the process to allow issues regarding an arbitrator's alleged failure to disclose material facts and relationships to be reviewed by a court for appropriate relief.

Thank you for the opportunity to submit this testimony in STRONG SUPPORT.

Very truly yours,



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Hawaii State Capitol
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RE: Support for SB 314 – Relating to Required Disclosures by Arbitrators

Hearing: February 1, 2017.

Dear Chair Keith-Agaran and members of the Senate Judiciary Committee:

I support SB 314 and urge that all the members of the Committee support this important legislation. In my view, SB 314 will correct an error in two decisions by the Hawaii Supreme Court that essentialyl re-writes section 658A-12(d) of HRS Chapter 658A, Hawaii's version of the Uniform Arbitration Act, which provides that:

(d) If the arbitrator did not disclose a fact as required by subsection (a) or (b), upon timely objection by a party, the court under section 658A-23(a)(2) ***may*** *vacate an award.*

The effect of two decisions in 2015 by the Hawaii Supreme Court has resulted in making mandatory a clearly discretionary provision of § 658A-12(d). In effect, section 658A-12(d) is now interpreted by the circuit courts as follows:

(d) If the arbitrator did not disclose a fact as required by subsection (a) or (b), upon timely objection by a party, the court under section 658A-23(a)(2) ***must*** *vacate an award.*

These decisions, *Nordic PCL Construction, Inc. v. LPIHGC, LLC,* 136 Hawai`i 29, 358 P.3d 1 (2015) and *Noel Madamba Contracting LLC v. Romero,* 137 Hawai`i 1, 364 P.3d 518 (2015), have created havoc in arbitration proceedings. The circuit courts are now reading and implementing HRS §658A-12(d), as a mandatory rule, without any discretion to determine if there any bias or "evident partiality" of the arbitrator.

Consequently, a losing litigant to an arbitration proceeding can take a second bite at the apple when the prevailing party applies to the circuit court to enter the arbitration award as an enforceable judgment. By raising non-disclosures made by the arbitrator(s), the non-prevailing party argues that the circuit courts must follow the *Nordic* and *Madamba* cases to vacate the

arbitration awards, irrespective of (i) whether or not the non-disclosure was "known, direct and material" and (ii) whether or not the non-disclosed relationship was a "substantial" relationship.

In my view, the Supreme Court's decisions were not based on a determination that the language adopted by the Hawaii Legislature was unconstitutional or in any other way unlawful. Nor did the Supreme Court determine that the Hawaii Legislature was without the lawful authority to adopt this statute. Instead the Supreme Court decided that the law would be better if the statute said "must" instead of "may".

The Supreme Court's decision all but compels counsel for the disappointed litigant to challenge the arbitration award on a non-disclosure basis even if counsel believes the decision to have been fair and just. Hawaii is a diverse community but a close one as well. There are many levels of relationships: schools, clubs, community activities, churches and places of worship, and on and on. The arbitrators need guidance. Arbitrators cannot be expected to know that he or she must disclose to the litigants in arbitration all of the relationships encountered and experienced in Hawaii as *facts that a reasonable person would consider likely to affect the impartiality of the arbitrator.*

The language of this bill is designed alleviate such issues and restore this issue to the Hawaii Legislature and the sound discretion of a judge of the circuit court by requiring that a fact be "known, direct and material" or a relationship "substantial" before disclosure is required. That will allow the circuit court to make the decision rather than have the decision mandated and imposed upon it.

Accordingly, I support the bill and urge the Committee to adopt it.

Sincerely yours,

Ted N. Pettit
Co-Chair American Judicature Society
Standing Committee on Civil Justice