

# Challenging Arbitrators for Alleged ‘Conflict of Interest’ in US-Based International Arbitrations

10/12/16

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A number of significant international arbitrations, particularly involving claims by investors against sovereign states, are venued in Washington, D.C. A September 30, 2016, decision by the U.S. District Court for the District of Columbia provides guidance on the issue of whether the losing party may seek to vacate the award on the grounds that one of the arbitrators had a conflict of interest that impaired his or her impartiality or independence.<sup>1</sup> In particular, the case holds (1) that where a “challenge” to an individual arbitrator occurred during the course of the arbitration, a U.S. court can take into account the “challenge decisions” issued under the rules of the relevant arbitral institution while the arbitration was pending; and (2) that in the courts of Washington, D.C. (as is the case in New York), a challenge based on “evident partiality” will only succeed where the court finds that the facts would cause a reasonable person to conclude that the arbitrator was “actually partial” — mere “impressions” or “suspicions” are not sufficient.

The case of *Republic of Argentina v. AWG Group*<sup>2</sup> arose after a U.K. investor — the former holder of interests in water and sewage concessions in Buenos Aires, Argentina — obtained a \$20.9 million damages award in 2015 from a Washington, D.C.-based arbitral tribunal.<sup>3</sup> The tribunal, constituted under the U.K.-Argentina bilateral investment treaty<sup>4</sup> and the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL), held that Argentina’s treatment of the water concessions had violated its treaty obligation to accord “fair and equitable” treatment to investors.<sup>5</sup> Argentina moved to vacate the award, and AWG cross-moved to enter the award (plus interest) as a final judgment.

The arbitration, which ran in tandem with a parallel claim by various co-investors led by the Suez group, had a 12-year history. Shortly after Suez and AWG commenced their claims in 2003, they appointed professor Gabrielle Kaufmann-Kohler, a Swiss lawyer, as their party-appointed arbitrator. Argentina appointed professor Pedro Nikken of Venezuela. A third arbitrator, professor Jeswald W. Salacuse of the United States, was then appointed as presiding arbitrator.

In 2006, the tribunal held that it had jurisdiction to hear and determine AWG’s claims against Argentina.<sup>6</sup> In 2007, in the wake of that decision, Argentina sought to disqualify the claimant-appointed arbitrator, Ms. Kaufmann-Kohler, on several grounds. One was that Ms. Kaufmann-Kohler had recently (in 2006) been appointed a nonexecutive director at an international bank, whose investment portfolio included an interest in one of the claimants. By prior agreement,<sup>7</sup> both challenges were heard and rejected by the

<sup>1</sup> This article is a follow-up to our January 2016 *Insights* article, “[Challenging the Selection of Party-Appointed Arbitrators](#),” which discussed the same case.

<sup>2</sup> *Argentina v. AWG Group Ltd.*, No. 15-1057 (BAH) (D.D.C. Sept. 30, 2016) (*AWG (Confirmation Opinion)*).

<sup>3</sup> The tribunal awarded a total of \$20,957,809 to AWG. *AWG Group v. Argentina*, Decision on Liability (UNCITRAL 2015). In a companion case, \$383,581,241 was awarded to AWG’s co-investors. *See Suez, Sociedad General de Aguas de Barcelona S.A. & Vivendi Universal S.A. v. Argentina*, No. ARB/03/19, Award ¶ 105 (ICSID 2015).

<sup>4</sup> Agreement for the Promotion and Protection of Investments Between the United Kingdom and Argentina, 1990.

<sup>5</sup> *See AWG Group Ltd. v. Argentina*, Decision on Liability (UNCITRAL 2010) (finding liability under U.K.-Argentina bilateral investment treaty for governmental measures that impaired investments in Buenos Aires water concessions); *see also Suez, Sociedad General de Aguas de Barcelona S.A. & Vivendi Universal S.A.*, No. ARB/03/19 (parallel finding of liability in favor of French investors).

<sup>6</sup> *AWG Group Ltd. v. Argentina*, Decision on Jurisdiction (UNCITRAL 2006).

<sup>7</sup> Ordinarily, challenges in an UNCITRAL arbitration are resolved by a third party (the “appointing authority”) — often an arbitral institution or a neutral lawyer or judge. Because the *AWG* case operated in tandem with the *Suez* case — which was governed by the 1965 Convention on Settlement of Investment Disputes Between States and Nationals of Other States (ICSID Convention) — it was agreed that arbitral challenges would be determined in the manner applicable to the ICSID Convention, *i.e.*, by the two nonchallenged arbitrators.

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two other members of the tribunal, which noted, first, that Ms. Kaufmann-Kohler had been unaware of the bank’s investment and, in any event, that the investment did not compromise her independence or impartiality, among other things, because the size was not material.<sup>8</sup>

After the award was rendered in April 2015, Argentina commenced proceedings to vacate the award before the U.S. District Court for the District of Columbia. Among the grounds advanced by Argentina was that the arbitrator’s ties revealed “evident partiality,” warranting *vacatur* under Section 10(a)(4) of the Federal Arbitration Act<sup>9</sup> (FAA).

In her opinion issued on September 30, 2016, Judge Beryl Howell first addressed the standards to be applied to the challenge. These included three threshold issues:

- What deference, if any, should be given to the 2007 reasoned decision by Ms. Kaufmann-Kohler’s co-arbitrators, rejecting the challenge to her independence and impartiality. Judge Howell determined that she should accord deference to this decision, particularly given that it took into account considerations that were relevant and applicable to the “evident partiality” test under the FAA.
- What deference, if any, should be given to a 2010 arbitral decision in a related case (*Vivendi v. Argentina*) that also analyzed the alleged “conflict” and arrived at a decision that was not only very critical of Ms. Kaufmann-Kohler for failing to detect the bank’s connections with Vivendi, but also implied that arbitrators were subject to a particularly stringent test in ascertaining potential “conflicts of interests.”<sup>10</sup> In Judge Howell’s view, the 2010 decision warranted no deference because, among other things, it failed to inquire into the “materiality” of the bank’s investment in Vivendi.<sup>11</sup>
- By what standard “evident partiality” should be assessed. In this respect, Judge Howell referred to the seminal 1968 United States Supreme Court case *Commonwealth Coatings Corp v.*

<sup>8</sup> See *Suez, Sociedad General de Aguas de Barcelona S.A. & Vivendi Universal S.A. v. Argentina*, No. ARB/03/19, Decision on Second Challenge to Gabrielle Kaufmann-Kohler, ¶¶ 36-40 (UNCITRAL/ICSID 2006). Indeed, Judge Howell’s opinion noted that the investment represented a mere 0.056 percent of the bank’s total portfolio. *AWG (Confirmation Opinion)* at 25.

<sup>9</sup> Argentina further argued that the tribunal had exceeded its powers in awarding damages.

<sup>10</sup> *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID No. ARB/97/3, Decision on Annulment ¶ 222 (UNCITRAL/ICSID 2010) (“In the view of the ad hoc Committee, this does not only require an arbitrator becoming or having become a member of the board of a major international bank first to specifically investigate whether the bank has any connection with or interest in any of the parties in its pending arbitrations but, if such an arbitrator decides in principle to continue, also to notify the parties in each arbitration of such a connection or interest. This imposes a continuous duty of investigation.”).

<sup>11</sup> *AWG (Confirmation Opinion)* at 27, n. 23 (D.D.C. Sept. 30, 2016).

*Continental Casualty Co.*, a plurality decision of the Supreme Court, which contains no clear majority holding. In that decision, she noted, the justices articulated two competing tests for arbitrator challenges. In his concurring opinion, Justice Byron White advocated a pragmatic test, which required a party to prove that an arbitrator had a “substantial interest in a firm which has done more than trivial business with a party.” In contrast, Justice Hugo Black advocated a stricter standard, which held arbitrators to a quasi-judicial standard, to “avoid even the appearance of bias.”

On this issue, Judge Howell noted that the D.C. Circuit had adopted Justice White’s approach and that the burden on a challenging party for vacating an arbitral award due to “evident partiality” requires the challenging party to demonstrate facts that would cause a reasonable person to conclude that an arbitrator was partial to one party to the arbitration.<sup>12</sup> Judge Howell considered that this test was functionally identical to the 2nd Circuit standard (applicable in New York)<sup>13</sup> — but was not the same as the (stricter) 9th Circuit standard, which follows Justice Black’s opinion and looks to whether there is an “impression” of partiality.<sup>14</sup>

Applying the D.C. standard, Judge Howell held that Argentina’s evidence was “wholly insufficient” and that the bank’s investment was “inconsequential” because it consisted mainly of shares held on behalf of third parties. The record showed that the arbitrator had no involvement in the investment decisions of the bank and that the arbitration would have a “negligible effect” on the bank’s financial fortunes.<sup>15</sup> Because the arbitrator had served in a nonexecutive capacity and only for a three-year period during the course of the 12-year arbitration, the court held that Argentina had not demonstrated that there was “evident partiality.”<sup>16</sup> After rejecting the remainder of Argentina’s challenges to the award, it confirmed the award, with the result that the judgment will be entered upon the full award sum (including interest).

<sup>12</sup> See *id.* at 22 (“Following the lead of Justice White’s concurrence, the D.C. Circuit, in *Al-Harbi v. Citibank*, instructed that ‘the burden on a claimant for vacation of an arbitration award due to “evident partiality” is heavy, and the claimant must establish specific facts that indicate improper motives on the part of an arbitrator.’”) citing *Al-Harbi v. Citibank*, 85 F.3d 680, 683 (D.C. Cir. 1996) (internal citations omitted).

<sup>13</sup> *Id.* at 23 (“Other circuits to have considered the issue have employed an objective test that ‘evident partiality ... will be found where a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration.’”) quoting *Morelite Constr. Corp. v. New York City Dist. Council Carpenters Benefit Funds*, 748 F.2d 79, 84 (2d. Cir. 1984).

<sup>14</sup> See *New Regency Prods., Inc. v. Nippon Herald Films Inc.*, 501 F.3d 1101, 1103 (9th Cir. 2007) (vacating award because there was a “reasonable impression of partiality” even though there was no evidence the arbitrator was aware of the potential conflict. The arbitrator’s failure to disclose the facts of his employment and ongoing negotiations with one of the parties was sufficient to create a reasonable impression of partiality to warrant *vacatur*.”)

<sup>15</sup> *AWG (Confirmation Opinion)* at 25.

<sup>16</sup> *Id.* at 27.

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If affirmed, the decision provides guidance for parties whose arbitrations are seated in Washington, D.C., New York and other locations whose federal judicial circuits have adopted Justice White’s test from *Commonwealth Coatings*.<sup>17</sup> It confirms that in the event of a post-award challenge, an arbitrator may only be found to have displayed “evident partiality” upon a showing

of specific facts and not just the mere “appearance of bias.” Moreover, the case provides a useful example of a U.S. court being willing to consider (and potentially give deference to) the reasoned “arbitrator challenge” decisions made during the course of the arbitration.

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<sup>17</sup> For jurisdictions such as California, which are governed by the 9th Circuit view of *Commonwealth Coatings*, the ruling is of potentially less significance.

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