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# Consequences of Violating Arbitrator's Disclosure Obligation

## Introduction

On August 5 2014 the Supreme Court considered the consequences of an arbitrator's failure to disclose circumstances that may give rise to doubts as to his or her impartiality and independence.(1)

This is the first Supreme Court decision on this matter, although it has been heavily debated in legal commentary. The strict view (which relies on German case law) holds that any violation of the disclosure obligation constitutes grounds for a challenge. On the other hand, the liberal view (which relies on the International Bar Association (IBA) Guidelines) holds that an arbitrator should be held accountable only for his or her failure to disclose facts that justify a challenge. The court suggested a third option by introducing both objective and subjective criteria:

- the weight of the non-disclosed fact; and
- whether the failure to disclose information was motivated by the arbitrator's desire to avoid a challenge.

## Facts

Professor R – a retired Austrian university professor who chaired the Civil Law Institute of the University of Linz and edited a civil law commentary – was contractually appointed and acted as the sole arbitrator in an *ad hoc* arbitration between a partnership and one of its former partners.(2)

On November 7 2012 the respondent's counsel requested that R disclose all circumstances which might give rise to doubts about his impartiality and independence or conflict with the parties' agreement. The respondent's counsel also posed a number of specific questions, including questions regarding R's relationship with the parties and with the parties' counsel. On November 15 2012 R submitted a detailed reply, disclosing a number of circumstances, including the following:

- He had spoken at events hosted by the claimants.
- One of the claimants was an author of his commentary.
- He was involved (on a honorary basis) in a foundation established by the claimant's counsel.
- Another claimant was involved in this foundation.
- One of the claimant's attorneys had previously worked for him.

He also noted that after his retirement he had moved to Vienna and thus had limited connections to his former institute. However, R failed to disclose that on his retirement in 2009, he had established a support fund for students in which the claimants' counsel was involved. On November 27 2012 the respondent's counsel asked whether R had any additional circumstances to disclose. On December 3 2012 R replied that his disclosure had been true and complete.

The respondent subsequently challenged the appointment of R as arbitrator on the grounds that he was not qualified as an attorney. The challenge was dismissed by R and subsequently by the court.

In June 2013 the claimants instituted a second claim against the respondent. R was again appointed as arbitrator. On September 26 2013 R notified the parties of the composition of the arbitral tribunal. In its October 11 2103 statement of reply, the respondent again challenged R as the arbitrator. On December 18 2013 R dismissed the challenge (as well as another challenge in the first proceedings). On January 14 2014 the respondent appealed before the Supreme Court and requested that R be dismissed.

**Arguments**

According to the respondent, R had failed to disclose circumstances that were likely to cause doubts about his impartiality and independence, despite having been explicitly asked about such circumstances. The respondent claimed that subsequent investigation had revealed serious doubts regarding R's independence and impartiality. The respondent asserted 10 distinct circumstances as possible grounds for challenge, including the support fund for students established by R on his retirement, in which one of claimant's attorneys acted as a member of the advisory board.

The claimants denied that the arbitrator was biased. Further, the claimants argued that the four-week challenge period had lapsed because the respondent knew about the composition of the tribunal in June 2013, but did not file a challenge until October 11 2013.

The respondent argued that the decision regarding the composition of the tribunal had been served on September 26 2013. Therefore, its October 11 2013 challenge was within the four-week deadline.

**Decision**

The Supreme Court agreed that the respondent's challenge was within the four-week deadline. The court noted that Section 589(2) of the Civil Procedure Code creates two separate four-week deadlines for the challenge of an arbitrator. The first commences when the respondent learns the reason for the challenge. The second commences on receiving knowledge of the composition of the arbitral tribunal. As the party filing the challenge can rely on either challenge, the decisive deadline is the one that commences later.

The court then detailed the purpose and scope of the disclosure obligation. It concluded that under this strict obligation, an arbitrator must disclose all circumstances that might give rise to doubts about his or her impartiality or independence – regardless of whether these are justified biases. It also noted that arbitrators are obliged to investigate whether any such circumstances exist. However, the court held that there is no obligation to disclose circumstances which – in the eyes of a reasonable party – do not give rise to doubts as to the arbitrator's impartiality or independence. The court concluded (although not explicitly) that R should have disclosed his relationship with the claimants' counsel in relation to the support fund.

The court also referred to the IBA Guidelines on Conflicts of Interest in International Arbitration which, according to the court, provide guidance for the interpretation of Section 588 of the Civil Procedure Code. However, the court remarked that the IBA Guidelines do not constitute binding law and thus parties would need an agreement in order for them to be effective. The court also referred to a Swiss Federal Supreme Court decision[3] which noted that contact between lawyers working in private arbitration (and thus possible arbitrators) often stems from economic or professional relationships. If this were seen as bias, every

well-connected lawyer in Austria would be biased – particularly in this case, as it took place in Linz, which has a relatively small legal community. The court clarified that friendly contact between lawyers and arbitrators on its own does not constitute a reason for rejecting an arbitrator.

The court also referred to the disclosure obligation of insolvency administrators under Sections 80b(2)(1) to (3) of the Insolvency Act, which states that insolvency administrators must disclose all circumstances that may create doubts regarding independence and impartiality.

While the court held that the disclosure obligation had been violated, it found that this did not justify a challenge. It discussed the opposing views of Austrian commentary as well as German case law and commentary:

- The strict view holds that any violation of the disclosure obligation constitutes grounds for a challenge, as otherwise the arbitrator would prevent the parties from exercising their right to challenge. Further, the mere fact that an arbitrator fails to disclose certain facts exposes him or her to the suspicion that he or she is not impartial and independent. This view is supported by German case law and commentary.
- The liberal view relies on the IBA Guidelines and provides that a violation of the disclosure obligation does not justify the challenge of an arbitrator *per se* if there is no reason for a challenge. This is so because even the question of whether a disclosure obligation exists cannot always be clearly answered. A challenge is justified only if the arbitrator consciously violated his or her disclosure obligation. Otherwise, the scope of admitted challenges would be overly broad.

The court adopted a solution that lies between these two extremes by assessing the weight of the accusations of non-disclosure. If non-disclosure is simply an oversight, it must be treated differently from non-disclosure intended to prevent a challenge. The Supreme Court stated that there must be suspicion that the arbitrator culpably concealed the circumstances.

The court held that R's non-disclosure carried no significant weight, nor was there any suspicion that R had concealed facts to secure his appointment; thus, the challenge was rejected.

**Comment**

Since January 1 2014 the Supreme Court has served as the first and last-instance court not only for annulment proceedings, but also for proceedings regarding the challenge of arbitrators. This is the first challenge decision that the court has made under this new regime.

When implementing the UNCITRAL Law Model Law, Austria elected not to limit the disclosure obligation to events that raise justifiable doubts (as suggested in Article 12), but instead mandated that arbitrators disclose all events that may give rise to doubts as to impartiality or independence. This strict obligation made it impossible for the court to disregard R's failure to disclose the link to the support fund.

The court thus had to tackle a delicate question, which affected a prominent legal scholar. The professor apparently had a number of links to the claimants in the arbitration. However, this is understandable, as the case took place in Linz – a city with fewer than 200,000 inhabitants – and the claimants were from one of the largest professional firms in Linz. Nevertheless, R had failed to disclose potentially relevant

circumstances. While the decision itself failed to address the disclosed facts in conjunction with the concealed circumstances, it is apparent that the court considered these when reaching its decision.

Although the court's decision appears to be correct, its foundation is questionable. The court discussed the two opposing views in its decision. Further, although the court acknowledged that Austrian and German law are identical, it provided no reason why it deviated from the German position supporting the strict view. By seeking a compromise and holding that R had unintentionally failed to disclose information, the court in fact applied the liberal view. Further, the two elements that the court applied (ie, weight of the facts and intention of concealment) are not set out in the law. As noted above, the first element was intentionally excluded. Arguably, the latter element is impossible to examine, unless the arbitrator is called as a witness in the challenge proceedings.

The court's decision was made under special circumstances and should in no way encourage arbitrators not to investigate and disclose all circumstances that may be seen as bias, except those that create no doubt as to the arbitrator's impartiality or independence.

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**Endnotes**

(1) BGE 129 III 445 [466].

(2) Docket 18 Onc 1/14p.

(3) In all published court cases, names are redacted and only the initials are stated. However, it is easy to deduce that the arbitrator was a prominent retired professor at the University of Linz and the claimants were a well-known international partnership of tax consultants which originated in Linz.