Arbitration Newsletter – 25 August 2016

Arbitrators beware! No such thing as a free lunch

Introduction

In an April 19 2016 decision the Austrian Supreme Court considered whether a lunch attended by a sole arbitrator and a party's counsel could give rise to doubts regarding the arbitrator's impartiality and independence.(1)

This was the second challenge to be brought by the respondent against the arbitrator. The first challenge had been dismissed by the Supreme Court even though the arbitrator had not fully disclosed his relationship with one of the parties, as it had been found that the arbitrator had had no intention to conceal the information (for further details please see "Consequences of violating arbitrator's disclosure obligation").(2)

The Supreme Court upheld the respondent's second challenge.

Facts

Professor R(3) – 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 to act as the sole arbitrator in two *ad hoc* arbitrations between a partnership and one of its former partners.

The respondent challenged R on the grounds that he had failed to fully disclose his relationship to the claimants. The challenge was dismissed by the Supreme Court on August 5 2014. Subsequently, R continued the arbitration by issuing a procedural order on September 23 2015. On October 6 2015 R and the claimants' legal counsel met for lunch.

In a letter dated October 13 2015, the respondent's counsel informed R that the respondent still had doubts regarding his impartiality and requested again that he disclose his relationship with the claimants and their legal counsel. R submitted a detailed reply disclosing a number of circumstances, including the lunch meeting of October 6 2015. R stated that during the lunch, he had discussed with the claimants' counsel a forthcoming private foundation event where he was to represent the board of trustees. Nonetheless, the respondent again challenged R. As R had dismissed the challenge on November 25 2015, the respondent sought a decision from the Supreme Court on December 11 2015 (within the four-week deadline stipulated by law).

Arguments

The respondent argued that the lunch meeting had revealed a lack of sensitivity and serious doubt as to R's independence and impartiality. The respondent asserted that R had failed to maintain neutrality and that the bond of trust had therefore been harmed beyond repair.

The claimants requested that the challenge be dismissed, once again denying that R was biased. Further, the claimants argued that the issue was *res iudicata*, as the Supreme Court had already issued a binding decision concerning R's impartiality and there were no new circumstances – only unfounded indications of a personal relationship between R and the claimants' legal counsel. R's role as a board of trustees member of a private foundation established by the claimants' legal counsel was considered to be a peripheral working relationship.

Decision

The Supreme Court emphasized R's full disclosure obligation and the fact that a challenge must be based on grounds which the party became aware of after R had been nominated. The Supreme Court concluded that its first decision had found that professional contact between lawyers and arbitrators on its own does not constitute a reason for challenge, as the fact that such contact typically stems from economic or professional interactions would mean that every well-connected lawyer would be biased.

However, the Supreme Court noted that its first decision had assessed only a past professional relationship. The lunch meeting, which had occurred after the first decision, indicated an ongoing relationship. Therefore, the Supreme Court concluded that new circumstances had arisen which must be considered and that the res judicata principle did not apply.

The Supreme Court stated that a strict approach is necessary when assessing impartiality; the mere appearance of partiality is enough to warrant a challenge, as justice must be seen to be fair. The court also referred to the International Bar Association Guidelines on Conflicts of Interest in International Arbitration, referring to the opinion of a reasonable third party with knowledge of the relevant facts and circumstances when assessing an arbitrator's impartiality and independence.

The Supreme Court noted that the disclosed lunch meeting between R and the claimants' counsel must be considered in the context that the respondent had previously challenged R. Arbitrators should proceed carefully following a challenge as it signals that a party has lost trust in their impartiality and independence. The court found that there was no need for a personal meeting over lunch, as the discussions between R and the claimants' counsel could have been conducted by telephone or email. The court also held that a lunch meeting indicates a certain personal connection, regardless of what is being discussed. Further, the lunch between R and the claimants' counsel had taken place shortly after R had dismissed the respondent's challenge. As a result, the court concluded that the lunch could raise the impression of doubt regarding R's impartiality and independence for a reasonable third party.

Comment

Since January 1 2014 the Supreme Court has served as the first and last-instance court for annulment proceedings and proceedings regarding the challenge of arbitrators. This is the fourth challenge decision that the court has made under the new regime and the first in which it has upheld the challenge.

In its first decision regarding R, the court had to tackle the delicate question of whether his failure to disclose certain circumstances that could have given rise to doubts regarding his impartiality and independence was sufficient grounds to find him partial and biased. While the court held that the disclosure obligation had been violated, it found that the disclosed circumstances (ie, the previous working and professional relationships between R and certain parties involved in the arbitration) did not justify a challenge, as R had not consciously violated his disclosure obligation.

In its first decision, the Supreme Court failed to apply the strict view applied in the United States – which has been adopted by some Austrian scholars and is evidenced in German case law – under which any violation of the disclosure obligation constitutes a ground for challenge. This view is based on the fact that:

- an arbitrator could otherwise prevent the parties from exercising their potential right of challenge; and
- failure to disclose exposes an arbitrator to the suspicion of not being impartial and independent.

However, the court also failed to apply the liberal view that a violation of the disclosure obligation per se cannot justify the challenge of an arbitrator.[(3)] Rather, the court (surprisingly) introduced a new element: the arbitrator's subjective reason for not disclosing. Apart from the fact that this aspect is not addressed by the law, it appears almost impossible to examine it in practice.[(4)]

In the second case decided by the Supreme Court, in which R had failed to act with sufficient care following an initial incident, the court had the opportunity to apply a strict view and rightly granted the challenge request.

Even though the court's decision was made under special circumstances, it should serve as a reminder for arbitrators not only to disclose fully all circumstances that could give rise to a challenge, but also to proceed with the utmost care when a challenge has been dismissed.

For further information on this topic please contact Nikolaus Pitkowitz at Graf & Pitkowitz by telephone (+43 1 401 17 0) or email (pitkowitz@gpp.at). The Graf & Pitkowitz website can be accessed at www.gpp.at.

Endnotes

(1) Docket 18 ONc 3/15h

(2) Docket 18 ONc 1/14p

(3) To all Austrian legal practitioners it is easily detectable that anonymized reference to “R” relates to the renowned Professor Peter Rummel who was until his retirement in 2009 chair of the Civil Law Institute at the Johannes Kepler University of Linz, Austria and edited the famous “Rummel Commentary” to the Austrian Civil Law.

(3) See the International Bar Association guidelines, which state that "non-disclosure cannot make an arbitrator partial or lacking independence: only the facts or circumstances that he or she did not disclose can do so".

(4) See also Nikolaus Pitkowitz, "Should there be Stricter Consequences for the Breach of the Arbitrator's Disclosure Obligation?", Liber Amicorum Siegfried Elsing, 2015.