

**UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT**

August Term, 2006

(Argued: April 18, 2007)

Decided: July 9, 2007)

Docket No. 06-3297-cv

APPLIED INDUSTRIAL MATERIALS CORP.,

Petitioner-Appellant,

v.

OVALAR MAKINE TICARET VE SANAYI, A.S. and
URAL ATAMAN, his wholly owned or partially owned subsidiaries,

Respondents-Appellees.

Before: WALKER, STRAUB, AND B.D. PARKER, *Circuit Judges.*

Appeal from an opinion and order of the district court denying petitioner's motion to confirm an arbitration award and granting respondents' motion to vacate the arbitration award.
AFFIRMED.

DANIEL GOLDMAN (Jonathan Choa, *on the brief*), Paul Hastings, Janofsky & Walker, LLP, New York, NY, Anthony J. Mavronicolas, New York, NY, *for Petitioner-Appellant Applied Industrial Materials Corp.*

JEFFREY L. KESSLER, (David G. Feher, *on the brief*), Dewey Ballantine LLP, New York, NY, *for Respondents-Appellees Ovalar Makine Ticaret Ve Sanayi, A.S. and Ural Ataman.*

1 BARRINGTON D. PARKER, *Circuit Judge*:

2 Applied Industrial Materials Corporation (“AIMCOR”) appeals from a judgment of the
3 United States District Court for the Southern District of New York (Patterson, *J.*) denying its
4 petition to confirm an arbitration award and granting appellees’ motion to vacate it. In the
5 underlying arbitration, Ovalar Makine Ticaret Ve Sanayi, A.S. (“Ovalar”), a Turkish corporation,
6 and Ural Ataman, its chairman, were found liable to AIMCOR for having breached a contract to
7 deliver petroleum coke. We agree with the district court that one of the three arbitrators, whose
8 vote was dispositive, acted with “evident partiality” by failing to either investigate what he knew
9 to be a potential business relationship between his corporation and one of the parties or inform
10 them that he had walled himself off from learning more. *See* 9 U.S.C. § 10(a).

11 **BACKGROUND**

12 In 1992, AIMCOR and Ovalar entered into a joint venture in which AIMCOR purchased
13 and transported petroleum coke (a chemical created during oil refinery) to Ovalar, which then
14 distributed the coke in Turkey. The contract provided that any disputes would be settled by
15 arbitration in New York.

16 In 1997, a dispute arose over the distribution of profits under the joint venture, and the
17 parties resorted to arbitration. The arbitration agreement provided that each party would select
18 an arbitrator, and the two party-appointed arbitrators would then select a third, presiding
19 arbitrator. Section 3 of the agreement provided:

20 Prior to the first hearing or initial submissions, all the arbitrators are required to
21 disclose any circumstance which could impair their ability to render an unbiased
22 award based solely upon an objective and impartial consideration of the evidence
23 presented to the Panel

1 No arbitrator shall accept an appointment or sit on a Panel, where the arbitrator or
2 the arbitrator's current employer has a direct or indirect interest in the outcome of
3 the arbitration.
4

5 All such disclosed relationships, experience and/or interests must be objected to
6 by the parties at or before the first procedural hearing, or they shall be deemed
7 waived as creating a bias, prejudice or conflict of interest which would warrant
8 overturning the final award in this matter.
9

10 Although the agreement did not specifically address whether the arbitrators were required to
11 make additional disclosures after commencement of the arbitration, section 4 provided that "[n]o
12 person shall *serve* as an arbitrator who has or has had a financial or personal interest in the
13 outcome of the arbitration or who has acquired from an interested source detailed prior
14 knowledge of the matter in dispute." (emphasis added).

15 Ovalar and AIMCOR each selected one arbitrator, and the parties selected Charles
16 Fabrikant as the third arbitrator and chairman of the panel. He was the Chairman, President and
17 CEO of Seacor Holdings, a multi-billion dollar company with 50 offices in 30 countries.

18 On September 3, 2003, before the hearings started, the arbitrators were advised that
19 AIMCOR was being sold to Oxbow Industries and that the transaction might be "relevant to the
20 disclosure issue." Each arbitrator submitted a disclosure statement. Fabrikant's statement, dated
21 September 25, 3003, indicated that he "ha[d] had no personal or business relationship with any of
22 the parties to this proceeding, or their affiliates," and would "reserve the right to amend or add to
23 this disclosure should future circumstances warrant it."

24 At a hearing on March 4, 2005, the parties agreed to bifurcate the arbitration proceedings
25 into liability and damage phases. The liability phase commenced soon thereafter. On April 16,
26 2005 Fabrikant sent an email to the parties:

1 Gentlemen: it came to my attention yesterday, or day before yesterday that my St.
2 Louis office, which runs our barge operation under the name SCF, has recently
3 been engaged with Ox-Bow of Palm Beach. The subject of conversation is a
4 contract for the carriage of petroleum coke. I had no knowledge of such
5 conversations taking place prior to the past week. I do not participate in contract
6 negotiations or get involved in day to day operations of SCF.
7

8 I would like to amend my prior disclosures. At that time I did ask if there had
9 been contacts between my group and these parties and there were none.
10

11 I do not plan to become involved in discussions between SCF and Ox-Bow,
12 should there be further conversations between them.
13

14 I do not feel my ability to decide this case on the merits is impaired.
15

16 There were no further disclosures or reactions from the parties before the arbitration panel's
17 decision on liability five months later on September 22, 2005. The panel, in a 2-1 decision in
18 which Fabrikant cast the deciding vote, found Ovalar liable to AIMCOR for breach of contract.
19 Following its loss, Ovalar secured new counsel.

20 Two months later, on November 21, 2005, with the issue of damages still to be decided,
21 Ovalar's counsel wrote to Fabrikant asking him to withdraw. Since the time of the liability
22 award, Ovalar had conducted an investigation and concluded that a previously existing,
23 inadequately disclosed commercial relationship existed between SCF, a division of Fabrikant's
24 company, and Oxbow, the parent of AIMCOR. Ovalar's claim was that since 2004 – well before
25 the liability award – SCF had been transporting petroleum coke for Oxbow, and that this
26 relationship generated approximately \$275,000 in revenue.

27 On December 5, 2005, Fabrikant responded to Ovalar's request, stating that "I see no
28 reason to withdraw from the panel." He revealed that when he was initially informed that SCF
29 was engaged in discussions with Oxbow, he told SCF's president that he "wished to know

1 nothing about SCF's conversations, or be a party to information about our activities with Oxbow
2 or be consulted concerning any business with them." Having erected a so-called "Chinese wall"
3 to prevent his learning of any agreements between his company and Oxbow, Fabrikant concluded
4 that he was unaware of the relationship until he received the letter from Ovalar.

5 In February 2006, when AIMCOR moved to confirm the partial arbitration award, Ovalar
6 and Ataman moved to vacate the award on the grounds that Fabrikant's failure to recuse himself
7 violated the Federal Arbitration Act, 9 U.S.C. § 10(a). The district court agreed with Ovalar and
8 Ataman. The court's decision focused on several things, including (1) the disclosure
9 requirements in the arbitration agreement, (2) Fabrikant's initial statement that, subject to later
10 clarification, no conflict existed, (3) and Fabrikant's later disclosure that talks were occurring
11 between Oxbow and SCF but that he did not know about them or intend to get involved. The
12 court found that these events gave rise to a reasonable expectation on the part of the parties that
13 they would be notified of any contractual relationship between Seacor and Oxbow. The court
14 held that by insulating himself from learning about any such relationship, and failing to tell the
15 parties that he had done so, Fabrikant created an "appearance of partiality" when a nontrivial
16 commercial relationship surfaced that pre-existed the April 2005 email.

17 Citing the standards of the American Arbitration Code of Ethics for Arbitrators and the
18 International Bar Association's Guidelines on Conflicts of Interest in International Arbitration,
19 the district court found that "[r]eason dictates that there must be a continuous obligation on the
20 part of the arbitrator to avoid partiality or the appearance of partiality." The court observed that
21 the arbitrator's "failure to investigate the status of SCF's negotiations with Oxbow and his
22 subsequent lack of knowledge do not excuse his lack of disclosure." Accordingly, the district

1 court vacated the award. This appeal followed.

2 DISCUSSION

3 When reviewing a district court's decision to vacate an arbitration award, we review
4 findings of fact for clear error and questions of law *de novo*. See *Wackenhut Corp. v.*
5 *Amalgamated Local 515*, 126 F.3d 29, 31 (2d Cir. 1997).

6 The Federal Arbitration Act, 9 U.S.C. § 10(a), provides that:

7 In any of the following cases the United States court in and for the district wherein
8 the award was made may make an order vacating the award upon the application of
9 any party to the arbitration –

- 10 (1) where the award was procured by corruption, fraud, or undue means; [or]
11 (2) where there was evident partiality or corruption in the arbitrators, or
12 either of them;

13
14 The Supreme Court addressed the meaning of “evident partiality” under § 10(a)(2)
15 in *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145 (1968), and
16 concluded that it existed when one of the parties was a regular, though sporadic, customer
17 of an arbitrator, who failed to disclose that fact. *Id.* at 146-48. There, although there was
18 no evidence of actual bias on the part of the arbitrator, Justice Black, writing for a plurality
19 of the Court, stated that, “[w]e can perceive no way in which the effectiveness of the
20 arbitration process will be hampered by the simple requirement that arbitrators disclose to
21 the parties any dealings that might create an impression of possible bias.” *Id.* at 149.
22 Justice Black imported this rigorous standard from those safeguarding the impartiality of
23 Article III judges. See *id.* He further concluded that when the parties have the relevant
24 information at their disposal, it is up to them to decide whether a conflict is significant
25 enough to warrant an objection. *Id.*

1 Justice White, concurring, underscored the importance of disclosing conflicts at the
2 outset of an arbitration. He also emphasized that federal courts ought not to hold arbitrators
3 to the strict impartiality standards applicable to Article III judges: “it is enough for present
4 purposes to hold, as the Court does, that where the arbitrator has a substantial interest in a
5 firm which has done more than trivial business with a party, that fact must be disclosed.”
6 *Id.* at 151-52 (White, *J.*, concurring). He concluded that “arbitrators are not automatically
7 disqualified by a business relationship with the parties before them if both parties are
8 informed of the relationship in advance, or if they are unaware of the facts but the
9 relationship is trivial.” *Id.* at 150.

10 In *Morelite Construction Corp. v. New York City District Council Carpenter Benefit*
11 *Funds*, 748 F.2d 79 (2d Cir. 1984) (“*Morelite*”), we concluded that the fractured court in
12 *Commonwealth Coatings* and our precedent provided us “with little guidance concerning
13 what standard is to be applied in construing the ‘evident partiality’ language of the statute.
14 See *Morelite*, 748 F.2d at 83. We held that a father-son relationship between an arbitrator
15 and an officer of one party to the arbitration rose to the level of “evident partiality.” *Id.* at
16 84. Noting that in *Commonwealth Coatings* Justice Black did not speak for a majority of
17 the Court, we elected to follow Justice White’s reasoning that arbitrators are not subject
18 to the same standards of impartiality as Article III judges. See *id.* at 82-84. Finding “the
19 standard of ‘appearance of bias’ . . . too low” and “‘proof of actual bias’ too high,” we held
20 “that ‘evident partiality’ within the meaning of 9 U.S.C. § 10 will be found where a
21 reasonable person would have to conclude that an arbitrator was partial to one party to the

1 arbitration.” *Morelite*, 748 F.2d at 84. Unlike a judge, who can be disqualified “in any
2 proceeding in which his impartiality *might* reasonably be questioned,” *Apple v. Jewish*
3 *Hosp. & Med. Ctr.*, 829 F.2d 326, 332-33 (1987) (emphasis added), an arbitrator is
4 disqualified only when a reasonable person, considering all of the circumstances, “would
5 *have to conclude*” that an arbitrator was partial to one side, *Morelite*, 748 F.2d at 84
6 (emphasis added).

7 An arbitrator who knows of a material relationship with a party and fails to disclose
8 it meets *Morelite*’s “evident partiality” standard: A reasonable person would have to
9 conclude that an arbitrator who failed to disclose under such circumstances was partial to
10 one side. Here, the court below did not make findings as to the nature and timing of the
11 arbitrator’s knowledge of the relationship between SCF and Oxbow. Instead, the district
12 court focused on whether or not there was an “appearance of partiality” on the part of the
13 arbitrator, a standard that we have made clear is too low. *See id.* As a result, we cannot
14 evaluate whether the arbitrator had knowledge of the relationship that would compel a
15 reasonable person to conclude that he was partial. Were this the only issue before us, we
16 would be inclined to remand to the district court for further development of this issue. *See,*
17 *e.g., United States v. Int’l Bhd. of Teamsters*, 170 F.3d 136, 146-47 (2d Cir. 1999)
18 (remanding for further consideration where the district court applied the wrong standard for
19 disqualification of an arbitrator); *Sanko S.S. Co. v. Cook Indus., Inc.*, 495 F.2d 1260, 1263
20 (2d Cir. 1973) (remanding for evidentiary hearing on the full nature of the relationships at
21 issue so that the district court could follow the holding of *Commonwealth Coatings*).

1 However, our analysis does not end there. While the presence of actual knowledge
2 of a conflict can be dispositive of the evident partiality test, the absence of actual
3 knowledge is not. Indeed, in *Morelite*, we did not address the scope of an arbitrator’s duty
4 to investigate or disclose potential conflicts of interest. We now conclude that if we are to
5 take seriously Justice White’s statement that “arbitrators are not automatically disqualified
6 by a business relationship with the parties before them if both parties are informed of the
7 relationship in advance, *or if they are unaware of the facts but the relationship is trivial*,”
8 *Commonwealth Coatings*, 393 U.S. at 150 (White, *J.*, concurring) (emphasis added),
9 arbitrators must take steps to ensure that the parties are not misled into believing that no
10 nontrivial conflict exists. It therefore follows that where an arbitrator has reason to believe
11 that a nontrivial conflict of interest might exist, he must (1) investigate the conflict (which
12 may reveal information that must be disclosed under *Commonwealth Coatings*) or (2)
13 disclose his reasons for believing there might be a conflict and his intention not to
14 investigate. *Cf. ANR Coal Co. v. Cogentrix of N.C.*, 173 F.3d 493, 500 n.4 (4th Cir. 1999)
15 (“[I]f an arbitrator fails to investigate facts that come to light after the award, and those
16 facts are not trivial, the aggrieved party may use this information to demonstrate evident
17 partiality . . .”). *But see Gianelli Money Purchase Plan & Trust v. ADM Investor Servs.*,
18 *Inc.*, 146 F.3d 1309, 1312-13 (11th Cir. 1998) (stating that evident partiality only exists
19 when an arbitrator knows of a potential conflict but fails to disclose it to the parties).

20 We emphasize that we are *not* creating a free-standing duty to investigate. The
21 mere failure to investigate is not, by itself, sufficient to vacate an arbitration award. But,

1 when an arbitrator knows of a potential conflict, a failure to either investigate or disclose an
2 intention not to investigate is indicative of evident partiality.

3 Turning once again to *Morelite*, the question before us is whether a reasonable
4 person, looking at an arbitrator’s decision not to investigate and his concomitant failure to
5 inform the parties of the “Chinese Wall,”¹ would conclude that evident partiality existed.
6 Here, the arbitrator was under an ongoing obligation to disclose conflicts and had
7 previously assured the parties that he intended to comply with that obligation. Once he
8 learned that a branch of his company was negotiating with Oxbow to enter into a business
9 relationship, he knew, at a minimum, that a potential conflict existed. It is possible that the
10 arbitrator believed in good faith that because the potential transaction involved a subsidiary,
11 would generate revenue that was small in light of the size of his business, and was far
12 removed from his daily concerns, nothing had occurred that would affect his ability to be
13 fair and impartial.

14 However, as *Commonwealth Coatings* and *Morelite* make clear, subjective good
15 faith is not the test. Once the arbitrator was aware that a nontrivial conflict of interest
16 might exist, the calculus changed. A reasonable observer attempting to assess whether
17 evident partiality existed would, we think, be given pause by a number of significant facts:
18 the arbitrator had a continuing duty to ensure that neither he nor his corporation had “a

¹ While we are not prepared to find that a “Chinese Wall” is an inadequate substitute for investigation, we note that it is preferable for the arbitrator to consult the parties before putting a “Chinese Wall” into place, rather than informing the parties after he has chosen that course of action unilaterally.

1 direct or indirect interest in the outcome of the arbitration.” When the arbitrator learned of
2 mere discussions between the two companies, he disclosed that fact alone.² Had he
3 investigated the potential conflict, that investigation would have revealed that a relationship
4 between SCF and Oxbow *already existed* and had generated \$275,000 in revenue, not a
5 trivial amount. *See Commonwealth Coatings*, 393 U.S. at 148 (finding that the arbitrator’s
6 business relationship with one of the parties was significant, even though “[t]he payments
7 received were a very small part of [the arbitrator’s] income” (internal quotation marks
8 omitted)); *see also id.* at 151-52 (White, *J.*, concurring) (agreeing that the business
9 relationship was not trivial and that the arbitrator was required to disclose it). Yet the
10 arbitrator failed to investigate those discussions or disclose that he would make no further
11 inquiries. We believe that, given these circumstances, a reasonable person would have to
12 conclude that evident partiality existed.

13 The standard of disclosure we apply is not an onerous one. Disclosure serves the
14 twin goals of “encourag[ing] conflicts over arbitrators to be dealt with early in the
15 arbitration process and help[ing] limit the availability of collateral attacks on arbitration
16 awards by a disgruntled party.” *Lucent Techs. Inc. v. Tatum Co.*, 379 F.3d 24, 29 (2d Cir.
17 2004) (internal quotation marks omitted). As Justice White noted in *Commonwealth*
18 *Coatings*, “it is far better that the relationship [i.e., a potential conflict between an arbitrator

² Because the arbitrator never disclosed the fact of the SCF-Oxbow contract, petitioner’s argument that respondents waived any objection on that basis is without merit. *See Morelite*, 748 F.2d at 84 n.5 (“Although it is true that a disgruntled party cannot object after an award has been made, this rule applies only where the party has actual knowledge of the facts that form the basis of the objection.” (internal citations omitted)).

1 and a party] be disclosed at the outset, . . . than to have the relationship come to light after
2 the arbitration, when a suspicious or disgruntled party can seize on it as a pretext for
3 invalidating the award.” 393 U.S. at 151 (White, *J.*, concurring). It is certainly true that an
4 arbitrator “cannot be expected to provide the parties with his complete and unexpurgated
5 business biography.” *Id.* But the distance between that type of disclosure and what we
6 would require here is sufficiently great to affirm the district court.

7 **CONCLUSION**

8 The order of the district court denying petitioner’s motion to confirm the arbitration
9 award and granting the respondents’ motion to vacate the arbitration award is **AFFIRMED**.