Schnader
ATTORNEYS AT LAW

Schnader Harrison Segal & Lewis LLP

CALIFORNIA DELAWARE JAKARTA* NEW JERSEY NEW YORK PENNSYLVANIA WASHINGTON, D.C.

ALTERNATIVE DISPUTE RESOLUTION

ALERT

SEPTEMBER 2015

THIRD CIRCUIT ADOPTS "CONSTRUCTIVE KNOWLEDGE" STANDARD FOR POST-AWARD ATTEMPTS TO DISQUALIFY ARBITRATORS

By Bruce P. Merenstein

In a recent opinion addressing an issue of first impression for the court, the United States Court of Appeals for the Third Circuit held that a "constructive knowledge" standard applies to post-award challenges to an arbitrator's qualification to serve. More specifically, in *Goldman, Sachs & Co. v. Athena Venture Partners, L.P.*, No. 13-3461 (Sept. 29, 2015), the court held that "if a party could have reasonably discovered that any type of malfeasance, ranging from conflicts-of-interest to non-disclosures . . ., was afoot during the [arbitration] hearings, it should be precluded from challenging the subsequent award on those grounds."

The Arbitrator's Failure to Disclose

In *Athena Venture*, one of three neutral arbitrators in a hearing conducted under Financial Industry Regulatory Authority (FINRA) rules disclosed that he had recently been charged with unauthorized practice of law but claimed it was simply the result of an "oversight" on his part. At the same time, he failed to disclose that he had been charged many more times for unauthorized practice of law over the prior dozen years.

The losing party in the arbitration, Athena Venture, investigated the arbitrator's background *after* the panel issued its post-hearing arbitration award. Based on its discovery of the arbitrator's additional problems (as well as new charges filed against him after the issuance of the award), Athena Venture moved in federal court to vacate the award. The trial court granted the motion, finding that the award should be vacated pursuant to the Federal Arbitration Act because FINRA had failed to provide the parties with three qualified arbitrators.

The Duty to Investigate

On appeal, the Third Circuit reversed. The court held that a party may not challenge an arbitration award on the ground that one of the arbitrators was not qualified or that he engaged in misconduct where the grounds for such a motion could have been discovered through the exercise of due diligence *before* the arbitration award was issued. In doing so, the court sided with at least five other circuit courts that had adopted a similar standard. In fashioning this "constructive knowledge" rule, the court largely relied on the policies of efficiency and finality underlying arbitration, as well as the goal of preventing parties from gaming the system by waiting until after learning the results of an arbitration proceeding to decide whether to challenge an arbitrator's qualifications or conflicts.

In the case before it, the court held that Athena Venture could have discovered the extent of the arbitrator's legal troubles, as well as his false FINRA disclosure about those troubles, if it had

simply investigated him at the time of his initial disclosure. By waiting until after the award was issued to do so, Athena Venture waived its right to challenge the arbitrator's qualifications and to seek vacatur of the arbitration award on this ground.

Lessons Learned

The obvious lesson from this decision and the rule that now governs arbitrations in the Third Circuit (and most other federal circuits to address the issue) is that parties should undertake due diligence of arbitrators' potential conflicts or disqualifying factors as early as possible and certainly well before a final arbitration award is issued. Losing parties seeking to rely on an arbitrator's conflicts or misconduct to vacate an unfavorable award will be out of luck if they don't flag those problems until after the award is issued but could have discovered them earlier.◆

For more information about Schnader's Alternative Dispute Resolution Practice or to speak with a member of the firm, please contact:

Bruce P. Merenstein
Vice chair, Litigation Department
215-751-2249
bmerenstein@schnader.com

Hon. Timothy K. Lewis
Co-chair, Alternative Dispute Resolution Practice
412-577-5290
tlewis@schnader.com

Ralph G. Wellington
Co-chair, Alternative Dispute Resolution Practice
215-751-2488
rwellington@schnader.com

* *See: www.schnader.com/jakarta*