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Do I Really Have To Ask?

Supreme Court of Texas Addresses Arbitrator Disclosures And Vacates $125 Million Award

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On May 23, 2014, the Supreme Court of Texas, in *Tenaska Energy Inc. v. Ponderosa Pine Energy LLC*, 2014 Tex. Lexis 427, reaffirmed the duty of a neutral arbitrator to fully disclose all non-trivial facts and relationships with parties and their counsel that might create a reasonable impression of the arbitrator's partiality.

Background

The underlying case concerned a $125 million arbitration award in favor of Ponderosa Pine Energy (Ponderosa) regarding the purchase of a power plant from a joint venture that included **Locke Lord's client** Illinova Generating Company and Tenaska Energy (collectively, Tenaska). In state district court confirmation proceedings, Tenaska moved to vacate the award, asserting that Ponderosa's appointed arbitrator was neither impartial nor free from bias. After extensive discovery and a two-day bench trial, the district court vacated the award and found that the arbitrator exhibited evidence of partiality due to a "calculated, deliberate attempt to minimize the relationship" between the arbitrator and counsel for Ponderosa. The court of appeals reversed, finding that Tenaska waived its claim by failing to object or "ask a few basic questions" of the arbitrator when the disclosure occurred. The Supreme Court of Texas, applying the Federal Arbitration Act and Texas Arbitration Act, reversed and reinstated the trial court's order vacating the award.

The disclosure: Ponderosa was represented in the arbitration by Nixon Peabody (NP) and it designated Samuel Stern (Stern) as one of the three neutral arbitrators. Stern's conflicts disclosure advised that NP had designated him as an arbitrator in three other proceedings. Stern also disclosed that he was a director of LexSite, a litigation outsourcing company, and that he had a discussion with NP about LexSite outsourcing work to NP. As edited by NP, the disclosure noted that NP and LexSite "have done no business, and it is not clear that [NP] would ever have any business to give LexSite."

Undisclosed information: The Supreme Court of Texas found that Stern failed to fully disclose, among other things, his relationship with LexSite or NP. For example, although Stern disclosed he was a director, Stern failed to disclose his financial interest in LexSite, including that he was a shareholder with stock options for additional shares, and president of the company after it changed its name to Exactus U.S. Also, Stern did not disclose that he was actively soliciting business for LexSite from NP, including the two attorneys representing Ponderosa in the arbitration at issue. It was just after Stern's efforts to solicit business for LexSite that he was recommended by NP as arbitrator in three proceedings, including the current dispute. The Court found that, even though Stern disclosed he was a director in LexSite and

that he had discussed doing business with NP, the undisclosed details of that relationship might cause a reasonable person to view the arbitrator as being partial toward NP's client in the arbitration in hopes of securing business for LexSite. The Court did not consider this undisclosed information to be "trivial." Even though the arbitration scheduling order referenced the parties' waiver of conflicts, the Court found that Tenaska could not waive a conflict it was unaware of and that full disclosure never occurred. More importantly, the Texas Supreme Court did not adopt the appellate court's view that, upon Stern's initial disclosure of the relationship, the burden shifted to Tenaska to "ask a few basic questions" about the partial disclosure.

Commentary

In *Tenaska*, the Texas Supreme Court made clear that the onus of full disclosure remains on the arbitrator, and that a general disclosure does not shift the burden to the parties to ask the right follow-up questions or request additional facts. General or generic disclosures of dealings with interested parties or law firms is not sufficient where there have been specific dealings or business solicitations. As applied to the facts in *Tenaska*, this duty of disclosure requires an arbitrator to reveal not only his dealings with a law firm generally, but also his relationships with specific lawyers in the firm. *Tenaska* should serve as a warning to arbitrators and counsel alike to make full and complete disclosure rather than rely on the ability or inclination of opposing counsel to ask the right questions.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors:

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