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March 27, 2017

Rep. Scott Y. Nishimoto, Chair
Rep. Joy A. San Buenaventura, Vice Chair
Members of the House Committee on Judiciary
State Capitol Building, Room 325
Honolulu, HI 96813

Re: STRONG SUPPORT for SB 314, SD1– Relating to Required Disclosures by Arbitrators; Hearing: March 29, 2017 at 2:00 p.m.

Dear Chair Nishimoto and Vice Chair San Buenaventura:

Thank you for the opportunity to submit testimony in STRONG SUPPORT regarding SB 314, SD1 relating to arbitration.

I am a member of the Board of Directors of the American Judicature Society, a former Attorney General of the State of Hawaii, a former President of the Hawaii State Bar Association, a former Lawyer Representative to the United States Court of Appeals for the Ninth Circuit, a former Vice-Chair of the Hawaii Supreme Court Rule 19 Committee on Judicial Performance (judicial evaluations), a practicing lawyer for 38 years, and a mediator and arbitrator.

This bill, which seeks to amend portions of HRS §658A-12, is necessary to redress the implications and possible unintended consequences of two recent decisions by the Hawaii Supreme Court in ***Nordic PCL Construction, Inc. v. LPIHGC, LLC***, 136 Hawai`i 29, 358 P.3d 1 (2015) and ***Noel Madamba Contracting LLC v. Romero***, 137 Hawai`i 1, 364 P.3d 518 (2015). These two decisions had the effect of re-writing the arbitrator's disclosure statute. As currently written, under HRS §658A-12, a court **may** vacate an arbitration award if an arbitrator failed to disclose a known fact that a reasonable person would consider likely to affect the impartiality of the arbitrator. The Hawaii Supreme Court cases noted above ruled that an arbitrator's nondisclosure of information that a "reasonable person" might find likely to affect the arbitrator's impartiality constitutes "evident partiality" as a matter of law and that a court **must** vacate the arbitrator's decision.

The bill seeks to return the arbitration process to a rule of reasonableness and proportionality, under the review of a trial court which can determine the facts and then impose relief that is appropriate. Currently, under the recent Hawaii Supreme Court decisions, the arbitration process is fraught with peril for both arbitrators and litigants. If an arbitrator

inadvertently fails to make a disclosure that is later deemed "material," an arbitration award is subject to automatic reversal. If a party loses an arbitration, that party has a great incentive to begin an investigation into the relationships of the arbitrator in the hopes that they can find something, anything, that can be called "material" so that the arbitration award can be vacated and reversed, so that the party gets a second bite at the apple. This creates uncertainty and adds substantially to the cost of arbitration. This bill restores the process to allow issues regarding an arbitrator's alleged failure to disclose material facts and relationships to be reviewed by a court for appropriate relief.

Thank you for the opportunity to submit this testimony in STRONG SUPPORT.

Very truly yours,

DAVID M. LOUIE
for
KOBAYASHI, SUGITA & GODA

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March 28, 2017

Re: **Strong Opposition to SB 314**
Hearing March 29, 2017 at 2:00 p.m.

Dear Members of the House Judiciary Committee:

I write in strong opposition to SB 314. I urge the Committee to reject this bill, as it would only further undermine the viability of arbitration as a method of dispute resolution in Hawai`i. SB 314 would change the carefully-crafted language of Section 12 of the Revised Uniform Arbitration Act, which was incorporated verbatim into the Hawaii Revised Statutes at HRS 658A-12.[1] The purported for reason amending the model law is to undo two ***unanimous*** Supreme Court rulings.[2] But those cases simply applied the model law and reached the correct decision in light of the egregious undisclosed conflicts on the part of the arbitrator at issue. The Supreme Court decisions are well within the mainstream of cases from around the country. They are good law and good policy. The only reason to change the law as proposed is to serve the interests a handful of professional arbitrators, and their acolytes, because they want to protect themselves from issues arising out of their own inadequate disclosures.

Background

I have been practicing law in Hawai`i for over 45 years. I am the president of the law firm Alston Hunt Floyd & Ing. I am also the past president of the Hawai`i State Bar Association, the Hawai`i Bar Foundation, and the Federal Bar Association (Hawai`i Chapter). Throughout the course of my career, I

[1] The model law was released by the National Conference of Commissioners on Uniform State Laws in 2000. Hawai`i adopted it in 2001.

[2] Those cases are *Nordic PCL Construction, Inc. v. LPIHGC*, 136 Hawai`i 29, 358 P.3d 1 (2015) and *Noel Madamba Contracting, Inc. v. Romero*, 137 Hawai`i 1, 364 P.3d 518 (2015).

have represented clients in numerous matters subject to arbitration. I am counsel for Nordic Construction, which recently prevailed at trial in its effort to prove that it was the victim of inadequate disclosures by an arbitrator who awarded $10 million to the opposing party.

The Importance of Arbitrator Disclosures

The importance of requiring complete disclosure cannot be understated. Unlike trial court's decisions, arbitrator's decisions cannot be overturned when the arbitrator has made mistakes of law or clearly erroneous factual findings. Because incorrect arbitration awards are largely immune from review, it is critical that parties to the arbitration have faith and confidence in the arbitrator's impartiality and lack of conscious and subconscious bias.

The proponents of SB 314 argue that the current law undermines arbitration because it damages the "finality" and the "efficiency" of the process. Those goals are important, but they must (as the Supreme Court has made clear) be subordinate to preserving public confidence in the **integrity** of the process. A party would always sacrifice efficiency and finality to avoid bias and hidden conflicts on the part of the arbitrator. Full disclosure of relationships is particularly important in a small state like Hawai`i. If disclosure requirements are not strong—and of the consequences of nondisclosure are not clear and harsh—parties will be unwilling to agree to arbitration because they cannot be sure when weak disclosure rules will conceal hidden bias on the part of the arbitrator(s).

SB 314 Advances the Interests of a Small Group of Professional Arbitrators at the Expense of the General Public

SB 314 will benefit only two groups:

- People who serve as arbitrators, like those who submitted testimony in favor of the bill before the Senate. They will gain by (1) not having to fear that a past arbitration award is subject to reversal due to an undisclosed conflict; and (2) not having to take greater care in the future to evaluate and disclose relationships with the parties to an arbitration and their counsel. And,

- People who win arbitrations that are affected by undisclosed conflicts. They benefit by making it harder for the victims to challenge the arbitrator's failure to make full disclosure.

Unfortunately, these interests are at odds with the public interest: If anyone needs protection, it is parties to arbitrations who lose after an arbitrator failed to fully disclose conflicts. It is hard to see how the public interest is served by allowing arbitrators to be ***more*** lax about disclosing conflicts.

There are inherently incentives for arbitrators to ***withhold*** disclosures. The last thing the Legislature should do is amend the law to protect arbitrators engaging in that behavior. Although the failure to disclose relationships can often be attributed to sheer laziness, arbitrators often benefit from disclosing less. An arbitrator in a major dispute can make over $100,000 in fees. An arbitrator therefore has an incentive to not disclose a relationship in order to avoid having one party challenge him or her and lose a lucrative appointment.[3]

The *Madamba* and *Nordic* Decisions Are Correct Given the Undisclosed Conflicts at Issue

The five professional arbitrators submitting testimony in favor of SB 314 all criticize the Supreme Court's unanimous *Nordic* and *Madamba*. But those cases are rightly decided and any other outcome would have undermined the integrity of the arbitration process.

In *Madamba*, the arbitrator employed one of the firms appearing before him ***as his own attorney*** on a personal matter. He ruled in favor of the law firm that was also representing him outside the arbitration, and only disclosed the conflict after his ruling. The Supreme Court's decision that the conflict should have been disclosed is far from shocking or unreasonable. If the Supreme Court had allowed the arbitrator's award to stand, it would make people think twice about ever agreeing to arbitrate their disputes.

[3] Some of SB 314's proponents criticize the fact that the Supreme Court did not consider whether actual bias was present in the *Nordic* and *Madamba* cases. This reflects a fundamental misunderstanding of the law. The Revised Uniform Arbitration Act is rooted in an explicit policy choice that no actual bias is required to vacate an award, and rather conflicts are evaluated based on an objective, "evident partiality" standard where the subjective views of the arbitrator are completely irrelevant. See Comment 3 to Section 12 of Model Law, available at http://www.uniformlaws.org/shared/docs/arbitration/arbitration_final_00.pdf. This is because actual bias can be virtually impossible to prove: a biased arbitrator will never admit to being biased; he/she won't admit, "I ruled in favor of Party A because I am biased in its favor or against Party B." Also, bias is often subconscious rather than explicit.

In *Nordic*, the same arbitrator who was involved in *Madamba* failed to disclose that one of the law firms that represented the winning party had (1) frequently represented the arbitrator in his capacity as a trustee, (2) contemporaneously hired him as an arbitrator in another case, and (3) contemporaneously hired him to mediate a dispute for the law firm itself. When the Supreme Court heard all these facts, it was obviously reasonable for it to be concerned. Therefore, it remanded the case for an evidentiary hearing on the arbitrator's knowledge of the conflicts and on whether the party that lost the arbitration had actual or constructive knowledge of the conflicts and thus may have waived a challenge by participating in the arbitration anyway.

In the subsequent proceedings before the Circuit Court, it became clear that the arbitrator (1) knew that the Carlsmith firm represented him as a trustee; (2) and was well aware of being hired—for pay—on contemporaneous assignments.

However, the arbitrator said that despite his practice to disclose the conflicts, he simply did not think of doing so in the *Nordic* matter. None of these facts was known by the Supreme Court at the time it made its ruling, and these conflicts would have been permanently concealed had the Supreme Court not ordered the evidentiary hearing.

In short the Supreme Court made excellent decisions in the *Nordic* and *Madamba* cases. It would substantially harm the reputation of arbitration as a process in Hawai`i had the Supreme Court allowed the arbitrator's decisions in those cases to stand in light of the undisclosed conflicts at issue.

Conclusion

There is no reason to amend a statute that simply restates the model law because of two unanimous Supreme Court cases that were rightly decided, particularly here where it would only benefit a handful career arbitrators and not the public. The Committee should reject SB 314.

Very truly yours,

PAUL ALSTON

PA:NIKA:rjkp

From: mailinglist@capitol.hawaii.gov
Sent: Monday, March 27, 2017 12:55 PM
To: JUDtestimony
Cc: fdr@hawaii.rr.com
Subject: Submitted testimony for SB314 on Mar 29, 2017 14:00PM

SB314
Submitted on: 3/27/2017
Testimony for JUD on Mar 29, 2017 14:00PM in Conference Room 325

Submitted By	Organization	Testifier Position	Present at Hearing
Frank D Rothschild	Individual	Support	No

Comments: I have read and fully support the letter submitted by Lou Chang regarding this bill. I have been arbitrating disputes in Hawaii for 25 years and believe this legislation will fix an unfortunate situation that undermines full, swift and final resolution of disputes in Hawaii.

Please note that testimony submitted less than 24 hours prior to the hearing, improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.

Do not reply to this email. This inbox is not monitored. For assistance please email webmaster@capitol.hawaii.gov

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March 25, 2017

The Honorable Scott Y. Nishimoto
Chair, House Judiciary Committee
Hawaii State Capitol
415 South Beretania Street
Honolulu, HI 96813

RE: STRONG SUPPORT for SB 314 and HB 164 – Relating to Required Disclosures by Arbitrators

Hearing: March 29, 2017.

Dear Chair Nishimoto and members of the House Judiciary Committee:

I write in STRONG SUPPORT for SB 314. This bill, which seeks to amend portions of HRS §658A-12, is necessary to redress the implications of *Nordic PCL Construction, Inc. v. LPIHGC, LLC,* 136 Hawai`i 29, 358 P.3d 1 (2015) and *Noel Madamba Contracting LLC v. Romero,* 137 Hawai`i 1, 364 P.3d 518 (2015). These two decisions had the effect of re-writing the arbitrator's disclosure statute. As currently written, under HRS §658A-12, a court **may** vacate an arbitration award if an arbitrator failed to disclose a known fact that a reasonable person would consider likely to affect the impartiality of the arbitrator. The Hawaii Supreme Court ruled that an arbitrators nondisclosure of information that a "reasonable person" might find likely to affect the arbitrator's impartiality constitutes "evident partiality" as a matter of law and that a court **must** vacate the arbitrator's decision.

The Hawaii Supreme Court's decisions did not even consider whether there was any actual bias on the part of an arbitrator.

The consequence of these rulings is that arbitrator disclosures are now unnecessarily long, with arbitrators going back decades to reveal any and every iota of usually meaningless information in an effort to address what are unclear requirements, in light of these decisions. For example, if an arbitrator met a lawyer years ago at a Bar Association function and had a passing conversation with the lawyer and that lawyer now represents a party in an arbitration proceeding, is the arbitrator required to disclose that conversation? What happens if the arbitrator doesn't remember the conversation and thus does not disclose it, but another person remembered seeing the lawyer and

the arbitrator in a conversation at the Bar Association function? Will the arbitration award be vacated on the basis of an innocuous conversation that occurred years ago that was not remembered and disclosed?

Another consequence of these rulings is that any party who lost at arbitration now has an incentive to search for any tidbit of information to support a claim that the arbitrator failed to make a disclosure so that they can vacate an award and repeat the arbitration process. The cost effective and timely arbitration hearings that motivated many to select arbitration in the first place has now been significantly eroded.

Certainly, a fact must be “known, direct and material” or a relationship must be “substantial” in order to require a disclosure.

Thus, I urge the Judiciary Committee to adopt this bill.

Very truly yours,

/s/ Victoria S. Marks
Judge Victoria S. Marks (Ret.)
Co-Chair American Judicature Society
Standing Committee on Civil Justice

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March 25, 2017

The Honorable Scott Y. Nishimoto, Chair, and
Members of the House Judiciary Committee
State Capitol Bldg.
415 So. Beretania St.
Honolulu, HI 96813

Re: SB 314/HB 164 Relating to Arbitration
Hearing: 2:00 p.m., Wed. Mar. 29, 2017, Room 325

Dear Representative Nishimoto and House Judiciary Committee Members:

This letter is submitted in support of Senate Bill 314 and House Bill 164 Relating to Arbitration.

As a civil litigation attorney in State and Federal Courts here for 36 years in hundreds of mediation and arbitration cases, as a continuing mediator and arbitrator of over 1000 civil cases here for 32 years, and as a member of the American Bar Association's Section of Dispute Resolution's leadership Council and frequent presenter in local, national and international programs on arbitration and mediation for over 30 years, I am familiar with the arbitration law of Hawaii and other states and countries. In particular, I am familiar with the holdings of the Hawaii Supreme Court, the Hawaii Intermediate Court of Appeals and the Hawaii Federal District Court that have vacated arbitration awards in cases in which there was no evidence or even allegation of error on the arbitration procedure, the findings of fact or the rulings of law, and the only ground to vacate the arbitration award was the allegation that a fact not disclosed by the arbitrator was presumed by the court, even when the court acknowledged that there was no actual partiality, to constitute evident partiality that left no discretion but to automatically vacate the arbitration award.

That is not the standard that is applied to disqualification or recusal of judges under the Hawaii Code of Judicial Conduct, Rule 2.11; it is not the standard of the majority of jurisdictions in this country; and it unfairly shifts the burden of an attorney's due diligence to the arbitrator to try to recall and guess whether the most tenuous connection or experience, no matter how remote and long ago, with any party, attorney or witness, or member of the party's, attorney's or witness's firm, organization or family, might require disclosure and might be taken by an appellate court as sufficient grounds for vacatur of an arbitration award that had no deficiencies of any kind in procedure, factual findings or legal rulings, and no evidence of any actual partiality or bias of any kind. It basically lets a loser on the merits of the case vacate the result for an alleged relationship that no evidence indicates had any effect on the proceeding or award.

The results of the creation and application of that inappropriate standard for automatic vacatur of arbitration awards for virtually any non-disclosure by an arbitrator, no matter how remote or unrelated to the arbitration, are (1) to eviscerate the primary values of arbitration over litigation: savings of time and expense, and increased subject-matter expertise and finality; (2) to apply a standard to arbitrators that is presumptive and far more stringent than the standard applied to disqualification or recusal of judges; (3) to apply a standard that is not accepted or applied by a substantial majority of US courts; (4) to enable a party who loses an arbitration case on the merits to nonetheless have the award vacated based on a presumption of partiality without any evidence of any actual partiality; (5) to enable a party whose attorney does not do due diligence on any relationships between the arbitrator and any party, attorney or witness to nonetheless shift the burden of that determination and disclosure to the arbitrator and to have the arbitration award vacated for the smallest and most remote alleged violation of that disclosure standard; and (6) to substantially damage Hawaii's previous stellar reputation nationally and internationally as a State and courts who favored and supported arbitration and alternative dispute resolution options to litigation.

In fact, I personally know that lead counsel for the party seeking to vacate the arbitration award in two of the above four cases were seeking any way they could to set aside the award, even though there was no error in the procedure, findings of fact or legal rulings, because they called me to review the awards and to try to find such an error, and meticulous review indicated that there was none. They were later nevertheless able to have those awards vacated on the court's presumption that a remote connection or experience that did not indicate any actual partiality had to be treated as evident partiality that required that the award be automatically vacated.

That would not and could not happen in a litigated case, as the standard for judicial disqualification or recusal has no such presumption of evident partiality and automatic vacatur, and the standards for disclosure are far less overbroad than those that have been applied to arbitrators.

Unfortunately, I also know as a long-time member of the American Bar Association's Section of Dispute Resolution's Council and presenter at many local, national and international dispute resolution programs that Hawaii's previous respected reputation as a leader in alternative dispute resolution has been substantially eroded by Hawaii's appellate and federal courts' vacatur of arbitration awards on presumptions of evident partiality and automatic vacatur for extremely remote connections and experiences that lack any evidence of any effect at all on the arbitrator's impartial proceedings, factual findings and legal rulings.

SB 314 and HB 164 are steps in a constructive direction to restoring the intended and actual benefits of arbitration without increasing any risks of unfair proceedings or outcomes, by eliminating the presumption of evident partiality and mandatory vacatur of an arbitration award unless the arbitrator's relationship that is not disclosed is a "substantial relationship." However, the concern, frankly, is that without a definition of "substantial relationship," the same courts that have applied the evident partiality standard to the most remote and unrelated of connections and experiences of the arbitrator to automatically vacate the arbitration award, may continue to do so by broadly construing "substantial relationship" as any relationship that might give rise to any concern at all about the arbitrator's impartiality. I would therefore recommend that SB 314 and HB 164 specifically incorporate by reference, as the standard for disqualification, recusal and disclosure, the standard of Rule 2.11 of the Code of Judicial Conduct, so that arbitrators would have the same disclosure, disqualification and recusal standard applied to them that judges do:

Rule 2.11. DISQUALIFICATION OR RECUSAL

(a) Subject to the rule of necessity, a judge shall disqualify or recuse himself or herself in any proceeding in which the judge's impartiality* might reasonably be questioned, including but not limited to the following circumstances:

(1) The judge has a personal bias or prejudice for or against a party or a party's lawyer, or personal knowledge* of facts that are in dispute in the proceeding.

(2) The judge knows* that the judge, the judge's spouse or domestic partner,* or a person within the third degree of relationship* to either of them, or the spouse or domestic partner* of such a person is:

(A) a party to the proceeding, or an officer, director, general partner, managing member, or trustee of a party;

(B) acting as a lawyer in the proceeding;

(C) a person who has more than a de minimis* interest that could be substantially affected by the proceeding; or

(D) likely to be a witness in the proceeding.

(3) The judge knows* that he or she, individually or as a fiduciary,* or the judge's spouse, domestic partner,* parent, or child, or any other member of the judge's family residing in the judge's household,* has an economic interest* in the subject matter in controversy or in a party to the proceeding.

(4) RESERVED.

(5) RESERVED.

(6)The judge:

(A) served as a lawyer in the matter in controversy, or was associated with a lawyer who participated substantially as a lawyer in the matter during such association;

(B) served in governmental employment and in such capacity, participated personally and substantially as a lawyer or public official concerning the proceeding, or has publicly expressed in such capacity an opinion concerning the merits of the particular matter in controversy;

(C) was a witness concerning the matter; or

(D) on appeal, previously presided as a judge over the matter in another court.

(b) A judge shall keep informed about the judge's personal and fiduciary* economic interests* and make a reasonable effort to keep informed about the personal economic interests* of the judge's spouse or domestic partner,* minor children, or any other person residing in the judge's household.

(c) A judge subject to disqualification or recusal under this Rule, other than for bias or prejudice under Rule 2.11(a)(1), may disclose on the record the basis of the judge's disqualification or recusal and may ask the parties and their lawyers to consider, outside the presence of the judge and court personnel, whether to waive disqualification or recusal. If, following the disclosure, the parties and lawyers agree, without participation by the judge or court personnel, that the judge should not be disqualified or recused, the judge may participate in the proceeding. The agreement shall be incorporated into the record of the proceeding.

(d) A judge of the trial courts may recuse himself or herself from a case if the judge has, or anticipates having within the next 60 days, a petition for retention or an application for judicial office pending before the Judicial Selection Commission, and the judge knows* that a witness, party, or counsel for a party in the proceeding is a Commissioner on the Judicial Selection Commission whose term of office does not expire before the anticipated date of consideration of the judge's petition or application.

Code Comparison

The Hawai'i Revised Code of Judicial Conduct modifies ABA Model Code Rule 2.11 by adding "recusal" consistent with Hawai'i's distinction between disqualification and recusal, and by adding paragraph (d) that allows for discretionary recusal by a judge under certain circumstances when a Commissioner of the Judicial Selection Commission is involved in a case before the judge .

COMMENT:

[1]Under Rule 2.11(a), a judge is disqualified or recused whenever the judge's impartiality might reasonably be questioned, regardless of whether any of the specific provisions of Rules 2.11(a)(1) through (6) apply.

[2]A judge's obligation to disqualify or recuse himself or herself under these Rules applies regardless of whether a motion to disqualify or recuse is filed.

[3]As provided for in Rule 2.11(a), the rule of necessity may override the rule of disqualification or recusal. For example, a judge might be required to participate in judicial review of a judicial salary statute, or might be the only judge available in a matter requiring immediate judicial action, such as a hearing on probable cause or a temporary restraining order. In matters that require immediate action, the judge must disclose on the record the basis for possible disqualification or recusal and make reasonable efforts to transfer the matter to another judge as soon as practicable.

[4]The fact that a lawyer in a proceeding is affiliated with a law firm with which a relative of the judge is affiliated does not itself disqualify the judge. If, however, the judge's impartiality might reasonably be questioned under Rule 2.11(a), or the relative is known by the judge to have an interest in the law firm that could be substantially affected by the proceeding under Rule 2.11(a)(2)(C), the judge's disqualification or recusal is required.

[5]Rule 2.11(d) was adopted to address the practical implications of Rule 5(Section 3)(B) of the Judicial Selection Commission Rules that requires recusal of a Commissioner if that Commissioner has a substantive matter pending before a judge who has a petition for retention pending before the Commission. Paragraph (d) provides the judge with discretion to determine the appropriateness of the judge's continued participation in a proceeding when the judge has a petition for retention or an application for judicial office pending and a Commissioner is involved in the proceeding. Recusal under this paragraph does not require a judge to find that the relevant circumstances give rise to an appearance of impropriety or that the judge's impartiality might reasonably be questioned.

[6]The fact that a judge has a petition for retention or application for judicial office pending does not impose an affirmative obligation upon the judge to review the record to determine whether a Commissioner is involved in the proceeding. Discretionary recusal under Rule 2.11(d) applies only upon a judge's actual knowledge of the Commissioner's involvement in a proceeding (See definition of "knows" in Terminology of these Rules). A judge's decision to recuse himself or herself may be informed by a variety of factors, including the nature of the judge's calendar, whether the Commissioner has already recused himself or herself, the timing of expected judicial action in the case in relation to the date when the Judicial Selection Commission is expected to decide the judge's petition or application, the effect of a recusal upon the timely disposition of the proceeding, the ease of substitution of another judge, the position of the parties with respect to recusal, and the anticipated extent of the involvement of the judge and the Commissioner in the proceeding.

[7]Rule 2.11(d) is intended to ensure that a judge may exercise his or her informed discretion without consideration of a potential challenge to the recusal decision at a later point in the proceeding. Thus, there is no per se impropriety or appearance of impropriety where a Commissioner on the Judicial Selection Commission appears before a judge as a witness, party, or counsel for a party in a proceeding.

(Amended June 17, 2014, effective July 1, 2014.)

Respectfully submitted,

Charles W. Crumpton

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March 27, 2017

The Honorable Scott Y. Nishimoto
Chair,
Members of the House Judiciary Committee
State Capitol Bldg.
415 So. Beretania St.
Honolulu, HI 96813

RE: Support for SB 314 and HB 164 – Relating to Required Disclosures by Arbitrators
Hearing: February 24, 2017.

Dear Chair Nishimoto and members of the House Judiciary Committee:

I wish to offer my strong support for HB 164 and urge that all the members of the Committee support this important legislation which will correct the Hawaii Supreme Court's decision to re-write HRS §658A-12(d), which provided that:

(d) If the arbitrator did not disclose a fact as required by subsection (a) or (b), upon timely objection by a party, the court under section 658A-23(a)(2) ***may*** *vacate an award.*

In the Supreme Court's decisions *Nordic PCL Construction, Inc. v. LPIHGC, LLC,* 136 Hawai`i 29, 358 P.3d 1 (2015) and *Noel Madamba Contracting LLC v. Romero,* 137 Hawai`i 1, 364 P.3d 518 (2015), HRS §658A-12(d), has been amended to read as follows:

(d) If the arbitrator did not disclose a fact as required by subsection (a) or (b), upon timely objection by a party, the court under section 658A-23(a)(2) ***must*** *vacate an award.*

The Supreme Court's decisions were not based on a determination that the language adopted by the Hawaii Legislature was unconstitutional, nor did the Supreme Court determine that the Hawaii Legislature was without the lawful authority to adopt this statute. Instead the Supreme Court decided that the law would be better if the statute said "Must" instead of "May".

While I and many others respectfully disagree with the Hawaii Supreme Court's belief that "must" is better than "may", I am most disturbed by the Supreme Court's view that its lawful authority includes the right and obligation to tinker with

constitutional laws passed by the Hawaii Legislature to make them "better", even though that right and obligation belongs the Hawaii Legislature. In addition to the separation of powers issue, the Supreme Court's decision did not make the arbitration process better, more predictable, more certain or more uniform. Instead it injected uncertainty and coupled that uncertainty with an irresistible incentive to challenge every adverse decision on the grounds of an undisclosed fact, because it is not possible to know in advance what undisclosed fact is a *fact that a reasonable person would consider likely to affect the impartiality of the arbitrator.*

Before the Supreme Court's decision, the impact of an arbitrator's failure to disclose facts that a reasonable person would consider likely to affect the impartiality of the arbitrator had been vested in the judges of the circuit courts. This was and remains wise because what a *fact that a reasonable person would consider likely to affect the impartiality of the arbitrator* is not capable of a fixed immutable and timeless definition. Instead, it mirrors the situation that resulted in Justice Potter Stewart's most famous quote..." *I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description ["hard-core pornography"], and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that. 378 U.S. at 197 (Stewart, J., concurring) (emphasis added).*

I believe we will have to be satisfied with a similar conclusion when it comes to what facts must be disclosed in order to satisfy the arbitrator's duty. I say that because the blacks of what must be disclosed (I forgot to tell you that I arbitrated 300 cases in which Liberty Mutual Insurance Company was involved over the last 18 months) and the whites of what need not (I met counsel when I ask him for directions to the bathroom at a state bar function) are easy. It's all the grey stuff in the middle that's hard. And it is that very grey matter that caused the statute to vest in the circuit court the power and discretion to determine which non disclosures required vacature or not.

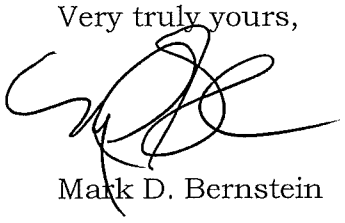
Here is but one of literally hundreds of examples of this challenge. Is the fact that an expert witness in an arbitration appeared as an expert witness 5 years before in a case when the arbitrator was a circuit court judge a *fact that a reasonable person would consider likely to affect the impartiality of the arbitrator*? If it is, just exactly how would the former judge have access to the information throughout his/her post judicial career as an arbitrator? The simple truth is that "blind luck" is the only way this fact gets disclosed.

In addition, the Supreme Court's decision all but compels counsel for the disappointed litigant to challenge the arbitration award on a non-disclosure basis even if counsel believes the decision to have been fair and just. After all, who knows whether the arbitrator's failure to disclose that he/she went to Punahou at the same time as counsel for the prevailing party constitutes a failure to disclose a *fact that a reasonable person would consider likely to affect the impartiality of the arbitrator.*

The language of this bill is designed alleviate such issues and restore control of this issue to the Hawaii Legislature and the judge of the circuit court by requiring that a fact be "known, direct and material" or a relationship "substantial" before disclosure is required and allowing the circuit court to

make the decision rather than have the decision imposed upon it. Accordingly, I strongly support the bill and urge the Committee to adopt it.

Very truly yours,



Mark D. Bernstein

LOU CHANG

MEDIATION • ARBITRATION • NEUTRAL SERVICES

Attorney At Law

The Honorable Scott Y. Nishimoto
Chair,
Members of the House Judiciary Committee
State Capitol Bldg.
415 So. Beretania St.
Honolulu, HI 96813

March 25, 2017

Re: SB 314 and HB 164 Relating to Arbitration

Dear Chair Nishimoto and Members of the House Judiciary Committee:

Thank you for the opportunity to submit testimony regarding Senate Bill 314 relating to arbitration.

My professional background is as a civil, business and commercial lawyer in the state of Hawaii since 1973. Over the course of my career, I litigated and arbitrated business, commercial and construction industry matters. Beginning in the 1970s and 1980s, I began serving as an independent and neutral arbitrator of a broad range of civil, business, construction, labor and employment matters. Since 2003, I changed the nature of my professional practice and have been primarily serving as a neutral mediator or arbitrator of such matters.

I strongly urge this committee to approve Senate Bill 314 (and the similar House Bill 164) for the following reasons:

1. Recent decisions by the Hawaii Supreme Court have caused and created perhaps unintended but severely damaging consequences upon the law and practice of commercial arbitration.

2. As a result of two recent decisions, Nordic PCL Construction, Inc. v. LPIHGC, LLC,[i] (the "Nordic" case) and Noel Madamba Contracting LLC v. Romero,[ii] (the "Madamba" case), the Hawaii Supreme Court has adopted a judicial interpretation of a provision of Hawaii's arbitration statute, HRS Chapter 658A, that has damaged the efficiency, practicality and finality of the arbitration process.

Lou Chang, ALC

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3. In the two decisions, the Hawaii Supreme Court ruled that an arbitrator's nondisclosure of information that a "reasonable person" might find likely to affect the arbitrator's impartiality constitutes "evident partiality" as a matter of law. Upon finding "evident partiality", the Court ruled that a reviewing court must vacate an arbitrator's decision and award, apparently without determination or consideration as to whether the arbitrator's nondisclosure of information is substantial or material. I note for this committee's attention that the statutory provision interpreted by the Court, HRS section 658-12(d), uses the term "may". The Hawaii Supreme Court concluded however that a reviewing court must vacate an award where there is the mere appearance of bias resulting from an arbitrator's nondisclosure of some relationship, conduct, connection or dealing. The court's ruling requires vacature, a) whether or not the undisclosed information is material or substantial; b) without an opportunity for rebuttal; and c) without a showing of any actual or unfair bias or impact upon the arbitration process.

4. As a practical result, these rulings make commercial arbitration, especially the larger cases, multi-round litigations. The traditional perceived benefits of arbitration as being fast, efficient and final are lost as a consequence. Parties who lose in an arbitration are virtually encouraged to seek judicial vacature by commencing an action and conducting discovery or extensive Google searches in the hopes of finding some element of arbitrator participation or involvement in prior matters that was not disclosed, however insignificant, so as to obtain vacature of the arbitration decision.

5. The rulings encourage unproductive game playing by parties and their advocates to "sandbag" the process. A party or its advocate can hold back knowledge of some prior contact, connection, involvement or relationship that an arbitrator may have had with some party, witness, attorney or other person or entity involved in the case that an arbitrator may have forgotten or failed to disclose. If the party loses in arbitration, they can throw out the arbitration decision and get a "second bite at the apple". Such a result creates more litigation and multiple arbitrations causing the arbitration process to lose one of its primary values, that of providing efficient finality to disputes.

Attached hereto is a copy of an article that I have written to provide to details as to the national case law in this area, background information regarding the circumstances of the Nordic and Madamba cases and describing the rulings of the Hawaii Supreme Court and the negative impacts that it has had upon the practice and practicality of arbitration. The article has been published in the March, 2017

edition of the Hawaii Bar Journal. I respectfully attach it for your committee's review and information.

There are multiple important objectives and goals of a fair and efficient arbitration process and procedure. They include the desire to promote and provide for a fair, just and impartial process, party participation in the selection of a decision maker for their dispute, efficiency and bringing practical finality to party disputes. The rulings of the Hawaii Supreme Court in the Nordic and Madamba cases promotes the appearance of fairness at the expense of other important objectives and goals of fair and just arbitration process. The rulings of the Hawaii Supreme Court in these cases have, in my judgment, placed Hawaii as an outlier, out of the mainstream jurisdiction on this matter.

Senate Bill 314 and House Bill 164 and the amendment of HRS section 658A-12 seeks to restore and establish an opportunity for rebuttal and a judicial review of claims of arbitrator nondisclosure. The proposed amendment provides for a healthy review of the circumstances regarding an arbitrator's failure to disclose some piece of information and an opportunity to determine whether the circumstances are truly material or significant and caused some actual unfairness before an arbitrator's decision is thrown out. Adoption of the amendment will restore the practicality, fairness, efficiency and finality of commercial arbitration in Hawaii.

Thank you for this opportunity to provide testimony on this matter.

Very truly yours,

Lou Chang

Attachment:

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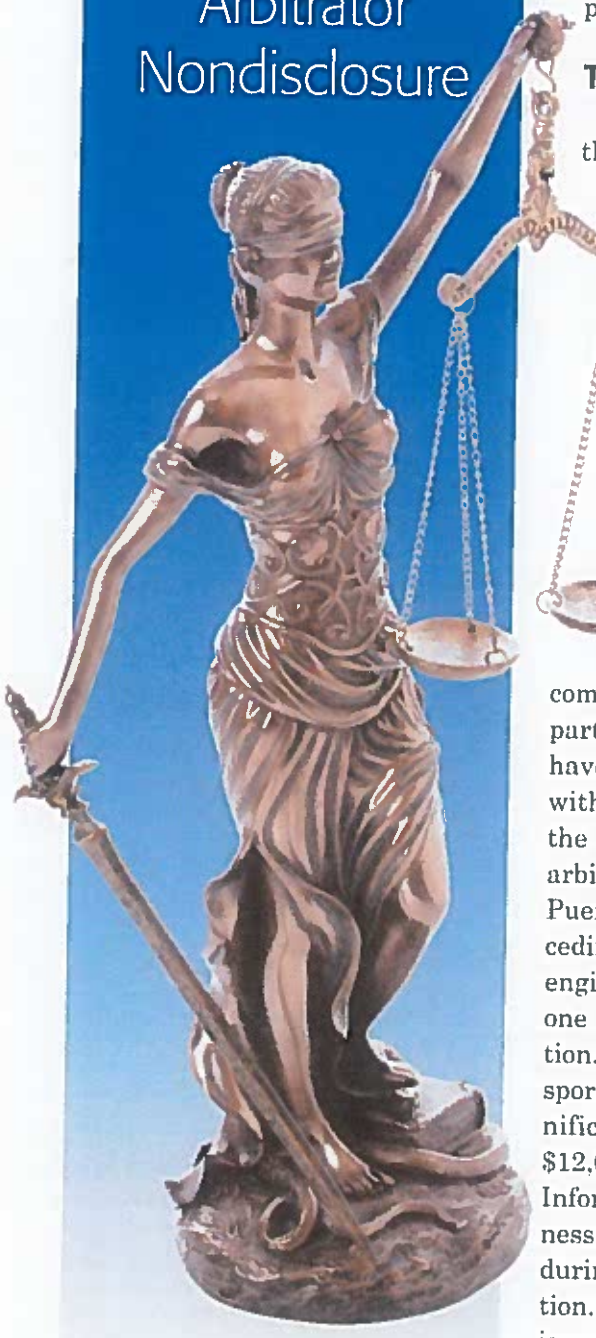
[i] 136 Hawai'I 29, 358 P. 3d 1 (2015)
[ii] 137 Hawai'i 1, 364 P.3d 518 (2015)

Trouble in the World of Hawaii

Arbitration Due to Vacature for Arbitrator Nondisclosure



by Lou Chang

When do the undisclosed "dealings" or "relationships" of an arbitrator warrant vacature of an arbitration decision? Section 10 of the Federal Arbitration Act ("FAA")[1] provides that an arbitration award may be vacated where it was "procured by corruption, fraud or undue means or (w)here there was evident partiality in the arbitrators."

The National Case Law

The seminal case dealing with this issue is the United States Supreme Court case of *Commonwealth Coatings Corp. v. Continental Casualty Co.*[2] The case involved a construction arbitration which called for a three-person panel. Each party selected an arbitrator and the two arbitrators selected a third neutral arbitrator. The arbitration dispute arose in Puerto Rico, a relatively small community where the advocates, parties and arbitrators appear to have had substantial familiarity with the construction industry and the third arbitrator. The third arbitrator owned a big business in Puerto Rico and served in the preceding five years as a consulting engineer for the general contractor, one of the parties in the arbitration. The business relationship was sporadic, but was repeated and significant and involved fees of $12,000 over that span of time. Information regarding this business relationship was not disclosed during the course of the arbitration. After the arbitration panel issued a unanimous decision in favor of the general contractor, the losing subcontractor sought to vacate the decision. The lower courts determined that the arbitration decision should be affirmed.

A divided Supreme Court addressed the matter and issued three minority opinions. Justice Black, writing for a plurality of four Justices, reversed the lower courts. The four judge plurality stated:

> We can perceive no way in which the effectiveness of the arbitration process will be hampered by the simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias.
>
> We cannot believe that it was the purpose of Congress to authorize litigants to submit their cases and controversies to arbitration boards that might reasonably be thought biased against one litigant and favorable to another.[3]

The plurality decision implicitly requires that a showing be made that undisclosed "dealings" "reasonably be thought" to create an "impression of possible bias".

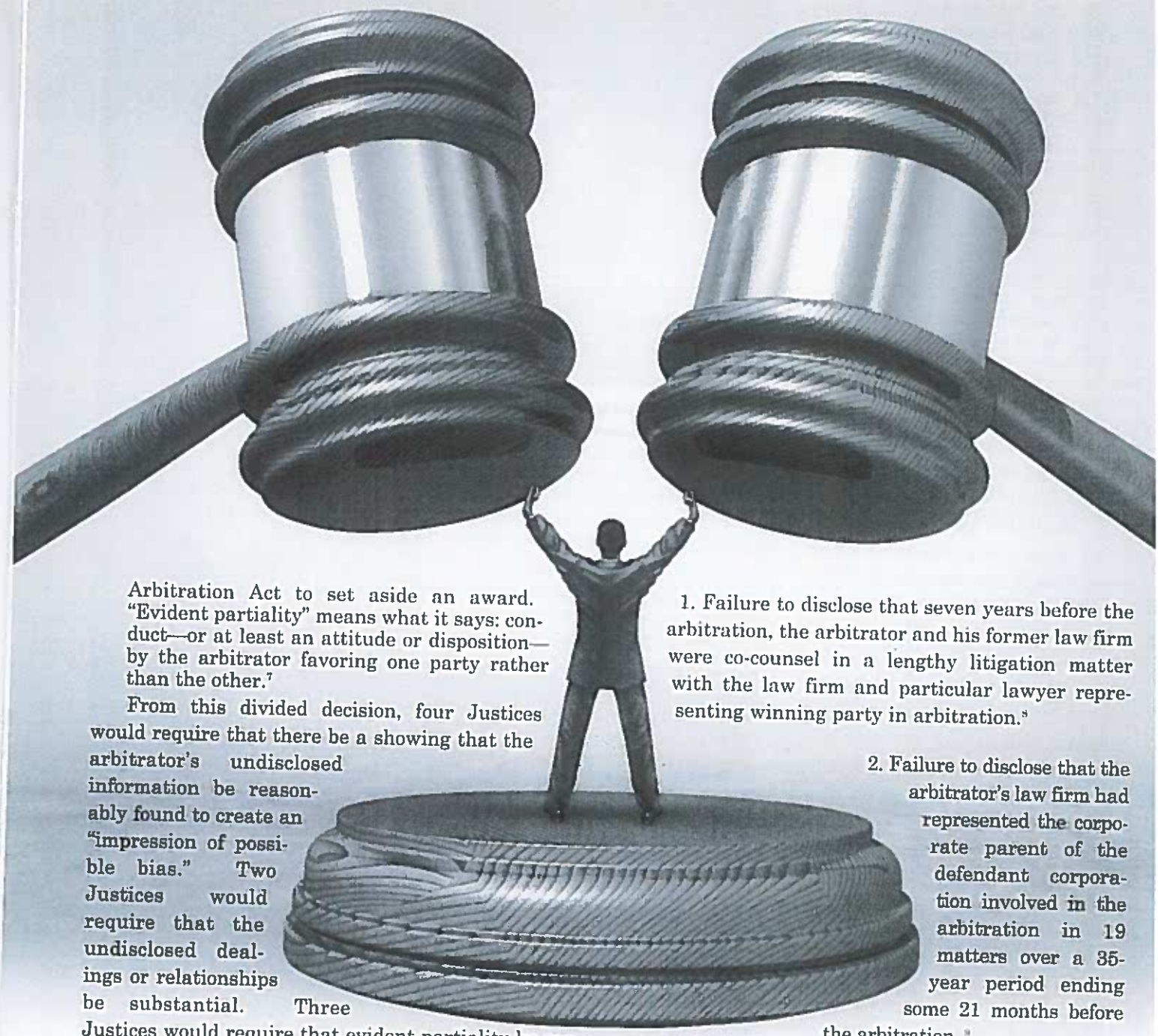
Justice White and Justice Marshall concurred with the reversal but would require a showing that the undisclosed "relationships" or "interests" be substantial. The White concurring decision recognized that arbitrators are selected by parties because they are often persons "of affairs, not apart from the marketplace, that they are effective in their adjudicatory function."[4] It stated:

> [A]n arbitrator's business relationships may be diverse indeed, involving more or less remote commercial connections with great numbers of people. He cannot be expected to pro-

vide the parties with his complete and unexpurgated business biography. But it is enough for present purposes to hold, as the Court does, that where the arbitrator has a substantial interest in a firm which has done more than trivial business with a party, that fact must be disclosed. If arbitrators err on the side of disclosure, as they should, it will not be difficult for courts to identify those undisclosed relationships which are too insubstantial to warrant vacating an award.[5]

Justices Fortas, Harlan and Stewart dissented and supported the position that a showing of "evident partiality" should be subject to a rebuttable presumption. In their dissenting opinion, they noted that the record reflected that the third arbitrator was a "leading and respected consulting engineer" who had performed services for most of the contractors in Puerto Rico and was well known to and personal friends with the petitioner's counsel.[6] Further, the petitioner's counsel indicated that he likely would not have objected to the arbitrator because he knew the arbitrator. The dissent noted:

> I agree that failure of an arbitrator to volunteer information about business dealings with one party will, prima facie, support a claim of partiality or bias. But where there is no suggestion that the nondisclosure was calculated, and where the complaining party disclaims any imputation of partiality, bias, or misconduct, the presumption clearly is overcome.
>
> I do not believe that it is either necessary, appropriate, or permissible to rule, as the Court does, that, regardless of the facts, innocent failure to volunteer information constitutes the "evident partiality" necessary under Sec. 10(b) of the



Arbitration Act to set aside an award. "Evident partiality" means what it says: conduct—or at least an attitude or disposition—by the arbitrator favoring one party rather than the other.[7]

From this divided decision, four Justices would require that there be a showing that the arbitrator's undisclosed information be reasonably found to create an "impression of possible bias." Two Justices would require that the undisclosed dealings or relationships be substantial. Three Justices would require that evident partiality be supported by a showing of conduct favoring one party over another and that the undisclosed information be subject to a rebuttable presumption.

What kind of "dealings" or "relationships" are sufficient to establish an "appearance of possible bias" or "evident partiality" is not defined in the *Commonwealth Coatings* decision. Since that decision, federal and state courts have struggled to apply its guidance to different factual circumstances.

Recent cases that have found vacature appropriate for arbitrator nondisclosure of prior connections include the following circumstances:

1. Failure to disclose that seven years before the arbitration, the arbitrator and his former law firm were co-counsel in a lengthy litigation matter with the law firm and particular lawyer representing winning party in arbitration.[8]

2. Failure to disclose that the arbitrator's law firm had represented the corporate parent of the defendant corporation involved in the arbitration in 19 matters over a 35-year period ending some 21 months before the arbitration.[9]

3. Failure of neutral arbitrator to reveal that he had served as a party-arbitrator for one of the parties.[10]

4. Failure to disclose that the arbitrator had represented investors with similar claims against predecessor-in-interest to respondent.[11]

5. Failure to disclose that, during the arbitration, the arbitrator began work as a senior executive with a production company that was negotiating with an executive of one of the parties to the arbitration to finance and co-produce a motion picture.[12]

6. Failure to disclose an ex parte communication with one of the parties' attorneys regarding the possibility of serving as a mediator in an unrelated action or the arbitrator's eventual appointment as a mediator in the action constituted "evident partiality" [13]

7. Failure to disclose that arbitrator was an official of a non-profit association that previously and presently solicited contributions from the medical institution party during the pendency of the medical malpractice arbitration matter. [14]

8. Failure to disclose arbitrator's law firm's contemporaneous representation of the Commonwealth of Australia, which owned one of the parties to the arbitration, constituted "evident partiality. [15]

9. Party-appointed arbitrator's failure to disclose that he had been employed by the appointing party as its representative and chief negotiator to negotiate the monthly rent for the subject property with the non-appointing party constituted "evident partiality. [16]

Cases that have found vacature not appropriate for arbitrator nondisclosure of prior connections include:

1. Prior service as expert witness for one of the parties does not constitute evident partiality when that service involved matter unrelated to dispute at issue and engagement concluded prior to arbitration. [17]

2. Party's undisclosed campaign contributions to arbitrator's election campaign not evidence of partiality because they are on the pub-

lic record and because opposing party's lawyers contributed more.[18]

3. Failure to disclose that arbitrator and a party's expert witness were both limited partners in a partnership unrelated to the arbitration.[19]

4. No evident partiality arising from arbitrators' financial dependence on Saturn where arbitrators, like the party in the arbitration matter, were Saturn auto dealers.[20]

5. No duty to disclose employer's prior dealings with a party because the arbitrator did not participate in or have a pecuniary interest in those transactions.[21]

6. Prior service as a pro bono mediator in an unrelated case involving a party's attorney.[22]

7. Party-appointed arbitrator, who had also represented a subsidiary of the appointing party in an unrelated matter four years prior to the arbitration, was not "evidently partial" for failing to disclose his prior involvement with the appointing party.[23]

The developing case law around the country has brought some instructive guidance for determining what kinds of dealings and relationships will be found to constitute "evident partiality" sufficient to support vacature of an arbitration award under the FAA.

The Hawaii Statute

Most states have a state arbitration statute modeled very closely to the FAA. In 2000, the Uniform Laws Commission proposed a newly stated arbitration act called the Revised Uniform Arbitration Act ("RUAA"). To date, a minority of jurisdictions (18 states plus the District of Columbia) have adopted the RUAA. While the FAA does not contain an explicit provision dealing with arbitrator disclosures, one is contained in section 12 of the RUAA which states, in pertinent part:

> SECTION 12. DISCLOSURE BY ARBITRATOR.
>
> (a) Before accepting appointment, an individual who is requested to serve as an arbitrator, after making a reasonable inquiry, shall disclose to all parties to the agreement to arbitrate and arbitration proceeding and to any other arbitrators *any known facts that a reasonable person would consider likely to affect the impartiality of the arbitrator* in the arbitration proceeding, including:
>
> (1) a *financial or personal interest in the outcome* of the arbitration proceeding; and
>
> (2) an *existing or past relationship with any of the parties to the agreement to arbitrate or the arbitration proceeding, their counsel or representatives, a witness, or another arbitrators.*(sic)
>
> ...
>
> (d) *If the arbitrator did not disclose a fact as required* by subsection (a) or (b), upon timely objection by a party, *the court under Section 23(a)(2) may vacate an award.*
>
> (e) An arbitrator appointed as a neutral arbitrator who does not disclose a known, direct, and material interest in the outcome of the arbitration proceeding or a known, existing, and substantial relationship with a party is presumed to act with evident partiality under Section 23(a)(2).[24] (italics added)

Hawaii adopted the RUAA. It is codified in HRS Ch. 658A.

Hawaii Supreme Court Decisions

In an apparent case of first impression, the Hawaii Supreme Court adopted a very troubling interpretation of the statutory provisions dealing with arbitrator disclosures. In two recent decisions, *Nordic PCL Construction, Inc. v. LPIHGC, LLC*,[25] (the "Nordic" case) and *Noel Madamba Contracting LLC v. Romero*,[26] (the "Madamba" case), the Hawaii Supreme Court ruled that an arbitrator's nondisclosure of information that a "reasonable person" might find likely to affect the arbitrator's impartiality constitutes "evident partiality" as a matter of law. Upon finding "evident partiality", the Court ruled that a reviewing court must vacate an arbitrator's decision and award, apparently without determination or consideration as to whether the arbitrator's nondisclosure of information is substantial or material.

The *Nordic* case involved a large, protracted construction deficiency arbitration case. The case involved three large local law firms and entailed 31 days of arbitration hearings. Following the hearings, the arbitrator issued an initial partial award in favor of LPIHGC, LLC, the general contractor, in an amount exceeding $9.8 million. The arbitrator later issued a supplemental award of more than $1.4 mil-

lion in attorneys' fees and costs to the prevailing party.

Nordic, the subcontractor, unhappy with the large adverse arbitration award, challenged the award and sought vacature of the award due to nondisclosure of information by the arbitrator. The case presents very complex factual circumstances and raises multiple legal issues regarding an arbitrator's duty of disclosure under the RUAA, the effect of the arbitrator's partial disclosure, party and counsel knowledge of facts that may raise a duty to inquire and whether the failure to inquire constitutes a waiver of the right to later object.

In *Nordic*, the losing party asserted as one of its grounds that the arbitrator had not disclosed that attorneys in one of the large law firms representing the party who prevailed in the arbitration had represented a large Hawaiian eleemosenary trust in several prior legal matters and that the arbitrator's role as one of three trustees of the trust represented by the law firm involved as an advocate in the arbitration should have been disclosed.

The arbitrator was a prominent and frequently utilized retired Circuit Court Judge who previously and at the time of his appointment was serving as a neutral arbitrator and/or mediator on other matters involving all of the law firms involved as advocates in the underlying arbitration and whose role and participation as a trustee of the prominent Hawaiian trust may well have been a matter of public knowledge in the local business and legal community. Complicating the circumstances, a partner of the law firm that represented the party that was seeking to vacate the arbitration award had a brother-in-law who worked as a vice president for the same Hawaiian trust, thus raising the prospect that the arbitrator's role as a trustee of the trust might have been known to the law firm or its client who lost in the underlying arbitration as a factual or legal matter. Further complicating the circumstances, the arbitrator, during the pendency of the arbitration, was requested to and did undertake to serve as a neutral in new matters involving attorneys from the two law firms that were representing the prevailing general contractor in the pending arbitration case. Because the trial court below had not made express findings of fact or conclusions of law, the Hawaii Supreme Court determined that it did not have the proper record from which to rule and thus remanded the matter for the trial court to make findings and conclusions. The results of the remand are presently pending.

The *Madamba* case was also a construction contract case between homeowners (the Romeros) and their general contractor, Noel Madamba Contracting LLC (Madamba). In the *Madamba* case, the arbitrator was the same retired judge involved in the *Nordic* case. The arbitrator made a similar general disclosure upon his appointment that when he was a Circuit Court judge, counselors and members of their firms appeared before him and since retirement he served as a neutral in matters for counselors and members of the firms representing the parties in the arbitration. No mention was made in the arbitrator's disclosure relating to the administration and legal review of the arbitrator's personal retirement accounts and that a third-party benefits administrator company that managed the arbitrator's personal retirement accounts was deciding to have certain other attorneys from the law firm that represented the homeowners perform legal services to bring the arbitrator's pension plan into compliance with federal and state laws.

Arbitration hearings were conducted in November, 2011. Following the hearings, the arbitrator issued a partial final award in favor of homeowner parties and against the contractor in the amount of $154,476.51 as compensatory damages. Following the arbitrator's issuance of the partial final award, it came to light that the arbitrator's retirement plan administrator had attempted to assign the task of performing the legal review and preparation of amendments needed to bring the arbitrator's pension plan into compliance with federal and state laws to a benefits plan lawyer who was in the same firm as the Romeros' attorney in the arbitration. When this fact became known, the arbitrator's retirement plan file was transferred to a different law firm. The losing contractor challenged the arbitrator's decision and sought vacature because of alleged insufficient disclosures.

The Court found the timing of discussions concerning the possibility of having the law firm do legal work for the arbitrator relating to his retirement accounts important to its conclusion that significant information that should have been disclosed was not disclosed and constituted a breach of the Hawaii RUAA provisions dealing with arbitrator disclosures. The Hawaii Supreme Court in the *Madamba* case held that an arbitrator's failure to disclose facts relating to a *potential future* relationship with the law firm that represented one of the parties involved in the arbitra-

tion was a fact that a reasonable person would consider likely to affect the impartiality of the arbitrator. It did not matter that no engagement letter had been signed, no legal work was done by the law firm that represented the Romeros in the arbitration and the file was transferred to a different law firm. Upon determining that there was nondisclosure of a fact that a reasonable person would consider likely to affect the impartiality of the arbitrator, the Court ruled that was equivalent to "evident partiality." The Court, interpreting HRS Sec. 658A-12 and HRS Sec. 658A-23 of the Hawaii RUAA, ruled that a reviewing court in such instance *must* vacate the arbitrator's decision. The Court appears to eliminate any requirement that an "appearance of partiality" be material or substantive, thereby elevating appearance over substance. Its ruling also eliminates the need or opportunity for a party to rebut the significance and materiality of the claimed nondisclosure.

The Hawaii Supreme Court made the following rulings:

• "an arbitrator's impartiality and appearance of impartiality is paramount;"

• " ... in the context of neutral arbitrators, "a failure to meet disclosure requirements under HRS § 658A-12(a) or (b) is equivalent to, or constitutes, 'evident partiality' as a matter of law." "(citing the Court's earlier *Nordic* decision, 136 Haw. 29 at 50, 358 P.3d at 22);
• the arbitrator's failure to disclose the possible relationship with another attorney in the firm of one of the arbitration party's attorney

"created a reasonable impression of partiality;"

• for claims of evident partiality based on a failure to disclose "an arbitrator's nondisclosure of facts showing a potential conflict of interest creates evident partiality *warranting vacatur even when no actual bias is present.*" *Daiichi*, 103 Haw. at 352, 82 P.3d at 438 (quoting *Schimitz*, 20 F.3d at 1045); and

• even if the relationship at issue is a prospective or future relationship, a failure to disclose may result in a reasonable impression of partiality, and accordingly, a violation of HRS § 658A-12(a) or (b).

Impact on the Practice of Arbitration

The *Nordic* and *Madamba* cases have turned the world of commercial arbitration in Hawaii into a litigator's haven or hell, depending upon your point of view. Any party who is disappointed by an arbitrator's decision is incentivized, if not required, to engage in an extended internet and media investigative search of the arbitrator's history, background, associations and activities in the hopes of finding some undisclosed factual circumstance that can support a claim that the arbitrator failed to make a needed disclosure and to get the proverbial "second bite at the apple."

Since the Court's issuance of the *Nordic* and *Madamba* decisions, additional arbitration disclosure challenges are working their way through the appellate court process. Some assertions of alleged improper nondisclosures include factual circumstances such as facts such as being listed on a panel of arbitrators maintained by an ADR administering agency along with a partner of an advocate attorney involved in the arbitra-

tion, failure to disclose that a witness in an arbitration was involved as an advocate in a prior case, and joint participation in community non-profit organization galas and membership in a community science club. The lack of definition of critical terms such as "dealings," "relationships," "reasonable person," and "likely to affect impartiality" provides great uncertainties and large room for creative argument. Without an opportunity to challenge or rebut the materiality of an item of nondisclosure, the temptation to "take a shot" to vacate an adverse arbitration decision may be irresistable.

The recent rulings introduce some troubling potential malpractice exposure into the process as well. Advocates who fail to thoroughly investigate a potential arbitrator for information concerning potential arbitrator interests, associations, past involvement in cases or relationships may face exposure to a claim of inadequate investigation. An arbitration advocate or a partner or principal of the advocate's firm who might know of a relationship, association or prior connection with the arbitrator who fails to disclose such information to the client or in the course of the arbitration to the agency or parties involved might create an opportunity for the non-client party who loses an arbitration to challenge and overturn an arbitration decision or award that was favorable to the client. If attorney misconduct is found, might that then lead to an action for disgorgement of fees?

These cases appear to assume that the State RUAA statute is applicable rather than the FAA. Unless the parties expressly adopted the Hawaii RUAA as the governing arbitration procedural law, given the broad sweep of the interstate commerce clause, would not the FAA be the appropriate governing statute? Is there preemption over contrary state law?

The ramifications of the *Nordic* and *Madamba* cases make arbitrations of any significant size, issue or amount in controversy no longer an efficient, practical or final conflict resolution procedure. The *Nordic* and *Madamba* cases resulted in the overturning of arbitration decisions in case that involved very substantial effort, fees and expenses. In *Nordic*, attorneys fees and costs alone exceeded a million dollars for just one of the parties. Advocates now are tempted to challenge any adverse arbitration decision through a post award internet and private investigation to dig up some undisclosed or forgotten past, present or future "dealing" or "relationship" of the arbitrator with parties, attorneys, other arbitrators, witnesses, experts, organizations, civic or social groups. Upon doing so, parties can gain vacature, settlement advantage and/or another "bite at the apple."

What Arbitration Practitioners Can Do

Until there is further clarification from the courts, what can parties and counsels do to maintain the integrity and finality of the arbitration process? Allow me to share some ideas for parties and their counselors and advocates.

At the Drafting Stage:

1. Parties can acknowledge in their contract and arbitration agreements that the relationship is one occurring in the course of interstate commerce and specifically adopt the provisions of the FAA. (The *Nordic* and *Madamba* cases were decided under the Hawaii Revised Uniform Arbitration Act (HRS Ch. 658A), which is arguably now far more restrictive

than the FAA.)

2. Parties should carefully review the arbitration rules of any dispute resolution service that they select and adopt as the applicable arbitration procedural rules for the contract. There are important differences in the arbitration rules of the Dispute Prevention and Resolution Inc., American Arbitration Association and JAMS. Note for example, that the rules of the Dispute Prevention and Resolution Inc., the leading Hawaii private dispute resolution agency, provides that unless otherwise noted and agreed by the parties, the provisions of the Hawaii RUAA are deemed the arbitration procedural rules applicable to arbitrations conducted under its rules. Such rule contemplates that parties may expressly agree otherwise.

3. Parties may also consider selecting the forum and jurisdiction of the Federal courts which now appear to be more supportive of the arbitration process as a party selected dispute resolution process.

4. Parties may adopt their own customized rules or adopt selected administrative rules of a dispute resolution agency which provide for a more open and fair arbitrator selection, disclosure and vetting process. For example, Dispute Prevention and Resolution Inc., has adopted a newly revised arbitration rule 9D dealing with nondisclosure and waiver. That rule provides the following: No party shall circumvent the disclosure process by failing to advise DPR of a known, but undisclosed fact or circumstance concerning the Arbitrator that the party believes merits disclosure prior to the confirmation of the Arbitrator and any such failure shall constitute a waiver of that party's right to seek disqualification of the Arbitrator or otherwise attack an Arbitrator's award. Further, no party shall engage substitute counsel, or name or call a previously undisclosed witness for the purpose of creating a basis to seek the disqualification of an Arbitrator.[24]

At the Pre-Hearing Stage:

1. Discuss and negotiate a fair disclosure protocol for the matter, such as:

a. Consider making an agreement that all parties involved in the arbitration (arbitrator, parties, counsels) share the duty to make good faith disclosures of any past, present or future dealings or relationships regarding the arbitrator that a reasonable person may determine likely to affect the impartiality of the arbitrator or the integrity of the arbitration process.

b. Acknowledge considerations of the desirability of the parties to participate in the selection of the arbitrator(s) from their community with desired or known experience and expertise.

c. Agree to a reasonable time for all parties during a research and investigation phase to thoroughly investigate the business, professional, civic and social history of the arbitrator(s).

d. Agree that after the agreed research and investigation phase, all parties accept the disclosures made and agree that it shall not be grounds for any party to seek vacature due to any subsequently discovered fact, dealing or relationship that could have been discovered during the agreed research and investigation phase.

During the Arbitration Process:

Parties and their counsels (and their firms) should refrain from communicating with, soliciting or offering to utilize the arbitrator in any other concurrent or future matter.

Conclusion

This aspect of arbitration practice addresses the tension of balancing three objectives: (1) providing for a fair and impartial decision maker; (2) providing for party participation and selection of their desired decision maker with suitable experience and expertise for the matter; and (3) assuring reasonable, timely and practical finality of decisions. The court has emphasized the importance of having the appearance of propriety of the arbitration process to the diminishment of the other desired objectives of arbitration, that of party selection and finality and practicality of the process.

As a practitioner and student of the arbitration process, one hopes that there will be some practical and prompt clarification in this area from the courts or, if necessary, from the legislature. Until then, practitioners can consider the suggestions set forth above to try to restore some reason and sensibility to the process.

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1 9 U.S.C. § 1-14.

2 393 U.S. 145, 89 S. Ct. 337, 21 L. Ed. 301 (1968).

3 393 U.S. at pp. 149-150.

4 393 U.S. at p. 150.

5 393 U.S. at pp. 151-152.

6 393 U.S. at pp. 152-153.

7 393 U.S. at p. 154.

8 *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 436 F.3d 495 (5th Cir. 2006).

9 *Schmitz v. Zilveti*, 20 F.3d 1043, 1044 (9th Cir. 1994).

10 *Neaman v. Kaiser Found. Hosp.*, 11 Cal.Rptr.2d 879 (Ct.App.1992).

11 *Wages v. Smith Barney Harris Upham Co.*, 937 P.2d 715 (Ariz.Ct.App.1997).

12 *New Regency Prods., Inc. v. Nippon Herald Films, Inc.*, 501 F.3d 1101 (9th Cir. 2007).

13 *Valrose Maui, Inc. v. Maclyn Morris, Inc.*, 105 F.Supp.2d 1118, 1124 (D. Haw. 2000).

14 *Kay v. Kaiser Foundation Health Plan, Inc.*, 194 P.3d 1181 (2008).

15 *HSMV Corp. v. ADI Ltd.*, 72 F.Supp.2d 1122, 1130 (C.D.Cal. 1999).

16 *Brennan v. Stewarts' Pharmacies, Ltd.*, 59 Haw. 207, 223, 579 P.2d 673, 682 (1978).

17 *Lucent Techs. Inc. v. Tatung Co.*, 379 F.3d 24 (2d Cir. 2004).

18 *Freeman v. Pittsburgh Glass Works, LLC*, 709 F.3d 240, 254–55 (3d Cir.2013).

19 *Apusento Garden (Guam) Inc. v. Superior Court of Guam*, 94 F.3d 1346, 1352 (9th Cir. 1996).

20 *Woods v. Saturn Distribution Corp.*, 78 F.3d 424 (9th Cir. 1996).

21 *Casden Park La Brea Retail LLC v. Ross Dress For Less, Inc.*, 75 Cal.Rptr.3d 763 (Ct.App. 2008).

22 *Guscinov v. Burns*, 51 Cal.Rptr.3d 903 (Ct.App. 2006).

23 *Sphere Drake Ins. Ltd. v. All American Life Ins. Co.*, 307 F.3d 617, 623 (7th Cir. 2002).

24 HRS § 658A-12.

25 136 Haw. 29, 358 P. 3d 1 (2015).

26 137 Haw. 1, 364 P.3d 518 (2015).

27 137 Haw. __; 364 P.3d at pp. 537-539.

28 Arbitration Rules, Procedures & Protocols of Dispute Prevention and Resolution, Inc. In effect September 1, 1995 © 1998, as revised December 31, 2015.

Lou Chang serves as an independent and neutral mediator and arbitrator for business, commercial, design and construction, labor-management, employment, franchise, real estate, insurance, probate, family business, personal injury and civil disputes.

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March 29, 2017

Via Online Testimony Website

The Honorable Scott Y. Nishimoto, Chair
Members of the House Judiciary Committee
State Capitol Building
415 South Beretania Street
Honolulu, Hawai‘i 96813

Re: **SB 314 AND HB 164 Relating to Arbitration**
Committee on Judiciary; Room 325; Hearing March 29, 2017 at 2:00 p.m.

Dear Chair Nishimoto and Members of the House Judiciary Committee:

Thank you for the opportunity to submit testimony in support of Senate Bill 314 and House Bill 164 relating to Arbitration.

I. MY BACKGROUND

I am a graduate of Harvard College and the William S. Richardson School of Law and have been a practicing attorney concentrating in litigation and arbitration matters since 1977. I am currently on the panel of arbitrators for the American Arbitration Association, (“AAA”) Dispute Prevention and Resolution (“DPR”), the National Association of Securities Dealers (“NASD”) and the National Academy of Distinguished Neutrals (“NADN”). I am certified by the National Board of Trial Advocacy in two areas; Civil Trial Advocacy and Civil Pre Trial Practice Advocacy (“NBTA”). I am recently retired from the American Board of Trial Advocates, (“ABOTA”). I have also been recognized in the following eight areas by Best Lawyers in Hawai'i: Mediation, Arbitration, Bet-the Company Litigation, Commercial Litigation, Employment Law – Individuals, Litigation – Labor & Employment, Medical Malpractice Law – Defendants and Medical Malpractice Law – Plaintiffs. Additionally, I have been named by Best Lawyers as Honolulu Labor & Employment Litigation Lawyer of the Year for 2012, Honolulu Mediation Lawyer of the Year for 2014 and Employment Law Individual 2017.

In my 40 years of trial practice I have served as an advocate for parties in more than a hundred arbitrations. I have served as an appointed arbitrator scores of times and have such assignments at the present time. I have appealed arbitration awards to the courts and have had them vacated. I have also defended against such appeals in the Hawai‘i Supreme Court, the United States District Court for the State of Hawai‘i and in the Ninth Circuit Court of Appeals. The cases that I have personally handled as an advocate have ranged in value from a few hundred thousand dollars to more $20 million. The same is true of the cases I have handled as an arbitrator.

II. COMMENTS ON PENDING BILLS

I have reviewed the recent testimony submitted by Mr. Lou Chang in favor of these pending bills. I would simply like to say that this legislation is very sorely needed for all of the reasons pointed out by Mr. Chang. I would also like to briefly enlarge on a few practical points for your consideration, as follow:

A. AVOIDING EXPENSE AND DELAY

The average time to get to trial for a civil case in Hawai‘i is between one and two years. After a verdict is rendered, the average time for appeal is a further two to five years.

The old saying that justice delayed is justice denied is quite true. The average citizen badly wants access to a reasonably early hearing on the merits of his or her claim and that is one of the most important parts of the process. When the other party can force wearying and expensive delays--before the process is ever complete--the injured party becomes frustrated and disgusted and feels that ‘there is no justice’ or that it is “only for the rich”. An effective arbitration system helps avoid these concerns. These bills greatly contribute to an effective arbitration system which is now badly broken.

B. TAKING SOME OF THE LOAD OFF THE OVERBURDENED COURTS

An effective arbitration system takes an enormous caseload out of the courts, which in turn saves substantial tax dollars and reduces backlogs and delays in court. I just checked with just one or our local arbitration providers--who confirmed that they had 250 new arbitrations filed within the last year. That gives one some idea of how many more courts and judges would be needed if all these matters had to be litigated rather than arbitrated.

Arbitration cannot replace the courts and never will--but it is a very important safety valve in appropriate cases and should be strengthened, not undermined. These bills help accomplish that.

C. THOSE WHO ARBITRATE CHOOSE TO DO SO.

Those who choose arbitration have always agreed to do so in a written contract signed by the parties. Such contracts should be enforced. The comments made by Mr. Chang about gamesmanship in the process are, in my experience, very true. One of the most challenging arbitrations in which I participated was a construction case where, after an exhaustive hearing that consumed six weeks on over a $20 million in claims, the wealthy Plaintiff lost--but then chose to pursue multiple appeals-all the way through the Ninth Circuit, before finally conceding defeat to the local contractor whom we represented. The appeals objected to the Arbitrator's well supported rulings and were all rejected--but they are illustrative of exactly the problems that Mr. Chang identified. Clever advocates can be expected to, and will, exploit any defense. However, it is unseemly for a party to agree to a process and then lie in wait and seek to undermine that process only when they lose. These bills will help to stem that problem.

III. CONCLUSION

Thank you for considering these comments and I hope these bills are adopted. They certainly do serve the public interest.

Sincerely,

HIATT & HIATT

Jerry M. Hiatt