Japanese Supreme Court's First Decision On Arbitrator's Non-disclosure

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On December 12, 2017, the Supreme Court of Japan rendered its first decision on the setting aside of an arbitral award based on an arbitrator's failure to disclose facts allegedly constituting a conflict of interest, reasoning that, in order for the award to be set aside on this ground, it is necessary that the arbitrator was aware of such facts or that such facts could ordinarily have been ascertained if the arbitrator had conducted reasonable research (*heisei* 28 (*kyo*) no. 43. Available at here). This post discusses the court's decision from a practical, theoretical, and comparative perspective.

Factual Background

The underlying arbitration was filed in June 2011 under the Japan Commercial Arbitration Association's Commercial Arbitration Rules ("JCAA Rules") and was seated in Osaka, Japan. Claimants in the arbitration were Japanese and Singaporean companies that manufactured and sold air conditioners and the two Respondents were Texas companies that sold air conditioners.

The chairman of the three-member tribunal (the "Chair") was a partner in the Singapore office of an international law firm (the "Firm"). In his Declaration of Impartiality and Independence submitted in September 2011, the Chair declared that he was not aware of any circumstances likely to give rise to justifiable doubts as to his impartiality and independence, but noted that a lawyer of the Firm could in the future advise or represent a party to the arbitration or related companies thereof on a matter unrelated to the arbitration.

In February 2013, another lawyer joined the San Francisco office of the Firm. That lawyer was representing a sister company (the "Affiliate", under 100% common ownership by the parent) of one of the Claimants in a class action before the U.S. District Court for the District of California and continued to do so during the arbitration (the "Facts"). The Chair did not disclose the Facts during the arbitration proceeding.

Set-aside Proceedings

After the tribunal rendered an award in August 2014 in favor of Claimants, the Respondents applied to the Osaka District Court (the "ODC") to have the award set aside under Article 44 of the Japanese Arbitration Act of 2003, on the basis that the composition of the arbitral tribunal or the arbitration procedure was not in accordance with Japanese laws and regulations (Art. 44, para. 1, item (vi)), and the content of the award was contrary to Japanese public policy (Art. 44, para. 1, item (viii)).

Respondents argued, *inter alia*, that the Chair had breached his obligation, under Article 18 para. 4 of the Arbitration Act, to "disclose … all facts that would be likely to give rise to doubts as to his/her impartiality or independence."

Dismissing the set-aside application, the ODC held that although the Facts might generally qualify as circumstances likely to give rise to justifiable doubts as to the arbitrator's impartiality and independence, the Facts did not reach this level under the particular circumstances of the case.

On appeal, the Osaka High Court (the "OHC") set aside the award. The OHC held that an arbitrator's obligations include the duty to conduct research to uncover any potential sources of conflicts that the arbitrator can find without substantial effort, and that the Facts could have been ascertained without exceptional difficulty through a conflict-check procedure within the Firm.

Reversing the OHC's decision, the Supreme Court held that, in order to find a breach of an arbitrator's duty to disclose facts that would likely give rise to doubts as to his/her impartiality or independence, it is necessary that the arbitrator either was aware of such facts or could have discovered such facts by making a reasonable search before the completion of the arbitration proceeding.

The Supreme Court found it unclear from the record whether the Chair had been aware of the Facts. It further found that it was unclear whether the Chair could have discovered the Facts by making a reasonable search before the completion of the arbitration proceeding, as it was unclear whether the Firm was aware of such facts, and unclear what methods the Firm used to check for conflicts.

The Supreme Court then concluded that the OHC's decision was erroneous because it had concluded that the Chair was in breach of his disclosure obligation without determining the relevant issues above.

Comments

The OHC and the Supreme Court accepted the same general premise that an arbitrator is obliged to disclose facts like those at issue in this case.

From a practical standpoint, however, the OHC's decision has been criticized by practitioners as ignoring the real world of international law practice. Specifically, the conflict check described by the OHC is considered too burdensome because it would apparently require the arbitrators and the parties to continuously monitor all relationships between the arbitrator's law firm and the parties' affiliates, regardless of the affiliate's degree of closeness to the party.

The Supreme Court's decision, to its credit, takes into account the complex reality of practice in an international law firm setting, requiring that courts, first, determine how the arbitrator's firm actually conducted conflict checks and whether the facts were, in some sense, known to the firm and, second, determine whether the arbitrator could have found the facts through reasonable research.

From a theoretical standpoint, the Japanese courts have not yet discussed the profound and frequently arising question of whether an arbitrator's apparent unawareness of his or her law firm's representation of an affiliate of a party, might preclude a finding of a lack of independence and impartiality that would warrant setting aside. Recent decisions in Switzerland and England offer an interesting comparison.

In a decision dated September 7, 2016 (4A_386/2015) (English translation here), the Swiss Federal Supreme Court analyzed a case involving an arbitrator at a Swiss law firm who failed to disclose that lawyers at a German law firm (operating in an alliance with the Swiss law firm) represented a sister company of one of the parties in the arbitration. The Court noted that there was no evidence that the

arbitrator was aware of the representation, and thus "he would have had no reason to show favor in the arbitration to the party affiliated to the [sister company]." Ultimately, the Court found there was no ground for setting aside because the arbitrator's purported "law firm" was actually just a network of independent law firms that did not share fees. Thus, referencing the IBA Guidelines, only Article 4.2.1 (Green List) could legitimately be invoked, which was not a ground to challenge the arbitrator or the award.

Similarly, in a decision dated March 2, 2016 (*W Limited v. M SDN BHD*, [2016] EWHC 422 (Comm), available here), the English High Court declined to set aside an award under similar circumstances. In that case, after a sole arbitrator had submitted a statement of independence and accepted his appointment, an existing client of the arbitrator's law firm became a sister company of a party in the arbitration, as the client was acquired by the party's parent company. Although the arbitrator had conducted a conflict check and made disclosures twice – first in his initial statement of independence and again later during the arbitration, the second conflict check failed to identify the fact that the firm's client had become affiliated with one of the parties. The arbitrator rendered awards in the arbitration, which were later challenged. While the court stated that the facts fell under Article 1.4 (Non-Waivable Red List) of the IBA Guidelines, it held that, since the arbitrator lacked knowledge of the fact, had made repeated disclosures, and would have disclosed the fact had he been aware of it, there was no doubt as to the arbitrator's independence and impartiality. The court found that "the arbitrator could not have been biased by reason of the firm's work for the client. That work was not in his mind at all; had it been he would have disclosed it."

In the case at hand, currently on remand to the OHC, it will be interesting to see whether the OHC takes into account the Chair's apparent lack of awareness concerning the Facts, which both the Swiss and English court decisions above considered to be a relevant factor.

Furthermore, neither the Supreme Court nor the OHC discussed when or how the Respondents first became aware of the Facts; nor did they take positions on whether or how such timing might affect the conclusion, both of which can be critical issues. Similarly, the Supreme Court and the OHC did not discuss the significance of the amount of fees that the Firm received from the Affiliate, the relationship between the Claimant and the Affiliate, and the relationship between the Chair and the Firm, all of which could affect the court's conclusion if the IBA Guidelines on Conflicts of Interest in International Arbitration were to apply.

Therefore, it also deserves continued attention whether the OHC or other Japanese courts will take these factors into consideration to see how close the Japanese courts' position is to those of national courts in other countries.