Kluwer Arbitration Blog

An Aroma of Conflict: The Importance of Context in Model Law Set-Asides

Geoff Moysa (Omni Bridgeway) · Tuesday, October 31st, 2023

How strong a scent of a conflict will a court tolerate before setting aside an international commercial arbitration award on procedural grounds? In *Aroma Franchise Company Inc. et al v. Aroma Espresso Bar Canada Inc. et al*, the Ontario Superior Court of Justice set aside a $10 million award as a result of an undisclosed subsequent appointment of the arbitrator by one of the counsels involved in the arbitration. In doing so, the Court appeared to send a message that even a whiff of a conflict may be enough to set aside an award in the right context.

Background

The underlying arbitration (the "Arbitration") was a coffee franchise dispute between Aroma Canada (a master franchisee based in Canada) and Aroma Franchise (the franchisor based in the US) under a Master Franchise Agreement ("MFA"). The MFA contained a very specific arbitration clause stating that all disputes shall be settled through arbitration proceedings seated in Toronto under the ADR Institute of Canada Rules, heard by single arbitrator jointly selected by the parties, who:

> "*must be either a retired judge, or a lawyer experienced in the practice of franchise law,* ***who has no prior social, business or professional relationship with either party****.*" (emphasis added)

The appointment of the arbitrator was the subject of considerable back-and-forth between the parties, with multiple arbitrators rejected based on past relationships with counsel on both sides. The parties eventually agreed on the appointment of an arbitrator who fit the MFA criteria of being experienced in the practice of franchise law (the "Arbitrator") after it was confirmed that neither the parties nor their counsel had any prior relationship with him.

During the Arbitration, Aroma Canada's counsel retained the Arbitrator as sole arbitrator on another unrelated matter. Neither Aroma Canada nor the Arbitrator disclosed this subsequent appointment.

The Arbitration proceeded to a final hearing. In emails to counsel leading up to delivery of the

Final Award (which awarded Aroma Canada more than $10 million in damages for wrongful termination of the MFA), the Arbitrator copied a lawyer from Aroma Canada's firm who had not been involved in the Arbitration. Counsel for Aroma Franchise replied to each of these emails asking why that lawyer had been copied on the email, and particularly:

> "whether there is or has been any other relationship of any kind between Mr. Arbitrator and *[Aroma Canada's firm]*, including any other appointments as arbitrator or mediator."

The Arbitrator initially did not address counsel's question, but responded only after it was repeated, disclosing for the first time that Aroma Canada's counsel *"has retained me as an arbitrator on another matter which is ongoing*" (the "Subsequent Appointment"), adding that he was the sole arbitrator on the new arbitration, and that the issues in the new arbitration were "c*ompletely unrelated*" to the parties to or issues in the Arbitration.

"A Bad Look": The Court's Decision

Aroma Franchise moved to set aside the Final Award under the Ontario equivalent of Articles 34(2) and 18 of the UNCITRAL Model Law on International Arbitration (the "Model Law"), asserting that the Arbitrator's failure to disclose the Subsequent Appointment gave rise to a reasonable apprehension of bias, and that the arbitral procedure was therefore not in accordance with the Model Law.

The Court analysed the issue of whether the Arbitrator's failure to disclose the Subsequent Appointment gave rise to a reasonable apprehension of bias using Article 12(1) of the Model Law, which provides that when a potential arbitrator is approached about a possible appointment, they:

> "shall disclose any circumstances likely to give rise to justifiable doubts as to his impartiality or independence. An arbitrator, from the time of his appointment and throughout the arbitral proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him."

The Court also relied extensively on the IBA Guidelines on Conflicts of Interest in International Arbitration (the "IBA Guidelines"), despite Aroma Canada's argument that they had not actually been adopted by the parties. The Court identified the Subsequent Appointment as being an "Orange List" conflict.

The expressly non-exhaustive nature of the Orange List requires arbitrators to assess on a case-by-case basis "*whether a given situation, even though not mentioned in the Orange List, is nevertheless such as to give rise to justifiable doubts as to his or her impartiality or independence.*"

The IBA Guidelines set out a number of illustrative examples of such a situation, one of which

reads:

> "an appointment made by the same party or the same counsel appearing before an arbitrator, while the case is ongoing, may also have to be disclosed, depending on the circumstances." (para. 6)

This example happens to be the exact situation that arose in *Aroma*, and the Court emphasized this passage in its analysis. The key to the Court's analysis is the phrase, "*depending on the circumstances*" – or as stated by the Court numerous times, "*context matters*".

The context that mattered for the Court was the history of correspondence between counsel for the parties regarding arbitrator selection. The Court found that it was very important to both parties, but:

> "perhaps even more to the applicants, who are not based in this country, that the selected arbitrator not have a professional or personal relationship with either party or their counsel" (para. 89).

In these circumstances, the Court found that the Arbitrator had a duty to disclose, and that his failure to do so gave rise to a reasonable apprehension of bias that required the award be set aside. In making this finding, the Court emphasized the appearance of fairness as paramount, noting that the Subsequent Appointment was a "*bad look*", and that "*a reasonable person in the applicants' position would lose confidence in the fairness of the proceeding and, in particular, the equal treatment of the parties*" (paras. 87 and 91).

The Spectrum of Results in Model Law Set-Asides for Bias

Aroma Canada argued on the application that there has never been a case where an international commercial arbitration award has been set aside in these circumstances, relying in particular on the U.K. Supreme Court case *Halliburton Company v. Chubb Bermuda Insurance Ltd* ("Halliburton") (previously discussed on this blog, for example, here) and another Ontario case, *Jacob Securities Inc. v Typhoon Capital B.V* ("Jacob Securities").

Halliburton is likely well-known to readers of this blog. In that case, the UKSC declined to set aside the award at issue, finding that while subsequent undisclosed appointments accepted by the arbitrator fit squarely in the IBA Guidelines Orange List and should have been disclosed, the lack of disclosure did not create a reasonable apprehension of bias in a context where it was not uncommon for a number of overlapping arbitrations arising out of the same reinsurance event to be heard by a limited number of arbitrators. It is perhaps noteworthy that Halliburton was an ad hoc arbitration not subject to institutional rules requiring disclosure, under the UK Arbitration Act which did not at the time adopt the Model Law provisions on disclosure.

Jacob Securities involved an award rendered by a Toronto-based independent arbitrator who formerly practiced at a large firm. He was appointed as sole arbitrator by the parties a year

following his departure from the firm. After he released his award, the respondent discovered that the arbitrator's former firm had acted for one of the claimant's underwriters before the arbitration, but while the arbitrator was still a member of the firm

The Court declined to set the award, finding that the connection between the former firm's clients and the arbitrator was "*far too remote*" to establish a reasonable apprehension of bias (para. 50).

In *SA Auto Guadeloupe Investissements v. Colombus Acquisitions Inc.*, another case relied upon by the Court in *Aroma*, the French Court of Cassation went the other direction. The arbitrator in that case disclosed that a partner at another office at his firm had represented the sole shareholder of the claimant over a number of years, but stated that there were no current engagements between that shareholder and the arbitrator's firm. However, the next year the arbitrator's firm published a bulletin publicizing that it had advised that same shareholder on another more recent transaction to sell mining interests worth US$575,000,000. The arbitrator did not disclose this subsequent engagement, and was unaware of it. The respondent relied on this undisclosed appointment to successfully set aside an interim award, even though the arbitrator was unaware of the subsequent engagement.

While these cases reached different results, each court carefully weighed and applied the factual and industry context surrounding the potential conflict, reinforcing that these decisions are heavily if not wholly fact-specific.

Does *Aroma* Fit Within the Normal Bounds for Set Aside of an Arbitral Award?

The result in *Aroma* may at first blush raise eyebrows, and even seem counter to arbitral principles of speed, finality and cost-effectiveness. After all, why would commercial parties subscribe to a system in which parties to a lengthy, hard-fought and expensive arbitration – resulting in a $10 million award – could be told to start from scratch because of a failure to disclose a discretionary Orange List scenario?

When taken in both its factual and legal context, however, *Aroma* should not be surprising. Indeed, one might counter that commercial parties would have little faith in arbitration unless the system is seen to strictly abide by its own codes of legitimacy.

What sets *Aroma* apart from other Model Law cases that declined to set aside awards? To quote Agent Smith in The Matrix, "*it's the smell!*" The Court was clearly preoccupied with the contrast between the parties' expressed procedural expectations, as set out in their arbitration clause and correspondence, and how the actual procedure appeared to unfold. Two points in particular seemed to bother the Court: the Arbitrator's initial reluctance to disclose the potential conflict even after being asked directly by counsel for Aroma Franchise, and Aroma Canada's failure to lead any evidence as to the circumstances of the Subsequent Appointment, which the Court said "*spoke volumes*" (para. 86). The reasonable apprehension of bias test is not concerned with actual bias, but the appearance of it, and those unexplained contextual factors did not pass the smell test. Absent these specific facts, one can fairly ask if the Court would have reached the same conclusion.

An appeal of the *Aroma* decision is scheduled to be heard by the Ontario Court of Appeal in December 2023, with a number of arbitral bodies seeking intervenor status. The appeal decision will be an important piece of Model Law jurisprudence clarifying the scope of the duty to disclose

in Ontario.

Meanwhile, in its recently released final report on the review of the UK Arbitration Act, the UK Law Commission recommended that the disclosure obligations set out in Halliburton be codified. This would impose a statutory duty on arbitrators to disclose any information which may result in 'justifiable doubts' as to the arbitrator's impartiality.

Each case serves as a reminder that the appearance of arbitrator impartiality is key to the legitimacy and integrity of the international arbitral system. Arbitrators, parties and their counsel should continually and critically maintain their "conflict hygiene" and assess the need for disclosure throughout the process, lest the end result carry a scent of impropriety.

To make sure you do not miss out on regular updates from the Kluwer Arbitration Blog, please subscribe here. To submit a proposal for a blog post, please consult our Editorial Guidelines.

Profile Navigator and Relationship Indicator
Access 17,000+ data-driven profiles of arbitrators, expert witnesses, and counsels, derived from Kluwer Arbitration's comprehensive collection of international cases and awards and appointment data of leading arbitral institutions, to uncover potential conflicts of interest.

Learn how **Kluwer Arbitration** can support you.

Newly updated
Profile Navigator and Relationship Indicator Tools
Wolters Kluwer
Request your free trial now →

This entry was posted on Tuesday, October 31st, 2023 at 8:24 am and is filed under Canada, Conflicts of interest, Duty to Disclose, Impartiality, Independence

You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.