The Supreme Court of Texas
May 23, 2014

Tenaska Energy, Inc. v. Ponderosa Pine Energy
No. 12-0789
Case Summary written by Tarryn Johnson, Online Edition Editor

Justice Guzman delivered the opinion of the Court.

Tenaska Energy, Inc., Tenaska Energy Holdings, LLC, Tenaska Cleburne, LLC, Continental Energy Services, Inc., and Illinova Generating Co. (collectively Tenaska) sold their interests in a power plant, located in Cleburne, Texas, to Ponderosa Pine Energy, LLC (Ponderosa). The purchase agreement contained a broad arbitration clause requiring that any dispute arising out of the agreement to be arbitrated. Each party would choose an arbitrator, with the two selected arbitrators then selecting the third panel member. All three arbitrators were required to be neutral. Arbitration was to be conducted under the American Arbitration Association (AAA) rules.

A dispute arose regarding whether the purchase agreement between Tenaska and Ponderosa required Tenaska to indemnify Ponderosa for breaching representations and warranties in the agreement. Ponderosa sought to enforce the arbitration clause and sought over $200 million in indemnity rights. Ponderosa was represented by lawyers from Nixon Peabody LLP's New York office, and these attorneys selected Samuel A. Stern as their arbitrator. Stern's curriculum vitae was attached to his designation and indicated that he was a director of twelve closely held companies—including a company in India named LexSite. AAA rules require any person appointed as an arbitrator to disclose "any circumstance likely to give rise to justifiable doubt as to the arbitrator's impartiality or independence. . ." Stern disclosed that he had served as arbitrator for Nixon Peabody in three other proceedings, and that previously he, on behalf of LexSite, had a discussion at Nixon Peabody's offices about Nixon Peabody outsourcing litigation discovery tasks to LexSite. Tenaska asked if Stern had a relationship with any of the sixteen bank entities that own Ponderosa and Stern replied in that he did not.

Tenaska designated Thomas S. Fraser as its arbitrator, and Fraser and Stern selected James Baker as the panel's third arbitrator. At Baker's suggestion, the panel issued a scheduling order stating the parties had made full disclosures of actual and potential conflicts and knowingly waived these conflicts of interest. Eventually, Ponderosa proposed a $125 million settlement; Tenaska proposed $1.25 million. A split panel consisting of Baker and Stern selected Ponderosa's $125 million proposal. When Ponderosa moved to confirm the award in state district court, Tenaska moved to vacate it. Tenaska asserted that Stern as an arbitrator was neither impartial nor free from bias. The trial court held a hearing on the motions.

Evidence presented revealed that Stern was on the advisory board for LexSite, an outsourcing company in India. Stern gave the company legal and

business advice, owned stock in the company, and that when he met with Nixon Peabody regarding LexSite, he made the comment "if you have any arbitrations that would be fun, keep me in mind." Nixon Peabody then used Stern for three arbitrations, including the one at issue in this case. When drafting the disclosure notification to Tenaska regarding Stern's relationship with the firm, a partner with Nixon Peabody edited Stern's disclosure to include one of the arbitrations he had performed at the appointment of the firm as well adding the notation that "Nixon-Peabody and LexSite have done no business, and it is not clear that Nixon-Peabody would ever have any business to give LexSite." Additionally, after Tenaska and Ponderosa agreed on arbitrators, Nixon Peabody changed its fee agreement with Ponderosa from an hourly basis to a contingency fee with staggered percentages based on recovery amounts. While arbitration proceedings between Tenaska and Ponderosa moved forward, LexSite's CEO remained in contact with Nixon Peabody partners regarding a potential business relationship.

After this hearing on the motions, the trial court granted Tenaska's motion to vacate the award due to Stern's evident partiality and the attempt by Stern and Nixon Peabody to minimize the relationship when disclosing partiality for arbitration. The trial court concluded that the Nixon Peabody/LexSite relationship was material and the undisclosed information might yield a reasonable impression that Stern was not impartial; thus, the motion to vacate the arbitration award was granted. The court of appeals later reversed the trial court's decision. It held that Stern's disclosures were sufficient to put Tenaska on notice of potential partiality and that Tenaska knowingly waived the potential conflict of interest.

Issues: (1) Whether an arbitrator is evidently partial if they partially disclose facts that might, to an objective observer, create a reasonable impression of their partiality?

(2) Does a party waive an evident partiality challenge if it proceeds to arbitrate with knowledge of partially disclosed facts?

The Court sought to determine whether the information the trial court found that Stern failed to disclose is supported by some evidence and reviewed de novo whether the undisclosed information demonstrated Stern's evident partiality. Much like the trial court's original determination, the Court found that Stern's partial disclosure, when compared with the information that was undisclosed, was not trivial and might have "conveyed an impression of Stern's partiality toward [Nixon Peabody's] client to a reasonable person." Furthermore, neither party disputed that Stern was heavily involved with LexSite, and LexSite was actively soliciting business from Nixon Peabody—specifically through the partners who represented Ponderosa.

The United States Supreme Court, in *Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 393 U.S. 145, 149 (1968), held that a neutral arbitrator is evidently partial if they fail to disclose facts that might, to an objective observer, create a reasonable impression of their partiality. The Texas Supreme Court, in *Burlington Northern Railroad Co. v. TUCO Inc.*, 960 S.W.2d 629, 630 (Tex. 1997), held that a party does not waive an evident partiality challenge if it proceeds to arbitrate

without knowledge of the undisclosed facts. "In short, the standard for evident partiality *in Commonwealth Coatings* and *TUCO* requires vacating an award if an arbitrator fails to disclose facts which might, to an objective observer, create a reasonable impression of the arbitrator's partiality, but information that is trivial will not rise to this level and need not be disclosed."

Although Ponderosa contended that disclosure of each relationship between Nixon Peabody, LexSite, and Stern were sufficient under the *Commonwealth Coatings* and *TUCO* standards, the Court explained that mere disclosure was not the operative test. Instead, the test is whether the *undisclosed* information might give the impression of the arbitrator's partiality to an objective observer. The Court also mentioned that adopting Ponderosa's view of the test would encourage partial disclosures by arbitrators. Additionally, the Court declined the invitation to revisit their decision in *TUCO* by lowering or raising the evident partiality standard.

The Court went on to find that Tenaska did not waive a conflict as to Stern's partiality because it was simply unaware of the relevant information. The Court cautioned that "[t]o hold otherwise 'would put a premium on concealment' in a context where the Supreme Court has long required full disclosure." Similarly, Tenaska did not waive its partiality challenge in the waiver of conflicts provision because the provision was "expressly predicated on a full disclosure that never occurred." The Court went on to note that nothing in their decision should be interpreted to mean that Stern was, in fact, biased; however, Stern did not fully disclose potential partiality information. In sum, as an arbitrator, Stern had a duty to disclose the additional information that had not been provided to Tenaska and the failure to do so constituted evident partiality.