UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK
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In re

Chapter 11

Case No.02-14758 (PCB)

First Quality Realty, LLC.,

Debtor.
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APPEARANCES:

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MEMORANDUM DECISION GRANTING DEBTOR'S MOTION
TO DISQUALIFY ARBITRATOR AND VACATE ARBITRATION AWARD

BEATTY, PRUDENCE CARTER, U.S.B.J.

This matter comes before the Court on a motion by the debtor seeking to disqualify an arbitrator on the grounds that his actions during the course of the arbitration give the appearance of partiality within the meaning of 28 U.S.C. § 455 and that therefore the award must be vacated pursuant to New York Civil Practice Law and Rules § 7511. Based on the findings of fact and conclusions of law which follow, the Court grants the debtor's motion and accordingly, the arbitration award is vacated.

Background

The arbitration at issue grew out of a pre-petition lease dispute. On January 17, 2000, Reva Holding Corp. (the "Landlord") entered into a 15 year lease (the "Lease") with First Quality Realty LLC. (the "Debtor") for floors two through five of a five story building at 28 Debevoise Street, Brooklyn, New York (the "Building").[1] The Building has a commercial certificate of occupancy and has been used for storage and manufacturing for the past 100 years. Although the Lease is only for 15 years, the Debtor wants to change the certificate of occupancy from a commercial certificate to a residential one in order to convert the Building into 71 residential apartment units. The Landlord has vigorously opposed this plan, both in the Supreme Court of the State of New York and here.

Pre-petition, the Landlord issued certain Notices of Default to the Debtor alleging Lease violations relating to the Debtor's installation of a heating system in the Building without the Landlord's authorization. On August 15, 2001, the Debtor commenced an action in the State Court, seeking, inter alia, declaratory relief that it was not in default of the Lease. The Debtor also requested a Yellowstone Injunction and Temporary Restraining Order pending the State Court's determination. The Landlord opposed the relief sought.

On September 27, 2002, prior to the State Court issuing its decision, the Debtor filed a petition under Chapter 11 of the Bankruptcy Code (the "Petition Date"). On October 9, 2002, the Debtor filed a motion to assume the Lease, which the Landlord opposed.[2]

Approximately one year after the Petition Date, the Landlord and the Debtor agreed to mediation and on August 14, 2003 an order was signed directing the parties to select a mediator from this Court's Mediation Register. Francis G. Conrad was chosen by the parties as mediator and was

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[1] On that same date, Sar-Pat Associates, Inc. ("Sar-Pat") entered into a 15 year lease with the Debtor for a parking lot adjacent to the Building.

[2] In that motion the Debtor also moved to assume the parking lot lease, which Sar-Pat opposed.

approved by the Court.[3] Also on August 14, 2003, the Court signed a stipulation and order (the "Arbitration Order") by which the parties agreed to submit their disputes not only to mediation, but also, if necessary, to arbitration and on August 26, 2003 an order was entered appointing Mr. Conrad as arbitrator ("Conrad" or "Arbitrator"). The Arbitration Order provided that the parties "have agreed to resolve any and all issues and disputes between them of or arising out of or relating to the Leases, including, without limitation, the issues in the State Court Action [and] the Debtor's Motion to Assume (including any cure amounts and use of the premises under the Leases) * * * and any objections to the aforesaid, through binding arbitration before the Honorable Francis Conrad (Ret.)."

Eight arbitration hearings concerning the Lease dispute took place in the winter of 2004, concluding on March 11, 2004 ("the Arbitration"). The parties submitted post-Arbitration briefs in September 2004. The Arbitrator stated he would issue his decision within a few weeks. Six months later, on February 14, 2005, the Arbitrator issued his Findings of Fact and Conclusions of Law. The Arbitrator found, inter alia, that the Debtor could not use the Building for residential purposes and that the Building could only be used for the commercial purpose of storage and manufacturing (the "Award").

On March 17, 2005 the Landlord moved to have the proposed Award confirmed by this Court. On March 22, 2005 the Debtor filed a cross-motion to disqualify the Arbitrator pursuant to 28 U.S.C. § 455 for the appearance of partiality and to vacate the Award pursuant New York Civil Practice Law and Rules ("CPLR") § 7511(b)(1)(ii).

In support of its motion to disqualify the Arbitrator, the Debtor cites the following incidents, which were originally conveyed to the Arbitrator in a letter dated March 10, 2005. The

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[3] Conrad is a former bankruptcy judge who was appointed to the Bankruptcy Court for the District of Vermont in 1985. He served a 14 year term. Given the lower case load in the District of Vermont, during his tenure on the bench Conrad was periodically appointed to serve as a visiting bankruptcy judge in the Southern District of New York, the Eastern District of New York, the Central District of California, the Northern District of Indiana, the Southern District of Florida, the District of Denver, the District of Maryland and the District of Columbia. As a Federal bankruptcy judge, he was governed by 28 U.S.C. § 455.

Arbitrator responded to the Debtor's letter via an e-mail dated March 14, 2005 (the "March 2005 E-Mail"). He subsequently filed an affidavit on July 8, 2005 (the "Affidavit").

1. The Arbitrator's Private Lunches

The Debtor states that on days when the parties would convene for the Arbitration, the Arbitrator regularly went to lunch with one of the Landlord's attorneys, Jeffrey Miller ("Miller") of Westerman Ball Ederer Miller & Scharfstein LLP. ("Westerman Ball"), and his client representatives. The Debtor admits that on at least one occasion the Arbitrator did ask Debtor's counsel, Abraham J. Backenroth ("Backenroth") of Backenroth Frankel & Krinsky, whether he minded if the Arbitrator went to lunch with Miller and Miller's client. Backenroth states that at the time both he and his clients felt it "impolitic" to refuse the Arbitrator's request. The Debtor asserts that these private lunches, in and of themselves, violate 28 U.S.C. § 455 and are grounds for the Arbitrator's disqualification.

The Arbitrator's only response to the Debtor's assertion that he regularly had improper private lunches with Miller and Miller's client, was to state in the March 2005 E-Mail that "everyone knows it is my policy never to talk about business during lunch."[4]

2. The Arbitrator Requested Use of Free Conference Rooms and Legal Support From Westerman Ball

The Debtor states that for the entirety of a multi-day mediation in December 2004, while the arbitration decision was pending, the Arbitrator requested and received from Westerman Ball the free use of two of its conference rooms as well as free legal research in connection with a mediation in a case pending in the Bankruptcy Court for the Eastern District of New York, In re Bais Hamedrish V'Yoel of Boro Park.[5] Westerman Ball was not a party to the Boro-Park mediation and had no involvement in the underlying case.

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[4] In this vein, Backenroth further states that in early 2004, after the Arbitration had commenced, the Arbitrator declined Backenroth's offer of car service to drive the Arbitrator to his Long Island home after a late night meeting at Backenroth's office. Instead the Arbitrator chose to share a ride with Miller. The Arbitrator stated in the March 2005 E-Mail that "the limo was turned down to save the mediation costs."

[5] Case No. 04-20744 (CED).

In the March 2005 E-Mail, the Arbitrator responded that he was justified in requesting, and accepting, the conference rooms and legal support from Westerman Ball because "[t]his is a courtesy that has been extended to me because I am a retired judge." In his later filed Affidavit, the Arbitrator further acknowledges his regular requests for the use of free office space and legal research in support of his practice. The Arbitrator states that since he does not have his own conference room, it is his "custom to contact various law and accounting firms in the New York area and request courtesy use of their conference room to hold arbitrations and mediations. No firm has ever refused my request unless the rooms were previously scheduled. * * * Numerous law firms and three accounting firms over the past several years have given me free use of space * * * . Included in this group is the Westerman Ball firm."

As for receiving free legal research, the Arbitrator admits that someone at Westerman Ball printed cases and statutes that the Arbitrator had researched or were brought to his attention by one of the parties. He further acknowledges that "[e]very law firm where I have conducted mediation and arbitration sessions has provided, in one form or another, free legal research, administrative, secretarial, fax, and telephone services, gratis to the mediating parties and me." The Arbitrator further asserts that the Debtor's disclosure of his receipt of free legal research before this Court violates the confidentiality rules for mediation in the Bankruptcy Court for the Eastern District of New York.

3. While His Initial Decision was Pending, the Arbitrator Was Retained to Represent the Principal of a Westerman Ball Client

The Debtor states that in June 2004, three months after the Arbitration hearings concluded, and at a time when post-Arbitration briefs were being prepared, Conrad accepted an engagement to act as counsel to Arthur Shapolsky, the principal of Broadwall America, Inc., another debtor before this Court.[6] Westerman Ball was Broadwall's bankruptcy counsel. While it is unclear how Conrad came to represent Shapolsky, it is clear that Conrad's client was the one person who was

[6] Case No. 04-13810 (PCB).

directing and instructing Westerman Ball on how to proceed with the Broadwall bankruptcy during the eight months that the decision in the instant arbitration was under advisement. Moreover, the two Westerman Ball attorneys handling the Broadwall bankruptcy were Miller and Mickee Hennessy ("Hennessy"), the two attorneys handling the Arbitration. The Debtor states that the Arbitrator did not disclose this retention to the Debtor.

In response, the Arbitrator stated that his retention was disclosed to Backenroth during a break in one of the Arbitration hearings, that Backenroth consented and "perhaps he forgot." Backenroth denies that this conversation took place.

4. The Arbitrator Accepted A Concurrent Mediation Engagement Involving Westerman Ball Without Disclosure to the Debtor

The Debtor states that in August 2004, only weeks before the post-Arbitration briefs were submitted, Conrad was again appointed as mediator in a case in which Westerman Ball was involved - - In re Med-Diversified, Inc.[7], another case pending in the Bankruptcy Court for the Eastern District of New York. That mediation was handled by Mickee Hennessy, one of the Westerman Ball attorneys handling the instant Arbitration. In November 2004, Conrad was awarded fees in excess of $11,000 in the Med-Diversified matter. The Debtor states that Conrad never disclosed his retention as a mediator in Med-Diversified to the Debtor[8]. The Arbitrator has not denied that he failed to disclose his role as mediator in Med-Diversified. He simply states in his Affidavit that "[t]he court asked me to conduct the mediation. I do not know how I was selected. I did know all the attorneys in the mediation. I do not know how the venue for the mediation was selected."[9]

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[7] Case No. 02-88564 (SB).

[8] The Debtor states that it discovered the Arbitrator's involvement with Westerman Ball in Med-Diversified and the other matters discussed herein after the Award was issued.

[9] This court does not know how the Bankruptcy Court for the Eastern District of New York chooses mediators. In this District, the parties submit the name of the proposed mediator and if there are no conflicts or objections, the Court approves the appointment.

Discussion

Procedural Standards

The Arbitration was conducted pursuant to the Court Annexed Dispute Resolution Program embodied in Amended General Order M-143 of the Bankruptcy Court, as further amended by Amended General Order M-211 (together, the "Amended General Orders"). Pursuant to § 2.3 of Amended General Order M-211, "[a]ny party selected as a mediator shall be disqualified in any matter where 28 U.S.C. § 455 would require disqualification if that person were a justice, judge or magistrate."[10] The mediators and arbitrators who are registered with the Bankruptcy Court must agree to comply with 28 U.S.C. § 455, which is the same disqualification provision that governs the conduct of federal judges, including bankruptcy judges.

28 U.S.C. § 455(a) provides that an [arbitrator] "shall disqualify himself in any proceeding in which his impartiality might be reasonably questioned." This provision governs circumstances that "constitute the appearance of partiality, even though actual partiality has not been shown." Chase Manhattan Bank v. Affiliated FM Insurance Company, 343 F.3d 120 (2d Cir. 2003), cert. dismissed, 54 U.S. 913 (2004). What matters, therefore, "is not the reality of bias or prejudice but its appearance." Liteky v. United States, 510 U.S. 540, 548 (1997).

As stated by the Second Circuit, the test as to whether Section 455 has been triggered is whether

> "an objective disinterested observer fully informed of the underlying facts [would] entertain significant doubt that justice would be done absent recusal,' or whether a 'reasonable person, knowing all the facts,' would question the [arbitrator's] partiality."

United States v. Yousef, 327 F.3d 65, 69 (2d Cir. 2003).

Pursuant to 28 U.S.C. §455(a) it is an arbitrator's obligation to disqualify himself, unless the parties waive such disqualification. To obtain such a waiver the arbitrator must fully inform the

[10] Among other things, Amended General Order M-211 expands Amended General Order M-143 as being applicable in arbitrations.

parties, on the record, of the facts that require his disqualification and then obtain their consent to his continuing to serve. See 28 U.S.C. §455(e).

CPLR § 7511(b)(1)(ii) provides that an award must be vacated when "partiality" on the part of an arbitrator has been established. Under New York law, this partiality requirement is satisfied by showing that facts exist that give rise to an appearance of bias, and that the arbitrator failed to disclose those facts to the parties. See J.P. Stevens & Co., Inc. v. Rytex Corp., 312 N.E.2d 466, 469 (N.Y. 1974); see also Weinrott v. Carp., 298 N.E.2d 42, 48 (N.Y. 1973). A failure to make the required disclosure mandates that the award be vacated, regardless of whether there has been any demonstration of error in the award or actual bias or prejudice. Matter of Catalyst Waste-To-Energy Corp. Of Long Beach, 560 N.Y.S.2d 22, 24 (1st Dep't 1990).

By participating in this Court's mediation program, the parties agreed that the provisions of 28 U.S.C. § 455 would apply with respect to disclosure and disqualification standards. Although the balance of Article 75 of the CPLR remains applicable, its disclosure standard has accordingly been superseded by the standards imposed by 28 U.S.C. § 455.

The Arbitrator's Failure to Disclose Involvement with Westerman Ball Gives Rise to Appearance of Bias in Favor of Landlord

A review of the affidavits and other papers submitted by each of the parties in this matter leads the Court to conclude that the Arbitrator must be disqualified for the appearance of partiality.

There is no dispute that the Arbitrator frequently enjoyed private lunches and meetings with Westerman Ball attorneys, clients and witnesses during the course of the Arbitration. That the Arbitrator believes that "everyone knows" that he doesn't discuss business over lunch is irrelevant. Even if the Arbitrator does not, in fact, discuss business during lunch, the fact that the Arbitrator regularly had lunch with only one party to the dispute during the entire course of the Arbitration would to any reasonable observer give the appearance of bias toward that party. The fact that the Arbitrator may have asked Debtor's counsel if he minded the lunch arrangements does not change the Court's

opinion. This Court has no doubt that Backenroth felt compelled to agree to the Arbitrator's request to have lunch with the Landlord and its legal team because no one in Backenroth's position could ever truthfully answer that question without worrying about raising the ire of the arbitrator presiding over his or her matter.

There is also no dispute that the Arbitrator requested and received free use of Westerman Ball's conference rooms and legal support. While the Arbitrator may believe that it does not appear improper to request and accept the free use of the facilities of various law and accounting firms without recompense as a courtesy to a former judge, the Arbitrator fails to recognize that it is his very position as a former judge which may cause these firms to agree to his requests in the first place.[11] In regard to the instant matter, the Court finds that the Arbitrator's request and acceptance of Westerman Ball's "courtesies" at a time when he was involved in the Arbitration, without the disclosure to and consent of the Debtor, gives rise to the appearance of partiality in favor of the Landlord and its counsel.

As to the Broadwall matter, the Court does not know whether Westerman Ball played a role in the Arbitrator's retention as counsel to Broadwall's principal shareholder. However, it is clear that as a result of that retention the Arbitrator was in a position to negotiate with the Westerman Ball attorneys in Broadwall during the period of time he was acting as Arbitrator in the instant case. Indeed, the Arbitrator had a direct interest, both for his client and in connection with his own fees, in one of Westerman Ball's cases. Again, the court finds this behavior gives rise to the appearance of partiality in favor of the Landlord and its counsel.

The court further finds that there has been no credible evidence presented to establish that prior to the Award being issued (1) the Arbitrator had disclosed to the Debtor that he was mediating Med-Diversified, a matter in which he received a substantial fee paid at least in part from Westerman Ball and its client; (2) that he was using the Westerman Ball offices and Westerman Ball

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[11] This practice of requesting free conference rooms and legal support may, in and of itself, be improper. Former judges are not entitled to accept services that they would otherwise have to pay for by virtue of their former public office.

lawyers to conduct his mediation business in Boro-Park; or (3) that he had an interest in the Broadwall matter.[12]

Finally, the Arbitrator has urged that the Debtor, by raising the issue of the Arbitrator's request and acceptance of free legal research, has breached the confidentiality rules for mediation and alternative dispute resolution in the Bankruptcy Court for the Eastern District of New York. This Court has reviewed Local Rule 9019-1(l) of the Bankruptcy Court for the Eastern District of New York [13] and finds the Arbitrator's argument without merit. Local Rule 9019-1(l) is plainly about the obligation of the participants to a mediation keeping confidential those facts, issues and documents brought forth in mediation and settlement discussions. Since the Debtor had no knowledge of what Conrad researched, and wasn't a party to the mediation, the Debtor could therefore not have breached any confidentiality rule.

It has been stated that "[p]recisely because arbitration awards are subject to * * * judicial deference, it is imperative that the integrity of the process, as opposed to the correctness of the individual decision, be zealously safeguarded." Matter of Goldfinger v. Lisker, 500 N.E.2d 857, 859 (N.Y. 1986). To achieve this goal, the Supreme Court has imposed "the simple requirement that arbitrators disclose to the parties any dealings

that might create the impression of possible bias." Commonwealth Coatings Corp. v. Continental Cas. Co., 393 U.S. 145, 149 (1968).

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The Court notes that had the Award been issued within the "few weeks" promised by the Arbitrator rather than eight months later, the Arbitrator's retention in Med-Diversified and Broadwall and his use of Westerman Ball's facilities and legal staff in the Boro-Park mediation would not be at issue. As to the Arbitrator's regular request for the free use of conference rooms and other amenities by various law and accounting firms, this Court believes that such "courtesies" should be monetarily compensated by the Arbitrator.

13 Rule 9019-1(l) Provides in relevant part:
"*Confidentiality*

Any oral or written statements made by the mediator, the parties or by others during the mediation process shall not be divulged by any of the participants in the mediation, or their agents, or by the mediator * * *."

In the instant matter the Court finds that the Arbitrator's actions both during the Arbitration and while the matter was under advisement gives rise to such an appearance. The Arbitrator had an affirmative duty to disclose to the Debtor his Med-Diversified, Boro-Park, and Broadwall engagements for which he was receiving fees and/or services from Westerman Ball and its clients.

Nothing in this opinion, however, should be taken as a conclusion that the Arbitrator was in fact biased. The Court only finds that a reasonable person could conclude that the Arbitrator's actions gives rise to the appearance of partiality within the meaning of 28 U.S.C. § 455.

Conclusion

For the reasons set forth above the Debtor's motion to disqualify the Arbitrator and vacate the Arbitration Award is GRANTED.

Settle Order.

Dated: New York, New York
February 17, 2006

/s/ Prudence Carter Beatty
United States Bankruptcy Judge