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Post-Arbitration Discovery: When Are Arbitrators Subject to Depositions?

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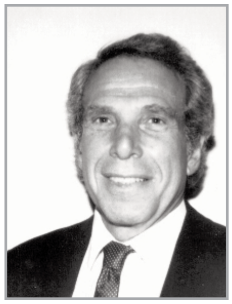

Eugene Wollan

Following in Dick Kennedy's footsteps is a daunting challenge, and I will do my best to live up to it. I expect to have a good deal of assistance from our excellent Editorial Board, now enhanced by the additions of Sue Grondine and Peter Chaffetz. Dick himself, although relinquishing the reins of the Quarterly, will continue to serve on the Publications Committee, so we will still have the benefit of his wisdom and experience.

A number of recent decisions have made it clear that arbitrator conduct is now the subject of increased judicial attention and comment. In their lead article, Doug Bond and Tom Ward have contributed their insights into the uses of, and limitations on, depositions of arbitrators in the context of post-arbitration efforts to confirm or vacate an award.

Closely related to this subject of arbitrator behavior is Charlie Fortune's article highlighting what the author perceives as significant shortcomings in the arbitration process, particularly relating to arbitrator bias, conscious or otherwise. This is somewhat of a departure from our usual focus on legal analysis, but it deals with a subject that has of late been much discussed and debated, sometimes contentiously. We would welcome, and indeed we solicit, articles that respond to this one or that continue the debate in some other way.

Also featured in this issue is a thoughtful analysis by Dave Nelson on the status of the Follow-the-Settlements concept, and whether it continues to thrive in today's environment.

The Law Committee has furnished reports of three recent cases arising from efforts to vacate awards. One of them (*Scandinavian Re*) granted the motion on the basis of "evident partiality" on the part of two of the arbitrators; this decision has been widely disseminated and discussed in the industry. Another (*United States Life*) rejected an attack on the panel's actions. In the third, however, (*PMA Capital*) the award was vacated on the unusual ground that it was "completely irrational." All three notes are worth reading.

You will also find in these pages some more of my own meanderings, a stream of consciousness triggered by Isaac Newton.

We are always on the lookout for articles that will be of interest to ARIAS members. Please don't be shy.

Eugene Wollan

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Editorial Policy

ARIAS•U.S. welcomes manuscripts of original articles, book reviews, comments, and case notes from our members dealing with current and emerging issues in the field of insurance and reinsurance arbitration and dispute resolution.

All contributions must be double-spaced electronic files in Microsoft Word or rich text format, with all references and footnotes numbered consecutively. The text supplied must contain all editorial revisions. Please include also a brief biographical statement and a portrait-style photograph in electronic form.

Manuscripts should be submitted as email attachments to ewollan@moundcotton.com .

Manuscripts are submitted at the sender's risk, and no responsibility is assumed for the return of the material. Material accepted for publication becomes the property of ARIAS•U.S. No compensation is paid for published articles.

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feature

Post-Arbitration Discovery: When are Arbitrators Subject to Depositions?

R. Douglass Bond

Thomas G. Ward

"...reviewing courts still operate according to the premise that arbitration "is intended to be a relatively prompt and inexpensive procedure..."

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R. Douglass Bond
Thomas G. Ward

While the grounds for vacating arbitration awards are narrow, courts will sometimes permit post-arbitration discovery relating to issues that constitute the basis for potential vacatur. This article considers the circumstances under which arbitrators could be required to respond to discovery requests, including sitting for depositions, in the context of a motion to vacate an arbitration award, and discusses the standards that courts use to decide whether to permit such discovery.

I. Post-arbitration Discovery Requests, Generally

Discovery in judicial proceedings to confirm or vacate an arbitration award is governed by the Federal Rules of Civil Procedure and not by the Federal Arbitration Act ("FAA"), but the liberality normally associated with civil litigation discovery is not considered appropriate in the context of post-arbitration petitions.[1] Despite the fact that arbitrations today can involve as much discovery as one might encounter in civil litigation, reviewing courts still operate according to the premise that arbitration "is intended to be a relatively prompt and inexpensive procedure,"[2] involving "expeditious and summary hearings, with only restricted inquiry into factual issues."[3] Further, courts recognize an arbitration panel's power to limit discovery, by virtue of the parties' agreement to trade judicial process and procedures for the simplicity, informality, and expedition of arbitration.[4] Perhaps most importantly, reviewing courts resist post-arbitration discovery because they recognize that it threatens one of the presumptive benefits of arbitration: finality;[5] and they are loathe to allow arbitration to become merely the "first step in lengthy litigation."[6]

Courts permit post-arbitration discovery, however, under certain circumstances. The requested discovery must be "relevant and necessary to the determination of an issue" raised by the petition to vacate.[7] If factual questions exist "that cannot be reliably resolved" by the reviewing court without some further information, discovery may be appropriate.[8] However, if the post-arbitration inquiries target an arbitrator, courts will consider the requests "particularly suspect" because of the inherent risks that the discovery will intrude upon the arbitrator's quasi-judicial function and create a chilling effect on the willingness of qualified individuals to offer their services as arbitrators.[9] Thus, the determination of whether post-arbitration discovery is appropriate turns on the purported bases for vacatur of the award, the specific subjects of the requested discovery, the type of discovery requested, and the degree to which the requesting party can justify the discovery.

II. Discovery Relating to Arbitrators

Courts have addressed the appropriateness of discovery relating to arbitrators in a variety of post-arbitration contexts, including: where the discovery is intended to reveal an arbitrator's decision-making process or reasoning; where the discovery is intended to support allegations of arbitrator misconduct, bias, or evident partiality; and where the discovery is not intended to impugn the arbitrator's decision or conduct. Different standards apply in each of these contexts.

A. Discovery Aimed at the Deliberative Process of Arbitrators

Courts routinely block efforts to depose arbitrators regarding their decision- making process, referring to it as the "forbidden purpose."[10] This judicial response comports with the well-established principle that a party may not vacate an arbitration award by showing that the arbitrator's decision was incorrect.[11] It is also consistent with the general principle that arbitrators may not testify or submit affidavits, even *voluntarily*, to sustain, impeach, clarify, or amend an award.[12] Regardless of whether a party intends to use the arbitrator's testimony to sustain or impeach the arbitration award, such discovery is not permitted.[13]

The strict rule against either seeking discovery or offering testimony from arbitrators regarding their decision-making process applies whether or not the award in question articulates the arbitrator's reasoning. Arbitrators "are not required to state reasons for their award, [and] courts generally presume that arbitrators relied on permissible grounds in determining their award."[14] Therefore, if parties want to know an arbitrator's reasoning for an award, they should ask the arbitrator in advance to include it in the award because they cannot seek this information after the fact.[15]

Accordingly, courts routinely deny discovery requests aimed at an arbitrator where the basis for vacatur necessarily turns on the arbitrator's deliberative process, such as an allegation that the arbitrator acted in "manifest disregard of the law."[16] Required to "closely supervise" discovery requests that address the validity of an arbitrator's decision, reviewing courts will limit deposition requests to exclude any inquiry into an arbitrator's reasoning.[17]

But might the courts, in limited circumstances, allow a party to seek arbitrator testimony concerning the deliberative process where the party is not attempting to impugn the arbitrator's decision-making or conduct? For example, a party seeking to vacate an arbitration award based on perjured testimony might attempt to depose an arbitrator for the purpose of demonstrating that the perjured testimony was "material" to the arbitrator's decision.[18] Or a party raising a *res judicata* defense in a civil litigation based on an earlier arbitration award might seek an arbitrator's testimony to clarify what issues were encompassed by the award.[19]

In either context, it seems highly unlikely that a reviewing court would permit the deposition or testimony of an arbitrator. In a case involving the allegation that the arbitration award was based on perjured testimony, it would be virtually impossible to depose the arbitrator regarding the materiality of a witness' testimony without probing the arbitrator's decision-making, which is the "forbidden purpose."[20] The court is more likely to remand the case back to the same arbitrators, as they alone would be able to assess whether the perjury, if proved, had any material impact on their decision.[21]

Indeed, remanding an arbitration involving perjury would be consistent with the courts' strict prohibition against probing into an arbitrator's deliberative process.

Similarly, courts have remanded "indefinite awards" to the same arbitration panel for clarification where *res judicata* has been raised in a later lawsuit.[22] Note, however, that one state's supreme court, considering this issue, determined that remand for this purpose was "improper" as it required the arbitrator, in effect, to "testify to the grounds for the decision."[23] Nonetheless, it is not unusual for courts to remand to the arbitrator where clarification is necessary for effective judicial review for a variety of reasons, including to determine *res judicata*.[24] Therefore, courts will remand rather than permit discovery that would necessarily invade the deliberative process of arbitrators, and there appear to be no exceptions to the prohibition against such discovery.

B. Deposing Arbitrators to Support a Party's Claim of Arbitrator Misconduct, Bias, or Evident Partiality

Post-arbitration discovery is most often sought by a party seeking to vacate an arbitration award on the basis of the alleged misconduct, bias, or evident partiality of an arbitrator. Such discovery has been permitted when it has not necessarily implicated the decision-making process behind the arbitration award. However, courts apply a strict standard to parties seeking to depose arbitrators for this purpose.

"Clear Evidence of Impropriety or Fundamental Defect" Standard

The majority rule, adopted by virtually all federal courts, requires a showing of "clear evidence of impropriety" or some fundamental defect in the arbitration proceedings or the arbitration award before courts will allow a party to depose an arbitrator in an effort to show arbitrator misconduct in support of a motion for vacatur.[25] Many state courts have applied the "clear evidence" standard as well.[26]

The "clear evidence" standard originated in the Second Circuit's opinion in *Andros Compania Maritima, S.A. v. Marc Rich & Co.*, 579 F.2d 691 (2d Cir. 1978). The dispute involved unpaid charges with respect to the chartering of a tanker to carry a cargo of crude oil.[27] After the arbitration panel ordered Marc Rich to make a payment to the plaintiff, Marc Rich moved to vacate on the ground that the chairman of the arbitration panel, Mr. Arnold, allegedly made insufficient disclosures—namely, failing to disclose a purportedly "close personal and professional relationship" with Mr. Nelson, the president of a third-party that allegedly owned the tanker at issue.[28] In support of its request to depose the arbitrator, Marc Rich submitted affidavits of two lawyers, stating that in twelve arbitrations since 1975, Nelson had been a party-selected arbitrator who had, in turn, selected Arnold as the neutral arbitrator.[29] In all but one of the arbitrations in which Arnold acted as chairman and Nelson was a member, Arnold cast his vote for the party that nominated Nelson.[30]

The court described Marc Rich's request to depose Arnold as "somewhat unusual," but "[at first blush ... reasonable" in light of the broad discovery allowed in federal courts.31 Nonetheless, the court affirmed the district court's denial of the deposition request, determining that: (i) the primary, if not only, basis of the claimed "close relationship" between Arnold and Nelson was that they had served together on more than a dozen panels;

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Thus, the court held that "in the special context of what are in effect post hoc efforts to induce arbitrators to undermine the finality of their own awards ...any questioning of arbitrators should be limited to situations where clear evidence of impropriety has been presented."

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(ii) Nelson had submitted an affidavit stating that his contact with Arnold was limited to the instances where they were members on the same panels and a few social meetings through the Society of the Maritime Arbitrators; and (iii) Nelson's contacts with Arnold were similar to those he had with the arbitrator appointed by Marc Rich, and yet that arbitrator also did not "think it important to disclose" that he had sat on panels with Nelson as well.[32] Relying on those submissions, the court determined that there was no "business relationship" in the ordinary sense between Arnold and Nelson, only a "professional relationship," and that Nelson's company had no direct financial stake in the outcome of the arbitration, making Nelson's alleged interest even more attenuated.[33] Thus, the court held that "in the special context of what are in effect post hoc efforts to induce arbitrators to undermine the finality of their own awards ...any questioning of arbitrators should be limited to situations where *clear evidence of impropriety has been presented*."[34]

Historically, parties have met the "clear evidence" standard only in rare instances.[35] Even though it may be difficult for parties alleging arbitrator bias to prove their allegations without deposing arbitrators, courts consistently block attempts to depose arbitrators without clear evidence of arbitrator impropriety.[36]

"Objective Basis" Standard

A minority of courts allow arbitrators to be deposed where there exists an objective basis for a reasonable belief that misconduct occurred. This standard is more relaxed than the "clear evidence" standard.[37] The "objective basis" standard is most clearly applied by state courts in North Carolina.[38] Although at least three federal district courts have seemingly applied the "objective basis" standard to post-arbitration discovery aimed at demonstrating arbitrator bias, in each of these cases the courts did not clearly articulate the applicable standard and, in any case, the deposition subpoenas served on the arbitrators were quashed.[39] Moreover, one of these opinions pre-dated the Second Circuit's opinion in *Andros Compania Maritima, S.A. v. Marc Rich & Co.*, 579 F.2d 691 (2d Cir. 1978), which was the genesis of the "clear evidence" standard.

Because virtually all federal courts appear to apply the "clear evidence" standard when addressing post-arbitration requests to depose arbitrators for the purpose of impugning an arbitration award, that standard warrants more detailed discussion.

C. The "Clear Evidence" Standard in Practice

To meet the "clear evidence" standard, a party must do one of two things: either (i) point to "objective evidence in the record" that suggests a demonstration of actual bias or misconduct at the arbitration hearing;[40] or (ii) present evidence of undisclosed business relationships between the party and arbitrator, or other improper conduct on the part of the arbitrator, such as undisclosed contacts with a party while the arbitration proceedings were pending.[41] Where a recorded transcript of the arbitration hearing is available, a deposition of the arbitrator for the purpose of demonstrating "evident partiality" may be deemed unnecessary.[42] As for affirmatively producing "clear evidence," one court has suggested that a party seeking to depose an arbitrator may do so by presenting "evidence that the individual arbitrator had any financial or personal stake in the outcome of the arbitration."[43]

Because courts routinely condemn nondisclosure of any material circumstances that could lead to an appearance of arbitrator impropriety, an arbitrator's undisclosed business relationships with a party to an arbitration have the potential to be fertile ground for post-arbitration deposition requests.[44] However, courts acknowledge a tension between allegations that an arbitrator has a business relationship with either a party or a party's affiliate and the fact that arbitrators are often selected explicitly because of their involvement in the industry in which the dispute occurred.[45] Thus, courts balance their condemnation of undisclosed business relationships with a practical evaluation of the degree and kind of any business relationship in question, so that the nondisclosure of "peripheral matters" unrelated to the arbitration will not necessarily satisfy the "clear evidence" standard.[46]

The U.S. District Court for the Eastern District of Pennsylvania recently ordered the deposition of an arbitrator because of his prior undisclosed business relationships with both a party to the arbitration and that party's outside counsel.[47] The dispute concerned an audit performed by Ernst & Young, LLP ("E&Y") for plaintiff EquiMed.[48] Pursuant to the arbitration agreement, the parties each selected an arbitrator, and the third arbitrator was chosen by the two party-selected arbitrators.[49] EquiMed did not raise any objections to E&Y's selected arbitrator at the time of selection.[50] However, after the arbitration panel found in favor of E&Y, EquiMed filed a petition to vacate on the basis that E&Y' s selected arbitrator failed to disclose his prior relationships with E&Y, as well as with E&Y's counsel for the arbitration.[51] EquiMed issued a subpoena to the arbitrator directing him to appear for deposition.[52] EquiMed submitted evidence that E&Y did hundreds of thousands of dollars worth of work directly for the arbitrator's company for several years while the arbitrator served as general counsel and senior vice president.[53] Furthermore, E&Y's arbitration counsel had worked directly for the arbitrator's company for three years.[54] None of these relationships had been disclosed by the arbitrator prior to the arbitration.[55] The court determined that these submissions were sufficient to warrant the arbitrator's deposition, after which the court would be better able to assess if the undisclosed relationships were "trivial," as E&Y contended they were.[56] Significantly, the court ordered the parties to conduct the deposition in the courtroom to ensure that the arbitrator would not be questioned regarding the thought process underlying the decision.[57]

Other courts have allowed the deposition of arbitrators where parties seeking discovery provided sufficient evidence regarding: (i) an arbitrator's undisclosed contacts with a party's counsel during the arbitration proceeding;[58] and (ii) an arbitrator's failure to disclose numerous social, business, and professional relationships with partners in the law firm representing one of the parties.[59] Similarly, courts have ordered post-arbitration evidentiary hearings, without explicitly approving arbitrator depositions, where: (i) a party produced evidence of undisclosed business relationships indicating the arbitrator may have had a financial interest in the outcome of the arbitration;[60] and (ii) the arbitrator's role as commissioner of a professional sports league suggested potential bias in resolving a contract dispute between team owners and players.[61]

While parties potentially can provide "clear evidence," such as significant business relationships or contacts between the arbitrator and a party to the proceeding, this is rare, especially when the arbitrator has *disclosed* the relationships or contacts. In the *Nationwide* case, the U.S. District Court for the Southern District of Ohio recently considered a variety of contacts submitted by a party attempting to justify deposing an arbitrator.[62] For example, the arbitrator in question had notified the panel and the parties that he intended to have one lunch with one of the party's counsel, and another lunch with an employee at that same party's subsidiary.[63] Both times the arbitrator confirmed that the arbitration would not be discussed.[64] No objection was made by either party in advance of the two meetings.[65] While the *Nationwide* court noted that it would have preferred that the arbitrator had no contacts with the parties during the pendency of the arbitration, it concluded that the contacts did not meet the "clear evidence" standard for multiple reasons.[66] The court relied heavily on the fact that the contacts were *disclosed* to the parties prior to the meetings, and that evidence established that the arbitration was not discussed at either meeting.[67] Furthermore, the court noted that the arbitrator did not have a business relationship with the party in question, and that the party seeking to depose the arbitrator began its attacks only after the panel issued unfavorable orders.[68]

Courts have also denied requests to depose an arbitrator based on: (i) comments made to a witness during a break praising a mutual acquaintance;[69] (ii) an arbitrator's alleged lack of qualifications where the issue of qualifications had been previously raised and denied by the AAA in selecting a qualified arbitrator for the parties;[70] and (iii) the fact that the arbitrator's recent departure from his law firm "paralleled" the partnership dissolution issues involved in the arbitration.[71] None of these requests met the high threshold required for deposing arbitrators to impugn their awards for misconduct, bias, or evident partiality.

D. Depositions of Arbitrators Where There is No Allegation of Impropriety, and No Risk of Invading the Deliberative Process.

Courts have indicated a willingness to allow an arbitrator to be deposed when the party seeking the deposition is neither attempting to impugn the arbitration award nor attempting to invade the arbitrator's decision-making process. Depositions in these circumstances may be burdensome to arbitrators, but they do not receive vigorous protection from courts.

When considering requests to depose arbitrators in these more limited contexts, courts focus on standard discovery concerns, such as the probative value and relevance of the testimony. The U.S. District Court for the Northern District of Illinois has considered this issue in two similar contexts. On one occasion, it allowed the deposition of arbitrators for the limited purpose of determining the actual date the panel issued its award.[72] The party seeking vacatur needed the discovery because the record was unclear, and the prevailing party had raised as an affirmative defense that too much time had lapsed between the date of the award's issuance and the date of the motion to vacate.[73] On an earlier occasion, the U.S. District Court for the Northern District of Illinois allowed a party to depose an arbitrator for the purpose of eliciting testimony as to the quality of a labor union's representation of an employee at an arbitration hearing, where the employee later claimed that the union's handling of his grievance was perfunctory."[74]

Other courts have also allowed parties to depose arbitrators when the integrity of the award itself was not being challenged. For example, one state court allowed the deposition of an arbitrator for the purpose of describing the

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Courts apply three different standards to post-arbitration requests for discovery from arbitrators, depending on the nature of the requests. Discovery into an arbitrator's decision-making, in any form, is not permitted. Deposition discovery aimed at an arbitrator's alleged bias, prejudice, or misconduct must meet the strict "clear evidence" standard. Finally, deposition discovery aimed at arbitrators where the party is not attempting to invade the arbitrator's reasoning or impugn the arbitrator's award usually will be treated under regular discovery standards.

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conduct at an arbitration of a driver and his victim in an automobile accident where the driver's insurer later claimed that the two parties had colluded in the judgment.[75] The insurer had not been present at the arbitration, but it believed that the insured had not vigorously defended itself against the victim's claims, without a clear record from the proceedings, the insurer was permitted to depose the arbitrator.[76] Also, a federal district court allowed the deposition of an arbitrator for the purpose of clarifying what claims had been presented and ruled upon in an arbitration, where the reviewing court had issued a prior order explicitly stating that any issues decided by the arbitrator could not be included in the lawsuit pending before it.[77]

III. Conclusion

Courts apply three different standards to post-arbitration requests for discovery from arbitrators, depending on the nature of the requests. Discovery into an arbitrator's decision-making, in any form, is not permitted. Deposition discovery aimed at an arbitrator's alleged bias, prejudice, or misconduct must meet the strict "clear evidence" standard. Finally, deposition discovery aimed at arbitrators where the party is not attempting to invade the arbitrator's reasoning or impugn the arbitrator's award usually will be treated under regular discovery standards.▼

1 *See Frere v. Orthofix, Inc.*, No. 99C1V.4049(RMB)(MHD), OOCIV, 1968(RMB)(MHD), 2000 WL 1789641, at *4 (S.D.N.Y. Dec. 6, 2000).

2 *1d.*

3 Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1,22 (1983).

4 *See In re Cotton Yarn Antitrust Litig.*, 505 F3d 274, 286 (4th Cir. 2007).

5 *Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 90 F. Supp. 2d 893, 898 (S.D. Ohio 2000).

6 *Nat'l Bulk Carriers, Inc. v. Princess Mgmt Co.*, 597 F.2d 819, 825 (2d Cit 1979).

7 *Frere*, 2000 WL 1789641, at *4.

8 *1d. at *5* .

9 *1d. at *4*.

10 See *Woods v. Saturn Distrib. Corp.*, 78 F.3d 424, 430 (9th Cu. 1996); OR. *Secs. Inc. v. Prof'l Planning Assocs.*, 857 F.2d 742, 748 (2d Cir. 1988); *Reichman v. Creative Real Estate Consultants*, 476 F. Supp. 1276, 1286 (S.D.N.Y. 1979). Although this article focuses mainly on the FAA and federal case law, it appears that state courts apply this same principle. *See, e.g., Craig v. Barber*, 524 So. 2d 974, 978 (Miss. 1988) (applying Mississippi's arbitration statute and overturning circuit court's order for arbitrator to explain and clarify arbitration award, and to provide additional findings of fact and conclusions of law); *Jackson v. Gov't Employees Ins. Co.*, 612 A.2d 1071, 1074 (Pa. Super. Ct. 1992) (acknowledging and accepting the general rule that an arbitrator's testimony cannot be used to impeach an award of arbitrators when analyzing the issue under Pennsylvania's Uniform Arbitration Act, 42 Pa. C.S.A. § 7301-7320).

11 *See, e.g., Martin Marietta Materials, Inc. v. Bank of Oklahoma,* 304 Fed. Appx. 360, 363 (6th dr. 2008) (noting that when it comes to the merits of an arbitration decision, such as one relating to a contract claim, the question is not whether the arbitrators *correctly* construed the contract; it is whether they arguably construed or applied the contract).

12 *See Rubens v. Mason,* 387 F.3d 183, 191 (2d dir. 2004) (holding that district court's reliance on an arbitrator's affidavit, submitted in conjunction with motion papers to the Court, "violated well-settled law that testimony revealing the deliberative thought processes of judges, juries or arbitrators is inadmissible"); *RD. Mgmt. Corp. v. Philadelphia Indem. Ins.*, 302 F. Supp. 2d 728, 736 n.1 (ED. Mich. 2004) (ignoring appraiser's affidavit that attempted to justify an award of damages; court applies similar analysis to appraiser that it would an arbitrator).

13 *Wood v. Gen. Teamsters Union, Local 406*, 583 F. Supp. 1471, 1474 (W.D. Mich. 1984) (noting that the distinction between testimony intended to sustain an award, as opposed to testimony intended to impeach an award, is meaningless because "sustaining" testimony will necessarily lead to efforts to cross-examine the arbitrator).

14 *Corsini v. Prudential Sees., Inc.*, No. 95-0707-B (RBB), 1995 WL 663174, at *2 (S.D. Cal. Sept. 29, *1995*); *see also O.R. Secs.*, 857 F.2d at 747.

15 *Hoeft v. MVL Group, Inc.*, 343 F.3d 57, 68 (2d Cir. 2003).

16 *1d.* at 67. *In light of Hall Street Associates, LLC v. Mattel, Inc.*, 128 S. Ct. 1396 (2008), it is now questionable whether a party can vacate an arbitration award under the FAA by showing a "manifest disregard of the law."

17 *See T. McGann Plumbing, Inc. v. Chicago Journeymen Plumbers 'Local 130, UA.*, 532 F. Supp. 2d 1009, 1015 (ND. Ill. 2007) (allowing party to depose arbitrators on specific issues, but preventing deposition from inquiring into the reasoning behind award); *Nat '1 Hockey League Players Ass 'n v. Bettman*, No. 93 CIV. 5769 (KMW), 1994 WL 38130, at *2 (S.D.N.Y. Feb. 4. 1994) (allowing party limited discovery, but not allowing deposition of arbitrator).

18 *See, e.g., Gimbel v. UBS Fin. Servs., Inc.*, No.08 C 4319, 2009 WL 1904554, at *10 (ND. Ill. May 28, 2009) (noting that the alleged perjury must be material to the arbitration outcome; however, the party moving to vacate had not attempted to depose the arbitrator).

19 *See, e.g., Boston Cattle Group v. ADM Investor Servs., Inc.*, No.94 C 4673, 1995 WL 723781, at *6 (N.D. Ill. Dec. 5, 1995) ("The doctrine of res judicata generally applies with equal force to arbitration awards as to prior court decisions.").

20 *See Reichman*, 476 F. Supp. at 1286.

21 *See In the matter of the Arbitration Between Red Apple Supermarkets/Supermarkets Acquisitions*, No. 98 CV. 2303 (LMM), 1999 WL 596273, at *8 (S.D.N.Y. Aug. 9, 1999). The *Red Apple* court noted that while remand back to arbitration is rare, it is appropriate in certain circumstances. *Id*. It then remanded the case back to the arbitrator for the limited purposes of: (i) determining the extent of the alleged perjury, including what bearing, if any, the perjury had on the arbitrator's award; and (ii) considering new evidence discovered by the party seeking vacatur. Id. Of course, if the reviewing court determines on its own that the perjury was material, it will likely vacate the award and order a new arbitration panel. *See, e.g., Medina v. Foundation Reserve Ins. Co., Inc.*, 940 P.2d 1175, 1176 123

N.M. 380, 381 (N.M. 1997) (ordering new panel of arbitrators after granting motion to vacate based on perjury).

22 *See, e.g., Boston Cattle Group*, 1995 WL 723781, at *7

23 *Vermont Built, Inc. v. Krolick,* 969 A.2d 80, 88, 185 Vt. 139, 149-50 (Vt. 2008).

24 *See, e.g, Raymond James Fin. Servs., Inc. v. Bishop*, 596 F.3d 183, 191 (4th Cir. 2010) ("[R]emand to arbitrator for clarification and interpretation is not unusual in judicial enforcement proceedings."); *McQueen-Starling v. Unitedhealth Group, Inc.*, No. 08 Civ. 4885 (JGK), 2010 WL 768941, at *3 (S.D.N.Y. Mar. 8, 2010) (remanding award to arbitration panel where arbitration agreement required arbitrator's explanation for decision); *Boston Cattle Group*, 1995 WL 723781, at *7 (remanded to arbitration panel so that court could consider *res judicata* effect of award).

25 The Ninth and Second Circuit Courts of Appeal are frequently cited for the standard. *See, e.g., Woods*, 78 F.3d at 430; *Andros Compania Maritima*, *S.A. v. Marc Rich & Co.*, 579 F.2d 691, 702 (2d Cir. 1978). Federal District Courts in the Third, Fourth, Fifth, and Tenth Circuits have applied this standard. *See, e.g., Amicorp Inc. v. Gen. Steel Domestic Sales, LLC*, No. 07-cv-01 105-LTB-BNB, 2007 WL 2890089, at *4 (D. Cob. Sep. 27, 2007) (applying "clear evidence" standard and denying request to depose arbitrator); *Van Pelt v. UBS Fin. Sen's.*, No. 3:05CV477, 2006 WL 1698861, at § 11(A) (W.D.N.C. June 14, 2006); *In re EquiMed, Inc.,* No. Civ. A. 05-1815, 2005 WL 2850373, at *2 (E.D. Pa. Oct. 28, 2005); *Lummus Global Amazonas*, *S.A. v. Aguaytia Energy Del Peru, SR. Ltda.*, 256 F. Supp. 2d 594, 626 (S.D. Tex. 2002) (indicating that the "clear evidence" standard applies when arbitrator bias has been alleged); *Corsini*, 1995 WL 663174, at *2 (describing the standard as the "majority rule"). The Sixth Circuit Court of Appeals has equivocated about which standard applies to parties seeking post-arbitration discovery. *See Uhl v. Komatsu Forklift Co., Ltd.*, 512 F.3d 294, 308(6th Cir. 2008) (acknowledging that the Court has been "ambiguous" about what standard applies). Nonetheless, federal district courts in the Sixth Circuit have applied the "clear evidence" standard without being overturned. *See, e.g., Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 90 F. Supp. 2d 893, 899 (S.D. Ohio 2000), *affirmed by Nationwide Mut. ins. Co. v. Home Ins. Co.*, 278 F.3d 621, 628-29 (6th Cir. 2002). District courts in the First, Seventh, Eighth, and Eleventh Circuit do not appear to have explicitly adopted a standard.

26 *See, e.g., Wilbanks Sees., Inc. v. McFarland,* No. 105451, 2009 WL 5910481, at *6 (OkIa. Civ. App. Oct. 8, 2009); *Truserv Corp. v. Ernst & Young LLP*, 876 N.E. 2d 77, 86, 376 Ill. App. 3d 218, 228 (Ill. App. Ct. 2007) (affirming circuit court's confirmation of arbitration award governed by the FAA and explicitly adopting "clear evidence of impropriety or some other fundamental defect in the arbitration proceeding" as the standard in denying post-arbitration discovery request); *Chrobak v. Edward D. Jones & Co.*, 878 SW. 2d 760, 765, 46 Ark. App. 105, 114 (Ark. Ct. App. 1994) (applying "clear evidence" standard in denying party's request for evidentiary hearing prior to court's ruling on motion to vacate arbitration award).

27 *Andros*, 579 F.2d at 693.

28 *Id.* at 695.

29 *Id.* at 696.

30 *1d.*

31 *Id.* at 697.

32 *Id.* at 701-02.

33 *1d.* at 701.

34 *1d.* at 702 (emphasis added).

35 *See, e.g., Uhl v. Komatsu Fork1ft Co., Ltd.*, 466 F. Supp. 2d 899, 910 (E.D. Mich. 2006).

36 *See Woods*, 78 F.3d at 430.

37 *See Nationwide*, 278 F. 3d at 628 (describing "objective basis" standard as a relaxed standard).

38 *See Carolina-Virginia Fashion Exhibitors, Inc. v. Gunter*, 230 SE. 2d 380, 388, 291 NC. 208, 219 (NC. 1976); *William C. Vick Constr. Co. v. North Carolina Farm Bureau Fed'n*, 472 S.E.2d 346, 123 N.C. App. 97 (NC. Ct. App. 1996); *In re Nat'l Risk Underwriters, Inc.*, 884 F.2d 1389, 1989 WL 100649, at *3 (4th dr. 1989) (unpublished opinion) (stating that North Carolina law under *Carolina- Virginia* calls for application of "objective basis" standard).

39 *See Gearhardt v. Cadillac Plastics Group, Inc.*, 140 F.R.D. 349,351 (S.D. Ohio 1992); *United Food & Commercial Workers Int'l Union, AFL-CIO v. SIPCO, Inc.*, No. 90-250-B, 1990 WL 364772, at *2 (S.D. Iowa Oct. 16, 1990); *DeFrayne v. Miller Brewing Co.*, 444 F. Supp. 130, 130-31 (E.D. Mich. 1978).

40 *See* Uhl, 466 F. Supp. 2d at 910-11.

41 *See In re EquiMed, Inc.*, 2005 WL 2850373, at *2 (concluding that evidence of undisclosed business relationships between arbitrator's company and both a party and the party's counsel was sufficient to warrant the arbitrator's deposition where evident partiality was alleged to be basis for vacatur of award); *Nationwide*, 90 F. Supp. 2d at 901 (considering as evidence certain contacts between the arbitrator and the party's internal counsel while the arbitration was pending, but ultimately concluding that the facts set forth did not meet the threshold for showing entitlement to discovery).

42 *See T. McGann Plumbing*, 522 F. Supp. 2d at 1014.

43 *Lyeth v. Chrysler Corp.*, 929 F.2d 891, 899 (2d Cir. 1991) (denying request for discovery).

44 *See, e.g., Nationwide*, 90 F. Supp. 2d at 901.

45 *See, e.g., id.* at 902 (considering as a factor in analyzing the alleged undisclosed business relationship of the arbitrator and the prevailing party that the parties' arbitration agreement required that "the arbitrators come from within the insurance industry and serve as an executive officer of an insurance or reinsurance company."); *Wilbanks*, 2009 WL 5910481, at *7 ("Arbitrators are usually knowledgeable in a given field and often have interests and relationships that overlap with the matter they are considering as arbitrators. The mere appearance of bias that might disqualify a judge will not disqualify an arbitrator."); *Greenwald v. Shayne*, 910 N.E.2d 536, 545, 152 Ohio Misc. 2d 12, 23 (Ohio Ct. Comm. Pleas 2009) (noting that fact that arbitrator's departure from his own law firm paralleled the partnership dissolution issues that formed the professional experience was "precisely why these parties hired [him]").

46 *Greenwald*, 910 N.E.2d at 544 (citing *Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 429 F.3d 640, 644-47 (6th Cir. 2005)).

47 *In re EquiMed*, 2005 WL 2850373, at *2.

48 *Id.* at *1.

49 *Id.*

50 *Id.*

51 *Id.*

52 *Id.*

53 EquiMed's Brief in Opposition to the Motion to Quash, located at 2005 WL 3675227, at § IV.

54 *Id.*

55 *Id.*

56 *In re EquiMed*, 2005 WL 2850373, at *2.

57 *1d.* at *3

58 *RZS Holdings AVV v. PDVSA Petroleos S.A.*, 598 F. Supp. 2d 762, 765 n. 1 (E.D. Va. 2009). The RZS opinion does not actually reveal the basis for allowing the arbitrator to be deposed, but rather refers to the court's prior unpublished order allowing the deposition. *Id*. However, a review of the opinion suggests that the court likely allowed the arbitrator to be deposed because: (i) there were undisclosed contacts between the arbitrator and a party's counsel, who was not involved in the litigation, at a professional association conference during the arbitration proceedings; and (ii) a draft of the arbitration award had been prematurely leaked to both parties. *Id*. at 768. Nonetheless, the court confirmed the arbitration award after the arbitrator's deposition, and noted that the arbitrator had testified at his deposition that he had no direct conversation with the party's counsel at the conference. *Id.* at 770.

59 *William C. Vick*, 472 S.E.2d at 349, 123 N.C. App. at 102 (applying less stringent "objective basis" standard). *See also Kauffman v. Haag*, 318 N.W. 2d 572, 573, 113 Mich. App. 816, 818 (Mich. Ct. App. 1982) (applying lesser standard and allowing deposition of arbitrator in light of potential relationship between arbitrator, who served as township community developer, and contractor who was party to the proceedings).

60 *Sanko S.S. Co., Ltd. v. Cook Indus., Inc.*, 495 F.2d 1260, 1262 (2d dr. 1973) (predating the "clear evidence" standard established by *Andros*).

61 *Nat'l Hockey League*, 1994 WL 38130, at *1.

62 *Nationwide* 90 F. Supp. 2d at 900.

63 *Id.*

64 *Id.*

65 *Id.*

66 *Id.* at 901.

67 *Id.*

68 *Id.*

69 *Schwartz v. Merrill Lynch & Co., Inc.*, No. 09 Civ. 900 (WHP), 2009 WL 2496028, at *2 (S.D.N.Y. Aug. 5, 2009).

70 *Crawford Group, Inc. V. Holekamp*, No. 4:06-CV-1274 CAS, 2007 WL 1656275, at *2 (E.D. Mo. June 7, 2007).

71 *Greenwald*, 910 N.E. 2d at 547.

72 *T. McGann Plumbing*, 522 F. Supp. 2d at 1016.

73 *Id.* at 1012.

74 *Bliznick v. Int'l Harvester Co.*, 87 F.R.D. 490,491 (N.D. Ill. 1980).

75 *Driskell v. Empire Fire & Marine Ins. Co.*, 547 S.E.2d 360, 362, 249 Ga. App. 56, 57 (Ga. Ct. App. 2001).

76 *Id.*

77 *Elgin Sweeper Co. v. Powerscreen Int'l*, PLC, 158 F.R.D. 494,495 (S.D. Ala. 1994). While the court made clear that the party requesting the deposition was not seeking to vacate the award, it is not entirely clear why the court allowed the deposition instead of remanding the case to the arbitrator for clarification, as some courts have done.

news and notices

ARIAS Announces New Mediator Program

In order further to promote the use of mediation in the insurance and reinsurance industry and to provide a mechanism for the resolution of smaller disputes, a number of ARIAS•U.S. Qualified Mediators have expressed willingness to serve as voluntary, uncompensated mediators on smaller matters. The details of this offer are as follows:

- Disputes involving three or fewer separate issues (as defined by the parties) and a contested value of up to U.S. $500,000 (exclusive of claims for interest, attorneys' fees and extra-contractual relief, if any) are eligible.
- Mediators can be selected by agreement of the parties from the List of Mediator Volunteees or can be chosen at random by ARIAS from the list.
- The mediator will lead a three-hour mediation between the parties without charge for the mediation or any preparation time.
- The parties will pay the mediator's reasonable out-of-pocket expenses for the three-hour mediation (e.g., reasonable travel costs, photocopying, etc.).
- Beyond the initial three hour mediation, the mediator will only incur additional time at the request of the parties, and will be paid as agreed by the parties and the mediator.
- The mediation will be conducted pursuant to a written agreement of the parties encompassing confidentiality and other procedural issues.

Qualified mediators who are willing to participate in this program are being identified on the ARIAS website, as they volunteer.

Note that ARIAS•U.S. Qualified Mediators are ARIAS•U.S. Certified Arbitrators who have undertaken significant mediation training and in many cases have significant mediation experience. ARIAS•U.S. Qualified Mediators who are interested, but have not yet volunteered, may send an email message to director@arias-us.org, indicating that they would like to be listed.

ARIAS•U.S. hopes that members will find this new program to be valuable in their pursuit of faster, less expensive dispute resolution. ARIAS•U.S. Mediator Programs are located on the website through the left-side navigation under "Mediator Programs."

Board Certifies Sixty-three Previous Arbitrators under New Requirements

At its meeting on March 11, the Board of Directors approved certification of the following 43 arbitrators under the new certification requirements:

- **Hugh Alexander**
- **David V. Axene**
- **George J. Biehl, Jr.**
- **D. Robert Buechel, Jr.**
- **Robert K. Burgess**
- **Mary Ellen Burns**
- **Susan S. Claflin**
- **Peter C. Clemente**
- **Robert Comeau**
- **Bina Dagar**
- **James F. Dowd**
- **Charles S. Ernst**
- **Ann L. Field**
- **Charles M. Foss**
- **Caleb L. Fowler**
- **James (Jay) H. Frank**
- **Richard C. Franklin**
- **George F. Grode**
- **Debra J. Hall**
- **Lawrence F. Harr**
- **Lydia Kam Lyew**
- **Stephen J. Kidder**
- **David D. Knoll**
- **Floyd H. Knowlton**
- **Jack E. Koepke**
- **Charles T. Locke**
- **Susan E. Mack**
- **Robert M. Mangino, Sr.**
- **Fred G. Marziano**
- **Timothy T. McCaffrey**
- **Stephen E. McCarthy**
- **David C. McLauchlan**
- **Graeme Mew**
- **Diane Nergaard**
- **Joseph J. Pingatore**
- **Andrew J. Pinkes**
- **Robert Redpath**
- **Robert C. Reinarz**
- **Edmond F. Rondepierre**
- **John D. Sullivan**
- **Michael J. Toman**
- **William A. Wilson**
- **George G. Zimmerman**

Then, at its meeting on May 5, the Board approved certification of the following 20 arbitrators under the new certification requirements:

- **John T. Andrews Jr.**
- **Frank J. Barrett**
- **Andrew D. Brands**
- **Dale C. Crawford**
- **Raymond Dowling**
- **Charles Ehrlich**
- **Dale S. Frediani Sr.**
- **Mark S. Gurevitz**
- **Cathy A. Hauck**
- **Eric S. Kobrick**
- **Mark T. Megaw**
- **John A. Morgan**
- **Richard E. Marrs**

- **James J. Powers**
- **Debra J. Roberts**
- **Kevin J. Tierney**
- **Richard L. Voelbel**
- **Michael T. Walsh**
- **Eugene T. Wilkinson**
- **Brian E. Williams**

All had been previously certified.

Board Certifies Eight New Arbitrators

Also, at its meeting on March 11, the Board approved certification of the following seven arbitrators for the first time. Their sponsors are indicated in parentheses.

- **Alan R. Bialeck** (Martin Haber, Elliot Orol, Fred Marziano)
- **Robert Lippincott III** (Paul Hawksworth, John Sullivan, Joseph Carney)
- **Timothy J. Muldowney** (Keith Dotseth, Douglas Houser, Paul Steinlage)
- **Edward W. Rich** (Paul Brink, Steven Gilford, Marc Rosenthal)
- **Carol A. Seaton** (Thomas Orr, John Dattner, Jack Koepke)
- **Aaron B. Stern** (Ronald Gass, Paul Hawksworth, Lawrence Brandes)
- **James R. Stinson** (Paul Dassenko. Thomas Stillman, Debra Hall)

Then, at its meeting on May 5, the Board approved certification of **Charles F. Barr** as an arbitrator for the first time. His sponsors were Thomas Forsyth, Timothy McCaffrey and John Nonna.

Eight ARIAS-U.S. Umpires Are Certified

At the March 11 meeting, the Board approved certification of five umpires.

- **Caleb L Fowler**
- **James (Jay) H. Frank**
- **Diane Nergaard**
- **Robert C. Reinarz**
- **Edmond F. Rondepierre**

Then, at the May 5 meeting, it approved certification of three more umpires.

- **Robert L. Comeau**
- **Charles M. Foss**
- **Michael H. Studley**

The complete list of Certified Umpires can be seen on the website through the section entitled "Selecting an Umpire."

Three Certified Arbitrators Approved As Qualified Mediators

Finally, at the May 5 meeting, the Board approved applications of three members to be ARIAS-U.S. Qualified Mediators. The new mediators are:

- **Edward W. Rich**
- **Richard M. Shusterman**
- **Aaron B. Stern**

The complete list of Qualified Mediators can be found on the website under "Mediator Programs."

Merrill Corporation Was Sponsor of Wednesday Reception

The Wednesday reception at the 2010 Spring Conference was sponsored by Merrill Corporation.

Merrill is a major provider of e-discovery and litigation support. In describing its relevant services, the company states,

> "Merrill Corporation expertly solves our clients' litigation support and document management challenges with a full suite of effective tools supported by responsive, efficient professionals. Our solutions range from forensic data acquisition through discovery review, depositions and trial presentation. Merrill has helped 90 percent of the AMLAW 100 and hundreds of the nation's top corporate law departments to find the critical evidence they need to win cases."

This year's Spring Conference marks the first time that ARIAS has offered sponsorship opportunities to organizations providing services to the industry.

ARIAS is grateful to Merrill for its support.

Board Provided Extension of Deadline

Some certified arbitrators were not able to complete, before the June 1 deadline, all of the qualifications under Option C of the new certification requirements; they needed to complete two seminars, but there was only one remaining before June 1.

At its meeting on March 11, the Board of Directors approved a conditional extension for members who were in that position. If they attended the conference and seminar in San Diego, their certifications have been extended until they attend the seminar on November 3. By submitting applications in advance, they can then be approved for certification at the November 4 Board meeting. Otherwise, certification would have been withdrawn until they completed the requirements.

Brenda Ross-Mathes

Brenda Ross-Mathes, an ARIAS•U.S. Certified Arbitrator, died on April 29, at age 53, from a rare form of breast cancer. She is survived by her husband of 21 years, Rick, and her sons, Ben and Peter.

Brenda joined ARIAS in 2005 and was certified in 2006.

She was a graduate of Dennison University class of 1978. She spent her 28-year career in insurance, eventually becoming Vice President of Reinsurance at Nationwide.

feature

Maintaining The Integrity of The Arbitration Process: The Parties' Dilemma

Charles W. Fortune

Charles W. Fortune

Complaints about arbitration are many and varied, but the essential concerns seem to be that arbitration is too costly and that the process can be unfair.

Charles Fortune is a partner of Day Pitney LLP where he has, for 19 years, concentrated his practice in the resolution of insurance and reinsurance coverage disputes. Mr. Fortune also brings to his practice seven years past experience as a commercial lines underwriter with Travelers.

ARIAS•U.S. was founded in 1994 for the purpose of promoting the improvement of the insurance and reinsurance arbitration process for companies doing business in the United States. In the years since, ARIAS members have worked tirelessly to develop procedural and ethical guidelines for arbitration, to train and certify arbitrators, and to promote efficiency and effectiveness in the process.

A decade and a half of hard work has not, however, eliminated every problem with insurance and reinsurance arbitration. Many involved in the business of insurance/reinsurance arbitration have at least one tale to tell (confidentiality constraints permitting) of an unsatisfactory arbitration experience. ARIAS•U.S. members continue to consider the effectiveness and reliability of the arbitration process and ask if it meets the needs of the insurance industry.[1] Some even question the fundamental fairness of arbitration and a few have expressed a lack of full confidence in the process.[2] Clearly, the work of ARIAS is not finished.

Complaints about arbitration are many and varied, but the essential concerns seem to be that arbitration is too costly and that the process can be unfair. Surely no one expects perfection from the process, but if it is to remain viable, it must at least continue to offer a reasonable alternative to resolution of disputes in the courts.

It is not beyond reason that some might come to consider litigation preferable to arbitration. Most of the cost-containment tools available to parties and panels in arbitration are equally available in court and can be used there when it is in the interests of both parties. Moreover, the courts have well-developed rules designed to promote fairness in the proceedings,[3] while insurance and reinsurance arbitrations rarely proceed under any formal rules. The court system is by no means uniformly fair or efficient, but neither is arbitration unless the parties and arbitrators choose to make it so in a particular case. Arbitration can be more cost-effective than litigation, but only when the participants specifically focus on efficiency and cooperate to that end. Likewise, arbitration panels can resolve disputes more fairly than the courts, but only when the panel's superior knowledge of the industry is used objectively and when the arbitrators adhere to a standard of conduct that eliminates bias and party influence.

Thus, fairness and efficiency in arbitration are largely a function of the voluntary cooperation of the parties. Winning in arbitration, on the other hand, is often inconsistent with cooperation. A cooperatively appointed purely neutral umpire does not increase a party's chances of winning. An umpire sympathetic to the party's cause does. This, then, is the parties' dilemma in arbitration: do the parties cooperate to achieve a fair and efficient proceeding, for the ultimate good of the arbitration process, or do they "defect" to improve their chances of winning? Classic game theory analysis suggests that rational parties will often "defect".[4] If they can improve their chances of winning through non-cooperation, they may not cooperate.

If there is a disincentive to cooperate, arbitrations that are not subject to specific rules and procedures will be more contentious, less cost-effective, and less fair. If this environment should become the norm, the purchasers of arbitration services will look elsewhere for the resolution of their disputes.

If the arbitration of insurance and reinsurance disputes is to remain the option of choice, it seems that the conduct of the arbitration process must be controlled and more regulated. Arbitrations will likely require specific procedural parameters and arbitrators, particularly umpires, may need a stronger framework to govern their conduct and decision-making. Mere guidelines will not suffice. Parties and arbitrators that are free to ignore processes when they choose will surely be tempted to do so once they are in dispute in a particular matter. Private arbitration can be a valuable tool and the insurance and reinsurance industry is best served by taking steps to preserve it as an effective means of resolving disputes.

Impediments to Efficient Arbitration

Arbitration is a process that exists in the United States only by agreement of the parties. Yet an agreement to arbitrate an insurance or reinsurance dispute often will not address the conduct of the arbitration, beyond providing a basic procedure for the selection of the arbitrator(s). Absent clear guidance in the agreement to arbitrate, those involved in the arbitration (parties, counsel, and arbitrators) are usually left to fill in the gaps.

Often the parties forget that one of the reasons they chose arbitration was to promote efficiency and control costs. With greater sums in dispute, more claims involving parties that are not active business partners, and increased reliance on aggressive lawyers, the greater is the temptation to try to win at all costs. Thus, the parties may end up in contentious proceedings where one or both seek extensive discovery, file numerous motions, and contest virtually every point. Moreover, the parties will often disagree as to the proper scope of the proceedings, and they may be at odds over the amount of discovery or briefing that should be allowed or the duration of the hearing. Where each party is motivated to win, discord is inevitable.

If the parties cannot agree on the scope of activity in the arbitration, the gaps in the process must be addressed by the arbitrator(s). Certainly, issues of efficiency will often be raised by the party opposing more arbitration activity, but the essential inquiry will usually be the need of the requesting party for the activity sought, and the potential prejudice to that party if the request is denied. Thus, although the arbitrators will be asked to decide for or against efficiency in the process, they will also have to focus on "fairness". As a general matter, such determinations are not subject to review.[5]

Efficiency may be compromised by arbitrators in the name of fairness. This is because arbitrators are rarely certain if a request for discovery, more briefing, etc. is legitimate, or is a tactical request designed merely to burden an opponent or buy time. The requesting party will always contend that it needs what it seeks, and otherwise will be prejudiced in the development of its case. The opposing party will always contend that the request is insufficiently significant to justify the time and expense it will entail. Thus, the arbitrators will find that they must balance the claimed need to avoid material prejudice against the wish to promote efficiency, and the safest and fairest course of action will usually be to allow the additional activity requested. It is one thing to sacrifice efficiency and quite another to limit the process available to a party. Again, there are typically no rules that even remotely govern what the arbitrators may allow, so there is little incentive to risk denying a party the process it seeks.

In this day and age of three arbitrator panels featuring party arbitrator/advocates, the process decisions may effectively be made by the umpire alone — and indeed, some panels delegate the bulk of such process activity to the umpire. Such an umpire may, of course, have biases or prejudices concerning certain process issues, as to cedents or reinsurers in general, or even in respect of specific parties. Try as they might to be objective, such umpires might favor a particular party in a process dispute, even to the extent that significant additional activity could be allowed even when no apparent legitimate purpose exists for the request. Even more troubling would be cases where the umpire was sympathetic to the interests of one party and knowingly ruled against the opponent, irrespective of the merits of the positions. A party harmed by such a decision of an umpire is not likely to be able to prove "evident partiality", and not even likely to demonstrate harm arising out of more discovery or delay in the proceedings. Moreover, even if there were grounds for overturning the umpire's process decision, the issue could not be addressed in the courts until after a final award was issued in the case.[6]

Of course most umpires believe they have an obligation to be neutral and fair, and they will decline to serve if they do not think they can be impartial and unbiased. Likewise, most umpires will try to resolve disputes efficiently and in a reasonable way. As indicated, however, when these principles come into play in a contentious dispute where one party seeks more activity than the other believes is necessary, it is the rare umpire who will place global efficiency ahead of the interests of the party that chooses inefficiency in the particular case. Absent any procedural rules or even guidelines that might apply by agreement of the parties, it is hard to fault an umpire for failing to create some.

Impediments to Fair Arbitration

Unfairness in the arbitration process may be in the eyes of the beholder. Certainly, some of those involved in arbitration are likely to be dissatisfied simply because they have lost. But sophisticated purchasers of arbitration services, such as make up the membership of ARIAS•U.S., might be expected to see beyond an unfavorable award and appreciate whether or not the proceedings were fundamentally fair. Thus, the opinion of even a small minority of members surveyed that they lacked full confidence in the process (see note 1) and the further report by a few that they had observed unethical behavior by arbitrators should be cause for some concern.

If there are problems with arbitrators, it is likely a function of the lack of court review of arbitration proceedings. The prospect of robust review of awards and remand for modification would certainly influence many arbitrators to promote fairness and more carefully support their conclusions. After all, parties that can select their panels would not long select those whose awards were overturned, and whose arbitrations had to be re-heard in whole or in part. But as the United States courts continue to take a hands-off approach to arbitration,

CONTINUED ON PAGE 12

Even an arbitrator who is scrupulously concerned about being fair may have a bias, as to a particular issue in dispute that he or she cannot help but bring to the table — whether he or she realizes that is happening or not. Likewise, arbitrators (including umpires) are aware that one party or the other "nominated" them and they might be influenced, even if somewhat unconsciously, by the desire for future work.

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correction of problems from this source is not likely.

Also contributing to the problem, of course, is the inherent bias that umpires, as humans, bring to the process. Even an arbitrator who is scrupulously concerned about being fair may have a bias, as to a particular issue in dispute that he or she cannot help but bring to the table — whether he or she realizes that is happening or not. Likewise, arbitrators (including umpires) are aware that one party or the other "nominated" them and they might be influenced, even if somewhat unconsciously, by the desire for future work.

Finally, if the complaints of some ARIAS members are to be believed, it would seem that a small number of arbitrators have strayed beyond the limitations on their conduct that are suggested by ethics formulations such as the ARIAS-US Code of Conduct. Perhaps this is inevitable given the more competitive nature of the arbitrator "business" (where numerous professionals make their living in service as arbitrators). In an environment where parties may look for umpires who will favor their position, umpires that are expected to vote a certain way might well be in demand. In any event, some perceive that a class of umpires has emerged who may be identified with particular positions, party arbitrators, or even particular parties, and who are routinely advanced as umpire candidates when a particular result is sought. This does not promote fair arbitration and it does not bode well for the integrity of the process.

Most umpires still appreciate and understand the requirement of neutrality and take seriously their obligations to both parties. Despite their best intentions, however, bias and inequity can creep into an arbitration. Moreover, a person with known sympathy for the positions of a party to a claim dispute can never really be objective, even if harboring no notions of overtly assisting the cause of that party. Some say that full disclosure cures this problem, but it does not. Absent clear "evident partiality" of the umpire candidate, he or she cannot effectively be challenged and may well serve in the arbitration to the detriment of one party.

Perhaps the most troubling attack on the integrity of the arbitration process comes from the appointment of umpires who sympathize with the positions of a particular party, not because of some fundamental belief in those positions, but because of a desire to support that party, no matter what. Needless to say, in this context, the potential umpire is not making full disclosure and is ignoring the principles of the ARIAS Code of Conduct (which also means it is difficult to establish that the umpire exhibits evident partiality — even if the decisions and award of the panel are plainly wrong). How often umpires of this sort serve is not known, although it is presumably very rarely. But the damage to the process from just one such case is immense.

The Parties' Dilemma

Clearly, protection of the integrity of the arbitration process is the responsibility of the parties that wish to rely on that process for efficient, fair, and effective resolution of disputes. If the integrity of the process is addressed only when parties are in dispute, however, it will struggle to survive. This is because parties, if given a choice, must and will use the process to enhance their chances of winning. Parties to arbitrations must answer to shareholders who care if claims were paid, or not paid, and care little for the preservation of an arbitration process that may or may not help resolve a future claim.

The dilemma for purchasers of arbitration services is most clearly seen in the context of umpire selection, where each party will, if given the opportunity, select an umpire most likely to rule in its favor. This is, in part, because umpire "neutrality" is measured in the courts in very broad terms, and even where there is some evidence of bias a challenge to the umpire usually cannot be made until a final award is issued. Under these circumstances, there is little risk to a party in proposing for service as umpire someone it has reason to believe will support its position. Moreover, the potential benefits of a fair and predictable arbitration will not outweigh the potential benefits of an unfair arbitration that allows the party in question to win (or improves the chances of winning).

This can be demonstrated in the context of arbitrations where the umpire is chosen by chance (e.g., selection of an even or odd digit in the Dow Jones Industrial Average for a future date). If each party advances an umpire candidate "sure" to follow its positions, then each party has a 50% chance of winning the arbitration — essentially at the time of the DJIA "coin toss". If each party advances a purely neutral candidate, then again, there is a 50% chance of each winning, assuming an objectively close coverage dispute. But if one party "defects" and advances a biased candidate while the other advances a purely neutral candidate, the defector has increased its chances of winning to 75% (a 50% chance of having the biased umpire selected plus a 50% chance of seating the neutral candidate — who has a 50% chance of ruling in favor of the defector). If this is the game being played, there is a strong incentive for each party to defect and advance a slate of umpire candidates it believes (or know) will side with it.

In terms of the classic "prisoners dilemma" (see note 8) we must assume the objectively close coverage dispute and a simultaneous exchange of prospective umpire slates by the parties. Then, the options for winning the game are:

	Party B Neutral Slate	Party B Biased Slate
Party A	A: 50% win	A: 25% win
Neutral Slate	B: 50% win	B: 75% win
Party A Biased Slate	A: 75% win B: 25% win	A: 50% win B: 50% win

In such circumstances, the parties may discuss the option of each advancing a neutral slate. Each party may agree that it appears fair and they will see that there is no disadvantage, as compared to each party selecting a biased slate (a 50% chance of winning, in either case). The parties may agree to cooperate and each advance neutral slates. There is, however, a great temptation to defect, especially if a party believes that the other party will honor the agreement and select a neutral slate. If Party A defects while Party B cooperates, Party A now has increased its chances of winning to 75%. Accordingly, each party will tend to defect, to protect itself, and because the ultimate result of defection/defection is the same as cooperation/cooperation, there is virtually no disincentive to defection.[8]

Unless there is some punishment external to the "game" that overwhelms the benefit of defection, no rational person would advance the neutral slate. Perhaps long-standing and future business partners could agree to a cooperative selection process and the fear of deterioration of the relationship would stop defection, but in the current insurance/reinsurance market no one can count on the future status of business relationships, and where the stakes are high enough, in a particular arbitration, the temptation to defect will be significant. Moreover, since umpire candidates rarely reveal in their disclosures that they are biased (unwittingly or otherwise), a cooperation agreement would also be challenged by attempts to advance umpire candidates who appeared objective to the other party but who were in fact not. In short, it would not seem possible that equilibrium could ever exist, except where both parties routinely "defected" and advanced biased slates of umpires.[9]

In such an environment, where the chances of winning or losing are always 50%, there are incentives to alter the chances of winning in other ways. Perhaps one might propose an umpire who is not only likely to decide in one's favor, but also to award costs, assess punitive damages, and grant broad declaratory relief with respect to matters not clearly in dispute in the arbitration. That party still has only a 50% chance of winning the arbitration, but the measure of the "win" has increased dramatically. Or perhaps a party might attempt to co-opt the umpire chosen by the other party with subtle promises or threats. Whether this has happened or not, the process, as it now exists, creates an incentive for both parties to behave badly, and that cannot be a good thing.

Some will say that arbitrations are more complex than the prisoners dilemma game, or that umpires, as a whole, take seriously their obligations to both parties and the process, so that they do not participate in the game. These people may point to the very few court decisions that address arbitrator misconduct. Similarly, some will point out that if the law does not hold arbitrators to any high standard of conduct that it is unreasonable for ARIAS-US members to do so. These arguments miss the point.

The point is that there is a significant incentive for parties to try to "game" the process and, given the very limited review for arbitrator conduct, the risk of unethical behavior is high. Perhaps some umpires will voluntarily shoulder the burden of adhering to some higher standards, sufficiently at least to give purchasers of arbitration services the confidence that arbitration is fundamentally fair. But if they do not all do so, and if some umpires elect to honor their ethical obligations in the breach, then the purchasers of arbitration services will lose confidence in the process and it will surely suffer.

The Existing ARIAS Framework

Absent a strong code for arbitrator conduct in the law, it is in most instances left to insurance and reinsurance arbitrators to govern themselves. Most arbitrators believe they have an obligation to be fair and they will decline to serve if they do not believe they can be truly neutral. Ethical issues can, however, be complex, and not everyone will reach the same conclusions from the same facts. Thus, ARIAS•U.S. developed a standard Code of Conduct to guide arbitrators and has made adherence to the Code a condition of ARIAS certification.[10]

The Code of Conduct for arbitrators consists of ten Canons:

I: Integrity: Arbitrators should uphold the integrity of the arbitration process and conduct the proceedings diligently.

II: Fairness: Arbitrators shall conduct the dispute resolution process in a fair manner and shall serve only in those matters in which they can render a just decision. If at any time the arbitrator is unable to conduct the process fairly or render a just decision, the arbitrator should withdraw.

III: Competence: Candidates for appointments as arbitrators should accurately represent their qualifications to serve.

IV: Disclosure: Candidates should disclose any interest or relationship likely to affect their judgment. Any doubt should be resolved in favor of disclosure.

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It is fairly clear from the Code that arbitrators must uphold the integrity of the arbitration process (Canon I), conduct the proceedings in a fair manner (Canon II), avoid impropriety or the appearance of impropriety in communicating with parties (Canon V), and make decisions justly, exercising independent judgment (Canon VIII).

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V: Communication with the Parties: Arbitrators, in communicating with the parties, should avoid impropriety or the appearance of impropriety.

VI: Confidentiality: Arbitrators should be faithful to the relationship of trust and confidentiality inherent in their position.

VII: Advancing the Arbitral Process: Arbitrators shall exert every reasonable effort to expedite the process and to promptly issue procedural communications, interim rulings, and written awards.

VIII: Just Decisions: Arbitrators should make decisions justly, exercising independent judgment and should not permit outside pressure to affect decisions.

IX: Advertising: Arbitrators shall be truthful in advertising services offered and their availability to accept arbitration appointments.

X: Fees: Prospective arbitrators shall fully disclose and explain the basis of compensation, fees and charges to the appointing party or to both parties if chosen to serve as the third arbitrator or umpire.11

It is fairly clear from the Code that arbitrators must uphold the integrity of the arbitration process (Canon 1), conduct the proceedings in a fair manner (Canon II), avoid impropriety or the appearance of impropriety in communicating with parties (Canon V), and make decisions justly, exercising independent judgment (Canon VIII). The comments to these Canons tell us, further, that arbitrators should act without influence of outside pressure, fear of criticism, or self-interest (Canon I, Comment 3), and that they owe a duty to the parties and to the industry to act in honest good faith (Canon I, Comment 2). There may be some disagreement among arbitrators concerning what is just and in good faith, of course, but there is a framework that can guide arbitrators to uphold the integrity of the arbitration process.

The ARIAS•U.S. Code of Conduct puts some flesh on the bone of the obligations of arbitrators to the process, but it does not ensure that arbitrations will be conducted in a fair and equitable manner. First, this is because the Code cannot effectively be enforced. There is no specific ARIAS•U.S. process for considering grievances or otherwise reviewing arbitrator conduct. There is no likely resort to a court if an ARIAS-Certified arbitrator fails to follow the Code of Conduct (and even if there were, arbitrators have usually been held harmless by the parties). Really, the Canons work only if arbitrators take very seriously their obligation to follow them. The second problem with the Code is that it is a fairly high-level construct that an arbitrator may misinterpret, or choose to misinterpret. This is not to criticize the Code. It is difficult if not impossible to draft a highly specific ethics code that will be interpreted and applied consistently.

The Code of Conduct also addresses the management of proceedings, requiring the arbitrators to exert every reasonable effort to expedite the process and to issue decisions promptly (Canon VII). In this vein, arbitrators are required to make all reasonable efforts to prevent delaying tactics, harassment of participants, or other abuse or disruption of the process (Canon VII, Comment 3). This is a very high-level outline for the conduct of arbitration proceedings. It does not address any particular procedural issues, sets no specific timeframes, and does not suggest that any particular conduct by the parties is prohibited. At best, Canon VII gives an umpire some support in seeking from parties justification for extensive discovery, briefing, or other activity. It cannot be expected to significantly influence the conduct of any arbitration.

Enhancements to the ARIAS Framework for Arbitration

The ARIAS•U.S. S. Long Range Planning Committee (the "Committee") considered some of the problems existing in the conduct of arbitrations and in May of 2009 identified nine enhancements to the ARIAS framework for arbitrations.[12] Several of the recommendations went to the conduct of party arbitrators (guidelines for disclosures, acceptance of appointments, *ex parte* communications, and permissible advocacy on behalf of a party) and the Committee proposed to focus, initially, on two initiatives in this area: 1) Development of a questionnaire for party appointed arbitrators; and 2) Guidelines for acceptable advocacy by party arbitrators.[13] Much as these enhancements are a step in the right direction, it remains to be seen whether they will, in any fundamental way, alter the dynamics that put arbitration at risk. The courts permit advocacy by party arbitrators[14], the parties hire party arbitrators to advocate, and party arbitrators will continue to advocate irrespective of ARIAS guidelines. Moreover, it is really the umpire, not the party arbitrators in a three arbitrator panel, who controls the destiny of the proceedings.

The Committee also focused on two additional enhancements that go specifically to the conduct of the umpire. These two enhancements consist of: 1) Guidelines for acceptance of appointments; and 2) Establishment of an Ethics Advisory Committee.[15] Here, the Committee proposed to establish appointment guidelines that reiterate the duties of umpires, under the ARIAS Code of Conduct, and include specific instances where umpire candidates should, reasonably, refuse to accept appointments.[16] The Ethics Advisory Committee would, then, be empowered to provide ethical guidance to arbitrators on appointment and other issues—but purely on a hypothetical basis.[17]

To the extent that umpires unwittingly allow bias and inequity to creep into an arbitration, these enhancements to the ARIAS framework should improve the process. Increased clarity as to what constitutes a conflict or appearance of impropriety may aid umpires eager to do the right thing but unsure of the parameters. Likewise, the existence of an advisory body will improve consistency in the application of the Code of Conduct and may provide an added incentive for someone generally inclined to do the right thing to actually do so.

But, of course, as all of the proposed enhancements are guidelines or advisory processes, they will not have the force of rule. Any umpire who does not wish to understand or follow the guidelines will still have wide latitude to stray, and no proposed enhancement will lessen the powerful incentive of parties to appoint umpires they believe *are* biased and will side with them. The integrity of the process will be protected only when umpires voluntarily adhere to the highest ethical standards and take seriously their duties to both parties.

The Call for Further Change

Because effective protection of the process must touch *all* umpires, enhanced guidelines, education, and awareness may not resolve essential problems with insurance/reinsurance arbitration. What is required is fairly obvious. In the context of ethical conduct there must be some mechanism to enforce compliance with specific standards. Likewise, optimum efficiency is achievable only if there are procedural rules in place that are designed to limit the availability of discovery, reduce briefing, and shorten hearings. If arbitrators are required to follow these rules, and failure to do so is a ground for appeal, then costs will be better contained.

Of course, this returns the parties to their dilemma: The imposition of rules, if they are to control the conduct of arbitration, requires the agreement of the parties and the parties will not be inclined to cooperate unless they perceive a real benefit from doing so. Parties to insurance and reinsurance arbitrations have generally not elected to agree to procedures and limitations; thus the perceived benefit must be small.

That parties won't agree when caught up in a dispute is understandable. Then, emotions are high and at least one party may sense that fewer limitations will improve its case. But parties seem reluctant as well to agree to limitations to the process even in advance of disputes occurring. Few reinsurance arbitration clauses contain any procedural requirements or refer to any ethical standards that will govern the conduct of the arbitrators. Few parties have entered into pre-dispute agreements governing the conduct of their arbitrations. Perhaps this is because parties do not really seek efficient and fair arbitration, except in the specific instances where *they* are treated unfairly. Might it be that some parties prefer an environment that might be manipulated, because they think they have the better contacts with prospective umpires and are better able to "game" the system? Or are they simply afraid to impose any limitations on the process for fear that, someday, it will be to their advantage to have no fetters?

Whatever the reasons for past failures to cooperate, all participants in insurance and reinsurance arbitrations should heed the warnings of dissatisfaction among purchasers of arbitration services. Those who become significantly dissatisfied will begin to avoid arbitration if they can, not wishing to have their arbitration outcomes determined by the "coin toss" that selects the umpire. If the ranks of the dissatisfied grow, it will surely compromise the utility of the arbitration process. Arbitration offers so many benefits to parties in dispute — from the involvement of arbitrators expert in the business, to finality of the proceedings, to confidentiality protection unavailable in the courts — that it seems rather shortsighted to risk letting it wither away and die.

Wouldn't ARIAS•U.S. best serve the interests of its members if it more clearly stated that compliance with the Code of Conduct was mandatory for certified arbitrators and supplemented the Ethics Advisory Committee with an Ethics Review Board imbued with the power to de-certify arbitrators found to have violated the Code in some material way? Certainly, some of the ARIAS membership already supports the establishment of an ethics "enforcement mechanism" and thinks that ARIAS should have the power to impose sanctions on certified arbitrators found to have violated the ethics Code.[18] Perhaps the time is drawing near.

Likewise, further development by ARIAS of procedures for general use in arbitration might be in order. These procedures would have to focus on efficiency, and parties using them would have to recognize that everything they might be permitted to do in court might not be available to them in the arbitration. This would be a knowing trade-off of some available "process" for efficiency and cost- containment.

Ultimately, however, it will rest with the parties to effect change. Even if ARIAS steps in to fill procedural gaps or better control certified arbitrators, it is the parties that must agree to apply the ARIAS procedures to existing contracts,

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Ultimately, however, it will rest with the parties to effect change. Even if ARIAS steps in to fill procedural gaps or better control certified arbitrators, it is the parties that must agree to apply the ARIAS procedures to existing contracts, and rely exclusively on ARIAS-certified arbitrators.

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and rely exclusively on ARIAS-certified arbitrators. Cooperative agreements among parties would have to be reached in the abstract, perhaps under the auspices of a global project involving many companies.

There is no question that fundamental change to the insurance and reinsurance arbitration process would be difficult to effect and difficult to justify with quantifiable analysis. But it is safe to assume that, if parties come to believe that the process does not return reasonable results, they will find ways to cease to use the process. It may be an overstatement to assert that the future of insurance and reinsurance arbitration is at stake — but it is equally possible that this assessment is entirely accurate. In any event, since the participants in the arbitration process have the ability to effect useful change, change should seriously be considered.

In some other contexts arbitration is more closely controlled by some central body, and there is nothing to suggest that these proceedings have become unworkable. Surely, changes to insurance/reinsurance arbitration, if made with care and thought, can improve the process.▼

1 ARIAS conferences have in the recent past addressed the effectiveness of the arbitration process (see Fall 2006 and Fall 2004 Conference agenda), discussed reconsideration of "the purpose and integrity of the arbitration process" (Spring 2008 Conference), and even asked if arbitration can lead to "jackpot justice." (Spring 2005 Conference).

2 ARIAS•U.S. Long Range Planning Committee Status Report to Membership, 2009 Spring Conference, May 7, 2009 (" LRPC May 2009 Report") at 2 (accessible through ARIAS•U.S. website at www.arias-us.org). A small number of members responding to the LRPC survey reported that they had less than full confidence in the process, and a small number reported as well that they had observed unethical behavior by arbitrators.

3 Court rules of procedure address the scope of the proceedings, disclosures, timing of submissions, and scope of discovery. Rules of evidence limit introduction of unreliable and prejudicial information. Litigants are entitled to certain due process rights, and the determinations of judges are subject to review by higher courts.

4 The classic "prisoner's dilemma" is a construct of modem game theory in which "cooperation" between two persons results in a mildly unfavorable result for each while "defection" by one (while the other "cooperates") results in a complete win for the defector (and a complete loss for the cooperator). If both "defect" the result is unfavorable for each, but not as unfavorable as a complete loss, such as would occur if a person cooperated while his counterpart defected. Since in any situation playing defect is more beneficial than cooperating (and since each player must fear that the other will defect) all rational players will defect. See, e.g. William Poundstone, *Prisoner's Dilemma* (Doubleday 1992).

5 Since the passage of the Federal Arbitration Act in 1924 the trend in U.S. law has been towards party and arbitrator control of the arbitration process. *See, e.g., United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960); *Hall Street Assoc. v. Mattel, Inc.*, 128 S. Ct. 1396 (2008); *Kergosien v. Ocean Energy, Inc.*, 390 F.3d 346 (5th Cir. 2004). Recent U.S. Supreme Court decisions such as *Hall Street* have further clarified and solidified the notion that courts can review arbitration awards only where the strict grounds for appeal under the FAA are met.5 These grounds are:

1) where the award was procured by corruption, fraud or undue means;
2) where there was evident partiality or corruption of the arbitrators
3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy, or of any other misbehavior by which the rights of any party have been prejudiced; or
4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10 (a). These grounds are interpreted closely, and applied to vacate arbitration awards sparingly.

6 *See Gulf Guaranty Life Insurance Co. v. Connecticut General Life Insurance Co.*, 394 F.3d 476 (5th Cir. 2002); *Certain Underwriters at Lloyd's, London v. Argonaut Insurance Co.*, 264 F.Supp.2d 926 (N.D.Cal. 2003).

7 LRPC May 2009 Report at 2-3.

8 In the classic prisoners dilemma game, the reward for cooperation (to each party) outweighs the reward (to each party) of joint defection, and yet, when the game is played repeatedly, both players will defect, consistently. Here, where the rewards of joint cooperation and joint defection are the same, there seems to be virtually no chance of cooperation.

9 When parties play the "game" repeatedly, selection of a purely neutral umpire candidate by either or both parties is unstable, because of the possibility that the other party will not cooperate and will instead pick a nonobjective candidate. Equilibrium is reached only when both parties advance the non-objective candidate.

10 In applying for certification by ARIAS each arbitrator agrees to "abide by and be subject to the ARIAS- U.S. Guidelines for Arbitrator Conduct." (See arbitrator and umpire application forms, accessible through the ARIAS•U.S. website.)

11 The ARIAS Code of Conduct (also referred to as the Guidelines for Arbitrator Conduct) can be found on the ARIAS•U.S. website. Each Canon of Conduct includes comments, designed to enhance understanding of the Code and to address common situations requiring interpretation under particular Canons. ARIAS•U.S. ethics committee members continue to address the Canons and the comments, in an ongoing effort to clarify and enhance the understanding of all members as to the application of the Code to the arbitration process.

12 *See* LRPC May 2009 Report at *5-6*.

13 *See* Long Range Planning Committee Status Report to Membership, 2009 Fall Conference, November 13, 2009 ("LRPC Nov. 2009 Report"). (Accessible through ARIAS•U.S. website at www.arias-us.org).

14 *See Sphere Drake Ins. Ltd. v. All Am. Life Ins. Cc.*, 307 F.3d 617(7th Cir. 2002); *Certain Underwriters at Lloyd's, London v. Continental Cas. Co.*, 1997 U.S.Dist. LEXIS 11934 (N.D.Ill. Aug 7, 1997).

15 LRPC Nov. 2009 Report at 2.

16 Id., at 22-28.

17 Id., at 4-8.

18 LRPC May 2009 Report at 4.

members on the move

In each issue of the Quarterly, this column lists employment changes, relocations, and address changes, both postal and email, that have come in during the last quarter, so that members can adjust their address directories and PDAs.

Although we will continue to highlight changes and moves, remember that the ARIAS•U.S. Membership Directory on the website is updated frequently; you can always find there the most current information that we have on file. If you see any errors in that directory, please notify us.

Do not forget to notify us when your address changes. Also, **if we missed your change below**, please let us know at director@arias-us.org, so that it can be included in the next Quarterly.

Recent Moves and Announcements

In a significant relocation, members at AIG Reinsurance Legal Group joined their colleagues around the corner at 180 Maiden Lane, 20th Floor, New York, NY 10038. As a result, the following changes should be noted. **Eric Kobrick**, phone 212-458-8270; **Paul Aiudi**, phone 212-458-8268, fax 877-442-1907; **Patricia Taylor Fox**, 212-458-8267; **William Goldsmith**, 212-458-8269; **Joanne Howell**, 212-458-8266. Other fax numbers have not changed. All email addresses remain the same.

Richard M. Shaw has retired. As of July 1, his official address is 80 Buckmanville Road, Newtown, PA 18940, phone 215-598-3885. But, while he does not disclose where to find him, he indicates that during May through October, he will be in Maine with a phone number of 207-567-3069. His email, RMSConsult2010@aol.com, reaches him at both locations.

Ron Gass and The Gass Company, Inc. have moved to a new address: 76 Hopewell Woods Road, Redding, CT 06896-1728. His telephone and fax numbers and e-mail address remain unchanged.

Katherine L. Billingham has a new street address: KB ReSolutions, Inc., 1628 Lookout Circle, Charlotte, NC 28173. All else remains the same.

Laird R. Criner is now located at Criner International Advisors, LLC, 4 John Todd Way, Redding, CT 06896, phone 203-664-1347, cell 203-947-4684, email laird.r.criner@crinerllc.com.

Myra E. Lobel's new address is Guy Carpenter & Company, LLC, 1166 Avenue of the Americas, New York, NY 10036, phone 917-937-3157, fax 917-937-3657, myra.e.lobel@guycarp.com.

David L. Fox has joined the New York office of Smith, Gambrell & Russell, LLP. His address is 250 Park Avenue, Suite 1900, New York NY 10177, phone 212-907-9725, fax 212-907-9825, email dfox@sgrlaw.com.

feature

The Follow-the-Settlements Doctrine

David R. Nelson

...the follow-the-settlements doctrine "binds a reinsurer to accept the cedents good faith decisions on all things concerning the underlying insurance terms and claims against the underlying insured: coverage, tactics, lawsuits, compromise, resistance or capitulation."

David Nelson is a partner at Akin Gump Strauss Hauer & Feld LLP and a certified public accountant. His practice focuses on complex civil litigation, principally for insurers and their insureds, including reinsurance and insurance arbitration and litigation.

David R. Nelson

The Significance of Follow-the-Settlements: Overview[1]

Reinsurance disputes often involve the question of whether to apply the "follow-the settlements" doctrine to the ceding company's decision to pay a claim and/or its method of allocating the loss to its reinsurance coverage.[2] In the past few years, several state and federal court cases have addressed follow-the-settlements issues in some detail. Two landmark cases were decided by the Second Circuit Court of Appeals,[3] which has under its jurisdiction New York (a hub of reinsurance arbitration) and Connecticut (which is home to a number of major players in the insurance industry). As those two cases make clear, the follow-the-settlements doctrine "binds a reinsurer to accept the cedent's good faith decisions on all things concerning the underlying insurance terms and claims against the underlying insured: coverage, tactics, lawsuits, compromise, resistance or capitulation."[4] Follow-the-settlements insulates a reinsured's liability determinations from challenge by a reinsurer unless they are unreasonable or in bad faith, or the payments are "clearly beyond the scope of the original policy" or "in excess of [the reinsurer's] agreed-to exposure."[5] The follow-the-settlements doctrine also extends to a cedent's post-settlement allocation decisions, as long as the allocation to the reinsurance coverage meets the typical follow-the-settlements requirements, i.e., is in good faith, reasonable, and within the applicable policies.[6]

According to the courts, the follow-the-settlements doctrine is intended to serve the goals of maximum insurance coverage and settlement[7] and to preserve the foundation of the reinsurance relationship.[8] Judicial review of either the settlement decision or the allocation decision "has an equal likelihood of undermining settlement and fostering litigation."[9] "If the ceding company knew that its settlement decisions could be challenged by every reinsurer, there would be little incentive to settle with the insured. The costs and risks of litigation avoided by settling with the insured would only be revived at the reinsurance stage."[10] The purpose of the "follow the settlements" doctrine is to prevent the reinsurer from second-guessing the good-faith settlement decisions of the ceding company.[11] Moreover, with respect to post-settlement allocations, "a cedent choosing among several reasonable allocation possibilities is surely not required to choose the allocation that minimizes its reinsurance recovery to avoid a finding of bad faith."[12]

Follow the settlements issues may arise from two distinct but related situations. The first is the ceding company's decision to settle a claim presented by its insured. As long as the loss can reasonably be considered covered under the reinsured policy, and is not excluded under the reinsurance agreement, a reinsurer will be bound by the cedent's reasonable settlements made in good faith. Secondly, follow-the-settlements also protects reasonable, good-faith allocations, thus requiring a reinsurer to "follow the allocations" as well. A reinsurer may have to honor allocations that are not technically correct, or not the most reasonable or likely outcome, or even inconsistent with the cedent's pre-settlement analysis. However, as some recent court cases have shown, the fact that a settlement is reasonable and in good faith does not necessarily give cedents a blank slate to make any reinsurance allocation they wish. Allocations, like settlements, must be reasonable and in good faith, and not lie outside the coverage provided in the reinsurance agreement.[13]

Courts have acknowledged limitations on how far the follow-the-settlements principles could be extended in order to bind reinsurers to post-settlement allocations.[14] In *American Employers v. Swiss Re*, the cedent argued that a follow-the-settlements clause bound the reinsurer to the post-settlement allocation regardless of what the settlement embodied.[15] The First Circuit, however, cautioned that "there are objections to this course and we are not presently prepared to adopt it.[16] Although the Court found that the post-settlement allocation was proper, the court remanded the case because it also found material issues of fact concerning whether the settlement was reasonable and in good faith.[17] In *Allstate v. American Home*, a New York state appellate court denied follow-the-settlements protection to a post-settlement allocation, where the cedent allocated the loss to its reinsurer in a way that contradicted the manner in which the cedent allocated the loss to the reinsured policies.[18]

In many cases, determination of whether follow-the-settlements applies and, if so, whether the reinsurer can establish one of the exceptions, will determine the outcome of the reinsurance dispute. In the absence of follow-the-settlements protection, the cedent may have the burden to prove that the claim or loss actually is covered or that the allocation to the reinsurer is technically correct.[19] The cedent may lose reinsurance protection for a claim that is not actually covered or be denied a favorable reinsurance allocation when subjected to a *de novo* review. If follow-the-settlements applies, however, the reinsurer will have the burden to establish bad faith, unreasonableness, or that the loss clearly is not covered under the reinsured policy or is excluded under the reinsurance agreement.[20] This often is a very difficult burden to overcome.[21] It may be nearly impossible to show that a claim is not reasonably covered or "not even arguably covered" under the reinsured policy. In addition, some courts have described the burden to show bad faith/unreasonableness as "extraordinary,"[22] and arbitration panels will very likely require similar proof. Follow-the-settlements protection also may influence the view of a court or panel as to whether a loss is outside the scope of the reinsurance coverage,[23] even though cases have consistently held that follow-the-settlements cannot override the terms of the reinsurance agreement.[24]

This article discusses key issues that may arise in a case where follow-the-settlements protection is sought, and how courts have treated these issues. Judicial cases, although certainly not definitive, are useful to illustrate and frame issues, and whether any particular situation or group of cases will be persuasive in a particular case depends on the circumstances. The outcome of a reinsurance dispute will almost always be driven by the specific facts of each case, and differences in policy language or underlying facts may render other court decisions inapplicable. Also, many reinsurance disputes will be decided in the context of confidential arbitrations, where the importance of case law may be quite limited. Reinsurance arbitration agreements frequently permit (if not require) arbitrators to resolve disputes in accordance with industry custom and practice and do not obligate arbitrators to strictly follow the law or judicial formalities. That is not to say that arbitrators can or should turn a blind eye to case law. The reasoning of courts addressing follow-the-settlements issues may be quite persuasive in many contexts. In addition, a panel award at odds with legal precedent, such as requiring payment of a loss that clearly is not covered (or refusing to honor cession of a loss that reasonably is covered), might be open to a court challenge under the Federal Arbitration Act. In some jurisdictions, notably the Second Circuit, the "manifest disregard" doctrine remains alive and well even after the Supreme Court decision in *Hall Street Associates*.[25]

Does Follow-the-Settlements Apply to the Reinsurance Agreement?

Not all reinsurance agreements contain definite, indisputable follow-the-settlements language, and some agreements clearly have none. In such cases, a critical threshold issue may be whether follow-the-settlements is inherent in every reinsurance contract as a matter of law or should be implied on the basis of industry custom and practice.

When a dispute arises, parties should carefully study the language of the reinsurance agreement to confirm that it actually does contain a follow-the-settlements clause, which may not be as clear cut as one might anticipate.[26] For example, courts reviewing virtually identical reinsurance provisions have reached opposite conclusions on whether the language amounts to a follow-the-settlements clause.[27] In *North River v Employers Re*, the court found that the terms of the policy did not contain an express follow-the-settlements clause.[28] However, six years later, the court in *Employers Re v. Mass Mutual*, construing what appears to be the same language, held that the reinsurance agreement unambiguously provided follow-the-settlements protection.[29] These two courts diverged in the significance they ascribed to the absence of certain terms in the agreements. In finding for the reinsurer, the Ohio court emphasized the lack of any language requiring the reinsurer to pay claims where coverage was in dispute.[30] Conversely, in finding for the cedent, the Missouri court stressed the absence of language allowing the reinsurer to question claims once the losses are paid.[31] The lesson from these cases is that a cedent should not presume (and the reinsurer should not necessarily concede) that the reinsurance contract has a follow-the-settlements clause, and the parties will need to evaluate the arguments on both sides.

Even if follow-the-settlements language is absent, some courts have found that the "follow-the-fortunes doctrine is implicitly contained in every reinsurance agreement.[32] However, the persuasiveness of these decisions in supporting a rule that follow-the-settlements applies to every reinsurance contract has been strongly questioned.[33] Still, the cases are on the books and may be useful to a cedent in certain cases. Other courts have rejected the proposition that the "follow-the-settlements" doctrine is implied as a matter of law in the absence of an express provision.[34] In the end, case law in this area offers lift le guidance in court proceedings, even less in arbitrations.

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Follow-the-settlements also may be applied as a matter of industry custom and practice.[35] The Eighth Circuit has upheld a trial court's application of follow-the-settlements where the retrocessionaire failed to expressly exclude such protection and the parties' experts agreed that follow the settlements is "customary" in reinsurance agreements.[36] In *ReliaStar*, the retrocessionaire argued that the agreement incorporated by reference the terms of the covered reinsurance that eliminated follow-the-fortunes protection.[37] The court rejected this argument, finding no intent or express agreement to "preempt the application of the customary [follow-the-settlements] doctrine."[38] Importantly, it appears that the court found that "customary" doctrine existed by virtue of the agreement of both parties' experts, and not as a matter of law.[39] In *American Insurance v. American Re*, the court found that, while follow-the-settlements may not be implied as a matter of law, the cedent still would be entitled to present evidence demonstrating whether, at the time the reinsurance certificates were entered into, follow-the-settlement clauses were widely understood by reinsurance industry custom and practice to be a tacit part of every facultative reinsurance contract.[40]

Thus, parties to reinsurance disputes may find it advisable to develop evidence of industry custom and practice and the course of dealing between the parties to either support or oppose application of follow-the-settlements. Certainly, in a court proceeding, litigants will need to develop evidence of industry custom and practice through expert testimony, including the party's own personnel who may qualify as lay experts.[41] In arbitrations, however, the panel members may be experts or at least very knowledgeable about industry custom and practice applicable to the dispute. Arbitrating parties will need to make strategic decisions regarding engagement of experts (or opposing the use of experts) in a given arbitration.

Is the Ceded Loss Reasonably Within the Scope of the Reinsured Policy?

While follow-the-settlements eliminates second-guessing of good faith settlements, it does not obligate a reinsurer to indemnify losses that clearly are not covered under the reinsured policies.[42] For example, a purely *ex gratia* payment by the cedent would not bind the reinsurer (in the absence of an agreement of the parties to the contrary).[43] In most cases, however, the ceding company likely has settled a claim after conducting some analysis of a dispute over coverage with its insured. Follow-the-settlements imposes considerable deference in such situations, requiring reinsurers to pay unless the loss is "clearly outside the scope of[44] or "not reasonably covered by"[45] or "not even arguably covered by"[46] the reinsured policies. Though the semantics may vary from one opinion to the next, this is a "purposefully low" standard[47] that can be very difficult for a reinsurer to overcome, as skilled insurance recovery counsel are capable of developing colorable arguments for coverage in just about any situation. Nevertheless, parties should be aware that there may be a real question regarding whether a loss reasonably is covered and take into account all policy defenses and the law of the particular jurisdiction in which the case was pending.

There are cases in which courts have found that a claim is not even arguably covered.[48] *NACPAC* concerned an attempt by a cedent to recover from its reinsurer a loss paid in a post-trial settlement, after the jury had awarded both compensatory and punitive damages. The settlement award clearly encompassed part of the punitive award, and because the policy did not cover punitive damages, the court refused to hold the reinsurer liable for risks beyond the scope of its policy.[49] The *Suter* decision is frequently held out as an example of how bad faith can take the form of grossly negligent claims handling, but the court in that case also found that the ceded claims were not reasonably covered because defective heart implants could not possibly have caused injury or anxiety (and thus triggered the liability coverage) before the devices actually malfunctioned.[50] In *City of Renton*, a federal district court held that a claim for damage to a bridge was completely outside the scope of the original coverage because of a policy exclusion for "inherent vice" in the reinsured policy.[51] The cedent made textual arguments that the inherent vice exclusion did not apply, pointing out that certain exclusionary language did not appear in the version of the policy in effect when the damage occurred but was added to later versions.[52] The Court rejected the cedent's position, although one could contend that the claim was at least "arguably" covered in light of the change in the wording of the exclusion.[53] More difficult issues may arise where the cedent pays a claim for which coverage is at least arguable but nevertheless highly doubtful. In some circumstances, it may be perfectly reasonable (from the cedent's perspective) to settle with its insured and pay a claim that likely is not covered. Perhaps the cedent has a history of paying such claims for the insured or has taken actions that may otherwise imperil its coverage defenses.[54] A reinsurer should look closely at the terms of the reinsured policy and try to learn as much as possible about the underlying settlement.

In addition, whether a claim reasonably is covered by the reinsured policy may depend on which state's law governs the coverage dispute.[55] Choice-of-law determinations typically are fact-driven and may require development of an extensive record on the subject. In the commendable interest of streamlining the arbitration process, panels may be disinclined to entertain choice-of-law disputes or allow discovery into such issues. However, there are many areas — allocation, trigger, occurrence, pollution exclusion, annualization, etc. — where the laws of two different jurisdictions may lead to conflicting results.

In all events, the parties (and the panel in arbitration) should carefully consider, at the beginning of a case, whether a claim reasonably is covered under the reinsured policies. Indeed, in some cases, this issue may be ripe for summary adjudication or partial summary adjudication motions by either side to the dispute. Early consideration of such issues by the court or panel should benefit both cedents and reinsurers. The knowledge that follow-the-settlements will apply unless the reinsurer proves bad faith or unreasonableness may lead to an early settlement. If the ceded loss is not reasonably within the scope of the reinsured policy, early disposition of the case will save the parties' resources.

Does the Reinsurance Agreement Override Follow-the-Settlements?

Even if a claim is covered under the original policies and reasonably settled in good faith, the reinsurance agreement still may preclude liability on the part of the reinsurer. This can happen in at least two general ways. First, the reinsurance contract may have language inconsistent with follow-the-settlements, requiring payment only of claims that are, in fact, actually covered. Second, even if there is a follow-the-settlements clause or the doctrine is implied, the reinsurance agreement may have limits, exclusions, or definitions (loss, occurrence, trigger, etc.) that differ from the terms of the reinsured policies.

Many reinsurance agreements have a "follow-form" clause that is intended to make the terms of the reinsurance agreement concurrent with the direct policies. Follow-form provisions, however, may be trumped by inconsistent provisions in the reinsurance agreement.[56] If the terms of the reinsurance agreement language expressly exclude claims covered under the reinsured policies, or limit the scope of coverage, then those terms cannot be overcome by follow-the- settlements or follow-form clauses.[57] In addition, courts have consistently ruled that the liability limits in a reinsurance agreement operate as a cap on the reinsurers' obligation, even where the cedent pays defense or other costs in excess of the policy limits.[58] According to the courts, then, follow-the-settlements creates no deference to the ceding company's settlements or allocations if the loss clearly is inconsistent with the terms of the reinsurance agreement. Whether the same is true in arbitrations, however, may be open to debate. Some have questioned whether certain judicial decisions are consistent with industry practice and whether arbitrators have followed (or will follow) these precedents.[59]

Regardless, the New York Court of Appeals has followed *Bellefonte* and *Unigard*, holding that follow-the-settlements does not require a reinsurer to reimburse defense costs beyond the stated indemnification limits in the reinsurance policy.[60] In another case, the New York Court of Appeals refused to impose follow-the-settlements to force aggregation of losses in a manner inconsistent with the definitions contained in the reinsurance policies.[61] The Court explained that, if follow-the-settlements negated the language in the reinsurance contract, the "practical result" would "bind a reinsurer to indemnify a reinsured whenever it paid a claim, regardless of the contractual language defining loss." *Id*. at 329.

Complicated issues also may arise where the language of the direct and reinsurance policies is different, but the reinsurance agreement contains follow-the-settlements and/or follow-form provisions. Courts have required that the reinsurance agreement clearly and unambiguously exclude or limit coverage of the ceded loss. In one case, the reinsurer argued that its agreement with the cedent contained a broader pollution exclusion than the direct policies, and thus excluded the ceded loss.[62] Applying Ohio law, the court found that the pollution exclusion in the reinsurance policy was ambiguous and, construing it against the reinsurer, refused to deny coverage of the ceded claims.[63] Because the court found that a reasonable construction of the broader exclusion made the coverages of the reinsurance and direct policies co-extensive, the reinsurer was required to follow the settlements of the cedent.[64] In another case, a reinsurer argued that 3-year reinsurance certificates clearly and unambiguously provided for a single aggregate limit that could not be annualized.[65] However, because the reinsured policies contained the identical limits language as the underlying policies, along with a follow-form clause, the court held that the reinsurance coverage also provided for annualized limits without the need to resort to extrinsic evidence of the parties' intent.[66]

In cases where the language is identical in both the reinsurance agreement and the reinsured policies, could the application of different state (or foreign) laws to the two policies override follow-the-settlements protection? In an interesting decision issued last year, the UK House of Lords disallowed follow-the-settlements protection in a proportional facultative cover that fully incorporated the terms of the direct policy and also contained follow-the-settlements and "full-reinsurance" provisions.[67] In litigation in the U.S., the cedent was found liable to indemnify its insured on an "all sums" basis under Pennsylvania law, for environmental contamination losses that spanned 44 years, despite having issued only 3 years of liability coverage.[68] The cedent then settled the claims for $103 million.[69] In applying English law to coverage of the claims under the reinsurance certificates, however, the House of Lords ruled that the period covered by the reinsurance certificates was limited to 3 years, notwithstanding the fact that the House of Lords and the parties agreed that the U.S. Court correctly applied Pennsylvania law to the reinsured policies.[70] Although neither the reinsured policy nor the facultative certificates contained an express choice-of-law provision, and despite the strong concurrency terms in the reinsurance agreement, the House of Lords refused to make the reinsurance coverage co-extensive under the follow-the-settlements doctrine.

It would not be unusual to find that choice-of-law principles result in applying one jurisdiction's laws to the direct policies and a different jurisdiction's laws to the reinsurance agreement. Parties to arbitration should be mindful of potential problems or opportunities presented if the law applicable to the reinsurance policy differs substantially from the law governing the direct policies. The House

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A cedent may allocate on any reasonable basis as long as the underlying settlement is made in good faith, involves covered claims, and is not the product of fraud or collusion. However, there are limits to what constitutes a reasonable allocation, as the allocation method must be reasonable and tethered in some way to the settlement, and must not run afoul of separate terms in the reinsurance agreement.

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of Lords decision in Lexington suggests that follow-the-settlements will yield even where the reinsurance agreement has follow-the-settlements and follow-form clauses, because the cedent may not impose liability on the reinsurer beyond that contemplated by the reinsurance terms —- as construed under the law applicable to the reinsurance agreement. Arguably, this is a correct result because the ceding company could have bargained for terms that required the same laws to apply on the direct and the reinsurance side, and this argument may have particular force where the reinsurance agreement designates its governing law. On the other hand, cedents may have persuasive arguments that the parties intended the reinsurance coverage to be co-extensive and that the same laws would govern on both sides of the cession, or that industry custom and practice or the parties' course of dealing effectively should lead to that result. If a reinsurance agreement does not specify its governing law, cedents also may argue that there is no express language in the reinsurance agreement to override follow-the-settlements.

Are both the Underlying Settlement and the Reinsurance Allocation Reasonable and made in Good Faith?

Courts or arbitrators may be asked to decide whether the settlement by a cedent and/or the cedent's subsequent allocation to its reinsurance coverage is reasonable and in good faith. Courts have held that a reinsurer may not validly challenge a cedent's allocation on the basis of an alleged inconsistency with the cedent's pre-settlement analyses of potential liability or with positions the cedent asserted in settlement negotiations.[71]
A cedent may allocate on any reasonable basis as long as the underlying settlement is made in good faith, involves covered claims, and is not the product of fraud or collusion.[72] However, there are limits to what constitutes a reasonable allocation, as the allocation method must be reasonable and tethered in some way to the settlement,[73] and must not run afoul of separate terms in the reinsurance agreement.[74] The question of whether a particular settlement or allocation is reasonable and in good faith necessarily is a case-specific and fact-intensive question.[75] Nevertheless, several court decisions have offered some insight into potential actions that could be construed as unreasonable or taken in bad faith.

- **Allocations unreasonably intended to maximize reinsurance recovery**

In 2007, a New York state appellate court held that follow-the-settlements did not bind the reinsurer to the cedent's post-settlement allocation, because the cedent's allocation "at odds with its allocation of loss with its insured, designed to minimize its loss, reflects an effort to maximize unreasonably the amount of collectible reinsurance. . "[76] Following on the heels of *Travelers Casually v. Gerling* and *North River v. ACE*, and several lower court decisions that adhered to those two rulings, *Allstate v. American Home* garnered substantial attention in the reinsurance industry, as perhaps a sign that the follow-the-settlements pendulum might be swinging in the other direction. In some respects, however, *Allstate v. American Home* presents a somewhat extreme fact pattern — the cedent's single-occurrence allocation contradicted the positions taken by both parties in settlement negotiations as well as a court ruling in the same case determining the number of occurrences.[77] On that record, the New York appellate division took a harsh view of the cedent's switch to single-occurrence allocation, describing it as "neither reasonable nor reflective of good faith."[78]

The *Travelers Casualty/North River* cases on one hand, and *Allstate v. American Home* on the other hand, seem to represent somewhat opposite ends of the good faith/reasonableness spectrum. In the former two cases, the Second Circuit concluded that the cedents' allocations were wholly consistent with their settlement analyses, industry custom, and positions taken by the cedents to try to minimize their liability to the direct insured, and also that the reinsurer proffered no evidence of any bad faith.[79] So, too, in many cases, ceding companies — typically with the assistance of coverage counsel — will have analyzed multiple coverage scenarios to develop a range of potential exposure, and will have settled within that range. The cedent will then have a number of allocation methods to choose from that have a foundation in the potential litigation outcomes, the cedent's pre-settlement analyses, and/or settlement negotiations.

In *Allstate v. American Home*, however, the cedent's allocation to the reinsurers was "at odds" with its allocation on the direct side and found to be a "disingenuous" effort to maximize reinsurance recovery. *Allstate v. American Home* does not appear to have spawned a flood of court decisions refusing to apply follow-the-settlements, and probably has had a limited impact on reinsurance arbitrations. But it does illustrate that follow-the-settlements protection is not a guarantee that a cedent will be able to allocate even a reasonable, good faith settlement in any manner that it chooses.[80] When an allocation approaches the realm of "a post-hoc characterization or a unilateral post-settlement allocation without grounding in the settlement process,"[81] it becomes more likely that the allocation will not qualify for follow-the- settlements deference.

Courts and arbitration panels no doubt will be presented with cases that lie somewhere in between the fact patterns of these cases, requiring development and careful examination of the record. In *American Employers v. Swiss Re*, the First Circuit rejected the argument that "regardless of what a settlement embodies, a cedent's . . . post settlement allocation. . . is binding under a follow-the-settlements clause."[82] The court also brushed aside the cedent's claim that only good faith, and not reasonableness, is required under the follow-the-settlements principles.[83] The court went on to discuss two ways in which the reinsurer might challenge reasonableness and good faith of the underlying settlement. A settlement may be challenged as unreasonable if the loss paid is not commensurate with the litigation risk that coverage will be found to exist.[84] The reinsurer also might establish that the cedent had no interest in contesting annualization of limits in its primary policies because it would shift liability to the cedent's excess policies (which apparently had less reinsurance protection). Thus, *American Employers v. Swiss Re* indicates that manipulating either the settlement process or the post-settlement allocation to maximize reinsurance recovery may be a ground for denial of follow-the-settlements protection.[85]

Notwithstanding precedents such as *North River v. ACE and Travelers Casualty v. Gerling*, courts presented with evidence of sharp practices by cedents have been reluctant to grant follow-the-settlements protection to underlying settlements or post-settlement allocations to reinsurers. In some instances, arbitrators may have different views owing to their own industry experience, but it is difficult to conceive of a widely-accepted industry practice that would validate actions that are unreasonable or undertaken in bad faith. Because so many follow-the-settlements disputes are resolved through arbitration, panelists should be alert for the possibility that a cedent may be taking unfair advantage. By the same token, arbitrators should be vigilant in weeding out unfounded claims of bad faith or unreasonableness. This can be done — as courts have done — through limiting "fishing-expedition" discovery, summary adjudication of untenable claims, and/or awarding interest and attorney's fees to the cedent (assuming the arbitration agreement bestows such powers on the arbitration panel).

- **Gross negligence or recklessness in claims handling**

Some court decisions stand for the principle that follow the settlements will not allow the cedent to recover from its reinsurer if the cedent jeopardizes coverage defenses or pays uncovered claims as a result of grossly negligent claims handling.[86] For example, in *Suter*, the court held that "[t]he application of 'follow the settlements' doctrine is subject to the requirement that the reinsured make a reasonable, businesslike investigation."[87] Cataloguing what it viewed as multiple failures by the cedent's claims handler to investigate coverage of the losses related to an allegedly defective heart valve under the reinsured policies, the court concluded that the cedent's decision to pay claims was "grossly negligent and amounted to bad faith." *Suter* may be viewed as a sign that cedents must implement reasonable and businesslike claims-handling practices or face the risk of losing follow-the-settlements protection. Or *Suter* might be viewed as an example of just how egregious a cedent's failures would have to be before a court, let alone an arbitration panel, will deny follow-the-settlements protection. The facts of the *Suter* case do appear to be unusual, as the court found what it considered to be several inexplicable failures to properly evaluate claims by the cedent's claims handler. 2006 WL 2000881, at **25-27.[88] Nevertheless, *Suter* remains a cautionary tale for cedents.

In *North River v. CIGNA Re*, the cedent failed to comply with scheduling procedures under the terms of the Wellington Agreement, allegedly resulting in liability for otherwise uncovered defense costs.[89] The district court found that the cedent's failure to comply with the scheduling procedures constituted gross negligence.[90] The Third Circuit reversed the grant of summary judgment for the reinsurer, but found that the questions of gross negligence in claims handling by the cedent and economic injury to the reinsurer were material fact issues.[91] In *CIGNA Re*, as in most cases, the court required gross negligence or recklessness in claims handling in order to find bad faith sufficient to obviate follow the settlements. An argument can be made that this standard is and should be demanding, so as to avoid creating an incentive for reinsurers to nitpick the cedent's claims handling in contravention of the salutary goals that the follow-the-settlements doctrine is intended to serve.

Conclusion

One can expect application of follow-the-settlements to continue to be a hotly contested issue in reinsurance disputes. Parties may face litigation or arbitration of several key follow-the-settlements issues, including: (i) whether the reinsurance agreement expressly or impliedly incorporates follow-the-settlements; (ii) whether the ceded loss is reasonably covered by the reinsured policy; (iii) whether the

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reinsurance agreement precludes coverage of the ceded loss; (iv) whether the underlying settlement is reasonable and in good faith; and (v) whether the allocation to the reinsurance coverage is reasonable and in good faith. In some cases, one or more of these issues may properly be resolved by an early motion for summary judgment or adjudication. Where legitimate issues over follow-the-settlements protection exist, however, development of a full factual record may be necessary to resolve the dispute. The following is a very brief checklist of steps a party may want to undertake in a case where application of follow-the-settlements is likely to be an issue.

- Conduct an in-depth review of the terms of the both the reinsured policy and the reinsurance agreement to verify coverage of the ceded loss.
- Analyze what jurisdiction's law will govern the direct policies and the reinsurance agreement and how that may affect the coverages.
- Confirm that the reinsurance agreement does or does not have an effective follow- the-settlements clause.
- If there is no follow-the-settlements language in the reinsurance agreement, evaluate whether the nature of the particular reinsurance agreement, and/or industry custom and practice, and/or the parties' course of dealing may operate to imply follow-the-settlements protection.
- Evaluate the access to records language (if any) in the reinsurance agreement.
- Consider whether to conduct an audit of claim files to evaluate the claims handling (or prepare to oppose or restrict an audit that may be unnecessary or overreaching).
- Investigate the circumstances that led to the settlement of the ceded loss and the settlement negotiations between the cedent and its insured.
- Determine if the allocation and settlement analyses are adequately documented.
- Interview potential witnesses who have knowledge of the coverage disputes, settlement negotiations, and allocation methods.
- Develop requests for information or discovery related to the cedent's pre-settlement analyses, settlement negotiations, and reinsurance allocation methods and analyses.
- Prepare to oppose or limit the reinsurer's requests for information or discovery related to the cedent's pre-settlement analyses, settlement negotiations, and reinsurance allocation methods and analyses.
- Gather and organize evidence supporting the reasonableness of the settlement and the post-settlement allocation, considering whether and to what extent to assert applicable privileges.▼

1 The views expressed in this article are solely those of the author and do not necessarily reflect those of Akin Gump Strauss Hauer & Feld LLP or any of its clients.

2 Follow the settlements is not the same as the "follow-the-fortunes" doctrine, although the terms frequently are used interchangeably. *North River Ins. Co. v. Employers Reins. Corp*., 197 F. Supp. 2d 972, 978, fn. 1 (S.D. Ohio 2002). As explained by courts, "follow the fortunes' more accurately describes the obligation to follow the reinsureds underwriting fortunes, whereas 'follow the settlements' refers to the duty to follow the actions of the cedent in adjusting and settling claims." *Id*. (citing *Aetna Cas. and Sur. Co. v. Home Ins. Co*., 882 F. Supp. 1328, 1346, flu. 9 (S.D.N.Y.1995)).

3 *Travelers Cas. & Sur. Co. v. Gerling Global Reins. Corp. of Am*., 419 F.3d 181 (2d Cir. 2005); *North River Ins. Co. v. ACE Am. Reins. Co*., 361 F.3d 134 (2dCir. 2004).

4 *North River*, 361 F.3d at 139-40 (quoting *British Int'l Ins. Co. v. Seguros La Republica*, S.A., 342 F.3d 78, 85 (2d Cir. 2003)).

5 *North River*, 361 F.3d at 140 (quoting *Christiania Gen. Ins. Corp. v. Great Am. Ins. Co*., 979 F.2d 268, 280 (2d Cir. 1992)).

6 *NorthRiver*, 361 F.3d at 141.

7 *Commercial Union Ins. Co. v. Seven Provinces Ins. Co*., 9 F. Supp. 2d 49, 66, affid, 217 F.3d 33(1st Cir. 2000) ("Seven Provinces").

8 *North River lns. Co. v. CIGNA Reins. Co*., 52 F.3d 1194, 1206 (3d Cir. 1995) ("CIGNA Re").

9 *Seven Provinces*, 9 F. Supp. 2d at 67-68

10 *Seven Provinces*, 9 F. Supp. 2d at 66.

11 *Travelers Casualty*, 419 F.3d at 189 (citation omitted).

12 *Id*. at 193; *see also, American Employers Ins. Co. v. Swiss Reins. Am. Corp.,* 413 F.3d 129, 136 (1st Cir. 2005) (observing that, while some concern exists as to a cedent's incentive to allocate settlements with a view to reinsurance recovery, "there is no law that says that insurer and reinsurer interests have to be perfectly aligned to trigger a follow-the-settlement clause.").

13 *North River*, 361 F.3d at 141. In some instances, the cedent's determination that coverage reasonably may exist and its decision to settle with its insured also will determine, for all intents and purposes, the allocation to the cedent's reinsurance coverage. However, in many cases, especially where the cedent issued multiple policies, multi-year policies, or insured different layers of coverage for the loss, a host of disputed issues may be compromised in a settlement — trigger, annualization, allocation, occurrence, number of occurrences, exclusions, exhaustion, aggregating limits, *etc*. — so that numerous methods of allocation to reinsurers arguably might be applicable in a given case.

14 *American Employers*, 413 F.3d at 136-38; *Allstate Ins. Co. v. American Home Assur. Co*., 837 N.Y.S.2d 138, 144-45 (N.Y. 2007).

15 *American Employers*, 413 F.3d at 136-37.

16 *Id., fn.* 8.

17 *Id.* at 136-37.

18 837 N.Y.S.2d at 144-45.

19 *See American Motorists Ins. Co. v. American Re. - Ins. Co*., No. 06-5202, 2007 WL 4197427, at *5 (burden on cedent to show that claims were covered under the direct policies).

20 *North River*, 361 F.3dat 141.

21 For example, the reinsurer may have to show "gross negligence or recklessness," *CIGNA Re*, 52 F.3d at 1212, fit 25, or that the settlement was not even "arguably" within the scope of the reinsurance coverage. *Mentor Ins. Co. (U.K.) v. Norges Brannkasse*, 996 F.2d 506, 516 (2d Cir. 1993).

22 *Travelers Casualty*, 419 F.3d at 189 (quoting CIGNA Re, 52 F.3d at 1216).

23 *See, e.g*., Larry P. Schiffer, <u>A Reinsurance Arbitration Primer</u>, 1997 WL 33624166, at 1, fit I (September 5-6, 1997) (stating that many arbitration panels construing the issue of whether a reinsurer is obligated to pay costs in addition to limits of liability have not followed the Second Circuits decisions on the subject).

24 *E.g., Unigard Sec. Ins. Co. v. North River Ins. Co*., 4 F.3d 1049, 1070-71 (2d Cir. 1993).

25 *See, e.g*., Robert M. Flail, Manifest Disregard of the Law as a Basis to Vacate Arbitration Awards After *Hall Street Associates*, Reinsurance Vol. 2, No. 4 (2009).

26 Examples of various forms of language that may (or may not) be construed as follow-the-settlements terms can be found in Staring, <u>Law of Reinsurance</u>, § 18:3 (Thomson Reuters 2010).

27 *Cf North River Ins. Co. v. Employers Reins. Corp*., No. 00-1221, 2002 U.S. Dist. Lexis 11711, at **6-8 (S.D. Ohio Jan. 3, 2002); with *Employers Reins. Corp. v. Mass. Mut. Life Ins. Co.,* No. 06-188, 2008 WL 3890358, at *7 (W.D. Mo. Aug. 19, 2008).

28 *River*, 2002 U.S. Dist. Lexis, at ** 7-8, 23-24.

29 *Employers Re*, 2008 WL 3890358, at *7

30 *River*, 2002 U.S. Dist. Lexis, at **8-9.

31 *Employers Re*, 2008 WL 3890358, at *7

32 *Aetna Cas. and Sur. Co. v. Home Ins. Co*., 882 F. Supp. 1328 (S.D.N.Y. 1995); *International Surplus Lines Ins. Co. v. Certain Underwriters and Underwriting Syndicates at Lloyd's of London*, 868 F. Supp. 917 (S.D. Ohio 1994); *see also, Am. Empl Ins. Co. v. Swiss Re. Am. Corp*., 275 F. Supp. 2d 29, 35 n. 32 (D. Mass. 2003), *vacated and remanded on other grounds*, 413 F.3d 129 (1st dr. 2005) ("the favored view is that 'follow the fortunes' and 'follow the settlements' are an industry custom, and apply even in the absence of express language to that effect.").

33 *See, e.g., American Ins. Co. v. American Reins. Co*., 2006 WL 3412079; *Affiliated F.M Ins. Co. v. Employers Reins. Corp*., 369 F. Supp. 2d 217, 227 (D.R.I. 2005) (the court was "hesitant" to read

the "follow the settlements" doctrine into a reinsurance contract as a matter of law given the "divergent precedent" on the issue).

34 *See North River Ins. Co. v. Employers Reins. Corp.*, 197 F. Supp. 2d 972, 984-86 (S.D. Ohio 2002) (finding no sound basis for applying follow the settlement as a matter of law); *Michigan Township Participating Plan v. Federal Ins. Co.*, 233 Mich. App. 422, 431(1999) (Michigan law would not imply a "follow the fortunes" clause where no such clause was contained in the contract); *see also*, Staring, Law of Reinsurance § 18:2 (Thomson Reuters 2010).

35 *See, e.g., American Ins. Co. v. American Reins. Co.*, 2006 ML 3412079, at *5 (N.D. Cal. 2006); *Aetna Casualty*, 882 F. Supp. at 1350, fn 15.

36 *ReliaStar Life Ins. Co. v. IOA Re, Inc.*, 303 F.3d 874 (8th dir. 2002).

37 *Id*. at 880.

38 *Id*. at 881.

39 *Id*.

40 *American Insurance*, 2006 WL 3412079, at *5

41 *See* Fed. R. Evid. 701.

42 *E.g., Travelers Casualty*, 419 F.3d at 193 ("It is well-established and not at all surprising that follow-the- fortunes does not require indemnification for losses not covered by the underlying policies.").

43 *See, e.g., Granite State Ins. Co. v. ACE Am. Reins. Co.*, 849 N.Y.S.2d 201, 203-04 (N.Y. App. 2007). (discussing ex *gratia exception*).

44 *CIGNA Re*, 52 F.3d at 1212.

45 *CIGNA Re*, 52 F.3d at 1207.

46 *Mentor Insurance*, 996 F.2d at 516.

47 *International Surplus Lines*, 868 F. Supp. at 921.

48 *American Ins. Co. v. North American Co. for Prop. & Cas. Ins.*, 697 F.2d 79, 81 (2d Cir. 1982) ("NAC-PAC "); *City of Renton v. Lexington Ins. Co.*, 2007 WL 2751356, at *8 (W.D. Wash. Sept. 19, 2007); *Suter v. General Accident Ins. Co. of Am., No.* 01-2686, 2006 WI, 2000881, at *23,27 (D.N.J. July 17,2006).

49 *NACPAC*, *697* F.2d at 81.

50 *Suter*, 2006 WL 2000881, at *27 (D.N.J. July 17, 2006); *see also Employers Reins. Corp. v. Newcap Ins. Ltd.*, 209 F. Supp. 2d 1184 (D. Kin. 2002) (determining that the claim was covered under an unreinsured professional liability cover and not under a reinsured CGL policy).

51 *City of Renton*, 2007 WL 2751356, at *8

52 *Id*. at**6-7.

53 This case appears to be driven at least in part by other factors — for instance, the court also found bad faith on the part of the cedent. 2007 WI. 2751356, at *8.

54 *See Suter*, 2006 WI. 2000881, at **25-27 (failure to properly investigate claims); *American Employers*, 413 F.3d at 137-38 (failure to schedule policy defenses).

55 If there is a legitimate question over a choice between two or more conflicting sets of state laws, then that may be a good reason to settle a claim.

56 *E.g., Commercial Union Ins. Co. v. Swiss Reins. Am. Corp.*, 413 F.3d 121, 128, fn. 5 (1st Cit 2005).

57 *See Commercial Union*, 413 F.3d at 128 (explaining that "sufficiently clear, specific limits in the [reinsurance] certificate control over the general aim of concurrence and ordinary 'follow' clauses."); *see also, Arrowood Surplus Lines Ins. Co. v. Westport Ins. Corp.*, No. 08-01393, 2010 WL 56108 at **34 (D. Conn. Jan. 5, 2010) (follow-the-fortunes clause did not require reinsurer to pay a settlement based on annualized limits in a multi- year policy, where the terms of the reinsurance agreement made it effective for only one of the three years).

58 *Unigard Sec. Ins. Co. v. North River Ins. Co.*, 4 F.3d 1049, 1070-7 1 (2d Cit 1993); *Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co.*, 903 F.2d 910 (2d Cir. 1990); *Travelers Cas. & Stir. Co. v. Certain Underwriters at Lloyds of London* 760 N.E.2d 319 (N.Y. 2001).

59 See Note 23, *supra*.

60 *Excess Ins. Co. Ltd v. Factory Mut. Ins. Co.*, 822 N.E. 2d 768, 771 (N.Y. 2004).

61 *Travelers Casualty*, 760 N.E. 2d at 325-27.

62 *Nat'l Union Fire Ins. Co. v. Am. Reins. Co.*, 351 F. Supp. 2d 201,211-12 (S.D.N.Y. 2005).

63 *National Union*, 351 F. Supp. 2d at 211-12.

64 *Id*.

65 *Travelers Cas. and Sur. Co. v. ACE Am. Reins. Co.*, 392 F. Supp. 2d 659, 663-65 (S.D.N.Y. 2005).

66 *Travelers Casualty*, 392 F. Supp. 2d at 663-65.

67 *Lexington Ins. Co. v. AGF Ins. Ltd.*, [2009, UKHL 40).

68 *Id*.

69 *Id*.

70 *Id*.

71 *E.g., Travelers Casualty*, 419 F.3d at 188.

72 *North River*, 361 F.3d at 141.

73 *See American Employers*, 413 F.3d at 136.

74 *CIGNA Re*, 52 F.3d at 1199.

75 The application of follow-the-settlements to the underlying settlement and the subsequent reinsurance allocation should be analyzed separately, though in some cases settlement and allocation do overlap. Perhaps because of this overlap, imprecise language in some court opinions may suggest that a reasonable settlement forecloses any challenge to the post-settlement allocation. For example, in one case a federal district court wrote that if the "settled claims were at least arguably within the terms of the [original] policy, then any "inquiry into the reasonableness of [the cedent's] post-settlement allocation is therefore inappropriate in light of *Travelers Casualty." Nat '1 Union Fire Ins. Co. v. American Re-Ins. Co.*, 441 F. Supp. 2d 646, 653 (S.D.N.Y 2006). While National Union appears to reach the correct result, the court overstates the effect of a reasonable settlement on the reinsurer's duty to follow a post- settlement allocation. The case law plainly requires the post-settlement allocation to meet the requirements of good faith and reasonableness, and the claim must be within the scope of the reinsurance coverage (and not just arguably covered, as with coverage under the reinsured policies). E.g., *North River*, 361 F.3d 141; *CIGNA Re*, 52 F.3d at 1199- 1200.

76 *Ins. Co. v. American Home Assur. Co.*, 837 N.Y.S. 2d 138, 144 (N.Y. App. 2007).

77 *Allstate*, 837 N.Y.S.2d at 144.

78 *Id*. at 14445.

79 Arguably, *Travelers Casualty v. Gerling* presented a relatively easy case for the court, as the reinsurer argued for an allocation method that the cedent never advocated with its insured (because it could have increased liability to its insured), and the cedent allocated the settlement to the excess layers using what the court found to be an industry-standard, "rising-bathtub" approach. One can posit facts that might have made this a more difficult case. For example, suppose the cedent had, in negotiations with its insured, pressed a position that would not really affect its direct liability but significantly maximize its reinsurance coverage. Or, suppose the cedent allocated a substantial portion of the settlement to higher excess layers and a smaller amount to the lower excess layers, in order to increase reinsurance coverage. In either hypothetical, the court might have reached a different result, or at least remanded the case for trial.

80 In an unreported case from Massachusetts, a federal district court refused follow-the-settlements protection to a cedent that allocated the ceded loss to its reinsurers based on an internal model that varied from the models actually1used in the settlement negotiations. *Stonewall Ins. Co. v. Argonaut Ins. Co.*, No. 05-12305 (D. Mass. Nov. 19, 2007) (Order on Mot. for Summary Judgment, pp. 6-8). Citing *American Employers v. Swiss Re and Allstate v. American Home*, the court found that a fact issue existed regarding whether the cedent's allocation based on its internal models was reasonable and in good faith.

81 See *American Employers*, 413 F.3d at 136.

82 *Id.* at 136, fn. 8.

83 *Id*. at 136-37.

84 Id. at 136 (explaining that reinsurer may litigate question of whether risk of a court applying annualized limits "was sufficiently small to make the settlement unreasonable").

85 A federal district court in Connecticut also has indicated that bad faith can take the form of structuring a settlement on the direct side in order to maximize a reinsurance recovery. *Hartford Accident & Indemnity Co. v. Columbia Casualty Co.*, 98 F.Supp.2d 251, 259 (D. Conn. 2000) (finding material facts in dispute as to whether the reinsurer was bound by the "follow-the-settlements" provision of the reinsurance contract where the cedents allocation may have reflected an effort to maximize the amount of reinsurance collected).

86 *Suter v. General Accident Ins. Co. of Am.*, No. 01-2686, 2006 WL 2000881, at *27 (D.N.J. July 17, 2006), *vacated pursuant to settlement, Goldman v. General Acc. Ins*. Co. of America, No. 201 -CV-02686, 2007 WL 2781935 (D.N.J. May 24,2007); CIGNA Re, 52 F.3d at 1214-16.

87 *Suter*, 2006 WL 2000881, at *26 (citing *National American ins. Co. v. Certain Underwriters at Lloyd's London*, 93 F.3d 529, 536 (9th Cir. *1996*)).

88 It is unclear whether the court would have denied follow-the-settlements protections on bad faith grounds if the claim investigation was not "reasonable and businesslike" but amounted to only ordinary negligence.

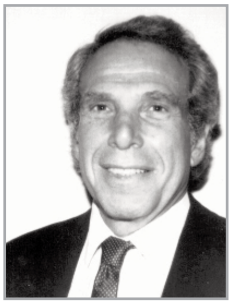
89 *CIGNA Re*, 52 F.3d at 1214-16.

90 *Id*. at 1214.

91 Id. at 1214.

off the cuff

Eugene Wollan



This column appears periodically in the Quarterly. It offers thoughts and observations about reinsurance and arbitration that are outside the normal run of professional articles, often looking at the unconventional side of the business.

The Laws of Physics

In the effort to reach a reasonable compromise adjustment of a contentious claim, the insured's Risk Manager (or attorney, if it has reached that point) will ALWAYS threaten a lawsuit that will include claims for punitive damages, bad faith, attorneys' fees, and the like.

Even those folks whose knowledge of Isaac Newton's formulations begins and ends with that probably apocryphal falling apple are aware that his insights into physics changed the world.

[I once stood at one end of a huge U-shaped arcade at Trinity College, Cambridge, where a Cambridge Don told me to clap my hands and listen for the echo; I did, and he then explained that this was exactly where and how Isaac Newton had measured the speed of sound. The very thought blew my mind.]

Even those folks whose knowledge of Galileo begins and ends with the Leaning Tower are aware that his insights into astrophysics changed the world.

Even those folks whose knowledge of Albert Einstein begins and ends with $e=mc^2$ (and perhaps a shock of electrified white hair) are aware that his insights into time and space changed the world.

[I regret that I have no Newton-like experiences to report vis-à-vis Galileo or Einstein.]

But despite their indisputably great contributions, there are, it seems to me, certain phenomena that these geniuses, and in fact all scientists in general, have completely neglected but that cry out for some simple but elegant formulaic explanation, along the line of For Every Action There Is An Equal But Opposite Reaction. For example:

- You pull up at a red light and glance over at the driver of the car that has pulled up to your right. Why does the driver of that car ALWAYS immediately look back at you?
- You wheel your cart onto a check-out line at your local supermarket. Why does that line ALWAYS move the slowest?
- You are checking in at the airport, without a lot of time to spare before your flight. Why does the person just ahead of you ALWAYS take at least twenty minutes to reroute what looks like a complete trip around the world?
- Two dog walkers are approaching each other on the street, leashed animals of disparate sizes in tow, perhaps a Lab and a Yorkie. Why is it ALWAYS the little one that starts growling or snarling and straining at its leash? [I am tempted to answer my own question by saying, "It's the leash he can do." but my fellow editors would probably red-line it anyhow.]
- A married couple is driving through an unfamiliar area, and seems hopelessly lost. Why is it ALWAYS the wife who insists that they stop and ask directions? [There is a theory that if Moses had been willing to ask directions the Hebrews would have gotten to The Promised Land about a week after leaving Egypt, instead of wandering around for forty years.]
- The five-year old, arrayed in her best dress and Mary Janes for the occasion, is settled happily in her Orchestra seat next to Grandma, eagerly looking forward to The Nutcracker. Why does she ALWAYS wait until ten minutes after the curtain has gone up to announce loudly, "I have to go."? [Been there, done that. I am nevertheless continuing my efforts to figure out a way to be a grandparent without being a parent first.]

These extra-sensory phenomena are perhaps inexplicable, and they are certainly not limited to the everyday world around us. Those of us who participate in the world of insurance and reinsurance encounter more than our share of such puzzlements (pace, Yul Brynner).

- The insured's attorney is closing to the jury in a coverage litigation. It is an absolutely foregone conclusion that at some point he will ALWAYS say, in words or substance, that this insurance company was happy to receive the premium but is now looking for any excuse to avoid paying the claim.
- The same attorney, in the same context, will ALWAYS refer to the policy conditions, exclusions, or warranties as "the fine print."
- When you are questioning the prospective

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panel on voir dire during jury selection (on behalf of an insurer, of course), there will ALWAYS be at least one individual who goes on at length about a really bad experience with an insurance company, leaving you to ponder whether the others' minds have been so irreversibly poisoned that you have to ask for an entirely new panel.

- During expert testimony from accountants about how to calculate a business interruption loss, at lease one juror will ALWAYS fall asleep.
- In the effort to reach a reasonable compromise adjustment of a contentious claim, the insured's Risk Manager (or attorney, if it has reached that point) will ALWAYS threaten a lawsuit that will include claims for punitive damages, bad faith, attorneys' fees, and the like.
- In that same scenario, if the facts even remotely indicate this to be a possibility, the threat will ALWAYS include the magic words "Harris County, Texas."
- The broker posturing himself or herself as an honest intermediary attempting to bring the parties together in order to avoid a difficult, expensive, unpredictable coverage litigation will ALWAYS embrace the insured's position.
- You are ready to argue your motion for summary judgment. The judge has piled before him all the briefs, answering brief, reply briefs, and exhibits laboriously prepared by the trial teams on both sides. If you are in Supreme Court, New York County, the judge will ALWAYS start off by saying, "I haven't read the papers, counselor, so tell me what this case is all about."
- When you are trying a case of such importance that the press is in attendance, and probably members of your family and a delegation of young associates from your office, at least one witness will ALWAYS double-cross you, leaving you with a substantial serving of egg adorning your countenance.
- When you have carefully prepared a meticulously structured oral argument before a U.S. Court of Appeals, you will ALWAYS be interrupted with a question, usually a real zinger, before you have even gotten through your first sentence.
- When you are trying to arrange the logistics for the next Market Meeting of a dozen or so insurers, at least one representative will ALWAYS (only semi-) facetiously suggest Hawaii, or a Caribbean venue in February.
- At least one member of that selfsame Market will ALWAYS be on holiday, and out of reach of e-mail, telephone, carrier pigeon, or signal drum, at the very time you consider it essential to schedule the next Market Meeting.
- In your dealings with London solicitors acting for reinsurers against whom your client, a US cedent, has lodged a major claim, you will ALWAYS be subjected to at least one diatribe about the shortcomings of the US judicial system.
- When you express a concern to a London broker about a possible conflict of interest, you will ALWAYS be assured that it's not a problem.
- When you are politely following up with certain clients for payment of your bills, at least one of them will ALWAYS say, "Gee, I can't seem to find those bills; would you please send me copies?"
- The next time you call, that same client will ALWAYS say exactly the same thing again.
- You have carefully explained to a group of young associates the difference between the subjective and objective cases, and the fact that "me" is not necessarily a dirty word. You will nevertheless ALWAYS receive, shortly thereafter, an e-mail that includes something like this: "Do you have a few minutes to go over this draft with George and I?"

I suppose members of every other profession could easily generate their own lists of comparable inexplicable inevitabilities. Do physicians always have at least one patient whose symptoms defy diagnosis? Do periodontists always find at least one recessed pocket that resists treatment? Do accountants always encounter at least one calculation that doesn't balance? Do life actuaries always find at least one apparently robust person who keels over at age thirty, and one seriously debilitated old timer who survives into the triple digits?

I'll bet they do. But the examples I have cited are my very own, and I wouldn't trade them for anyone else's.▼

You are ready to argue your motion for summary judgment. The judge has piled before him all the briefs, answering brief, reply briefs, and exhibits laboriously prepared by the trial teams on both sides. If you are in Supreme Court, New York County, the judge will ALWAYS start off by saying, "I haven't read the papers, counselor, so tell me what this case is all about."

ARIAS·U.S.

Spring Confere

2010 Spring Conference Takes On Arbitration Reform

Workshop and Seminar Folded into Same Week

Chairman Susan Stone welcomes attendees

The most extensive-ever series of ARIAS training programs and events were conducted during the first week of May, 2010. The back-to-back intensive workshop, 2010 Spring Conference, and educational seminar attracted 345 participants who joined together for one or more of the three events. In addition, 50 spouses and guests attended the food events and joined in for recreation.

The main event of the triple-header was, of course, the Spring Conference. The Co-Chairs, **Dan FitzMaurice**, **Linda Dakin-Grimm**, **Eric Kobrick**, and **Betty Mullins** set out an aggressive agenda, taking on controversial issues and scheduling breakout sessions or workshops on each of the three days. With the title of "**Arbitration is A-Changin': Learn About New Reforms or Be Left Behind**," attendees were challenged to participate in a range of topics focused on reforming the dispute-resolution process.

To set the stage for change at the outset on Wednesday, **Elaine Caprio Brady** led four prominent CEOs through an open discussion of the challenges their companies face on a range of developing industry issues, including risk retention by insurers, adequacy of reserves, possible inflation, consolidation of P&C companies, changing solvency standards, lessons learned regarding investment risks, financial regulatory reforms, and diversity. **Andrew Appel**, of Aon Benfield, **Rod Fox** of TigerRisk Partners, **Judy Mann** of Swiss Re Underwriters Agency, and **Patrick Thiele** of PartnerRe Ltd. offered their perspectives on these questions and provided insightful, enlightening, and thought-provoking comments.

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Moving directly to change in the arbitral context, **Eric Kobrick** moderated a wide-ranging discussion of reforms of dispute-resolution procedures, especially the latest version of the New Procedures from the Insurance and Reinsurance Dispute Resolution Task Force. Following up on the 90 pages of materials that registrants received in preparation, **Reka Koerner** and **Myra Lobel** summarized the key provisions of the Procedures and highlighted significant changes from 2004. **Mark Gurevitz** reviewed the ARIAS•U.S. Practical Guide to Reinsurance Arbitration and pointed out the differences in nature and application between the Procedures and the Practical Guide. **Andrew Maneval** concluded by explaining AIRROC's newly announced procedure, which offers an alternative process designed for small or less-complicated disputes.

Following a break, attendees proceeded to ten assigned rooms for small group (33) brainstorming sessions about the various procedures. Each group had a designated discussion leader and reporter. The reporters captured the essential content of these sessions and relayed this information so that, on Thursday morning, **Larry Greengrass** and **Eridania Perez** were able to provide a 45-minute consolidated presentation of the brainstorming results.

In the next phase, **Dan Perry** summarized recent court decisions that criticized arbitrators and overturned arbitral decisions. He pointed out how these decisions challenge the rationale for using arbitration to avoid litigation. **Betty Mullins** then led a discussion with **Mark Cloutier** and **Ray Prosser** of

CEO Panel

CEO Panel (from left) Patrick Thiele, Judy Mann, Rod Fox, Andrew Appel

Patrick Thiele and Judy Mann

Reforming Arbitration

Moderator Eric Kobrick

Andrew Maneval and Myra Lobel

Mark Gurevitz and Reka Koerner

CEO Panel


Moderator Elaine Caprio Brady


Rod Fox and Andrew Appel

these and other reform-related issues, addressing how insurance and reinsurance companies feel about the need for reform in arbitration today.

After the Thursday refreshment break, keying off of that discussion, attendees broke into three groups divided by their professional roles. Companies (80), arbitrators (90), and attorneys (190) candidly discussed the need for reform from their respective vantages. Then, the next morning, the leaders of these three groups, **Joanne Howell**, **Connie O'Mara**, and **Deirdre Johnson**, reported on these discussions.

With all of that discussion as preamble, the rest of Friday morning consisted of workshops that analyzed many different aspects of reform. Each attendee had indicated his/her choice of two at registration. Workshops were repeated so that everyone was able to attend both selections. All workshops were well-attended. The following topics were presented:

- **Insanity in Action: Hiring the Same Small Pool of Arbitrators and Expecting Different Results**
- **Reforms Without Subscribers: Good Ideas Not Implemented**
- **Market-Based Reforms: New and Emerging Arbitration Clauses**
- **Despites Its Flaws, Does Arbitration Beat the Alternative or Not?**
- **Mediation's Role in Reform**
- **Structural Solutions: Single Arbitrators, Baseball Arbitration, and Other Options**

In total, the conference completely met its title. From start to finish, the focus of the conference remained about change. Candid discussions about reform gave attendees a clear sense of the validity of alternatives and left them appreciative of what should not be changed, as well.

At the break on Thursday afternoon, 64 golfers went to Steele Canyon, 21 tennis players competed at the Marriott courts, and 44 ARIAS•U.S. tourists saw San Diego by Land and Sea. The optional Wednesday dinner was attended by 134 members and guests.

The events before and after the Conference were well attended. The Intensive Arbitrator Training Workshop, on Tuesday and Wednesday, continued its traditional combination of instruction and mock arbitration. Experienced arbitrators — **Dick White**, **Ron Gass**, and **Andrew Maneval** – served as instructors. Twenty-seven students presided as mock arbitrators over arguments provided by attorneys from **Larson•King LLP, Milbank, Tweed, Hadley & McCloy LLP, and Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.**

The Friday afternoon seminar was the fourth in the ARIAS•U.S. Educational Series that provides continuing education for ARIAS•U.S. members and qualifies for certification credit and renewal of certification. The topic was **Case Development and Preparing for the Arbitration Hearing**. Mostly conducted in a mock arbitration context, the faculty addressed issues of consolidation and pre-hearing security, summary judgment and choice of law, requests to change the scope and schedule of the arbitration, management of hearing exhibits and expert witnesses, handling stays and continuances, and scheduling issues.

Education Committee members, **Reka Koerner** and **Bill O'Neill** planned and organized the seminar. Handling the afternoon of presentations were **Clive Becker-Jones**, **Jack Gordon**, **Ray Prosser**, **Steve Schwartz**, **David Thirkill**, and **Elizabeth Thompson**.

The Hotel del Coronado won rave reviews for beauty, service and food.

Beautiful weather prevailed for the whole week, with sunny skies and high temperatures in the low 70s.

It was a memorable week for ARIAS•U.S. ▼

Group Discussions

The small group discussions resulted in very animated interactions among the participants.

Aluyah Imoisili kept track of it all

Group Discussions

Outside

Three breaks, two luncheons and the Wednesday reception took advantage of the perfect weather outside.

Debra Roberts, Claudia Morehead, and Mary Kay Vyskocil

Will Fiske, Larry Monin, Doug Maag, and Lloyd Gura

Dorothy Muir, Paul Dassenko, and Jane Byrne

(l-r) Angus Ross, Irene Haber, David Fox, Dee-Ann Fox, Claudia Morehead, and Marty Haber

(left) Brenda Knoll, David Knoll, and Carol Comeau

Law Committee Case Summaries

Since March of 2006, in a section of the ARIAS•U.S. website entitled "Law Committee Reports," the Law Committee has been publishing summaries of recent U.S. cases addressing arbitration and reinsurance-related issues. Individual members are also invited to submit summaries of cases, legislation, statutes or regulations for potential publication by the committee.

As of the middle of February 2009, there were 48 published case summaries and three regulation summaries on the website. The committee encourages members to review the existing summaries and to routinely peruse this section for new additions

Provided below are three case summaries taken from the Law Committee Reports.

Scandinavian Reinsurance Co. Ltd., v. St. Paul Fire & Marine Insurance Co. et al. No. 09 Civ. 9531(SAS), 2010 WL 653481 (S.D.N.Y. 2010)

Court: United States District Court, Southern District of New York

Date Decided: February 23, 2010

Issue: Whether two panel members exhibited evident partiality in failing to disclose their simultaneous participation as arbitrators in another arbitration that involved a common witness, similar disputed issues and contract terms, and a related ceding company as petitioner.

Submitted by Jennifer R. Devery and Timothy E. Curley*

In *Scandinavian Reins. Co., Ltd. v. St. Paul Fire & Marine Ins. Co.*, the United States District Court for the Southern District of New York granted Scandinavian Reinsurance Company's ("Scandinavian Re") petition to vacate a final arbitration award issued in favor of its cedent, St. Paul Fire & Marine Ins. Co. ("St. Paul"). In doing so, the Court held that two of the three arbitrators presiding over the award exhibited "evident partiality" because of their failure to disclose their simultaneous involvement as panel members in a separate arbitration between Platinum Underwriters Bermuda, Ltd. ("Platinum") and PMA Capitol Insurance Company ("PMA") ("Platinum/PMA Arbitration"). The arbitration between Platinum and PMA involved a common witness, similar disputed issues and contract terms, and Platinum had a financial relationship with St. Paul.

The Scandinavian Re Arbitration

In 1999, Scandinavian Re and St. Paul entered into a Retrocessional Casualty Stop-Loss Agreement ("Scandinavian Re Agreement") through which St. Paul ceded a portion of its casualty reinsurance business to Scandinavian Re. The Scandinavian Re Agreement was a "finite retrocessional agreement," through which the amount of risk transferred was limited. Eventually, a dispute arose between the parties involving (1) whether a cap on liability should be read into the agreement or whether the agreement should be rescinded; and (2) whether the Scandinavian Re Agreement created one experience account for the entire term of the agreement or separate experience accounts for each year of the agreement.

In late 2007, St. Paul demanded arbitration ("the Scandinavian Re Arbitration") and shortly thereafter, each side appointed an arbitrator, who in turn selected an umpire. In June and July of 2009, an evidentiary hearing was held. During the hearing, Mr. Bart Hedges testified on behalf of Scandinavian Re as to its intent in entering into the Scandinavian Re Agreement. Mr. Hedges was an employee at Scandinavian Re when the Scandinavian Re Agreement was executed but had subsequently become an executive at Platinum. In August 2009, the arbitrators issued a written award in St. Paul's favor on both disputed issues.

Throughout the arbitration, the arbitrators and the umpire made various disclosures but none of the arbitrators disclosed that they had also been serving as panel members in the Platinum/PMA Arbitration, or that they had received Mr. Hedges's testimony as a witness during that arbitration.

The Platinum/PMA Arbitration

In September 2008, Platinum demanded arbitration against PMA. At that time, the Scandinavian Re Arbitration had commenced but an evidentiary hearing had not yet taken place. One of the disputed issues between Platinum and PMA involved whether to construe the agreement as intended or as written. The other disputed issue was a repeat of the dispute in the Scandinavian Re Arbitration as to whether the contract created one experience account or separate annual experience accounts.

Platinum has a relationship with St. Paul in that St. Paul transferred a portion of it reinsurance business to Platinum, St. Paul administers that business, and Travelers Companies Inc., St. Paul's parent company, holds a financial stake in Platinum.

Platinum appointed the same arbitrator as St. Paul had previously appointed in the Scandinavian Re arbitration and the two arbitrators also chose the same umpire as the Scandinavian Re Arbitration.

At the organizational meeting and in disclosures, the arbitrator and the umpire disclosed that they were simultaneously serving together in another arbitration, but they did not disclose that Scandinavia Re or St. Paul were involved. An evidentiary hearing was held in the Platinum/PMA Arbitration in April and May of 2009. Mr. Hedges's video-taped deposition testimony

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was presented at the hearing, in which he took a position on interpretation of the agreement that was inconsistent with his subsequent testimony in the Scandinavian Re Arbitration, in that he testified, on behalf of Platinum, that the contract should be enforced as written without regard to the parties' intent. On May 22, 2009, the arbitrators issued an award in Platinum's favor.

District Court Vacates the St. Paul/Scandinavian Re Award

On October 22, 2009, Scandinavian Re learned that the arbitrator and umpire on its panel had also served on the panel in the Platinum/PMA Arbitration. As a result, Scandinavian Re filed the subject petition in the District Court seeking to vacate the award against it on the basis of the "evident partiality" of the arbitrators. St. Paul cross-petitioned to confirm the award.

As a threshold matter, St. Paul sought to have the Court dismiss Scandinavian Re's motion to vacate on the ground of defective service of process because Scandinavian had served its motion without a summons. However, the Court found sufficient service. St. Paul, in entering into a reinsurance agreement to arbitrate the matter in New York, was deemed to have consented to personal jurisdiction in the state.

Turning to the issue of arbitrator partiality, the District Court held that the arbitrators' failure to disclose their simultaneous participation in the Platinum/PMA Arbitration met the standard of "evident impartiality," as set forth by the Second Circuit in *Morelite Construction Corp. v. New York City District Council Carpenters Benefit Funds*, 748 F.2d 79 (2d Cir. 1984) and *Applied Indus. Materials Corp. v. Olvalar Makine Ticaret Ve Sanayli A.S.*, 492 F.3d 132 (2d Cir. 2007). In *Morelite*, the Second Circuit held that "'evident partiality' within the meaning of [the Federal Arbitration Act] will be found where a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration." 748 F.2d at 84. In *Applied Industrial*, the Second Circuit held that "[a]n arbitrator who knows of a material relationship with a party and fails to disclose it meets Morelite's 'evident partiality' standard." 492 F.3d at 137. St. Paul attempted to distinguish this case from Applied Industrial because the undisclosed relationships were not with a party but rather were between the two arbitrators and the arbitrators and a witness. The District Court rejected that distinction, stating that "[a] reasonable person concludes that an arbitrator is partial to one side because the undisclosed relationship is material, not because the material relationship is with a party."

The Court similarly rejected St. Paul's argument that the undisclosed relationships were trivial rather than material. The Court deemed material the fact that two common arbitrators presided over arbitrations that overlapped in time, shared similar issues, involved related parties, and shared a witness, Mr. Hedges, who interpreted similar agreements as *written* in one arbitration but as intended in the another. The Court explained that the two arbitrators, having presided over the hearing in the Platinum/PMA Arbitration, could receive ex parte information about the kind of reinsurance business at issue in the Scandinavian Re Arbitration, be influenced by Hedges's prior testimony, and could influence each other's thinking on relevant issues.

Furthermore, the Court held that the arbitrators' purported good faith could not cure the disclosure. Specifically, the Court said that the failure to make such disclosures had the same effect regardless of whether the arbitrators believed in good faith that they would not be influenced by the information they learned during the Platinum/PMA Arbitration.

The case was remanded for arbitration in front of a new panel of arbitrators.▼

** Jennifer R. Devery and Timothy Curley are partner and associate, respectively, in the Insurance/Reinsurance Group of Crowell & Moring LLP, where they represent cedents and reinsurers in litigation and arbitration involving a broad spectrum of issues.*

United States Life Ins. Co. v. Superior National Ins. Co., 2010 WL 6384 (9th Cir. Jan. 4, 2010)

Court: United States Court of Appeals for the Ninth Circuit

Date Decided: January 4, 2010

Issue: Whether an arbitration panel violated Section 10 of the FAA by conducting ex parte meetings with panel-retained experts.

Submitted by Michael P. Mullins*

In an action to vacate an arbitration award, the Ninth Circuit ruled that an arbitration panel's ex parte meeting with panel-retained experts did not violate the Federal Arbitration Act ("FAA"). U.S. Life reinsured Superior National Insurance Company and other insurers (collectively, "SNICIL"). U.S. Life alleged that SNICIL had engaged in improper claims handling practices, resulting in bills to U.S. Life in excess of the amounts due under the reinsurance contract. The parties agreed to arbitrate the claim and selected a three-person panel in the usual fashion, with each party selecting an arbitrator and the two arbitrators selecting a neutral third member. After a hearing in which each of the parties presented its own expert testimony, the panel was unable to reach a decision and advised the parties that two panel-appointed experts would be retained to review the bills at issue.

The panel determined that it would meet privately with the panel-retained experts. After the ex parte meeting, however, the panel-retained experts' written conclusions were shared with the parties, a two-day hearing was held for the parties to question the experts, and pre-and post-hearing briefs were allowed. The panel ultimately issued an award unfavorable to U.S. Life, which filed an action to vacate the award under §10(a)(3) of the FAA because of the ex parte meeting. Section 10(a)(3) of the FAA provides, in relevant part, that a U.S. court may vacate an arbitration award "where the arbitrators were guilty of misconduct in... refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced."

The Ninth Circuit held that the arbitrator's *ex parte* meeting with the experts was neither a refusal to hear evidence pertinent and material to the controversy nor misbehavior prejudicing the rights of the parties. The Court began its analysis by noting that arbitration is not governed by the federal courts' strict procedural and evidentiary requirements, and held as follows:

- The panel had authority to adopt its own rules of procedure, and it did.
- The panel's *ex parte* meeting with the panel-retained experts was not a refusal to hear pertinent and material evidence because, although the parties were not privy to what occurred during the ex parte meeting, the panel gave the parties ample opportunity to discover and critique the conclusions and qualifications of the panel-retained experts.
- While the parties did not specifically stipulate to the ex parte meeting, they did allow the panel to adopt such other processes and procedures as the panel deemed fair and appropriate.

In reaching its holding, the Ninth Circuit expressly disagreed with case law from the Fifth Circuit stating that "[a]rbitrators cannot conduct ex parte hearings or receive evidence except in the presence of each other and of the parties, unless otherwise stipulated." The Ninth Circuit held this prohibition to be too broad in light of the Supreme Court's holding in *Hall Street* — i.e. that the FAA provides the exclusive grounds for vacating an arbitration award — because the FAA does not expressly prohibit *ex parte* contacts.▼

** Mike Mullins is a partner in the Boston law firm of Choate, Hall & Stewart LLP, where he specializes in litigating insurance and reinsurance disputes.*

PMA Capital Insurance Co. v. Platinum Underwriters Bermuda Ltd., F.Supp.2d ——, No. 09-mc-0084, 2009 WL 2989804 (E.D.Pa. Sep. 17, 2009)

Court: Eastern District of Pennsylvania

Date Decided: September 17, 2009

Issue: Whether $6 million arbitration award to reinsurer requiring reinsured to immediately pay deficit in experience account and eliminating deficit carry forward provision was rational.

Submitted by Michael T. Walsh and Aron M. Zimmerman*

In *PMA Capital Insurance Co. v. Platinum Underwriters Bermuda Ltd.* (hereinafter "PMA Capital"), the Eastern District of Pennsylvania recently vacated a $6 million arbitration award to reinsurer Platinum Underwriters Bermuda Ltd. ("Platinum"), holding that the award requiring reinsured PMA Capital Insurance Company ("PMA") to immediately pay the deficit in an Experience Account and eliminating the Deficit Carry Forward Provision to be "completely irrational."

The Court acknowledged that it could only vacate the award where: (1) the award could not "be rationally derived either from the agreement between the parties or from the parties submissions to the arbitrators"; and (2) the award's terms are "completely irrational." *PMA Capital, at *4 (quoting Mut. Fire, Marine & Inland Ins. Co. v. Norad Rein, Co., 868 F.2d 52, 56 (3d Cir. 1989)).* Here, however, the court found vacatur to be proper.

In short, the Court held that: (1) the award could not be rationally derived from the parties' 2003 reinsurance agreement; (2) the award could not be rationally derived from the parties' submissions to the arbitrators; and (3) the award was "completely irrational." The court therefore vacated the $6 million award.

Underlying Facts

The Court in *PMA Capital* reviewed an arbitration award in a dispute between reinsured PMA and reinsurer Platinum. The parties entered into a reinsurance contract in 2003, pursuant to which PMA paid Platinum to indemnify PMA for obligations arising from insurance policies it issued (the "2003 Agreement"). Previously, PMA had purchased reinsurance from St. Paul Re (a division of the St. Paul Insurance Company) for the period of 1999 to 2001. In 2002, St. Paul Re became Platinum, and in 2003 the parties entered into the 2003 Agreement that was the subject of their dispute.

The parties' 2003 Agreement contained a Deficit Carry Forward Provision, which provided that any deficit from PMA's 1999 to 2001 contract with predecessor St. Paul Re could be carried forward to the 2003 period and applied at the end of that period to any balance left in an "experience account" (deposited by the reinsured PMA into an interest-bearing account controlled by the reinsurer Platinum). The 2003 Agreement provided that at the end of the 2003 period, Platinum could deduct any losses St. Paul Re incurred from the 1999 to 2001 period from any funds remaining in the Experience Account, before returning the balance to PMA.

A dispute arose between the parties as to the validity and scope of the Deficit Carry Forward Provision in 2008, when PMA claimed that Platinum could not carry forward losses St. Paul Re incurred from 1999 to 2001 since Platinum was not a party to

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that contract. The parties also disagreed as to the amount of any such losses.

On June 2, 2008, Platinum demanded an arbitration pursuant to the 2003 Agreement's arbitration clause. Platinum sought a declaration that, in accordance with the 2003 Agreement's provision, Platinum could carry forward St. Paul Re's losses from the 1999 to 2001 period.

On May 22, 2009, the arbitration panel awarded Platinum $6 million. The panel's award, which consisted of one page, provided that: "(1) PMA is to pay Platinum "$6,000,000.00 within 30 days of the date of this award"; (2) that upon such payment, "any and all references to a 'deficit carry forward' in the [2003 Agreement will be] removed from the contract"; and that (3) "[a]ll other requests for relief by both parties are denied." *Id*. at *3. The panel gave no explanation for its decision ordering PMA to pay Platinum $6 million and eliminating the Deficit Carry Forward Provision from the 2003 Agreement.

On June 3, 2009, PMA filed suit in the U.S. District Court for the Eastern District of Pennsylvania, asking that the award be vacated as contrary to the relief the parties sought as well as the 2003 Agreement's plain language. Platinum, in turn, moved to confirm the award on June 17, 2009.

The Court's Analysis

Judge Paul S. Diamond first acknowledged that "the 'court's function in confirming or vacating a commercial [arbitration] award is severely limited.'" *Id*. at *4 (quoting Mut. Fire, 868 F.2d at 56). However, while review of an arbitration panel's award must be "highly deferential," the court noted that it was "'neither entitled nor encouraged simply to 'rubber stamp' the interpretations and decisions of arbitrators.'" *Id*. (quoting *Matteson v. Ryder Sys*., 99 F.3d 108, 113 (3d Cir. 1996)). The court further noted that it could only vacate the award if: (1) the award could not "be rationally derived either from the agreement between the parties or from the parties submissions to the arbitrators"; and (2) the award's terms were "completely irrational." *Id.* at *4 (quoting *Mut. Fire*, 868 F.2d at 56).

In first finding that the $6 million award could not rationally be derived from the parties' 2003 Agreement, the court stated: "[t]he Arbitrators evidently found the Deficit Carry Forward Provision to be more trouble than it was worth and simply eliminated it from the 2003 Agreement." *Id*. The court pointed out that an award ignoring the Deficit Carry Forward Provision—albeit one that appeared to work to Platinum's advantage by awarding it $6 million—ultimately worked against reinsurers like Platinum since such provisions allow them to spread deficits across period years in the hope of recovering them later.

"In an apparent effort to 'compensate' Platinum for this loss," the court continued, "the Arbitrators allowed Platinum to 'carry forward' one last deficit: they ordered PMA to pay Platinum $6 million—the amount PMA had earlier indicated was the deficit in the 1999-2001 Experience Account." *Id*. The panel did so, according to the court, even though Platinum had not satisfied two preconditions under the 2003 Agreement to Platinum's retaining any funds from the Experience Account: (1) Platinum had not paid out its policy limits; and (2) the parties had not agreed to any commutation.

Platinum cited in support of the award the 2003 Agreement's Honorable Engagement Clause, which allowed arbitrators interpreting it to be "relieved of all judicial formalities," and to "abstain from following the strict rules of law" in order to effectuate in a "reasonable manner" the 2003 Agreement's "general purposes." *Id*. at *4-5. The court held, however, that, while arbitrators have broad discretion under such Honorable Engagement Clauses, "[e]ven broad discretion has limits." *Id*. at *5. Arbitrators, the court held, are without authority to simply rewrite the contract they are interpreting.

The court further held that "[t]he 2003 contract itself requires the enforcement of the Deficit Carry Forward Provision, not its elimination," and that "it is obvious that the Arbitrators exceeded their authority under the Honorable Engagement Clause." Thus, the court held that, in these circumstances, "the Panel's award cannot be rationally derived from the 2003 Agreement." *Id*.

In reaching this conclusion, the court quoted the Third Circuit's decision in *Kaplan v. First Options*, stating that a court "may vacate an arbitrator's award that does not 'draw its essence' from the contract." 19 F.3d 1503, 1512 (3d Cir. 1994).

Next, in finding that the panel's award could not rationally be derived from the parties' submissions, the court noted that neither of the parties suggested that the Deficit Carry Forward Provision should be eliminated altogether, but rather they disagreed on how to calculate any St. Paul Re 1999 to 2001 period loss that should apply. In addition, the court noted that neither party sought an order directing PMA to immediately pay any deficit to Platinum. In fact, what Platinum sought was a declaration that it was entitled to deduct St. Paul Re's 1999 to 2001 losses from any funds remaining in the Experience Account before refunding PMA the balance at the period's conclusion. Thus, the court held that in these circumstances, "the award was not rationally derived from the Parties' submissions." *Id*. at *7.

Finally, the court noted that even an award not rationally derived from either the underlying agreement or the parties' submissions to the panel may not be set aside unless it is "completely irrational." *Id*. at *7 (quoting *Swift Indus., Inc. v. Botany Indus., Inc*., 466 F.2d 1125, 1131 (3d Cir. 1972)). The court stated that an award is "completely irrational" if it "does not draw its essence" from the contract it is interpreting, and "is in manifest disregard thereof." *Id*. (quoting Swift, 466 F.2d at 1134). The court concluded that the panel's award "does not draw its essence" from the 2003 Agreement, since the Deficit Carry Forward Provision it eliminated was an essential part of it. The award was therefore "completely irrational." Moreover, the panel's failure to include any explanation of its reasoning made evaluating the decision that much more difficult. ▼

** Michael T. Walsh is a Principal and Aron M. Zimmerman is an Associate in the New York office of Boundas, Skarzynski, Walsh & Black, LLC.*

Recently Certified Arbitrators

in focus

Charles F. Barr

Charles Barr is an attorney and underwriter with over 30 years of experience at P/C, Life and Financial Guaranty re/insurers, an intermediary, and a derivatives dealer, with 20 of those years at the General Counsel level.

Mr. Barr worked 15 years at insurers (General Accident, Reliance, Commercial Union, Reliance Life), 15 years at reinsurers (General Re, XL Capital, Ariel Re, Cologne Life Re) and 2 years as General Counsel of Benfield-US. He was a commercial casualty underwriter for Aetna L&C, is a CPCU and is a member of the bars of Connecticut and Massachusetts.

While General Counsel of General Re, Mr. Barr supervised multi-million dollar assumed reinsurance disputes and retro collections. He handled the acquisitions of Cologne Re, National Re, and New England Asset Management and formed/capitalized Tempest Re. He formed and tax-planned General Re Financial Products, a derivatives dealer with global trading desks. He supervised 25 lawyers providing advice to P/C and life re/insurers and operating advice for derivatives and asset managers. He managed the Second Circuit reversal of a mail fraud conviction of a subsidiary. He extricated Cologne Life Re from membership in the Unicover Pool and as a retrocessionaire of WC carve-out.

At XL Capital, Mr. Barr supervised global disputes with policyholders and cedents and retro collections of both risk and finite reinsurance. He restructured cessions to Bermuda affiliates, oversaw global tax planning and developed hybrid reinsurance/derivative contracts and side-car coverages. He managed the interaction with the NY Attorney General's inquiry into PSAs and allegations of bid-rigging and the SEC and DOJ inquiries into both Finite Re and Municipal GICs.

Mr. Barr drafted policy language for E&S and specialty insurers and reinsurance terms and conditions for Benfield and reinsurers, including risk and finite treaties and ILWs. He has managed issues with MGA/MGUs and books of business and has drafted employment contracts and restrictive covenants.

Alan R. Bialeck

Alan Bialeck is an attorney with over 30 years of experience in the insurance industry where he has worked on legal and financial issues regarding property and casualty insurance, life insurance, and reinsurance.

From 1968 thru 1976, Mr. Bialeck worked as a tax associate at several law firms. In 1976, he became Tax Counsel to The Continental Insurance Companies and in 1978 was promoted to Vice President -Taxes with responsibility for the world wide tax position of the Companies. In this capacity, he was responsible for negotiating and settling tax disputes with the Internal Revenue Service, state and local taxing authorities and the taxing authorities of various foreign countries. He was also active in the capital management of the Companies employing reinsurance principles to enhance its capital position and in implementing various acquisitions and dispositions. In performing this function, Mr. Bialeck was responsible for integrating domestic and foreign regulatory, accounting and tax principles to achieve the optimum effects. He also helped design commercial insurance products with an emphasis on tax efficiencies and worked extensively with the U.S. Treasury and members of Congress regarding the implementation of legislation affecting the insurance industry.

In 1995, Mr. Bialeck became Vice President - Corporate Finance Director at Citigroup with responsibility for designing bank products to more efficiently meet the needs of the bank's insurance clients. In this capacity, he employed life and non-life reinsurance strategies, worked with regulators and insurance company CEOs, CFOs and Treasurers, and coordinated efforts by lawyers, accountants and actuaries.

Mr. Bialeck, in 2002, became Vice President - Taxes at Guardian Life where he was responsible for its tax function and, in 2004, formed his own consulting company, ALAN R BIALECK LLC, where, on behalf of banking clients, he consulted with various large life insurance companies regarding their reserving for term insurance and universal life insurance with secondary guarantees under Regulations XXX and AXXX. He continues to work with various

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Charles F. Barr

Alan R. Bialeck

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companies regarding various insurance matters.

Timothy J. Muldowney

Carol A. Seaton

Timothy J. Muldowney

For over 30 years, Timothy Muldowney, a member of Godfrey & Kahn's Insurance and Litigation Practice Groups, has worked in various areas of insurance and reinsurance law. His clients range from Fortune 500 insurers and mutual insurance companies to governmental and quasi-governmental entities such as the Wisconsin Commissioner of Insurance, the Wisconsin Insurance Security Fund and the Wisconsin Injured Patients and Families Compensation Fund.

Insurance coverage, construction defect, toxic tort and long tail exposure cases have been a focus of Mr. Muldowney's insurance and reinsurance practice. These cases have often involved pollution hazards, environmental clean-up, asbestos and injury cases concerning silica and other emerging torts. He has represented insurers and reinsurers in complex litigation involving insurance coverage and extra-contractual claims. Before trial and appellate courts, Mr. Muldowney has successfully argued many insurance and reinsurance cases involving domestic and foreign insurers and reinsurers. Many of Mr. Muldowney's cases not resolved through trial or after appeal have been decided through arbitration or alternate dispute resolution. Additionally, Mr. Muldowney has served as a mediator and expert in several cases throughout his career.

Mr. Muldowney is a member of several professional organizations, including the American Bar Association, Defense Research Institute and the International Association of Defense Counsel and has served on the Wisconsin Supreme Court's Board of Attorneys Professional Responsibility District Committee. He has authored articles in many publications, served on the Board of Editors of the Defense Counsel Journal, and spoken and taught for many organizations.

Mr. Muldowney currently serves as a Trustee of the Wisconsin Medical Society Foundation, as a board member and the President of the Friends of the Waisman Center and as an active member in his local Rotary group. Mr. Muldowney graduated in 1974 with honors, Phi Beta Kappa, from the University of Wisconsin with a B.A. in Economics and in 1977 with honors, Order of the Coif, from the University of Wisconsin Law School. He is admitted to practice in all the state and federal courts of Wisconsin, the U.S. Court of Appeals for the Seventh Circuit and the United States Supreme Court.

Carol A. Seaton

Carol Seaton has 35 years in the insurance and reinsurance industry, the last 21 years of which were spent at General Reinsurance, from which she retired in 2007 as a Vice President. Ms. Seaton's responsibilities at General Reinsurance Corporation included prospective, operational and periodic claim audits of a wide range of business models. She also consulted with external clients on operational issues, best practices, individual claim strategies, reserves, and emerging trends. Internally, Ms. Seaton maintained collaborative relationships with underwriting and marketing with regard to reinsurance contract and policy construction, jurisdictional, claims and marketing issues. Because of high excess of loss retention levels, her case load consisted of catastrophic injury claims with multi-million dollar exposures. Business handled included treaty, facultative, and broker markets.

From 1985-1986 Ms. Seaton was the Claim Manager of the American Medical Assurance Company, a wholly owned reinsurance subsidiary of the American Medical Association, which supported medical society sponsored physician companies on London slips and provided start up claim services to the Iowa Physicians Mutual Insurance Trust.

Ms. Seaton was the claim manager of the Chicago Hospital Risk Pooling Program from 1979-1985 during the "start up" years of the 5000 bed hospital insurance trust. In addition to overseeing claims, she was responsible for developing policies and procedures and the trust's claim management computer program.

Ms. Seaton began her insurance career in the Chicago office of Hartford Insurance in 1972 and advanced to a regional claims supervisor in Hartford's health care claim unit supervising local and downstate field offices' handling of professional liability claims.

Currently, Ms. Seaton's services are available as an ARIAS•U.S. Certified Arbitrator, an expert witness, or claim auditor. While Ms. Seaton's expertise is in hospital and physician medical liability claims, she also handled claims in supporting lines of business as well as participated in audits involving other lines of business during her tenure at General Re.

Aaron B. Stern

Aaron Stern has more than 35 years of experience in virtually all aspects of insurance and reinsurance. As President of Stern A. B. Inc., Mr. Stern serves as an arbitrator, expert witness, litigation consultant, performs underwriting, claims and operations audits and provides run-off management services.

Mr. Stern displays a unique capacity to integrate the diverse knowledge and experience gained across his expansive career. His experience includes developing and underwriting specialty insurance products, serving as senior executive of insurance and reinsurance companies involved in mortgage and financial guaranty, residual value insurance, credit and surety insurance, alternative risk transfer ("ART"), and structured coverages bridging the insurance and capital markets. His diverse background, training, and hands-on experience in accounting, finance, tax and regulation with respect to the U.S., U.K., Bermuda, and other international insurance jurisdictions enables him to bring an unparalleled perspective to assignments.

Previous positions have included President & CEO of the Alternative Risk Transfer Division of AXA Corporate Solutions, serving as Global Underwriting Class Manager for alternative and financial risks; organizing and raising capital for two Bermuda-based start-up property catastrophe reinsurers; underwriting manager for St. Paul Re for "weather derivative" insurance products; consultant to Guy Carpenter, providing strategic advice related to insurance risk securitization; President & CEO of Normandy Re, transforming futures and options contracts into reinsurance coverages; Director of Guy Carpenter Advisors, Inc., providing innovative reinsurance and capital market solutions for financing insurance risk; Director, President & CEO of Guaranty Holdings Corp. and its subsidiaries, developing, marketing, and underwriting innovative financial guaranty programs.

Mr. Stern has been a licensed P&C broker, E&S broker, reinsurance intermediary and MGA. He has held membership and leadership appointments to industry committees and associations, including the Financial Guaranty Study Group of the NAIC to develop and draft a Model Act. He has served on the Advisory Committee of the CBOT on Catastrophe Insurance Futures and was a founding member of the Bermuda Commodities Exchange (BCOE). He coordinated publication of a financial textbook, "Risk Based Capital Charges for Municipal Bonds", by Robert Godfrey and co-authored a Special Report, "The Emerging Asset Class: Insurance Risk."

James R. Stinson

James Stinson is a partner in the Chicago office of Sidley Austin LLP, where he co-chairs the Insurance & Financial Services Group and the Reinsurance Disputes and Insurance Insolvency practices. The Insurance Group has over 90 lawyers based in Chicago, London, Los Angeles and New York. Mr. Stinson represents ceding insurers and reinsurers in reinsurance disputes and handles all manner of domestic and non-U.S. insurer insolvency matters, representing receivers, reinsurers, ceding insurers and creditors. He is a past director of the International Association of Insurance Receivers (IAIR) and editor of the legal chapter of the National Association of Insurance Commissioner's (NAIC) Handbook for Insurance Company Insolvencies. He also chaired the Interstate Insurance Receivership Compact Commission's Receivership Law Advisory Committee, which drafted the Uniform Receivership Law.

Mr. Stinson has served as an administrative hearing officer, and as an arbitrator, umpire and mediator in reinsurance and insurance arbitrations. He has spoken at and chaired reinsurance and insurance insolvency conferences for the Reinsurance Association of America, ARIAS•U.S., the American Bar Association, IAIR, Intermediaries & Reinsurance Underwriters Association, Mealey's and the NAIC.

Mr. Stinson has been recognized by clients and fellow lawyers as a Leading Lawyer in the fields of reinsurance and insurance insolvency by Chambers USA-America's Leading Business Lawyers (2003-2007) and the International Who's Who of Insurance & Reinsurance Lawyers (2003-2007). He earned his undergraduate degree from Indiana University and his law degree magna cum laude from the University of Illinois College of Law.

in focus

Aaron B. Stern

James R. Stinson

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