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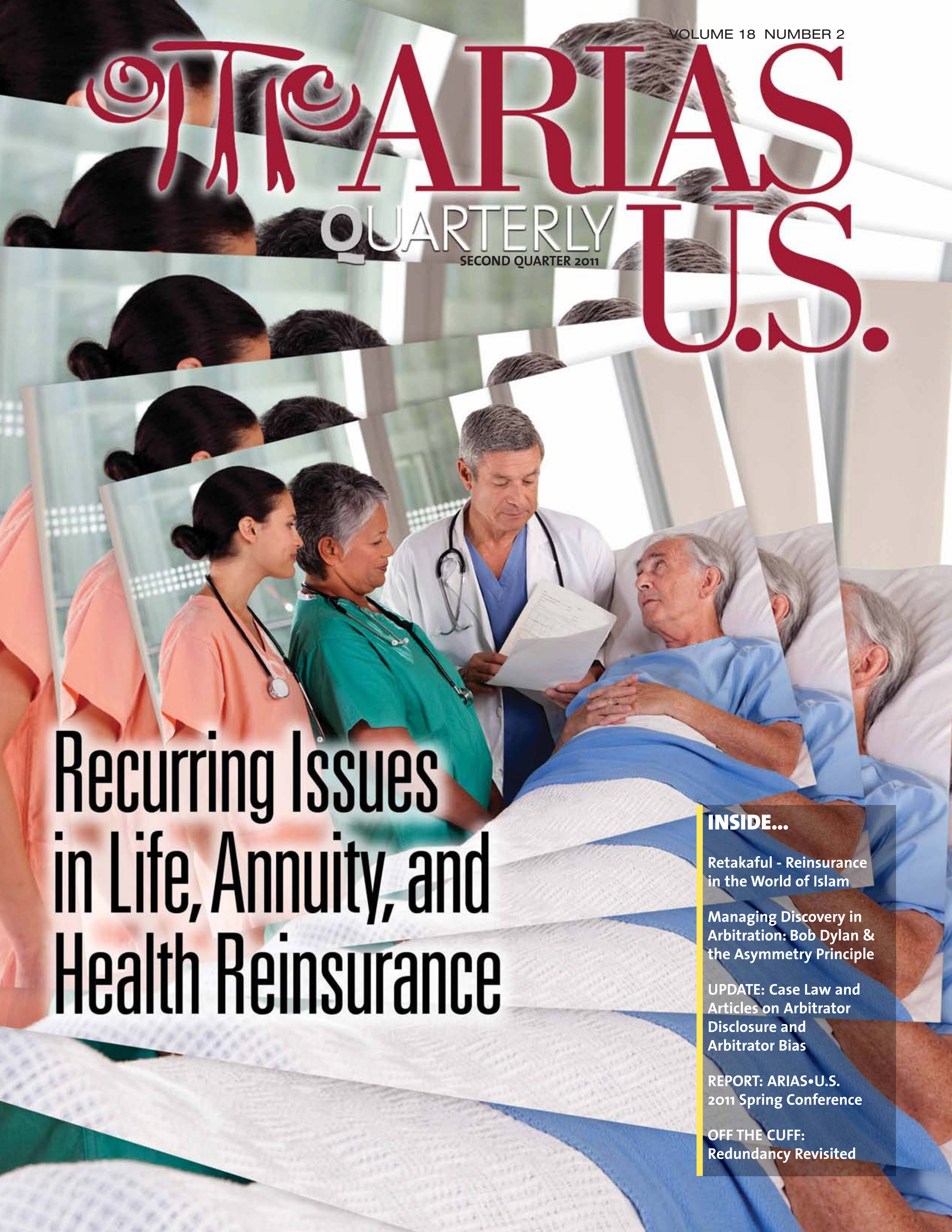

Recurring Issues in Life, Annuity, and Health Reinsurance

INSIDE...

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ARIAS•U.S.
P.O. Box 9001
Mt. Vernon, NY 10552
914.966.3180, x112
914.966.3264 fax
info@arias-us.org
www.arias-us.org

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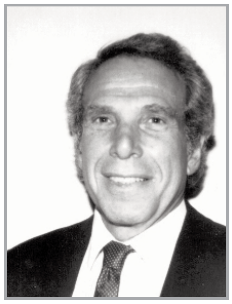
Eugene Wollan

We are particularly pleased in this issue to address an unusually broad diversity of subjects.

According to Rich Mason and Robert Tomilson, 18% of ARIAS•U.S. Certified Arbitrators describe themselves as having expertise in life and health insurance. Their article on recurring issues in reinsurance of such coverages should serve as a helpful refresher to the 18% and a very informative introduction to the other 82%.

Rob Whitney really takes us into an entirely new world with his erudite and fascinating discussion of reinsurance under Islamic law. Much of the vocabulary is strange to us, but many of the concepts are familiar.

David Attisani and Ethan Torrey return us to somewhat more familiar ground with their article on the discovery phase of arbitration. Their approach suggests that greater consideration might often usefully be given to bifurcation and summary adjudication as tools for managing discovery. We would be delighted (and I'm sure the authors would be, too) to hear from any readers who either disagree or who would like to expand on their comments. Remember: we are soliciting Letters to the Editor, and we welcome debate.

Teresa Snider and Eric Haab have furnished a piece on arbitrator disclosure and bias that fits into these descriptions:

1. It's really too short for a full-fledged article.
2. It's really too long to be called a Case Note.
3. It needs to be published because it updates the case law in what has recently become a hot-button issue.

We therefore publish it without attempting to assign it to any particular category.

The ARIAS Law Committee gives us summaries of a case dealing with attorney's fees and another that sounds very much like a reprise, with some variations, on the Bellefonte theme.

We are delighted to report that we have our first letter the editor. Its content is challenging, and we hope that it will provide a good deal of discussion, whether agreement, disagreement, comment, or just venting.

To round out this issue, I continue to rant about legal overwriting and just plain bad writing. So what else is new?

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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 .

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feature

Recurring Issues in Life, Annuity, and Health Reinsurance

Richard C. Mason

Robert L. Tomilson

Richard C. Mason
Robert L. Tomilson

Life, Annuity, and Health reinsurance have distinctive characteristics that lend these classes of business to specialization. The business is a different world from Property and Casualty reinsurance that may be more familiar to many reinsurance practitioners. It follows that the terminology, concepts, disputes, and dynamics of arbitration can differ. This article discusses some critical distinctions that characterize Life, Annuity, and Health reinsurance, the issues that give rise to disputes, and how they may bear on arbitration.

1. Important differences between Life and Health reinsurance and Property and Casualty reinsurance

One observable distinction between the Property and Casualty business and Life, Annuity, and Health business has been the greater prominence of actuaries at relatively high executive levels in the company as a whole, or at least within the company's Life and Health reinsurance group. Life and Health reinsurance has been actuarially driven to a greater extent than many Property and Casualty lines.

This is principally explained by deal-driven growth acquisition opportunities in these classes of business where massive blocks of inforce policies are bought and sold. The benefit of these acquisitions often uniquely depends on the astuteness of the pricing actuary. In such transactions, the ability to evaluate actuarial factors such as investment performance, delayed acquisition cost, lapse rate, and mortality (or morbidity) may vault a company from a marginal player to an upper tier insurer or reinsurer. The decision-makers approach such problems from an actuarial perspective—*i.e.*, mathematical and statistical assessment of risk using deterministic and stochastic modelings and they frequently view disputes from that perspective as well. During the last decade, actuarial executives have occupied the highest levels of, for example, American United Life, AXA Equitable Life, Transamerica Re, New York Life, Lincoln Financial Group, and other large life/health companies. When the primary decision-maker is an actuary, rather than an MBA or an attorney, the reinsurance practitioner must be able to speak and understand the operative language and master (at least) a working knowledge of key concepts.

The Life and Health industry employs unique terminology. Policies do not pay indemnity, they pay benefits. (There are rarely "defense costs," as such). A single policy frequently is referred to as a "case," and a single insured as a "life." A group of policies reinsured under a treaty is a "block" of business. Managing agents are "MGUs," or managing general *underwriters*—at least nominally.

Benefit ratios may fluctuate, depending on factors such as persistency, amortization of acquisition costs, and claim continuance, not found in property and casualty business. The "lapse rate" reflects the frequency with which policyholders allow their coverage to terminate, usually because of cessation (voluntary or involuntary) of premium payments. "Persistency" relatedly refers to the rate at which policyholders keep the subject policy in force. "Acquisition costs" consist principally of agency commissions, which may exceed 90% in the first year, and typically are carried as a depreciating asset on the balance sheet. "Claim continuance" describes how long a claimant, for example under a long term care insurance policy, will continue to require benefits. Mortality and longevity, often conflated, are in fact inverse measures of human life expectancy. Mortality is the rate of death under life policies; longevity the measure of life under disability, long term policies and annuities. Each of these factors can make the difference between profit and loss, and thus often figure in disputes, especially disputes over

> Life and Health reinsurance has been actuarially driven to a greater extent than many Property and Casualty lines.

Richard C. Mason and Robert W. Tomilson are members of the Cozen O'Connor law firm, who represent clients on Life, Annuity, and Health reinsurance matters, as well as Property and Casualty matters. Further information concerning the authors is available at www.cozen.com.

disclosure to the reinsurer at the time of underwriting of the reinsurance.

Treaties reinsuring Life and Health risks contain numerous distinctive provisions. Treaty provisions that are foreign to property and casualty insurance include:

- A multi-life warranty, often found in catastrophe reinsurance, which may cover anywhere from two to twenty (or more) lives, and provides that no liability arises under the treaty until the specified number of lives is involved in the same event.
- A MAOL ("maximum any one life") clause, which sets forth the maximum stated limits, per life, for the policies that will be insured, "or so deemed," in a reinsurance treaty.
- The Recapture clause governs when and how the cedent may be permitted to increase the retention applicable to the reinsurance, whereupon all further premium and claims ceded on the reinsured block within the new retention become the responsibility of the cedent. Some contracts contain recapture clauses that expressly provide the right to recapture after a certain period of time with no increase in retention necessary.
- Reductions and Terminations governs allocation of liability between the parties when the insurance in force with the ceding company, for individual life policies, is terminated or reduced.
- Errors and omissions clauses in life and health reinsurance are typically concerned with the cedent's administration of the reinsurance agreement, rather than its mistakes concerning policyholders.
- Contract duration frequently distinguishes Life and Health treaties from Property and Casualty treaties. Property and Casualty treaties do not customarily have a period exceeding thirty-six months, while Life treaties commonly are indefinite in duration. With no automatic termination provisions, it is not uncommon for such treaties to remain in force for two decades or longer. The treaties often are terminated only when claims on the reinsured business have diminished to the point where the cost of administering the treaty exceeds the value of the reinsurance. At that point, the treaty customarily is terminated by mutual consent.

Because Life and Health reinsurance contracts typically are perpetual, there are a suite of clauses governing how policy changes, continuations, and conversions will affect the reinsurance.

2. Recurring Issues in Life and Health Reinsurance

While trigger and allocation issues have been grist for the mill of Property and Casualty reinsurance disputes, a different set of issues has caused Life and Health reinsurers to proceed to arbitration.

Annuities. Perhaps the most hotly contested Life and Health reinsurance disputes in recent years have arisen from reinsurance of annuity products and their attendant benefits, including GMIB (guaranteed minimum income benefits) and GMDB (guaranteed minimum death benefits). In the late 1980s and early 1990s, some issuers began adding guaranteed benefits to their annuity contracts in order to make them more attractive to the investing public. These benefits included guaranteed minimum annual returns and guaranteed minimum annuity payments. GMDB contracts were exposed to the equity market's performance, and the guarantees acted as a floor for the purchaser's investment. The issuers reinsured their market exposure on these guaranteed benefits, frequently by 100%. The reinsurance was often written with an expectation of occasional equity market declines in an overall upward trajectory. For GMDB business, underlying insurance consisted mainly of "permanent" life policies and the reinsured guarantee would only pay in the event of the infrequent coincidence of death and market decline.

In 2001-2002 and again in 2008, however, reinsurers of these contracts suffered substantial losses or were forced to increase reserves by hundreds of millions of dollars because of steep market declines. Some disputes that followed these downturns focused on the issuer's ability to change investment options without notice to the reinsurer, the contract holders' ability to lock in the reinsured guarantees while simultaneously withdrawing the bulk of their investment, and wordings in underlying contracts that placed no limitations on the investor's ability to transfer the contract and its benefits.

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Perhaps the most hotly contested Life and Health reinsurance disputes in recent years have arisen from reinsurance of annuity products and their attendant benefits, including GMIB (guaranteed minimum income benefits) and GMDB (guaranteed minimum death benefits).

Technical features of the alleged nondisclosure frequently differ from Property and Casualty disputes. Because of the calculated long-tail nature of life, long-term care, and (certain) disability insurance products, reinsurers may need to rely on "early indicators" of performance. Factors such as persistency and continuance may emerge prior to losses, yet signal that a block of business could underperform.

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The fundamental area of dispute in annuity reinsurance (at least for much written in 1980-2008) was the perception by some of non-alignment of interests between the issuer and the reinsurer: the issuer's concern for profitability and the reinsurer's effort to mitigate loss by the strict application of the terms of the underlying contracts and the reinsurance treaties. A frequent result was double digit percentage rate increases in reinsurance premium and the withdrawal of many reinsurers from the market.

Non-disclosure/Misrepresentation. Life and Health disputes, in common with the Property and Casualty world, certainly have seen their share of alleged nondisclosure, concealment, and misrepresentation. Indeed, claims of nondisclosure may be the most common dispute leading to reinsurance arbitrations for Life and Health.

Technical features of the alleged nondisclosure frequently differ from Property and Casualty disputes. Because of the calculated long-tail nature of life, long-term care, and (certain) disability insurance products, reinsurers may need to rely on "early indicators" of performance. Factors such as persistency and continuance may emerge prior to losses, yet signal that a block of business could underperform. Actuaries monitoring such development may be able to observe at an early stage that experience is deviating unfavorably from assumptions, potentially warranting strengthening of reserves in view of the likelihood of adverse loss development. Reinsurers have asserted that the failure to disclose such "early warning signs" represents material nondisclosure, warranting rescission. Other nondisclosure issues have arisen over the scope of benefits provided under the reinsured policies, the use of "aggressive" underwriting practices such as issuance of long-term care policies to nonagenarians residing in Florida, and the use of reciprocal reinsurance as a means of spiraling "working layer" claims to catastrophe excess reinsurance layers.

Treaty administration gives rise to frequent disputes, though in the authors' experience only a small fraction cannot be resolved short of an arbitration hearing. Administrative disputes arise because life insurance treaties often reinsure massive blocks of policies that may number in the hundreds of thousands. Accordingly, the reinsured is responsible for accurately ceding large volumes of premiums and thousands of claims, often in accordance with detailed reporting requirements in the treaty. The treaty provisions will define and restrict the policies eligible for cession, according to the amount insured (which may depend on whether the life is insured under more than one policy), and sometimes on the basis of geographical region, age of insured, underwriting guidelines, or other specified criteria.

The volume of business written may overwhelm the cedent's ability to accurately cede the appropriate premium and claims. Volume also may impair the cedent's capacity to avoid ceding claims and premium precluded by the terms of the policy. Overlooked claims may prove more likely to be discovered by the cedent than overlooked premium. Disputes often concern whether the error is "clerical." The result may be that after a decade or more the cedent or reinsurer discovers that millions of dollars in premium, claims, or both, were incorrectly ceded. Concomitantly, it also may be discovered that millions in premium or claims *should have been* ceded, but were not. Errors in the form of "missed premium" or "missed claims" often are not discovered until long after they occurred, and documentation may be incomplete.

The ensuing audit in these circumstances can be grim. The reinsurer may suspect that the cedent has sweated blood to find omitted claims, but has not worked quite as diligently to seek out omitted premium. Cedents not uncommonly seek to excuse compliance with automatic cession rules by reliance on the treaty's "errors and omissions" clause. While incorrect cessions, or "missed cessions," sometimes are forgiven by parties to life reinsurance treaties, if the past mistakes prove to have been deliberate, repeated, or "systematic," or cannot be reconciled, parties have proceeded to arbitrate these disputes.

Commencement and Termination disputes provide another source of contention in life reinsurance. Typically, quota share treaties for individual life insurance do not contain an automatic expiration provision, and are theoretically perpetual in duration. Accordingly, if one party wishes to terminate the treaty it must obtain the other's agreement to commute the contract, in the absence of terms permitting unilateral termination. When treaties have not clearly specified whether termination applies to risks previously ceded, disputes have arisen concerning whether termination allows for run-off coverage.

Right to increase reinsurance premium rates. Yearly renewable term (YRT) treaties typically provide that reinsurance premium rates are not guaranteed. YRT Treaties so provide, because regulatory requirements have been deemed to mandate setting up of a deficiency reserve by the reinsurer in the absence of language permitting it to raise rates. Yet despite common usage of rate increase provisions, historically it was extremely rare for reinsurers to raise rates even in the event of adverse mortality experience.

More recently, reinsurers have become more inclined to raise rates, though it is by no means common practice. Some cedents have fought back with contentions that rate increases were undertaken in "bad faith," with only certain treaties selected. Cedents have contended that rate increases are contrary to the partnership concept in reinsurance. Some cedents have sought to recapture such treaties rather than pay the increased rates. Cedents also have negotiated the right to contractually limit the right to increase rates, employing a wide variety of wordings, including provisions that permit rate increases only if consistent with specified mortality tables, or only to the extent necessary to eliminate the deficiency reserve.

Unwelcome rate increases have been the cause of ill feeling between a number of cedents and reinsurers, leading to broader disputes that may center on issues such as nondisclosure or termination.

Recapture. In excess-of-loss reinsurance, the reinsurer assumes risks above the retention specified in the treaty. The cedent may, however, have the contractual right to "recapture" ceded business, going forward, if it increases its retention. (This has also sometimes arisen with regard to quota share reinsurance.) The cedent frequently is required, in the insurance contract or (it has been asserted) by custom, to increase its retention in the entire class of business, not just on the business ceded under the treaty at issue. Typically, the contract specifies or otherwise contemplates that such a recapture cannot be effected for a specified period of years after policy issuance, to permit the reinsurer to recoup its acquisition costs.

Because cedents have often sought to exercise recapture rights only with regard to profitable business, to their reinsurer's financial disadvantage, disputes (and arbitration) over recapture are not infrequent. Issues have included: (i) whether the treaty permits recapture; (ii) whether the reinsurer gave proper notice of recapture; (iii) whether notice of recapture by the reinsurer is irrevocable; (iv) whether the cedent seeking to recapture actually increased its retention; (v) whether recapture must include all treaties between the parties; and (vi) whether the cedent must apply the recapture to the entire class of business that it insures.

Facultative Cessions not uncommonly generate reinsurance disputes. Life treaties typically contain a clause precluding automatic reinsurance for any risk the cedent submitted previously on a facultative basis to the reinsurer, or indeed to any reinsurer. Such cases nevertheless sometimes are ceded automatically, and disputes arise later in the event of a significant claim under such a policy. The parties' course of dealing with respect to acceptance of such cessions has, in the authors' experience, proved weighty if not dispositive. This is also an area in which the panel's grasp of industry custom and practice can be extremely important given the view of certain industry participants that, regardless of treaty provisions, a facultative cession that previously was offered to any reinsurer thereby becomes ineligible for automatic cession.

Sometimes the cedent comes to believe that the reinsurer did facultatively accept a policy. The reinsurer may have had loose processes for recognizing acceptance of facultative cessions. Or the ceding company may deliver a policy, but neglect to advise the facultative reinsurer of the commencement of risk by transmitting a formal cession. Absent clear treaty language specifying how acceptance must be made, disputes will arise if the cedent later claims, for example, that the reinsurer's failure to expressly reject the cession constituted acceptance.[2] Reinsurers have also disputed facultative cessions in which the policy was not underwritten in accordance with the cedent's normal procedures for underwriting and issuance.[3]

3. Arbitrating the Life, Annuity, or Health Reinsurance Dispute

Arbitrators within ARIAS who have designated themselves as having some in-house expertise in life reinsurance represent approximately 18% of the total number of arbitrators. Overall, parties seeking expertise among ARIAS-certified arbitrators for a life, annuity, or health reinsurance dispute have relatively fewer choices than with respect to property and casualty disputes.

Historically, some accident and health treaties, and a few life reinsurance treaties, have provided for certain disputes to be decided by "actuarial arbitration." Disputes subject to actuarial arbitration typically are limited to: (i) disputes solely involving mathematical issues, such as reserves or experience refund calculations, and (ii) commutations.

In an actuarial arbitration, a single actuary might be selected, or (more commonly) a panel of three actuaries would decide the issue. Unlike the usual reinsurance arbitration, such panels not infrequently have dismissed the need for a conventional hearing, and instead approached the dispute as if it were a mathematical equation – which frequently it is – so that little, if any, legal argument would be welcome. Attorneys often do not directly participate, but can be instrumental in ensuring that any award is clear, precise, and enforceable.

If the contract contains a standard arbitration clause, the procedures ordinarily will not vary from property and casualty disputes,[4] and the parties will evaluate party-appointed arbitrators

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Rather than hearing an argument focused on the legal definition of "materiality" in a rescission case, the panel likely will be far more interested in hearing how, for example, the projected lapse rate was contrary to the cedent's underwriting experience in an "apples-to-apples" analysis.

CONTINUED FROM PAGE 5

and umpires by the traditional criteria. One important criterion, of course, is hands-on experience, and here there can be some less than obvious distinctions. Many arbitrators can say they understand first-party benefits; fewer, no doubt, have dealt with a wide range of issues at a granular level concerning the precise business at issue. Experience in individual life reinsurance, for example, differs markedly from experience in group life reinsurance. Similarly, experience in disability and long term care reinsurance may be an imperfect background for certain personal accident reinsurance disputes.

Direct actuarial training and knowledge on the arbitrator's part has, in the authors' experience, proved most valuable with regard to reinsurance disputes that center on nondisclosure or similar issues. In such cases, when the central question concerns a subject such as whether the data disclosed accurately reflected the recognized degree or kind of risk, an actuary / arbitrator's superior knowledge can be an indispensable asset in evaluating and explaining during deliberations the relative merits of the parties' positions. In disputes in which contract wording becomes the dominant issue, however, actuary / arbitrators have sometimes been less influential than attorney / arbitrators, even though the attorney / arbitrator's interpretation of a particular clause may vary from the prevailing, practical understanding of the clause in the life, annuity, and health reinsurance business.

Other differences are significant. If the panel is comprised of non-lawyers, such as actuaries, the panel likely will prefer that the arguments emphasize the technical aspects rather than "legalese." Rather than hearing an argument focused on the legal definition of "materiality" in a rescission case, the panel likely will be far more interested in hearing how, for example, the projected lapse rate was contrary to the cedent's underwriting experience in an "apples-to-apples" analysis. Expert witnesses seem to be employed with a slightly higher frequency than in Property and Casualty disputes. This may be so because in general experts are of course more readily received when the umpire does not have superior experience with regard to the subject matter, and this seems more often to be the case in Life, Health, and Annuity reinsurance arbitrations than in Property and Casualty arbitrations.

Counsel's own mastery of Life and Health concepts may be indispensible. Because Life, Annuity, and Health reinsurance disputes frequently turn on concepts that are foreign to many attorneys and arbitrators, the panel cannot help but be inclined to feel greater confidence in positions presented by the side that displays mastery of these concepts. Practitioners who rarely handle Life and Health reinsurance matters should invest in extended hours with the clients' business people to develop optimal knowledge of the reinsurance issues, underwriting terminology, and actuarial concepts.▼

1 The views in this article do not necessarily reflect the views of the authors' clients. The authors thank Denis W. Loring, FSA, Senior Vice President, Global Financial Solutions, RGA Reinsurance Co., for his valuable comments and insight.

2 See Treaty Committee Reinsurance Section Society of Actuaries, Discussion of Reinsurance Provisions in a Life Reinsurance Agreement, p. 10 (On file with author).

3 See id.

4 There may be a somewhat higher inclination for panels to permit enforcement of audit rights during an ongoing arbitration, particularly if new business is being written.

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THAT THE **LAW COMMITTEE REPORTS** SECTION OF THE WEBSITE PROVIDES CASE SUMMARIES OF 72 COURT DECISIONS RELATING TO REINSURANCE ARBITRATIONS? THEY CAN BE LOCATED BY NAME, ISSUE ADDRESSED, OR DATE DECIDED. ACCESS IS THROUGH THE LEFT-SIDE NAVIGATION BUTTON LABELED "LAW COMMITTEE REPORTS." THE WEBSITE IS AT WWW.ARIAS-US.ORG .

news and notices

Mullins Named to ARIAS•U.S. Board of Directors

At its meeting on May 4, the Board of Directors approved Elizabeth A. Mullins of Swiss Re America Holding Corporation as a member of the ARIAS•U.S. Board to complete the term of George A. Cavell of Munich Re America, who resigned recently. The By-Laws require that any vacancy be filled "without undue delay by a majority vote by ballot of the remaining members of the Board..." Ms. Mullins, has been active in ARIAS•U.S. for many years. She will serve until November, at which time she will be eligible for re-election.

Board Certifies Five New Arbitrators

Also at its meeting on May 4, the Board of Directors approved certification of the following arbitrators. Their sponsors are indicated in parentheses.

LeRoy A. Boison, Jr. (Roger Moak, Robert Bear, David Appel)

Detlef A. Huber (Paul Dassenko, Stephen Kidder, Suzanne Fetter)

Steven G. Lehmann (Richard White, Charles Cook, Cecil Bykerk)

Kevin M. Madigan (Clive Becker-Jones, Robert Buechel, David Thirkill)

James G. Sporleder (David Brodnan, Mark Gurevitz, Thomas Stillman)

Financial Statements Now Posted on Website

A new section of the website has been created within the password-protected Members Area. To address member requests to have a source for information about ARIAS finances, financial exhibits will now be made available. Documents will be added and retained there, creating an archive over time for future reference. The first statement posted was the Auditor's Report for the fiscal year ended June 30, 2010.

The new location can be accessed through a grey button in the left-side navigation labeled "Financial Statements." It also can be found when entering the Members Area through the Membership Directory button.

Board Names Burns as Certified Umpire and Rivers as Certified Arbitrator

At its meeting on March 10, the ARIAS-U.S. Board of Directors named **Mary Ellen Burns** as an ARIAS•U.S. Certified Umpire and recertified **Timothy C. Rivers** as a Certified Arbitrator under the new requirements.

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To the Editor...

In response to your invitation (in the 2011 ARIAS First Quarterly Issue) to offer my views in the new Letter to the Editor section, I offer the following:

During a general session at the 2010 ARIAS•U.S. Spring Conference, a large bold type 3-word display reading SMARTER FASTER CHEAPER was shown to indicate the intended outcome of using arbitration to settle reinsurance disputes.

Well-----As a consequence of stretch the edge of the envelope claims/defense concepts , unnecessary use of witnesses, fishing expedition discovery and an overabundance of exhibits and charts, all of which cause drawn out hearings, we are deteriorating into DUMBER SLOWER COSTLIER.

At the same 2010 Spring Conference, I attended a workshop entitled, "Does Arbitration Beat the Alternative or Not?" About ten minutes into the presentation, I stood up and commented that the presentation sounded more like a seminar on how to game the system rather than what the workshop's title indicated. I was not alone in my views as another attendee stood and made a similar comment.

I believe ARIAS and all its members should focus on delivering SMARTER FASTER CHEAPER. Arbitration as originally conceived does beat the alternative!!!

Don A. Salyer
ARIAS•U.S. Certified Arbitrator

Letters to the Editor may be sent to Eugene Wollan at ewollan@moundcotton.com

feature

Retakaful - Reinsurance in the World of Islam

Robert A. Whitney

Robert A. Whitney

Introduction

"Retakaful" is reinsurance governed by Islamic, or Sharia, law. Although it is still a relatively new form of reinsurance, the number of Retakaful companies and contracts will continue to grow over the next few years throughout the world, including in the United States. As a result, there is a growing need for attorneys and arbitrators who are familiar with these contracts and with Sharia insurance and reinsurance law.

Insurance as a risk transfer mechanism dates back thousands of years before Edward Lloyd opened his coffee house in the City of London. Early methods of transferring or distributing risk were practiced by Chinese and Babylonian traders as long ago as the 3rd and 2nd millennia BCE, respectively. Chinese merchants would redistribute their wares across many ships so as to limit the loss from the sinking of any single vessel. The Babylonians developed a system that was also practiced by early Mediterranean sailing merchants: if a merchant received a loan to fund his shipment, he would pay the lender an additional sum in exchange for the lender's guarantee to cancel the loan should the shipment be stolen.[2]

In the early days of the Islamic era, there were Muslim desert trade caravans travelled throughout Arabia and adjoining lands. They were exposed to potential catastrophic risks, especially sandstorms and losses to raiders. This was also the time when Muslim Arabs started to expand their trade to India, the Malay Archipelago, and other countries in Asia. On these long voyages, they often incurred huge losses because of ships sinking during storms or encountering pirates along the way.[3] Motivated by the Islamic principle of "mutual help and cooperation in good and virtuous acts", the vessel owners or caravan sponsor would get together and mutually agree to contribute to a fund before they started their long journey. The fund was used to compensate anyone in the group who suffered losses on the caravan trip or ocean voyage. Muslim scholars generally acknowledge that the basis of "shared responsibility" as practiced between these early Muslim traders laid the foundation for a form of "mutual insurance" under Islamic law.[4]

Motivated by the Islamic principle of "mutual help and cooperation in good and virtuous acts", the vessel owners or caravan sponsors would get together and mutually agree to contribute to a fund before they started their long journey.

What Is Takaful?

"Takaful" - derived from the Arabic verb "Kafal", which means to "aid" or "help out"— is a form of risk management or "cooperative insurance" that has been practiced in various forms for over 1400 years, since the earliest days of Islam in what is now Saudi Arabia. Some early Islamic scholars believe that "insurance" of any form is unnecessary because members of society should help its victims, and should trust in the mercy of God to provide against loss.[5] Most of these initial clerical apprehensions were overcome, however, both through a recognition of the practical need for a mechanism to trade and develop commerce in a global system, and by finding a way to implement the Takaful concept in the sayings of the Islamic Prophet Muhammad.

One of the best-known sayings of the Prophet Muhammad in the Western word is also one of the bases cited for allowing such "mutual cooperation" against loss.[6] As the story goes, one day a man ran up to the Prophet Muhammad and said "O Prophet, I'm a good Muslim. I do everything required of me by God and then some." The prophet praised the man for his fastidiousness and piety. The man then continued,

> "Well, O Prophet, I do all this and I trust fully in God. When I went to the market today, I recited a prayer and asked God to please look after my camel while I shopped. I left the

Robert A. Whitney is Counsel in the Boston office of White and Williams LLP. His practice areas include major insurance coverage, reinsurance and commercial litigation and arbitration. He is also an ARIAS-U.S. Certified Arbitrator.

camel there and went to shop. When I returned, the camel was gone! Why didn't God keep my camel safe?"[7]

According to the story, the Prophet Muhammad then chuckled and replied:

"Brother, it is good that you trust in God... but always tie up your camel!" The moral of this story is, obviously, that while having faith is a great thing it is also necessary to take basic precautions, or "God helps those who help themselves."[8]

Sharia, the religious law of Islam, forbids certain elements of conventional insurance contracts, including "Riba," or interest, "Maisir," or gambling, and "Gharar," or excessive uncertainty. The takaful system is considered fully "Sharia compliant" because its purpose is not profit, but to uphold the principal of sharing the burden or risk.[9]

The principles of takaful are based upon certain sayings of the Prophet Muhammad both in the Koran and in the hadith (certain reports of the statements or actions of Muhammad or of his tacit approval of something said or done in his presence, collected in the 8th and 9th centuries). These principles include: policyholders cooperate among themselves for their common good; every policyholder pays his subscription to help those that need assistance; losses are divided and liabilities spread according to the community pooling system; uncertainty is eliminated in respect of subscription and compensation; and no one derives advantage at the cost of others.[10]

Takaful companies are very similar to mutual or cooperative insurance companies in that participants contribute to a common pool from which claims are paid. The surplus from the pool is then distributed to members in some form of profit-sharing device. For the purpose of takaful, premiums are classed as "donations" — a voluntary contribution to the pool for those in need of assistance. The purpose of this system is not profit but to uphold the principle under the Koran of "bear ye one another's burden."[11]

The world's first modern "takaful" company, the Sudanese Islamic Insurance Company, was established in 1979. By January 2009, there were about 124 takaful companies and 38 takaful "windows" (i.e., conventional insurers undertaking takaful business through a "window" that allows for safeguards and separation of contributions and assets).[12]

Takaful companies are usually structured in one of two ways: Al-Wakala, a fee- based model, or Al-Mudaraba, a profit-sharing model.[13] Under the "wakala" model, the co-operative risk sharing occurs among participants with a takaful operator who earns a fee for services as agent for the fund, and does not participate or share in any underwriting profits that belong to the participants. Under the Al-Wakala Model, the fund operator may also charge a fund management fee and a performance incentive fee. Profits, or returns on investment plus underwriting surplus, are paid as dividends to participants.[14]

Under the "mudaraba" model, the participant and the takaful operator are mutual partners in the takaful fund. The participant contributes premiums and the operator handles investing and administration of the fund. Profits are shared proportionately among the participants and the takaful operator. Generally, these risk - sharing arrangements allow the takaful operator to share in the underwriting profits from operations as well as any favorable performance returns on invested premiums.[15]

Takaful distinguishes itself from conventional insurance in many different ways, the main distinction being the fundamental principles that govern each practice. Riba — interest - in conventional insurance is, in a sense, generated by the exchange between contributions and indemnities, and also in the income derived from from interest-bearing investments.[16]

Conversely, Riba — interest - is avoided in takaful by using contracts for profit shares rather than fixed interest and by investment in Sharia compliant schemes.[17]

The practice of conventional insurance also involves the use of Gharar — uncertainty - because of uncertainty about how much will be paid, and when. When a claim is not made the insurer will retain all the profits. Takaful contracts, on the other hand, have to follow specific rules to avoid Gharar. These include making sure that the subject matter of the insurance is a legitimate and essential need, that the insurer is able to safeguard the interests of the insured, and that the

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Another essential difference is that conventional insurance by its conception is a risk-transfer mechanism. Takaful does not entail a risk transfer mechanism, but rather a social function of mutual risk-sharing. The contract of takaful is not a sale or an exchange, but is rather a membership contract to a common pool, of which every member is entitled to certain benefits but also exposed to some risks of loss.

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insurance is transacted on a co-operative basis under which ownership of the premium is with all contributors to the takaful fund, who collectively bear the risk and can share profits or losses from the pool.

Another essential difference is that conventional insurance by its conception is a risk-transfer mechanism. Takaful does not entail a risk transfer mechanism, but rather a social function of mutual risk-sharing. The contract of takaful is not a sale or an exchange, but is rather a membership contract to a common pool, of which every member is entitled to certain benefits but also exposed to some risks of loss. This also makes the takaful system commercially more viable, because the remaining money after all claims does not belong to the shareholders but rather to the participants, and it should thus be given back.[18]

In addition, motivations of conventional and Islamic insurance companies are different. Conventional companies are directed by the search for profit. Takaful companies are also directed by ethical means for the overall benefit of society and the environment. Regulation in takaful is undertaken through Sharia supervisory bodies, which ensure that all operations are conducted in line with the Sharia principles and fulfill Islamic objectives of social welfare.[19]

Retakaful Is Islamic Reinsurance

Reinsurance of takaful business under Islamic principles is known as "retakaful". Retakaful enhances takaful activity by distributing the risks. It is mainly for covering large risks and accumulation of risks subject to common loss. It also ensures that takaful funds are managed to meet the indemnity obligations of the insured and reinsured and to assure the continuity of takaful operations. This means that retakaful enhances the underwriting capacity of the takaful ceding company.

While the concept of reinsurance started as early as the 17th Century BCE, the earliest recorded document that can be described as a form of reinsurance dates back to 1370 CE.[20] The first specialized reinsurance company — the Cologne Reinsurance Company — was not founded until 1853. The first Islamic reinsurance company was formed in 1985,the Islamic Reinsurance Company in Bahrain.[21]

Retakaful does not, in principle, differ from takaful operations. The Sharia principles applying to takaful apply to retakaful operations as well. The difference, if any, is that in the Retakaful operations the participants are takaful operators instead of individual participants.[22] There are two parties involved in retakaful operations: 1) the ceding company, which desires to relieve itself of part of the insured risk(s) called the "takaful operator;" and 2) the reinsurer, the company, that accepts the portion of risk that is reinsured, and that is called the "retakaful operator."[23]

Retakaful is an Islamic alternative to conventional reinsurance, based on Sharia compliant approved concept for reinsurance. The takaful company pays an agreed sum (or "premium") to the retakaful company in return for the retakaful company to providing security and assurance that the takaful company is protected against adverse risks. The operation of takaful companies is the same as any other insurance companies except that they do not utilize the elements of riba, gharar, maysir, and other elements that are prohibited by Sharia.[24]

At present, most takaful operators still must reinsure with conventional reinsurers, as a consequence of the scarcity of retakaful companies that are capitalized to the levels required by insurers, and more particularly the lack of 'A' rated retakaful companies. The "authorization" from Sharia scholars to deal with the conventional reinsurers is, however, temporary and conditional. Only when Sharia compliant capacities are not available, and there is no practicable Sharia compliant alternative, is it permissible to use a conventional reinsurer.[25]

The Difference between Retakaful and Traditional Reinsurance

As noted, conventional reinsurance, like conventional insurance, is prohibited under Islamic law because of its features of riba (interest), gharar (excessive uncertainty), and maisir (gambling) elements. Retakaful operation has eliminated these elements because it uses permissible contracts. A retakaful operation does not earn commission or interest because this commission is subject to riba and dilutes the purpose of setting up a Takaful operation. The retakaful operation is dependent on actual expenses by the Takaful operator in the process of retakaful, while in conventional reinsurance the operation is subject to riba and gharar, which are not in line with the Sharia.[26]

Under Islamic laws, the reinsured party is *not* entitled to reinsure the property of the original insured party without permission from the policyholder, but, the retakaful operation vests a right to reinsure on the insurer because permission from the policyholder is automatically inherent in the mutually- beneficial contract.[27] Under conventional reinsurance principles, an insurable interest is vested in the reinsured party. The fact that the reinsured party has issued a policy and assumed liability to its original insured party has been held to give it insurable interest sufficient to enable it to reinsure. The point is that although the reinsured party (direct insurance company) has no actual legal interest in the property, the subject matter of the original insurance policy, it has assumed responsibility in regard to it, and has therefore put itself into a position, recognized by law, in which it would be prejudiced by its loss.[28]

Looking Ahead: Future Issues Concerning The Issuance and Enforcement of Retakaful Contracts in the U.S.

The market for Islamic insurance products — takaful and retakaful — has grown exponentially since its current inception, with double digit growth rates over the past few years. Takaful operators have been set up mainly in the Muslim world, and currently there are more than 80 companies active in the primary insurance business. It is expected that in the future growth will be between 15 and 20 percent annually, with gross premiums likely to reach $14 billion by the year 2015, almost a three-fold increase over today's level. [29]

In late 2006, Hannover Re, the fifth largest reinsurance company, set up its Islamic subsidiary, Hanover ReTakeful B.S.C., in Bahrain, with an initial capitalization of $185 million. In 2010, the world's largest reinsurance company, Swiss Re, announced the formation of its Sharia-compliant reinsurance business in Dubai for life/family Retakaful.30 In December 2008, it was announced that Risk Specialists Companies, Inc., a subsidiary of AIG Commercial Insurance, was introducing what it said was a first in the U.S.: a homeowners insurance product that was compliant with key Islamic finance tenets and based on "takaful," the concept of mutual insurance under Islamic law.[31]

As the number of retakaful companies and contracts continues to grow throughout the world, it is inevitable that disputes over those retakaful contracts will invariably arise, just as they have with respect to ordinary reinsurance contracts. And as retakaful contracts become more commonplace, and involve risks that include American-based assets, one question will be: Can disputes over such contracts be decided here the United States?

Anti-Sharia sentiment in the United States is on the rise, in part because of issues relating to the potential locating of a mosque at "Ground Zero" in New York City. There was a ballot initiative recently proposed to amend the Oklahoma Constitution to require Oklahoma courts to "rely on federal and state law when deciding cases" and "forbids courts from considering or using" either international law or Islamic "Sharia" religious law, which the amendment defined as being based on the Koran and the teachings of the Prophet Mohammed.[32]

In November 2010, a federal judge in Oklahoma issued an order putting on hold the certification of the ballot measure, to allow the judge more time to consider the constitutional issues raised by the ballot measure, which had been approved by over 70% of Oklahoma voters.[33] While the law was proposed as a measure to prevent the imposition of Sharia-based criminal and divorce law, Rick Tepker, a law professor at the University of Oklahoma School of Law, has noted that the proposed constitutional amendment may have the unwanted side effect of disrupting Oklahoma commercial contracts. He stated that "Oklahoma is getting an increasing amount of business overseas, and if this measure passes, it may make foreign business partners tentative to sign contracts with us."[34]

More recently, a decision came down in the United States District Court for the Eastern District of Michigan on January 14, 2011, in the case of *Kevin J. Murray v. Timothy F.*

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The market for Islamic insurance products — takaful and retakaful — has grown exponentially since its current inception, with double digit growth rates over the past few years. Takaful operators have been set up mainly in the Muslim world, and currently there are more than 80 companies active in the primary insurance business.

In the Murray case, Federal District Judge Lawrence Zatkoff noted that AIG had advertised itself as the market leader in Sharia-compliant financing ("SCF"), i.e., financial and insurance products that comply with certain dictates of Islamic law, so that Islamic adherents would not be prohibited from purchasing the products for religious reasons.

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Geithner and Board of Governors of the Federal Reserve System.[35] In that action, the plaintiff claimed that Federal funds were being used to support Sharia-based insurance activities in the United States in violation of the United States Constitution. Specifically, a legal challenge had been made to the Emergency Economic Stabilization Act of 2008 ("EESA")[36] because some of the EESA funds had gone to American International Group, Inc. ("AIG"). The plaintiff in the case had claimed that because AIG, through its subsidiaries (including Lexington), was offering products that were "Sharia-compliant," the appropriated funds under the EESA going to AIG were being used "to finance Sharia-based Islamic religious activities in violation of the Establishment Clause" of the First Amendment to the US Constitution.[37]

In the *Murray* case, Federal District Judge Lawrence Zatkoff noted that AIG had advertised itself as the market leader in Sharia-compliant financing ("SCF"), *i.e.*, financial and insurance products that comply with certain dictates of Islamic law, so that Islamic adherents would not be prohibited from purchasing the products for religious reasons. The court stated that a prominent example of SCF is "Takaful," and that AIG, through several of its subsidiaries, offered products that complied with Sharia insurance law.[38]

[39]The Court initially denied the Defendants' motion to dismiss the action, holding that the plaintiff has standing to bring an as-applied challenge to the EESA on the basis that the "appropriated funds are being used to finance Sharia-based Islamic religious activities in violation of the Establishment Clause."[40] On cross-motions for summary judgment, however, the *Murray* Court held that there was insufficient evidence to establish that the EESA funds going to AIG had an "unlawful purpose or effect" under the Establishment Clause.

The Court held that the plaintiff had failed to prove that AIG's development and sale of SCF products had resulted in the "instruction of religious beliefs for the purpose of instilling those beliefs in others or furthering a religious mission," and that therefore the plaintiff had failed to "demonstrate that a reasonable observer could conclude that AIG has engaged in religious indoctrination by supplying SCF products" to the general public.[41] The Court also held that plaintiff has "failed to present evidence that would allow a reasonable observer to conclude that the EESA, as applied to the Secretary's purchase of AIG stock, has resulted in religious indoctrination attributable to the government."[42]

Conclusion

As noted, the number of Retakaful companies and contracts will continue to grow throughout the world over the next few years. In particular, there is a growing demand for Sharia-compliant insurance and reinsurance programs in the United States. The parties to retakaful contracts that have agreed to arbitrate their disputes, however, might have difficulty arbitrating those disputes in the United States.[43] First, U.S. arbitrators may not have experience or expertise dealing with retakaful issues. Second, the victor in arbitration may face difficulties trying to enforce the arbitration award in a Sharia law-employing country, especially if the award deviates from what is permissible under Islamic law.[44] Third, there is a growing debate in this country as to the proper role of Islamic insurance and reinsurance products in the marketplace, including legal challenges to the use of takaful or retakaful principles in the interpretation and enforcement of these contracts.

It is clear that in the future there will be a need for attorneys and arbitrators experienced in Islamic insurance and reinsurance law, who are able to handle disputes concerning these unique and interesting contracts. This will present a great opportunity for those who become familiar with the principles of takaful and retakaful and can offer advice and guidance to clients in this developing area.▼

1 The views expressed in this article are those of the author alone and do not necessarily reflect the views of White and Williams LLP, any of its attorneys, or those of its clients. The title of this article is the same as the title for a PowerPoint presentation on some of the same issues set forth herein that the author made before a meeting of the members of the Massachusetts Reinsurance Bar Association on February 9, 2011 in Boston, Massachusetts.

2 *See History of Insurance*, http://en.wikipedia.org/wiki/History of insurance

3 *See Takaful And Retakaful*, https://www.reorient.co.uk/pdfs/takaful_retakaful.pdf.

4 *Id.*

5 *See* FINANCIALISLAM.COM,-http://www.financialislam.com/takaful—-islamic-insurance.html.
6 *See Takaful*, http://en.wikipedia.org/wiki/takaful.
7 *See* M. Ashraf, *Takaful Insurance Business*, ACCOUNTANCY, http://www.accountancy.com.pk/articles.asp?id=157 (June 10, 2005).
8 *See id. See also Tie Your Camel: the Hadith/Proverb*, TIE YOUR CAMEL, http://tieyourcamelco.uk/tap/proverb.
9 *See A Guide to Risk Transfer, Policies of Insurance and Reinsurance*, REACTIONS, http://www.reactionsnet.com/AboutUs/Stub/WhatIsReactions.html.
10 *See Takaful*, http://en.wikipedia.org/wiki/takaful.
11 A Guide to Risk Transfer, Principles of Insurance and Reinsurance, supra.
12 See P. Hodgins and C. Jaffer. *The Future of Takaful: Potholes in the Streets of Gold*?, ISLAMICA, August 2009, https://www.clydeco.com.knowledge/articles/the-future-of-takaful-potholes-in-the-streets-of-gold.cfm.
13 A Guide to Risk Transfer, Principles of Insurance and Reinsurance, supra.
14 *See Takaful And Retakaful*, https://www.reorient.co.uk/pdfs/takaful retakaful.pdf.
15 *See id.*
16 B. Kettell, *A Guide To Islamic Co-Operative Insurance*, http://www.cpifinancial.net/v2/print.aspx?pg=magazine&aid=391.
17 *Id.*
18 *Id.*
19 *See* FINANCIALISLAM.COM, http://www.financialislam.com/takaful—-islamic-insurance.html.
20 *See* A. MULHIM & A. SABBAGH, ISLAMIC INSURANCE — THEORY AND PRACTICE 108. As noted above, the first reinsurance contract on record relates to the year 1370, when an underwriter named Guilano Grillo contracted with Goffredo Benaira and Martino Saceo to reinsure a ship on part of the voyage from Genoa to the harbor of Bruges. Grillo offered to retain the risk on the voyage through the Mediterranean and to transfer to Benaira and Sacca the risk from Cadiz through the Bay of Biscay and along the French coast. *See E. Kopf, Notes on the Origins and Development of Reinsurance 26*, reprinted at http://www.casact.org/pubs/proceed/proceed29/29022.pdf.
21 *See* A. MULHIM & A. SABBAGH, *supra at 108*.
22 *See* B. Kettell, *A Guide To Islamic Co-Operative Insurance*, CPIFINANCIAL, http://www.cpifinancial.net/v2/print.aspx?pg=mapazine&aid=391.
23 *See* M. Billah, *Re-takaful* (Islamic Re-insurance) Paradigm, www.takaful.coop/doc store/takaful/Retakaful%20Paradigm.doc at 3.
24 *See id.*
25 *Id.*
26 *See id.* at 4-5.
27 *Id.* at 5.
28 *See id.*
29 *See Getting in the Game*: *Retakaful in a Changing Environment*, ISLAMICA, 1 www.ae.zawya.com/story.cfm. (March 13, 2007).
30 *Id.*
31 *See AIG Offers First Takaful Homeowners Insurance Product for U.S.*, INSURANCE JOURNAL 1(Dec. 2, 2008) http//www.insurancejournal.com/news/national/2008/12/02/95930. htm. The "Takaful Homeowners Policy" was to be underwritten through RSC member company A.I. Risk Specialists Insurance, Inc., in conjunction with the Lexington Insurance Company, and in association with AIG Takaful Enaya. Headquartered in Bahrain, AIG Takaful Enaya was established in 2006 to provide Takaful products, including accident and health, auto, energy, property, and casualty products. The Takaful Homeowners Policy was to build on "LexElite," the homeowners policy from Lexington that is sold throughout the U.S., and was to be available in all 50 states. *See id.*
32 *See* D. Edwards, *Oklahoma May Have Banned Use of Ten Commandments Along with Sharia Law*, RAW STORY.COM 1 (November 8, 2010) http://www.rawstory.com/rs/2010/11/oklahoma-banned-ten-commandments- sharia-law/
33 *Id.*
34 *Id.*
35 *See Murray v. Geithner et al.*, Civil Action No. 08-15147, United States District Court for the Eastern District of Michigan, slip op.(January 14, 2011).
36 On October 3, 2008, Congress enacted the Emergency Economic Stabilization Act of 2008 ("EESA"), 12 U.S.C. § 5201 et seq., with the following stated purpose: "[T]o immediately provide authority and facilities that the Secretary of the Treasury can use to restore liquidity and stability to the financial system of the United States. . . in a manner that (A) protects home values, college funds, retirement accounts, and life savings; (B) preserves homeownership and promotes jobs and economic growth; (C) maximizes overall returns to the taxpayers of the United States; and (D) provides public accountability for the exercise of such authority." *See Murray*, slip op. at 3. citing 12 U.S.C. § 5201. To accomplish this purpose, the EESA provides the Secretary of the Treasury Department with the authority "to establish the Troubled Asset Relief Program to purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary." *Murray*, slip op. at 3, citing 12 U.S.C. § 5211(a)(1).
37 *Murray*, slip op. at 6.
38 *Id.* The court also noted that in December 2008, AIG had issued a press release announcing the "First Takaful Homeowners Products for U.S.," which stated that "[a]ccording to Ernst & Young's 2008 World Takaful Report, Takaful was estimated to be a $5.7 billion market globally with over 130 providers in 2006. The Takaful market is estimated to be in excess of $10 billion by 2010." Of AIG's approximate 290 subsidiaries, the Court noted that six had engaged in SCF since the enactment of the EESA. Id.
39 *See id.*
40 *Id.*
41 *See id.* at 13-14.
42 *See id* at 19.
43 For an excellent discussion of arbitrating disputes under Sharia-compliant reinsurance products, see the article by Larry P. Schiffer, Alexander M. Kayne and Suman Chakraborty entitled *Arbitrating Disputes In The Retakaful World*, in MEALEY'S LITIGATION REPORT: REINSURANCE, Volume 20, Issue No. 8 (Aug. 21, 2009), *reprinted at* http://www.deweyleboeuf.com/~/media/Files/inthenews/2009/20090824 ArbitratingDisputes.ashx.
44 *See* A.Imoisili, *Get The Facts On Dispute Resolution Before Entering Into A Takaful Venture*, NATIONAL UNDERWRITER PROPERTY & CASUALTY, http://www.milbank.com/NR/rdonlyres/68D54F33-8FC3-4409-83F7-9D0EE974340010/102609 NUCO Aluya Imoisili.pdf (October 26, 2009).

It is clear that in the future there will be a need for attorneys and arbitrators experienced in Islamic insurance and reinsurance law, who are able to handle disputes concerning these unique and interesting contracts. This will present a great opportunity for those who become familiar with the principles of takaful and retakaful and can offer advice and guidance to clients in this developing area.

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

George A. Cavell can now be contacted at 540 Palmer Farm Drive, Yardley, PA 19067, phone 215-266-0723, email gc540@comcast.net.

Thomas A. Rush II has a new address at 403 Vixen Place, Lincoln University, PA 19352, phone 215-589-5142, email trushatty@yahoo.com.

Paul R. Koepff has relocated to Clyde & Co US LLP, The Chrysler Building, 405 Lexington Avenue, 16th Floor, New York, NY 10174, phone 212-710-3945, fax 212-710-3950, email paul.koepff@clydeco.us.

Maria Orecchio has also moved over to Clyde & Co US LLP. She is also located in The Chrysler Building, 405 Lexington Avenue on the 16th Floor, New York, NY 10174. Her phone is 212-710-3971, email maria.orecchio@clydeco.us.

Michael W. Pado is now Chief Executive Officer of Aurigen U.S.A. Holdings Inc., 125 Half Mile Road, Suite 200, Red Bank, NJ 07701- 6749.

David L. Fox has been named a partner at the New York office of Smith, Gambrell & Russell, LLP. His new phone number is 212-907-9725.

Savannah Sellman has joined MedAmerica Mutual Risk Retention Group as Executive Vice President and Corporate Counsel. She remains affiliated with Clyde & Co as Of Counsel. In that capacity, she will continue her arbitrator practice, which should benefit from her additional qualification as an active officer of an insurance company.▼

feature

Managing Discovery in Arbitration: Bob Dylan & the Asymmetry Principle

This article is based on a paper presented at the ARIAS•U.S. 2011 Spring Conference.

David A. Attisani
Ethan V. Torrey

I. Introduction

Two purported truisms animate the longstanding discourse regarding discovery in reinsurance arbitration. First, there is a pervasive assumption that discovery can and should be circumscribed in some equitable way, in order to address profligate practices. Second, in many (but not all) cases, there is a presumption that the reinsurer is in greater need of more extensive discovery than its cedent. The primary purpose of this brief thought piece is to surface and explore the tension between the assertedly widespread wish to limit discovery and the parties' (sometimes) asymmetrical needs for its putative benefits.

Otherwise stated, when the relevant information in both parties' possession is in rough parity, they may share a mutual interest in limiting the scope of discovery, which may assist the panel in structuring a more efficient arbitration proceeding. In such cases, broad-ranging discovery requests can be deterred by the prospect of "mutually-assured destruction" — *i.e.*, onerous discovery requests propounded by one side will only precipitate like demands, implicating similar burdens and expense, from the adversary. However, when one party enters the process with a far greater volume of potentially relevant information, the parties' mutual interests cannot easily be leveraged to achieve an efficient proceeding, and other means must be considered. In the prescient words of Bob Dylan: "When you ain't got nothin', you got nothin' to lose."[2] The party with "nothing," of course, lacks incentive to stanch the free flow of discovery. Accordingly, it is incumbent upon parties, lawyers, and arbitrators to consider creative mechanisms to achieve the efficiency long-touted as one of arbitration's most attractive hallmarks.

This article proposes that parties and arbitrators consider a more disciplined approach to structuring arbitrations to achieve such efficiencies, even when the parties' interests in managing discovery may not be seamlessly aligned. More specifically, practitioners have at their disposal two under-utilized procedural devices that can be used to narrow or eliminate disputed issues — bifurcation of proceedings and summary adjudication.

II. Bifurcation

Bifurcation presents opportunities to streamline the arbitration process by eliminating wasteful inquiry into areas of potential dispute that may ultimately prove inconsequential.[3] It is, of course, most commonly used to partition the liability and damages phases of an arbitration. In simplest terms, a finding of no liability obviates the need for any damages phase — an exercise that generally necessitates costly fact (and, often, expert) discovery. Bifurcation can also be used to precipitate a finding on one issue that may control or portend the outcome of a second disputed issue. See Alcatel Space, *S.A. v. Loral Space & Communications, Inc.*, No. 02 Civ. 2674 (SAS), 2002 U.S. Dist. LEXIS 11343 at **5-6 (S.D.N.Y. June 25, 2002). In *Alcatel*, for example, the parties segregated selected liability issues, such as the termination date of the contract and its alleged breach, from other liability issues — including tortious conduct in connection with the same contracts.[4]

Bifurcation can also be effective in resolving jurisdictional and choice-of-law issues. *See, e.g.*, Gary Born, *International Commercial Arbitration 1816* (2009) ("The efficient organization of the parties' presentation of disputed issues sometimes occurs by identifying preliminary or 'cut-across' issues, whose resolution will avoid wasted effort

CONTINUED ON PAGE 16


David A. Attisani

Ethan V. Torrey


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David Attisani is Chairman of the Insurance & Reinsurance Practice Group at Choate Hall & Stewart LLP, where he has practiced for the past eighteen years. Ethan Torrey is a partner in the same Group.

Although often discussed, summary adjudication is used sparingly in reinsurance arbitration, despite the hospitable legal landscape supporting its employment. A number of courts have confirmed arbitration awards, after a panel has awarded summary judgment with respect to purely legal issues.

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and expense. Typical examples of this are jurisdictional issues, choice-of-law questions, and separation of liability and damages."). Resolution of these "gatekeeper" issues may eliminate the need for discovery into other areas, provided that the Panel is both adept in these areas and declines to dismiss them as procedural technicalities aloof from the commercial dispute properly submitted to industry arbitrators.[5]

Bifurcation will be ineffective, however, if it results only in reordering events without eliminating issues subject to discovery. *E.g. Halliburton Energy Servs., Inc. v. NL Indus.*, 553 F.Supp.2d 733 (S.D. Tex. 2008) (confirming arbitration award where panel bifurcated proceedings into two phases relating to [1] a restructuring plan and [2] allocation of environmental remediation costs among various parties, and it permitted supplementation of the record as to the earlier contract phase during the second allocation phase); *Marathon Oil Co. v. Arco Alaska, Inc.*, 972 P.2d 595 (Alaska 1999) (affirming order declining to vacate arbitration award, where panel altered its decision concerning liability in later damages phase of arbitration). Arbitrators should be circumspect in their review of a party's request for (what amounts to) rehearing of an earlier phase of the case, even if the courts have generally declined to vacate in the wake of retrospective modifications. Otherwise, bifurcation amounts to temporarily re-arranging the deck chairs on a ship bound for all of the same ports — *i.e.*, there will be no net discovery saving.

III. Summary Adjudication

Early decision on contract provisions, waiver, governing law, preclusion, or other issues can, in some cases, resolve selected substantive claims and defenses. Although often discussed, summary adjudication is used sparingly in reinsurance arbitration, despite the hospitable legal landscape supporting its employment. A number of courts have confirmed arbitration awards, after a panel has awarded summary judgment with respect to purely legal issues. *E.g., Sherrock Bros., Inc. v. DaimlerChrysler Motors Co.*, No. 06-4767, 260 Fed.Appx. 497, 2008 U.S. App. LEXIS 282 (3d Cir. Jan. 7, 2008). In *Sherrock Bros.*, for example, the Third Circuit Court of Appeals concluded that arbitrators did not violate Sections 10(a)(3) and (4) of the FAA when they determined—-on summary process — that the doctrines of res judicata, collateral estoppel, and waiver precluded the subject claims. The Court said:

> [A]n arbitrator is empowered to grant *any* relief reasonably fitting and necessary to a final determination of the matter submitted to him, including legal and equitable relief . . .. . . We will decline to find the arbitrators' decision to grant summary judgment irrational where they concluded no disputed facts were present and the disposition was based on legal doctrines that were resolved on written submission.

Id. at **12-14 (emphasis in original). *See also Vento v. Quick & Reilly, Inc.*, No. 04-1413, 2005 U.S. App. LEXIS 6986 (10th Cir. Apr. 20, 2005) (affirming trial court's approval of panel's decision as a matter of law, and dismissing plaintiff's claim with prejudice); *Sheldon v. Vermonty,* 269 F.3d 1202, 1206 (10th Cir. 2001) (FAA § 10(a)(3) did not preclude an arbitrator from granting a motion to dismiss "facially deficient claims with prejudice").

Courts have, of course, also upheld arbitration awards granting summary judgment on grounds other than preclusion or waiver principles. *E.g., Hodgson v. IAP Readiness Mgmt. Support*, No. 5:lOcv86/RS/MD, 2010 U.S. Dist. LEXIS 106095 at *13 (N.D. Fla. Sept. 20, 2010) (refusing to vacate summary arbitration award with respect to the alleged breach of an employment contract, and concluding that "summary judgment is permissible in arbitration"); *Campbell v. American Family Life Assurance Co. of Columbus, Inc.*, 613 F. Supp.2d 1114 (D. Minn. 2009) (denying motion to vacate arbitration award, specifying that insurer did not violate sales coordinator agreement with its employees, for refusal to hear pertinent and material evidence under FAA § lo(a)(3), and concluding that "summary judgment is permissible in arbitration").[6]

There are a number of reasons why summary adjudication—which can be used to great effect in reinsurance disputes—has not been employed pervasively. First, although the FAA and most arbitration provisions do not require arbitrators to hold a full evidentiary hearing, the behavior of some panels evinces their concern at running afoul of the codified proscriptions against "exceed[ing] their powers" and refusing to hear "evidence pertinent and material to the controversy." 9 U.S.C. § 10(a)(3), 10(a)(4). As noted, these worries cannot—in the abstract—be dismissed as entirely fictional. *Supra* at n.6; *Chem-Met Co. v. Metaland Int'l. Inc.*, 1998 WL 35272368 at *4.[7]

On the other hand, it is important to observe that, absent a governing arbitration rule to the contrary, courts do not vacate awards solely because they emanate from summary process, and that (more broadly) vacatur of summary awards is anomalous. See *TIG Ins. Co. v. Global Int'l Reinsurance Co.*, 640 F.Supp.2d 519 (S.D.N.Y. 2009). In TIG, the federal trial court confirmed an arbitration award granting partial summary judgment in favor of a ceding company with respect to its reinsurer's fraud and bad faith claims. The court concluded that "[a]rbitrators. . . have great latitude to determine the procedures governing their proceedings and to restrict or control evidentiary proceedings, and thus may proceed with only a summary hearing and with restricted inquiry into factual issues." *Id.*. at 523. *See also Brooks v. BDO Seidman, LLP*, No. 09-107884, 2011 N.Y. Misc. LEXIS 834 (N.Y. Sup. Ct. Feb. 22, 2011) (confirming arbitration award that rendered summary judgment for accounting firm in fee dispute with former client and rejecting argument that rendering summary judgment on the merits constituted arbitrator misconduct); RAA Manual for the Resolution of Reinsurance Disputes at 47 (2010) ("During the pre-hearing period, after review of the parties' briefs, the panel should consider whether a formal hearing is necessary. If a full and fair decision can be reached on the basis of the briefs, depositions, affidavits, and other documentary evidence, the panel should suggest that the parties proceed without a hearing."). Those cases that do memorialize vacatur of a summary award are often driven by unusual facts and practices not often employed by sophisticated reinsurance arbitrators in complex cases. In *Chem-Met*, for example, "the arbitrators admitted no documents into evidence," and entered judgment without a written opinion. *Chem-Met*, 1998 WL 35272368 at *2.

In general, "there is a trend towards greater efforts to reduce cost and delay in arbitration, and one can anticipate that summary dispositions will gain wider currency in the future. . . .There should be no doubts concerning a tribunal's authority (absent contrary agreement and subject to permitting the parties an opportunity to be heard) to make awards based on a dispositive motion." Born, *International Commercial Arbitration* at 1817 & n.417. In other words, in appropriate cases — and after ensuring that each party's right to present an essential quantum of evidence is safeguarded — reinsurance arbitrators can afford to employ summary adjudication with more zeal and less trepidation.

A second impediment derives from the principle that arbitration is a creature born of mutual consent, and there is a variety of reasons why one party may object to summary process. *E.g. Granite Rock Co. v. International Bhd. of Teamsters*, 130 S.Ct. 2847, 2857 (2010) ("arbitration is strictly a matter of consent"); *Volt Info. Sciences v. Board of Trustees*, 489 U.s. 468, 479 (1989) ("Arbitration under the [Federal Arbitration] Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit... [T]hey may... specify by contract the rules under which that arbitration will be conducted."). For example, a party whose case turns on evidence extrinsic to the relevant contract might seek to avoid a process that arguably limits the scope of discovery and ostensibly leaves the panel to decide in a vacuum with only the relevant wording to guide it. A deft panel should, however, dig deeper. There is no reason why a svelte pre-summary adjudication discovery period cannot embrace all issues relevant to interpreting the relevant contract provision(s) — including any extrinsic evidence emanating from placing/renewal materials and the parties' course of dealing — and it may cost a fraction of the discovery expense required to support a one- to two-week evidentiary hearing.

Third, a party may be reluctant to commit to a potentially duplicative summary "process within a process," in the incipiency of an arbitration — particularly in light of the presumed reluctance of some arbitrators to issue a summary award.[8] In fact, delay is hard-wired into the arbitration process, which features (not a "notice pleading" regime, but) a "no-pleading" regime, followed by a potentially non-substantive organizational meeting at which each party may seek to avoid being tethered to substantive positions or procedural commitments. One solution is to select and reserve a date for a summary adjudication hearing at the organizational

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meeting, subject to the parties' and the panel's later analysis of its potential usefulness. A number of factors should be considered, including: identification of issues that rationally can be severed for separate adjudication; the likelihood that materially limited discovery will, in fact, put the panel in a position to decide the issue(s) submitted to summary process; and whether the requested summary award would dispose of (or narrow) significant issues in dispute. When these rudimentary questions can be answered in the affirmative, summary adjudication may effectively limit discovery and precipitate a fair outcome that is not unusually vulnerable to challenge. For example, a reinsurance dispute might involve issues pertaining to aggregation, allocation, late notice, choice of law, or potential cover for declaratory judgment expenses. Any one of these issues may, in an appropriate case, represent a substantial portion of the disputed liability, making it a candidate for bifurcation or summary adjudication.9

IV. Conclusion

As this discussion and the collective industry experience attest, streamlining discovery is a laudable goal that is fraught with perceived impediments. Asymmetric institutional information — a feature often endemic to reinsurance arbitrations — can eliminate the salutary deterrence that might otherwise organically limit both the scope of parties' discovery battles and the associated time and expense. In short, Dylan's observation "when you ain't got nothin', you got nothin' to lose" — was right, as far as it goes. But the dynamic of asymmetrical discovery needs and objectives in reinsurance arbitration can be (and has been) addressed effectively.

The most promising approach to the problem is to downsize the task by carefully structuring a sequential arbitration process — in which the panel and the parties: (1) order disputed issues with care; (2) take targeted discovery culminating (if appropriate) in one or more summary hearings; and (3) maximize the use of discovery material elicited at each phase. Techniques such as bifurcation and summary adjudication do not depend for their efficacy on the parties' mutual interest in prodigious discovery, and they can be effective even though the parties' discovery needs and objectives may vary materially. A party with little discoverable information might arguably have nothing to lose by launching an onerous array of discovery demands in a conventional reinsurance arbitration, but an efficient and creative structuring of the process may well leave such a party with little or "nothin' to gain" by doing so.▼

1 The views articulated in this document do not necessarily reflect the positions of Choate, Hall & Stewart LLP or its clients.

2 See http://en.wikipedia.org/wiki/Like_a_Rolling _Stone (last visited Mar. 31, 2011).

3 Certain arbitration rules expressly authorize and arguably seek to encourage bifurcation. See. e.g., AAA Rule 30(b) (arbitrators "may ... bifurcate proceedings and direct the parties to focus their presentations on issues the decision of which could dispose of all or part of the case"); CPR Rule 9.3a (arbitrators may consider "the desirability of bifurcation or other separation of the issues in the arbitration."). Other rules permit the panel to issue "interim, interlocutory, or partial awards." See, e.g., UNCITRAL Arbitration Rules, Rule 32.1; London Court of International Arbitration Rules, Art. 26.7 ("[t]he Arbitral Tribunal may make separate awards on different issues at different times"). See also RAA, Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes §13.1 (2009) ("The Panel may hear and decide a motion for summary disposition of a particular claim or issue, either by agreement of all Parties or at the request of one Party, provided the other interested Party has reasonable notice and opportunity to respond to such request.").

4 The ICC panel rendered an award in Phase I of the arbitration, and the court confirmed it. The court noted that "[am interim award that finally and definitely disposes of a separate, independent claim may be confirmed notwithstanding the absence of an award that finally disposes of all claims that were submitted to arbitration. As neither party has identified any claim in the Phase I award that is not severable from the claims that will be addressed in Phase II, the Award is hereby confirmed." Id. at *15.

5 Reasonable minds can differ on this one, and the scope of the applicable arbitration clause may militate in favor of (or against) the view that the province of an industry panel is sufficient in breadth to embrace all aspects of a dispute, including jurisdiction and governing law.

6 Needless to say, summary awards must — like any other award — safeguard the arbitral parties' rights under the FAA and other governing arbitration rules, in order to insulate them from vacatur. *See, Chem-Met Co. v. Metaland Int'l, Inc.*, No. Civ. A. 96-2548, 1998 WL 35272368 at *4 (D. D.C. Mar. 25, 1998) (vacating arbitration award because governing AAA Commercial Arbitration Rules required an evidentiary hearing and the arbitrators exceeded theft powers under FAA § 10(a)(4), and refused to hear material evidence under FAA § 10(a)(3) when they awarded summary judgment); *Prudential Sees., Inc. v. Dalton*, 929 F. Supp. 1411, 1417 (ND. Okla. 1996) (vacating NASD arbitration award that dismissed plaintiff's claims without holding evidentiary hearing, under FAA § 10(a)(3) and (4)(c)).

7 Whether summary adjudication and preliminary issues hearings are available depends, of course, on the facts of any individual case, and some commentators have noted that dispositive issues may, in particular circumstances, best be determined in the context of a full factual record. See, e.g., Redfern & Hunter, *Law And Practice Of International Commercial Arbitration* 315 (1991) ("It may emerge, however, that the correct legal interpretation to be put upon the clause which limits or purports to limit liability depends upon the factual situation, and that to ascertain and understand this factual situation adequately it is necessary to enquire fully into all circumstances of the case, with the assistance of expert witnesses on each side."); *see also* RAA Manual for the Resolution of Reinsurance Disputes at 47 ("In a complex case, briefs may not be enough.").

8 From empirical experience, the authors do not share any such generic presumption.

9 Parties to English arbitrations may seek to convene a "preliminary issues" hearing with respect to any legal issue that may narrow or eliminate potential subjects of discovery. The English Arbitration Act permits application to a court, in order to "determine any question of law arising in the course of the proceedings which the court is satisfied substantially affects the rights of one or more of the parties," unless otherwise agreed by the parties. *See* English Arbitration Act § 45(1). Unlike bifurcation and summary judgment, however, preliminary issues hearings require a trip to courts, which may nullify some of the savings in time and money otherwise realized through summary process in arbitration. *Cf.* Ned Beale, Lisa Nieuwveld & Matthijs Nieuwveld, Summary Arbitration Proceedings: A Comparison Between The English And Dutch Regimes, *Arbitration International*, Vol. 26, No. 1, 139, 144-45 (2010) ("Arguably, the general procedural discretion conferred upon the tribunal is wide enough to permit the summary disposition of claims" in English arbitrations, but noting that the English Arbitration Act does not expressly permit summary adjudication).

In short, Dylan's observation "when you ain't got nothin', you got nothin' to lose" — was right, as far as it goes.

update

Case Law and Articles on Arbitrator Disclosure and Arbitrator Bias

This article is based on a paper presented at the ARIAS•U.S. 2011 Spring Conference.

Teresa Snider
Eric A. Haab

A list of some of the recent cases and some of the leading federal court opinions that illustrate the jurisprudence on the issues of arbitrator disclosure and bias is set forth below. The list and accompanying summaries are not meant to be exhaustive, as a great deal has already been written on this subject. For those interested in additional information, a number of recent articles that provide a more comprehensive discussion of the case law or of particular recent cases are listed following the cases.

U.S. Supreme Court

Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U.S. 145, 89 S. Ct. 337 (1968). The Supreme Court reversed the lower courts' refusal to set aside an arbitration award where the neutral arbitrator, an engineering consultant, failed to disclose that one of the parties to the arbitration was a regular customer of the neutral arbitrator. In the plurality opinion, the Court referred to both the "evident partiality" and "undue means" provisions of Section 10 of the Federal Arbitration Act ("FAA") in setting aside the award without specifying upon which of those provisions it relied in rendering its decision. In his concurring opinion, Justice White noted that "arbitrators are not automatically disqualified by a business relationship with the parties before them if both parties are informed of the relationship in advance, or if they are unaware of the facts but the relationship is trivial."

Second Circuit Cases[2]

Applied Industrial Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi, A.S., 492 F.3d 132 (2d Cir. 2007) (affirming district court's decision vacating arbitration award). The Second Circuit Court of Appeals concluded that "if we are to take seriously Justice White's statement that 'arbitrators are not automatically disqualified by a business relationship with the parties before them if both parties are informed of the relationship in advance, or if they are unaware of the facts but the relationship is trivial,'... arbitrators must take steps to ensure that the parties are not misled into believing that no nontrivial conflict exists. It therefore follows that where an arbitrator has reason to believe that a nontrivial conflict of interest might exist, he must (1) investigate the conflict (which may reveal information that must be disclosed under *Commonwealth Coatings*) or (2) disclose his reasons for believing there might be a conflict and his intention not to investigate." *Id*. at 138 (citation and emphasis omitted).

Morelite Construction Corp. v. New York City District Carpenters Benefit Funds, 748 F.2d 79, 84 (2d Cir. 1984) (holding that "'evident partiality'... will be found where a reasonable person would have to conclude that an arbitrator was partial to one party in the arbitration"). The Court held that, although the party moving to vacate an arbitration award must show more than an appearance of bias, proof of actual bias is not required. *Id.*

Andros Compania Maritima, S.A. v. Marc Rich & Co., A.G., 579 F.2d 691, 701 (2d Cir. 1978) (explaining that "a principal attraction of arbitration is the expertise of those who decide the controversy. Expertise in an industry is accompanied by exposure, in ways large and small, to those engaged in it").

Scandanavian Reinsurance Co. v. St. Paul Fire & Marine Insurance Co., 732 F. Supp. 2d 293 (S.D.N.Y. Feb. 23, 2010) (holding that failure of party-arbitrator and umpire to disclose that they had served on a panel involving a dispute between one of St. Paul's successors that involved contracts and witnesses that

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Teresa Snider is a partner at Butler Rubin Saltarelli & Boyd LLP. Eric A. Haab is a partner at Foley & Lardner LLP.

The resulting standard is that in nondisclosure cases, an award may not be vacated because of a trivial or insubstantial prior relationship between the arbitrator and the parties to the proceeding. The 'reasonable impression of bias' standard is thus interpreted practically rather than with utmost rigor." *Id.* at 283.

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overlapped with the instance dispute merited vacating the award on the basis of evident partiality) (appeal pending).

Arrowood Indemnity Co. v. Trustmark Insurance Co., No. 3:03-CV-1000(PCD) (D. Conn. Feb. 2, 2010) (refusing to stay remand to arbitration panel and rejecting argument that one party's choice of the umpire as a party-appointed arbitrator in unrelated cases showed bias or evidenced an improper relationship between the party and the umpire in the current proceeding).

Third Circuit Cases

Kaplan v. First Options of Chicago, 19 F.3d 1503, 1523 n.30 (3d Cir. 1994) (holding that evident partiality requires "proof of circumstances 'powerfully suggestive of bias'") (citation omitted).

Ario v. Cologne Reinsurance (Barbados) Ltd., Civil No. 1:CV-98-0678, 2009 U.S. Dist LEXIS 106133 (M.D. Pa. Nov 13, 2009) (granting motion to confirm arbitration award, holding that panel member's disclosure of appointment in another proceeding is timely if made while proceedings were still pending before the panel, and concluding that "there is no evident partiality from an arbitrator's accepting a position as an umpire in another, unrelated arbitration while the current arbitration is still ongoing, even if that position was partially obtained by the action of a party-appointed arbitrator, or is a position in an arbitration where one of the parties is an affiliate of a party to the current arbitration").

Fifth Circuit Cases

Positive Software Solutions, Inc. v. New Century Mortgage Corp., 476 F.3d 278 (5th Cir. 2007) (holding arbitrator's failure to disclose trivial connection to attorney for one of the parties did not justify vacating the award) (en banc). The Fifth Circuit Court of Appeals concluded that "the better interpretation of *Commonwealth Coatings* is that which reads Justice White's opinion holistically. The resulting standard is that in nondisclosure cases, an award may not be vacated because of a trivial or insubstantial prior relationship between the arbitrator and the parties to the proceeding. The 'reasonable impression of bias' standard is thus interpreted practically rather than with utmost rigor." *Id.* at 283.

Dealer Computer Services, Inc. v. Michael Motor Co., No. H-10-2132, 2010 WL 5464266 (S.D. Tex. December 29, 2010) (granting motion to vacate where party-appointed neutral arbitrator had previously served on an arbitration panel between the plaintiff and another automobile dealership and, although arbitrator disclosed she had served on a three-person panel in the prior arbitration, she failed to disclose that the prior arbitration involved the same issues of contractual interpretation and damages calculation, as well as related witnesses) (appeal pending).

Sixth Circuit Cases

Nationwide Mutual Insurance Co. v. Home Insurance Co., 429 F.3d 640, 645 (6th Cir. 2005) (affirming confirmation of award, reiterating rejection of appearance of bias standard, and requiring that party alleging partiality "establish specific facts that indicate improper motives on the part of the arbitrator") (citation omitted).

Apperson v. Fleet Carrier Corp., 879 F.2d 1344, 1358 (6th Cir. 1989) (adopting objective test and rejecting appearance of partiality test for evident partiality).

Seventh Circuit Cases

Trustmark Insurance Co. v. John Hancock Life Insurance Co. (U.S.A.), 631 F.3d 869, 873 (7th Cir. 2011) (overturning district court's grant of preliminary injunction, ruling that knowledge relevant to the dispute that was acquired as an arbitrator in a prior arbitration, even if subject to confidentiality, is not a disqualifying interest and citing *Sphere Drake Insurance Ltd. v. All American Life Insurance Co.*, 307 F.3d 617, 622 (7th Cir. 2002) for the proposition that "'evident partiality' for arbitrators means acts that simultaneously show support for one side and disregard the rules; party-appointed arbitrators can't be dismissed on the ground that they are inclined to support the party who named them").

Sphere Drake Insurance Ltd. v. All American Life Insurance Co., 307 F.3d 617, 621 (7th Cir. 2002) ("[O]nly evident partiality, not appearance or risks, spoils an award."). The Seventh Circuit Court of Appeals reversed the district court's decision granting a motion to vacate an arbitration award, holding that failure of party-appointed arbitrator to make a full disclosure regarding his representation of party's subsidiary in prior unrelated arbitration did not demonstrate "evident partiality" under Section 10(a)(2) of the FAA.

Merit Insurance Co. v. Leatherby Insurance Co., 714 F.2d 673 (7th Cir. 1983) (reversing district court's decision vacating arbitration award where the neutral arbitrator failed to disclose that he had worked for the president of one of the parties to the arbitration while both were employed at another company).

Midwest Generation EME, LLC v. Continuum Chemical Corp., No. 08 C 7189, 2010 WL 2517047, at * 5 (N.D. Ill. June 21, 2010) (refusing to permit post-arbitration discovery and explaining that "only nonspeculative, reasonably certain evidence of impropriety will suffice to allow post-arbitration discovery" of arbitrator's alleged bias).

Trustmark Insurance Co. v. Clarendon National Insurance Co., No. 09 C 6169, 2010 WL 431592 (N.D. Ill. Feb. 1, 2010) (refusing to disqualify party-arbitrator because of "fear of a future breach" of the confidentiality agreement from a prior arbitration).

Employers Insurance Company of Wausau v. Certain Underwriters at Lloyds of London, No. 09-cv-201-bbc, 2009 WL 3245562, at *4 (W.D. Wis. Sept. 28, 2009) (refusing to disqualify arbitrator because respondents did not show that arbitrator was "partial" or "non-neutral" on the basis of allegations that arbitrator engaged in ex parte communications with petitioner concerning the merits of the reinsurance dispute and that arbitrator was beholden to petitioner's parent company because arbitrator was certified as an arbitrator by ARIAS and senior counsel for petitioner's parent company was the vice president of ARIAS).

Ninth Circuit Cases

New Regency Productions, Inc. v. Nippon Herald Films, Inc., 501 F.3d 1101 (9th Cir. 2007) (affirming district court's decision vacating an arbitration award where the arbitrator failed to investigate or disclose possible conflicts arising from his acceptance of employment with a company in negotiations with one of the parties). In reaching its decision, the Court utilized a "reasonable impression of partiality" standard, explaining that an arbitrator "may have a duty to investigate independent of [his] ... duty to disclose." *Id.* at 1106.

Schmitz v. Zilveti, 20 F.3d 1043, 1047 (9th Cir. 1994) (vacating award where arbitrator did not investigate of disclose his law firm's long-time representation of parent company of party, adopting a "reasonable impression of partiality" standard, and suggesting that an arbitrator might have an affirmative duty to investigate).

Arora v. TD Ameritrade, Inc., No. CV 10-01216 CW, 2010 U.S. Dist. LEXIS 84856 (N.D. Cal., July 26, 2010) (holding that allegations of casual small talk between arbitrations and one of the parties during a hearing are not sufficient to establish evident partiality or actual bias).

Articles[3]

Daniel L. FitzMaurice, *Trustmark v. Hancock: A Significantly Flawed Decision with the Potential to Wreak Havoc for Confidentiality Agreements in Arbitration*, Mealey's Litigation Reports: Reinsurance, Vol. 20, No. 22 (March 19, 2010) (analyzing district court's decision).

Paul Janaskie and Steven McNutt, *When Does an Arbitrator's Failure to Disclose Prior Relationships Constitute "Evident Partiality" Under the Federal Arbitration Act,* Mealey's Litigation Reports, Reinsurance, Vol. 17, No. 8 (August 17, 2006)

Wm. Gerald McElroy, Jr., *Navigating the Ethical Thicket in Reinsurance Arbitrations, ARIAS•U.S. Quarterly*, Vo. 18, No. 1 (First Quarter 2011)

Steven C. Schwartz and David Wax, *Arbitrator Disclosure Requirements and Enforceability of Awards, New York Law Journal* (October 22, 2010)

Brian Silbernagel, *Pre-Award Disqualification of Biased Arbitrators Under the FAA*, Mealey's Litigation Reports: Reinsurance, Vo. 21, No. 6 (July 23, 2010)

Kathryn A. Windsor, *Defining Arbitrator Evident Partiality: The Catch-22 of Commercial Litigation Disputes*, 6 Seton Hall Cir. Review 191 (Fall 2009)▼

2 Cases decided by the various federal courts of appeal are listed in reverse chronological order under each heading, followed by district court cases from within that circuit (again, in reverse chronological order).

3 Articles are listed alphabetically by author's last name

Employers Insurance Company of Wausau v. Certain Underwriters at Lloyds of London...(refusing to disqualify arbitrators because respondents did not show that...arbitrator was beholden to petitioner's parent company because arbitrator was certified as an arbitrator by ARIAS and senior counsel for petitioner's parent company was the vice president of ARIAS).

2011 Spring Conference Resets Agenda for the Future

Supported by the largest ARIAS•U.S. faculty assembled to date, the 2011 ARIAS•U.S. Spring Conference took a zero-based look at the world of reinsurance disputes and arbitration, both today and in the future, delivering on the theme of "**Hitting the Reset Button: A New Start**." The conference attracted 322 total participants (including nine non-member speakers who joined just for specific events). In addition, 32 spouses and guests attended the food events and recreational activities.

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Chairman Daniel FitzMaurice
welcomes attendees

Mary Lopatto welcomes
Senator LeMieux

Keynote Speaker
Senator George LeMieux

Clients Provide Their Perspectives...

From left, Stephanie Dunn, Michael Frantz, Mark Megaw, David Sobotka, Alysa Wakin, with Moderator Ann Field

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After a welcome by Chairman **Daniel FitzMaurice**, the conference began Wednesday afternoon with a keynote address by former U.S. Senator from Florida **George LeMieux**. The senator described his relevant involvement with insurance industry issues and emphasized several of his basic political imperatives that are affecting insurance and the economy, in general.

The session then moved quickly into fundamental issues affecting arbitration today, with **Ann Field** of Zurich moderating a panel of key company people who laid out the critical factors they consider when analyzing disputes and strategizing resolutions. Company perspectives were presented by **Stephanie Dunn** of Transamerica, **Michael Frantz** of Munich Re, **Mark Megaw** of ACE, **David Sobotka** of Guy Carpenter, and **Alysa Wakin** of Odyssey Re.

Following a break, attendees returned to the general session room, where **Edward Krugman** prepared them for the upcoming mock arbitration breakouts. Using slides and videos, Mr. Krugman emphasized the key elements of the fact pattern and showed

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testimony from relevant underwriters in the scenario.

The fact pattern, which had been distributed two weeks in advance to registrants, focused on the role of the intent of underwriters who were involved in preparing the original contract. This fact pattern, created by Mr. Krugman, was the most in-depth and extensive (30 pages) mock arbitration situation that ARIAS•U.S. had ever presented for a training session. With crucial elements highlighted and testimony observed in videos, attendees broke up into four rooms, where the two sides of the dispute were simultaneously argued by attorneys in front of four arbitrator panels.

After full discussions in the four rooms, the panels met privately to deliberate and decide on their awards. On Thursday morning, the four umpires, moderated by **Nick DiGiovanni**, announced the decisions: all four panels found for the reinsurer, Emerald Re. They discussed the factors that influenced these decisions, offering an interesting window into the ways that different considerations can lead to similar results. The umpires were **Sylvia Kaminsky**, **Tom Tobin**, **Caleb Fowler**, and **Elizabeth Thompson**.

The conference then focused in on the "New Start" theme by examining "**What the Future Holds**" in terms of the disputes that can be expected to come out of the types of policies written in the past decade. **Dennis Kerrigan** of Zurich led a panel of company people consisting of **Scott Birrell** of Travelers, **Nicholas Canelos** of General Re, **Eric Kobrick** of AIG and **Elizabeth Mullins** of Swiss Re. They examined the types of disputes that are developing from these recent policies and what the industry can anticipate as a result of newer risks, the smaller reinsurance market, the difficult economy, and emerging claim trends.

The final panel on Thursday morning aggressively pursued the central complaint about arbitration and techniques to solve it. In "**Controlling**

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Extrinsic Evidence

Edward Krugman lays out the fact pattern

Mock Arbitrations Demonstrated the Role of Underwriting Intent.

Arbitrators: David Thirkill, Sylvia Kaminsky, and Susan Mack...Attorneys: William O'Neill and Jane Byrne.

Attorneys: James Rubin and John Nonna... Arbitrators: Thomas Tobin, Mark Gurevitz, and Mark Wigmore

Attorneys: Michael Knoerzer and David Raim...Arbitrators: Caleb Fowler, Susan Claflin, and Thomas Orr

Attorneys: Peter Chaffetz and Mary Lopatto... Arbitrators: Linda Barber, Elizabeth Thompson, and Thomas Stillman

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Discovery," **Edward Krugman** moderated a team of arbitration veterans who sought to give realistic advice about how to reign in runaway costs. **David Attisani**, **Jonathan Bank**, **Mary Ellen Burns**, **Robert Hall**, and **Susan Stone** explored proactive management of the discovery process, including serious upfront planning and early issue spotting. They also covered the circumstances in which such controls are likely to work and when the panel should let the parties and their counsel resolve issues themselves.

Friday morning "Hit the Reset Button" regarding the emerging insurance and reinsurance markets in Latin America. Liberalization and deregulation of insurance in various countries of the region have opened up markets and expanded capacity in recent years. **David Bradford** of Zurich Financial Services moderated a discussion among **Anthony Phillips** of Willis Re, **Robert Romano** of Locke Lord, **Gustavo Scheffler** of Odyssey Re, and **Javier Vijil** of Transatlantic. Featured were the advantages of recent changes and the challenges presented within the key countries.

The remainder of Friday morning consisted of four workshops that analyzed different aspects of current and future developments. Each attendee had indicated his/her choice of two at registration. Workshops were repeated so that everyone was able to attend two sessions. All workshops were well attended. The following topics were presented:

- **The Stolt-Nielsen Decision – The Future of Consolidation of Arbitrations and other Procedural Controls**

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After Hours…

Glimmer Terrace provided the venue for further discussion of the day's sessions.

Daniel Neppl, Ann Fields, Mark Megaw, Mary Ellen Burns, and Sylvia Kaminsky

Wednesday's reception was sponsored by Merrill Corporation.

Mary Lopatto, Paul Aiudi, Lydia Kam Lyew, and Marc Abrams

After Hours...

Dennis Kerrigan, Paul Braithwaite, and Richard Hershman

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- **Impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act, including Collateral Requirements and other Issues**
- **Developments in the Law on Arbitrator Disclosure and Arbitrator Bias**
- **Tips on How to Write a Reasoned Award**

In total, the conference effectively met its title, presenting new information and resetting thinking about the future of arbitration. Candid discussions about what has changed and what is coming gave attendees a clearer understanding of how the industry is evolving into the new decade. Credit for the successful event goes to **Jeffrey Rubin**, **Nick DiGiovanni**, **Ann Field**, and **Edward Krugman**.

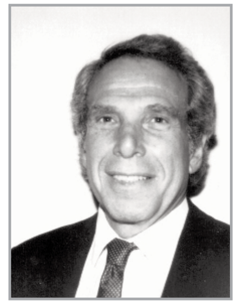
At the break on Thursday afternoon, 64 golfers went to the Miami Beach Golf Club and 20 tennis players competed at the Flamingo Park Tennis Center in their respective tournaments. Rain showers interfered with both events, but they held off enough to allow much of the play to be completed. **Jennifer Devery** and **Eric Kobrick**, respectively, chaired the golf and tennis tournaments.

The Fontainebleau Miami Beach filled its role as a change of pace. It was high style and modern in its atmosphere. It felt a little like Las Vegas in its over-the-top mannerisms. Yet the service and support teams were very professional and thorough, so that meeting events took place almost seamlessly. However, after two years away, it will be nice to get back to **The Breakers on May 9-11 of 2012. Save the Dates!**

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.

off the cuff

Redundancy Revisited



Eugene Wollan

I have recently held forth in these pages on the redundant clichés "clear and unambiguous" and "custom and practice." That article seems to have struck a responsive chord with a number of readers. Outstanding among the responses was one from a young lawyer named Brad Rosen. (I know he's a young lawyer because I googled him and learned that he graduated from Law School in 2008; on the other hand, from my perspective just about everyone in the world is young, with the possible exception of Fidel Castro.)

Mr. Rosen, who I suspect shares my passion for language as well as my intolerance for solecisms, clichés, and sloppy writing in general, sent me a copy of a 2005 decision of the Ohio Court of Appeals, First Appellate District, Hamilton County, in the case of *Kohlbrand et. al. v. Ranieri et. al.*, the full title of which would consume most of the page allotment for this article. The facts of the case were fairly complicated and entirely irrelevant for present purposes, but the main thrust was the difference in meaning, if any, between "clear title" and "free and clear title." This sounds exactly like the sort of thing we lawyers love to go on and on about, but the court did a wonderful skewering job on such professional pretentiousness in this passage:

> Would that Harold had not lost the Battle of Hastings.
>
> *Free* and *clear* mean the same thing. Using both is an unnecessary lawyerism. *Free* is English; *clear* is from the French *clere*. After the Norman Conquest, English courts were held in French. The Normans were originally Vikings, but after they conquered the region of Normandy, they became French; then they took over England. n3 But most people in England, surprisingly enough, still spoke English. So lawyers started using two words for one and forgot to stop for the last nine hundred years.
>
> So *free* and *clear* do not mean separate things; they mean, and were always meant to mean, *exactly the same thing*. Just as *null* and *void* and *due* and *payable* mean the same thing. All of these couplets are redundant and irritating lawyerisms. And they invite just what has happened here – an assertion that they somehow have different meanings.
>
> The Norman Conquest was in 1066. We can safely eliminate the couplets now.
>
> And this case involved a "clear, free and unincumbered" title. Would Monfort argue that this, too, provides less protection than a clear title? Black's Law Dictionary defines "clear" as "free from encumbrances and claims." n4 And "incumbrance" means the same thing as "encumbrance," so we can deduce that "unincumbered" means the same thing as "unencumbered." So it is only logical that "clear, free and unencumbered" is a mere redundancy for clear or for "free from encumbrance." n5
>
> n3 Teirsma, Legal Language (1999), 19
> n4 Black's Law Dictionary (8 Ed.2004) 268
> n5 See *Condorodis* v. *Kling (1928), 33 Ohio App. 452, 169 N.E. 836.*

I love it!

Mr. Rosen has also kindly checked in on another of my pet peeves, excessively lengthy and wordy writing. (The Strunk and White rule most often ignored by my professional colleagues appears to be "Omit Needless Words.") The New York Court of Appeals, in the 1975 case of *Stater v. Gallman*, apparently had finally enough and issued this scathing rebuke:

CONTINUED ON PAGE 30

"So free and clear do not mean separate things; they mean, and were always meant to mean, exactly the same thing. Just as null and void and due and payable mean the same thing. All of these couplets are redundant and irritating lawyerisms."

Eugene Wollan, Editor of the Quarterly, is a former senior partner, now counsel, of Mound Cotton Wollan & Greengrass. He is resident in the New York Office.

"However, in recent years we have witnessed great technological advances in the methods of reproduction of the written word. Too often this progress is merely viewed as a license to substitute volume for logic in an apparent attempt to overwhelm the courts, as though quantity, and not quality, was the virtue to be extolled."

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> In addition to considering the merits of this appeal, we feel that this case presents an appropriate opportunity to comment on a matter that concerns us greatly, namely, the quality, length and content of briefs presented to this court. Although this is an extreme example, unfortunately it is not always the rare case in which we receive poorly written and excessively long briefs, replete with burdensome, irrelevant, and immaterial matter. Although counsel candidly admits that his 284-page brief is "unusually long," his claim that it is "meticulously structured, thoroughly documented, exhaustively researched, carefully analyzed and comprehensively presented" seems too self-congratulatory. His argument wanders aimlessly through myriad irrelevant matters of administrative and constitutional law, pausing only briefly to discuss the issues raised by this appeal. * The brief pursues, in seemingly endless fashion, matters not properly before this court for the simple reason that they were not raised below. (See, e.g., *Flagg v. Nichols, 307 NY 96, 99*.) This is in contrast to the brief filed on behalf of the Tax Commission which, even though consisting of only 21 pages (including preliminary material in addition to a 14-page argument on the merits), cogently and concisely discusses all of the issues presented in this relatively uncomplicated appeal.
>
> * * * * *
>
> We speak now on this matter only with some hesitancy lest counsel in the future be discouraged from vigorously and comprehensively urging their cases and, where appropriate, suggesting novel approaches to complex legal issues. However, in recent years we have witnessed great technological advances in the methods of reproduction of the written word. Too often this progress is merely viewed as a license to substitute volume for logic in an apparent attempt to overwhelm the courts, as though quantity, and not quality, was the virtue to be extolled. As we noted many years ago, for obvious reasons this problem never arose when "every lawyer wrote his points with a pen" (*Stevens v. O'Neill, 169 NY 375, 377*). Hopefully, the solution to this problem will not require that we return to that system, ignoring decades of technological advances.
>
> This issues presented upon this appeal are neither novel nor complex; the brief and reply brief filed by counsel constitute an unwarranted burden upon this court. These briefs neither assist our deliberations nor serve the best interests of his client. Although recognizing this to be a wholly inadequate sanction, at a minimum, costs should be imposed against appellant, (*CPLR 5528,* subd[e].)

Apart from the court's mis-use of "hopefully" to mean "we hope," I love this too.

Finally, at the very opposite end of the spectrum, Mr. Rosen has brightened my day by sending a copy of what may turn out to be my all-time favorite judicial opinion, at least in the linguistic sense. Here is the *complete* opinion in the 1970 Michigan Court of Appeals decision in *Denny v. Radar Industries*:

> The appellant has attempted to distinguish the factual situation in this case from that in *Renfroe v. Higgins Rack Coating and Manufacturing Co., Inc.* (1969), 17 Mich App 259. He didn't. We couldn't.

My effusive thanks go to Mr. Rosen, my continued admiration goes to lawyers who write really well, and my continued disdain goes to those who are addicted to verbosity and lack of clarity.▼

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 May 2011, there were 72 published case summaries and five regulation summaries on the website. A comprehensive listing of relevant state statutes is also provided. The committee encourages members to review the existing summaries and to routinely peruse this section for new additions

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

Pacific Employers Ins' Co. v. Global Reins. Corp. of America

No. 09-6055, 2010 U.S. Dist. LEXIS 40506 (E.D. Pa. April 23, 2010).

Court: United States District Court for the Eastern District of Pennsylvania

Dates Decided: April 23, 2010

Issues Decided: Whether the language of a facultative certificate referring to a limitation on liability applied to expenses incurred by the cedent.

Submitted by: Michele L. Jacobson, Esq. and Seema A. Misra Esq.*

In Pacific Employers Ins. Co. v. Global Reins. Corp. of America, the United States District Court for the Eastern District of Pennsylvania considered the effect of language of a limitation of liability in a facultative certificate (the "Facultative Certificate") issued by Global Reinsurance Corporation of America ("Global") to Pacific Employers Insurance Company ("PEIC"). The Facultative Certificate reinsured an umbrella commercial liability policy that PEIC had issued to the Buffalo Forge Company. PEIC's Complaint, alleging breach of contract and seeking a declaration of rights under the Facultative Certificate, alleged that Global "owe[d] PEIC $ 559,072 under the Facultative Certificate for its share of defense and indemnity payments in connection with the underlying asbestos claims against Buffalo Forge." Global's Answer asserted a counterclaim seeking a declaration that $1 million was the maximum that PEIC could recover under the Facultative Certificate in connection with the asbestos litigation liabilities. The parties filed cross-motions for judgment on the pleadings on Global's counterclaim. PEIC asked that the Court find, as a matter of law, that Global was obligated for up to $1 million of loss and, in addition, a pro rata share of expenses. Global asserted that the $1 million limit of liability was a total cap of liability, applicable to both the loss and expenses. The Court granted Global's motion and denied PEIC's motion.

The Court's decision first stated that the parties agreed that language in the Facultative Certificate's Declarations page imposed a cap of $1 million but that the parties disagreed whether " that cap encompasses expenses or excludes them." Pacific Employers Ins. at *9. To address this issue, the Court cited the "Reinsurance Accepted" section in the Declarations page, which was phrased as follows: "$1,000,000 ANY ONE OCCURRENCE AND IN THE AGGREGATE..." The Court held that "this broad and unambiguous language clearly encompasses expenses because it defines Global's maximum exposure under the Facultative Certificate." Id. The Court further held that its interpretation was supported by the following language in the Facultative Certificate's Conditions section, Paragraph E, despite PEIC's argument to the contrary:

All loss settlements made by the Company, provided they are within the terms and conditions of this Certificate of Reinsurance, shall be binding on the Reinsurer. Upon receipt of a definitive statement of loss, the Reinsurer shall promptly pay its proportion of such loss as set forth in the Declarations. In addition thereto, the Reinsurer shall pay its proportion of expenses (other than office expenses and payments to any salaried employee) incurred by the Company in the investigation and its proportion of court costs and interest on any judgment or award, in the ratio that the Reinsurer's loss payment bears to the Company's gross loss payment . . . .

(emphasis added by PEIC). Although PEIC argued that the emphasized language created two separate obligations and excluded the payment of expenses from the $1 million liability limit set forth in the Declarations page, the Court held that this language in Paragraph E "does not outline limits of liability, but merely outlines the two separate proportions of losses and expenses that Global is obligated to pay pursuant" to the Facultative Certificate. The Court stated that if the "parties intended to exclude expenses from this total liability limit, they could have made that clear in some section of the [Facultative] Certificate," including the paragraph highlighted by PEIC. Id. at *12.

The Court found further support for its interpretation in the preamble paragraph to the Facultative Certificate's Conditions page. The preamble paragraph stated that it was applicable to all paragraphs of the "Conditions" page and stated: "In consideration . . . of the premium, and subject to the terms, conditions and limits of liability set forth herein and in the Declarations made a part thereof, the Reinsurer does hereby reinsure the ceding company named in the Declarations . . . in respect of the Company's policy(ies) as follows." Id. at *12

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(emphasis by Court). The Court held that this sentence made clear that Global's reinsurance obligations, including those outlined in Paragraph E, are "subject to" the "terms, conditions, and limits of liability" contained in the Declarations and on the "Reinsuring Agreements and Conditions" pages. Noting that the only limit of liability in the Facultative Certificate was the $1 million limit found in the Declaration page, the Court held that Global's maximum exposure was inclusive of expenses. In concluding, the Court noted that the case was "similar" to the Second Circuit's ruling in Bellefonte Reinsurance Company v. Aetna Casualty and Surety Company, 903 F.2d 910 914 (2d Cir. 1990), in which the Second Circuit had considered similar contract language.

**Michele L. Jacobson and Seema A. Misra are partners in the litigation department of Stroock & Stroock & Lavan, LLP, concentrating on insurance and reinsurance litigation and arbitration.*

Amerisure Mutual Insurance Co. v. Global Reinsurance Corporation of America

927 N.E.2d 740 (Ill. App. Ct. 2010)

Court: Appellate Court of Illinois, First District

Dates Decided: March 15, 2010

Issues Decided: Whether an arbitration panel's award of attorney fees exceeded its powers and was a gross error of law based upon the terms of the reinsurance agreement and Illinois law.

Submitted by Jennifer R. Devery and Michael T. Carolan*

In Amerisure Mutual Insurance Co. v. Global Reinsurance Corporation of America, the First District Appellate Court of Illinois vacated an arbitration panel's award of attorney fees to Amerisure Mutual Insurance Co. ("Amerisure") because it found that the panel exceeded its powers and committed a gross error of law. In doing so, the court held that neither the terms and conditions of the reinsurance contract, nor Illinois law, gave the panel the power to award attorney fees when one of the parties objected to the panel's consideration of the issue.

The Arbitration

The reinsurance dispute began when Amerisure demanded payment of outstanding balances from Global Reinsurance Corporation of America ("Global Re") due under an Umbrella Quota Share Reinsurance Agreement (the "Treaty") between the parties. Pursuant to Article 24 of the Treaty, the dispute was to be resolved before a three-person arbitration panel in Chicago, Illinois. According to a choice-of-law provision also in Article 24 of the Treaty, Illinois law governed.

In its pre-hearing filings, Amerisure expressly sought to recover not only the outstanding principal balances and interest thereon, but also its own attorney fees and costs. Global Re opposed this claim, arguing that the panel had "no authority" to award such relief since both parties had not requested them and the Treaty did not authorize the panel to award attorney fees. In reply, Amerisure asserted that the panel had the ability to order such relief pursuant to both the traditional reinsurance principle of utmost good faith, and to Section 155 of the Illinois Insurance Code ("Section 155"), which punishes an insurer for vexatious and unreasonable actions or delays by allowing recovery of attorney fees as relief. Global Re denied that Section 155 applied to reinsurance relationships.

Ultimately, the arbitration panel awarded Amerisure the principal amount sought and interest, as well as attorney fees in an amount not to exceed $1.5 million, based upon the panel's finding that Global Re violated its duty of utmost good faith to Amerisure. Specifically, the panel stated that attorney fees were awarded "based on a finding of...[Global Re's] violation of its duty of utmost good faith to [Amerisure]."

Amerisure filed a motion to confirm the arbitration award in Illinois state court and Global Re filed an answer and counter application to vacate the award of attorney fees. Global Re argued that the panel exceeded its authority by awarding attorney fees because, among other things: (i) such remedy was not provided for in the parties' arbitration agreement; (ii) the parties did not "collectively vest" the panel with the authority to decide the issue; (iii) Section 155 does not apply to reinsurance disputes; and (iv) Section 155 does not authorize arbitration panels to order the recovery of attorney fees, only courts. Global Re claimed gross error appeared on the face of the award.

The trial court denied Global Re's counter-application, holding that the panel did not exceed its authority and issuance of the award did not amount to a gross error of law and confirmed the arbitration award, including the award of attorney's fees.

On appeal, the First District Appellate Court of Illinois first held that Global Re did not waive the attorney fee issue by declining to bring a petition in state court to stay the arbitration and challenge the arbitrability of the authority of the panel to consider the attorney fee issue.

In sum, the appellate court held that Section 2 of the Illinois Uniform Arbitration Act is permissive and that Global Re preserved the attorney fee issue for judicial review by timely objecting to the panel's consideration of the issue in the arbitration proceedings.

Second, the appellate court stated that "a violation of the duty of utmost good faith does not, in itself, provide a basis for awarding attorney fees" but that Amerisure's position was that the violation of the duty of utmost good faith, in conjunction with Section 155, provided the panel a basis for awarding attorney fees. Nevertheless, because both parties did not request attorney fees (only Amerisure) and the arbitration agreement did not expressly provide for attorney fees, the appellate court held that "the parties agreed to arbitrate only those attorney fees authorized by Illinois law, as the chosen forum." As to Illinois law, while the appellate court recognized that Illinois law permits the recovery of damages incurred as a result of unreasonable delays in the settlement of insurance claims, it held that Section 155 does not authorize arbitrators to award attorney fees and that, accordingly, the panel exceeded its authority. Specifically, the appellate court held that Section 155 does not permit an award of attorney fees by any tribunal other than a court of law. In the appellate court's words, "Section 155 does not provide arbitrators with the authority to award attorney fees; the plain language of the statute reserves that authority to circuit courts."

The appellate court noted that it did not "come to [its] decision lightly, without consideration of the deference given to arbitrators and the public policy behind arbitration." It found, however, that the instant case was an extraordinary one where the arbitrators awarded attorney fees on the basis of a statute that clearly reserved the authority to award such fees to the courts.

Amerisure contended that the arbitration panel's error amounted to merely a mistake of law and was not a sufficient ground to vacate the award of attorney's fees. The appellate court disagreed, holding that the issue did not concern statutory interpretation, but an award that was clearly contrary to Illinois law.

Thus, while admitting that "on its face, the arbitrators awarded attorney fees based on [Global Re's] violation of the duty of utmost good faith," the appellate court stated that Illinois follows the "American" rule of only allowing a successful litigant to recover attorney fees if authorized by the parties' agreement or statute, and that Amerisure and Global Re did not contract for the awarding of attorney fees in the event of a violation of the duty of utmost good faith. In addition, the court noted that Illinois law does not recognize a "bad faith exception" to the "American" rule.

Notably, the court explicitly declined to address whether Section 155 actually applies to reinsurance relationships, stating that even if Section 155 does apply to the reinsurance relationship, the arbitrators did not have the authority to award attorney fees pursuant to the statute.

** Jennifer R. Devery and Michael T. Carolan are partner and associate, respectively, in the insurance/reinsurance group of Crowell & Moring LLP. They each represent cedents and reinsurers in disputes involving a broad spectrum of issues.*

in focus

Recently Certified Arbitrators

LeRoy A. Boison, Jr.

Steven G. Lehmann

LeRoy A. Boison, Jr.

LeRoy Boison has more than 40 years of experience as an actuary in the Property/Casualty Insurance field. He is currently a Principal and Consulting Actuary with Pinnacle Actuarial Resources, Inc. and advises clients in the areas of pricing, reserving, strategic planning and general management. During his 30+ years at ISO, he served as SVP of Insurance Operations, overseeing ratemaking and policy form development for all lines of business under ISO's jurisdiction, and was in charge of their International area as well.

Mr. Boison is a member of the American Academy of Actuaries and a Fellow of the Casualty Actuarial Society (CAS). He is also a member of the International Actuarial Association (IAA). He is the past Vice President-International of the Executive Council of the CAS. He is also the past Chair of the Actuarial Standards Board Casualty Committee, the Casualty Actuarial Society Ratemaking Committee, and the Board of Directors of the Actuarial Education and Research Fund.

Mr. Boison has co-authored a paper entitled "New Jersey Automobile No Fault Study: Analysis of the Cost Effects of AB 3531 and SB 2533" which was published in the NAIC's Journal of Insurance Regulation. He has also given numerous speeches and panel presentations in professional and public forums.

Mr. Boison has testified extensively in numerous rate regulatory proceedings having testified in California, Florida, Indiana, Louisiana, Massachusetts, Mississippi, Missouri, New Jersey, New York, North Carolina, Oklahoma, Pennsylvania, South Carolina, and Texas.

Mr. Boison began his actuarial career with the Insurance Rating Board in 1970. He has a BA degree in Mathematics from Fordham University.

Steven G. Lehmann

Steven Lehmann has nearly 40 years of experience as a Property/Casualty actuary, including 14 years experience as a consultant. He is currently a Principal and Consulting Actuary with Pinnacle Actuarial Resources, Inc., in the Bloomington, Illinois, office.

Mr. Lehmann is a past President of the Casualty Actuarial Society (CAS) and a past President of the American Academy of Actuaries, and has served as Chair of the Boards of both organizations. He is a Fellow of the CAS, a Fellow of the Society of Actuaries, a member of the American Academy of Actuaries (AAA), and a Fellow of the Canadian Institute of Actuaries. He has also served as Chair of the Casualty Practice Council of the AAA and Chair of the Ratemaking Subcommittee of the Actuarial Standards Board.

Mr. Lehmann's has testified before numerous regulatory and legislative bodies and before an arbitration panel on a variety of insurance matters including ratemaking, risk classification, agents' contingent commissions, and fair rates of return. His experience includes substantial involvement with loss reserving including, insurance companies and other public entities. He also has a strong background in pricing of insurance products, including coordination of underwriting and rating programs, credit score analysis, financial examinations, rate filings, residual market studies, and rate of return analysis.

Mr. Lehmann has authored a CAS Forum paper entitled "Contingency Margins in Rate Calculations" and an article entitled "Auto Insurance Residual Market Mechanisms," and co-authored a CAS Forum paper entitled "Building a Public Access PC-Based DFA Model." He holds a Bachelor of Science Degree, *cum laude*, in actuarial science from the University of Illinois.

Profiles of all certified arbitrators are on the website at www.arias-us.org in focus

Kevin M. Madigan

James G. Sporleder

Kevin M. Madigan

Kevin Madigan is a Consultant with Pinnacle Actuarial Resources, Inc., with an extensive educational background in Mathematics, earning a Ph.D. and an MA from the State University of New York at Albany, and a BS in Mathematics from Auburn University.

He has provided expert witness testimony and actuarial support for several reinsurance arbitrations.

Mr. Madigan is an Associate of the Casualty Actuarial Society, and a Member of the American Academy of Actuaries. Since being admitted to the CAS, he has been an active volunteer, serving as chair of the Joint CAS/SOA Committee for the Enterprise Risk Management Symposium, and as a member of several CAS and ASB committees, task forces, and working groups.

Before joining Pinnacle Actuarial Resources, Inc., Mr. Madigan gained valuable experience in a variety of areas. He spent six years in the Bermuda reinsurance market, three of those years as a property reinsurance treaty underwriter and three years pricing and underwriting structured reinsurance products. Earlier, Mr. Madigan worked at two insurance companies (one a large international insurer, the other a run-off entity), where he frequently applied his considerable technical skills to the analysis of reinsurance purchases, commutations, and arbitrations.

Mr. Madigan co-authored the paper "Reserving for Asbestos Liabilities," CAS Forum, Fall 2003, and has spoken at numerous events on topics such as capital allocation, ERM, company valuation, asbestos liabilities, and linkages between the reinsurance and capital markets.

James G. Sporleder

James Sporleder is Vice President and Assistant General Counsel at Allstate Insurance Company in South Barrington, Illinois. He manages Allstate's Specialty Operations Law Practice Group, which handles ceded and assumed arbitrations for Allstate's legacy book of business. Mr. Sporleder's group also provides legal counsel for all of Allstate's property casualty catastrophe reinsurance protections throughout the United States and Canada.

Mr. Sporleder was designated an ARIAS•U.S. Certified Arbitrator on May 4, 2011. He qualifies also as an "active" arbitrator in clauses requiring active arbitrators, since he has been employed in Allstate's Law and Regulation Department for over 32 years. During that time, Mr. Sporleder has supervised hundreds of arbitrations and has acted as trial counsel on several arbitrations. He also supervises all legacy reinsurance litigation matters at Allstate. He has handled property casualty, life, and auto/warranty cases.

Mr. Sporleder has remained an active member of the Insurance and Reinsurance Dispute Resolution Task Force since its inception. He is also a member of AIRROC Small Claims Drafting Committee. He has been a speaker at ARIAS, AIRROC, Mealeys, ACI, and Marcus Evans.

Mr. Sporleder has co-authored the following publications: "In-House Counsel's Suggestions for Managing the Arbitration Process," Journal of Reinsurance, Winter 2006; "Drawing Lots to Select the Reinsurance Umpire, a High Stakes Gamble," ADR Currents, American Bar Association Newsletter, June-August 2001; "Confidentiality Agreements: Let the Signer Beware," The Risk Management Letter, Vol. 20, Issue 3, 1999.

Mr. Sporleder is licensed to practice law in Illinois and New York, in addition to being licensed in the United States Supreme Court. He is also licensed to practice law in the State of Texas-inactive status. He is a graduate of IIT-Chicago Kent College of Law and received his Bachelor of Arts degree at North Central College in Naperville, Illinois.

Do you know someone who is interested in learning more about ARIAS•U.S.?

If so, pass on this letter of invitation and membership application.

An Invitation...

The rapid growth of ARIAS•U.S. (AIDA Reinsurance & Insurance Arbitration Society) since its incorporation in May of 1994 testifies to the increasing importance of the Society in the field of reinsurance arbitration. Training and certification of arbitrators through educational seminars, conferences, and publications has assisted ARIAS•U.S. in achieving its goals of increasing the pool of qualified arbitrators and improving the arbitration process. As of May 2011, ARIAS•U.S. was comprised of 379 individual members and 121 corporate memberships, totaling 1039 individual members and designated corporate representatives, of which 264 are certified as arbitrators.

The Society offers its *Umpire Appointment Procedure,* based on a unique software program created specifically for ARIAS•U.S., that randomly generates the names of umpire candidates from the list of ARIAS certified umpires. The procedure is free to members and non-members. It is described in detail in the Umpire Selection Procedure section of the website.

Similarly, a random, neutral selection of all three panel members from a list of ARIAS Certified Arbitrators is offered at no cost. Details of the procedure are available on the website under Neutral Selection Procedure.

The website offers the "Arbitrator, Umpire, and Mediator Search" feature that searches the extensive background data of our Certified Arbitrators who have completed their enhanced biographical profiles. The search results list is linked to those profiles, containing details about their work experience and current contact information.

Over the years, ARIAS•U.S. has held conferences and workshops in Chicago, Marco Island, San Francisco, San Diego, Philadelphia, Baltimore, Washington, Boston, Miami, New York, Puerto Rico, Palm Beach, Boca Raton, Las Vegas, Marina del Rey, Amelia Island, and Bermuda. The Society has brought together many of the leading professionals in the field to support its educational and training objectives.

For many years, the Society published the *ARIAS•U.S. Membership Directory*, which was provided to members. In 2009, it was brought online, where it is available for members only. ARIAS also publishes the ARIAS•U.S. *Practical Guide to Reinsurance Arbitration Procedure* and *Guidelines for Arbitrator Conduct*. These publications, as well as the *Quarterly* journal, special member rates for conferences, and access to educational seminars and intensive arbitrator training workshops, are among the benefits of membership in ARIAS.

If you are not already a member, we invite you to enjoy all ARIAS•U.S. benefits by joining. Complete information is in the Membership area of the website; an application form and an online application system are also available there. If you have any questions regarding membership, please contact Bill Yankus, Executive Director, at director@arias-us.org or 914-966-3180, ext. 116.

Join us and become an active part of ARIAS•U.S., the leading trade association for the insurance and reinsurance arbitration industry.

Sincerely,

Daniel L. FitzMaurice
Chairman

Elaine Caprio Brady
President

ARIAS U.S. Membership Application

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Complete information about ARIAS•U.S. is available at www.arias-us.org. Included are current biographies of all certified arbitrators, a current calendar of upcoming events, online membership application, and online registration for meetings.

914-966-3180, ext. 116

Fax: 914-966-3264

Email: info@arias-us.org

Online membership application is available with a credit card through "Membership" at www.arias-us.org.

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NOTE: Corporate memberships include up to five designated representatives. Additional representatives may be designated for an additional $300 per individual, per year. Names of designated corporate representatives must be submitted on corporation/organization letterhead or by email from the corporate key contact and include the following information for each: name, address, phone, cell, fax and e-mail.

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Cardholder's address ______________________________

Signature ______________________________

By signing below, I agree that I have read the By-Laws of ARIAS•U.S., and agree to abide and be bound by the By-Laws of ARIAS•U.S. The By-Laws are available at www.arias-us.org in the About ARIAS section.

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Signature of Individual or Corporate Member Applicant

ARIAS U.S.

P.O. Box 9001
Mt. Vernon, NY 10552

ARIAS U.S. Board of Directors

Administration