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Reinsurance Arbitration Awards: How Secure Are They In Court?

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Federal and state arbitration laws sharply restrict the grounds on which a court may vacate or modify an arbitration award. This article discusses the limited grounds on which a court may do so, as well as a few steps parties and arbitrators can consider to limit the chance that an award may be successfully challenged in court.

I. Arbitration Statutes

The primary sources of American arbitration law are federal and state arbitration statutes. The Federal Arbitration Act ("FAA"), 9 U.S.C. §1 et seq., applies to arbitration agreements "involving commerce", and has been held to preempt inconsistent state laws. 9 U.S.C. § 2; Allied-Bruce Terminix Companies, Inc. v. Dobson, 115 S.Ct 834, 839 (1995); Southland Corp. v. Keating, 465 U.S. 1, 15-16 (1984).[1] State arbitration statutes, on the other hand, apply to arbitration agreements that do not involve interstate commerce. They may also apply if the parties to an arbitration agreement have expressly agreed to be bound by state rather than federal arbitration law. See Volt Information Sciences, Inc. v. Bd.

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San Francisco Reinsurance Arbitration Workshop, A Success

A Report to ARIAS•US Board of Directors and Workshop Participants

I am pleased to report that the San Francisco workshop was considered a great success by all participants. Virtually every survey considered all aspects of the workshop "excellent."

This was intended to be a presentation of a model US domestic arbitration. Perhaps the most telling evidence of its success was brought home to me while I was standing behind the audience during the hearing while counsel argued and the panel deliberated the points: everyone was riveted on the presentation and dialogue. The counsel, Tom Allen of White & Williams, Philadelphia, and Jim Shanman of Shafman, Siviglia, Poret, Kook and Ross, P.C., New York City were superb. And the panel of Rick Gilmore (umpire) and Charlie Niles and Bob Reinarz was truly exceptional.

I would like to thank Mike Isaacson, Therese Arana Adams and Mark Gurevitz for their assistance on the Workshop Committee and Peter Chaffetz of Chadbourne & Parke, Linda Lasley of Reinsurance Counsel, and Barry Weissman of Graham & James for their assistance in the Q&A periods.

This was my first experience putting together a seminar, and I found it most rewarding, in large part due to the people I was fortunate enough to work with.

Respectfully submitted,

Daniel E. Schmidt, IV
Program Chairman

OPINION

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Arbitration, Experts and Case Law

by Therese Arana Adams

When most people think of an "Expert Witness," they tend to think of "specialists." In the usual process of litigation and related matters, the use of specialists for medical, marine, aviation, engineering, environmental, systems/data processing etc., is certainly appropriate. One of the author's expert witness assignments was for an arbitration involving a Political Risk Policy dispute, covering the perils of confiscation, expropriation and nationalization; a.k.a.: "CEN". The underwriting of such insurance requires specialization, and the coverage issues which often lead to disputes in claims settlement, needs the assistance of such specialists.

Therefore, those who are involved in dispute resolution in the area of reinsurance need to be aware that experts and consultants could and should be used outside of the arbitration hearing or the courtroom. With the help and assistance of competent reinsurance professionals, counsel can frame its case using the knowledge and experience of the expert.

In *National American Insurance Co. v. Certain Underwriting at Lloyd's of London*,[1] the Court of Appeals based its decision on the uncontradicted testimony of an "expert" on the follow the fortunes doctrine. The reinsurers wanted to re-litigate coverage issues and the court gave the reinsurers no opportunity to re-litigate because it held that the "follow the fortunes" principle is inherent in all reinsurance contracts, even those contracts that lack a follow the fortunes clause. This decision was widely criticized and the court amended its opinion to delete its citations, but it still adhered to its conclusion. The use of experts in this case was pivotal.

The advocate needs to understand the reinsurance negotiating process be it treaty or facultative, to establish intent of the parties and other relevant matters. During the investigative stage, counsel is often dealing with missing facts and persons who had been party to the negotiation and are no longer with the client and/or unwilling to cooperate. Having a reinsurance expert on your team, can help fill in the blanks. When the client has the burden of proof experts can often help counsel build the case providing the court with the customs, usage and technical help to guide the court in its decision making process.

In *Unigard Security v. North River Insurance Co.*[2] the court equated good faith with the absence of bad faith and wrote that, at least, in the handling and notice of claims, "the proper minimum standard for bad faith should be gross negligence or recklessness." What does this mean in terms of an insurance company's or a reinsurance company's claims/management operation? Perhaps an expert who has experience in claims handling and the performance of claims reviews with many different companies, is a person you would want on your team to help set those standards. The Third Circuit in *North River v. Cigna Re*[3] stated that bad faith requires an extraordinary showing of a disingenuous or dishonest failure to carry out a contract.

The reinsurance professionals and experts have been there; the long hours of negotiation, the deals, the proverbial "cocktail napkin", and present when the

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of Trustees of Stanford Univ., 489 U.S. 468 (1989); cf. Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S. Ct. 1212 (1995).

Reinsurance arbitrations are likely to be governed by the FAA. Reinsurance agreements almost invariably involve interstate commerce. Further, few reinsurance agreements indicate that the parties have agreed to be bound by state rather than federal arbitration law.

II. Statutory Grounds for Vacating or Modifying Awards

A party to an arbitration can attack an award in one of two ways: by moving to vacate the award or moving to modify the award.[2] The grounds for such attacks under the FAA are similar to those available under parallel state statutes.

A. Grounds for Vacating Awards

Under the FAA, a court may vacate an arbitration award:

(1) Where the award was procured by corruption, fraud, or undue means.

(2) Where there was evident partiality or corruption in the arbitrators, or either of them.

(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of a party have been prejudiced.

(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10. Parallel provisions of several state statutes are reprinted in the appendix.

In reinsurance cases, the most common grounds on which parties have sought to vacate awards have been the last three.

• Partiality or corruption in the arbitrators

An example of an attempt to vacate an arbitration award by reason of an arbitrator's alleged bias is found in Employers Ins. of Wausau v. National Union Fire Ins. Co., 933 F.2d 1481 (9th Cir. 1991). In that case, prior to the arbitration, Wausau's party-appointed arbitrator had briefly consulted with Wausau's counsel on an issue related to the subject of the arbitration. After National Union objected to his service on the panel, the arbitrator fully disclosed the documents that had been provided in the prior consultation, and stated that he had not formed an opinion on the matter. With the advice of outside counsel, the panel ruled that the arbitrator was qualified to serve. The court later rejected an attack on the arbitrator's impartiality "[b]ecause the consultation relationship was brief, and because [the arbitrator] had neither preconceived convictions on the merits of the case nor a proven informational advantage. . .." 933 F.2d at 1490.

In Transit Casualty Co. v. Trenwick Reins. Co., 659 F. Supp. 1346 (S.D.N.Y. 1987), the party seeking to vacate the award claimed that the umpire was biased. This attack was based primarily on the umpire's undisclosed ownership of stock in the parent company of one of the parties, and on his service on another panel with one of the party-appointed arbitrators. Although the court noted that "failure to make appropriate disclosure will justify setting aside an award," it noted that the umpire's failure to disclose his stock ownership was "trivial". As to the umpire's service on a panel with one of the arbitrators, the court noted that both sides "agreed that the number of qualified arbitrators available to sit on insurance arbitration disputes is quite small and that arbitrators often sit together on a number of disputes." Thus, the court ruled that such service by itself did not show bias.

These cases show that courts take account of business realities in evaluating arbitrators' impartiality. There may also be a reluctance to throw out an entire proceeding where the alleged grounds for bias appear insubstantial and any nondisclosure inadvertment.[3] From an arbitrator's point of view, these cases demonstrate that the most important step to avoid any appearance of bias is full disclosure.

• Misconduct

The most common grounds for an allegation of misconduct on the part of the panel are that the panel has refused to admit briefs or other submissions, or that it has allowed ex parte communications between the parties and their arbitrators. Such allegations have usually been rejected.

Courts have held that misconduct can justify vacating an award only where it prejudices a party. See, e.g., Employers Ins. of Wausau, supra, 933 F.2d at 1490; Mutual Fire, Marine & Inland Ins. Co. v. Norad Reins. Co. Ltd., 868 F.2d 52 (3d Cir. 1989). Thus, a party complaining that the panel refused to accept a submission must demonstrate that the outcome of the arbitration would have been changed by the submission, or that it was otherwise prejudiced by the panel's failure to accept the submission. If the panel has accepted the party's submissions on the same terms as it has accepted those of the other party, it will be difficult to prove prejudice.

Courts have also generally rejected allegations that panels' allowance of ex parte communications between a party and its arbitrator justifies vacating an award. If a panel makes it clear that both parties are allowed such communications on the same terms, courts will be unlikely to find either party prejudiced by them. As one court put it:

> The reinsurance contracts empowered the arbitrators to craft their own rules of procedure. The decision to permit ex parte contacts was open and above board. There was nothing sinister or inherently one-sided about the contacts. Absent evidence of prejudice, therefore, we decline to vacate the award on this ground.

Employers Ins. of Wausau, supra, 933 F.2d at 1491.

• Exceeding Powers

Parties have attempted to use the FAA's provision that arbitration awards may be overturned where the arbitrators exceed their powers as an avenue for obtaining judicial review of the substance of an award. Thus, where an arbitration panel has devised a remedy that is not found on the face of the contract, parties have argued that the panel has exceeded its authority by changing the contract. Again, courts have not been receptive to such arguments.

For example, in Michigan Mutual Ins. Co. v. Unigard Security Ins. Co., 44 F.3d 826, 831-32 (9th Cir. 1995), an arbitration panel had ruled that retrocessionaires of Unigard's retention on a reinsurance facility would bear the risk of the reinsurers' insolvency, but that Unigard would be required to obtain the consent of

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the retrocessionaires to claim payments as a condition to obtaining recoveries from the retrocessionaires. Unigard argued that the panel had exceeded its authority by imposing conditions precedent that did not exist under the contract. The court rejected this argument because the reinsurance contract "gave the arbitration panel broad powers to fashion relief for issues submitted to it." 44 F.3d at 831. The court distinguished cases in which courts vacated awards that exceeded express contractual limitations on a panel's authority. Accord, Advanced Micro Devices, Inc. v. Intel Corp., 36 Cal. Rptr. 2d 581 (Cal. 1994).

Similarly, in Executive Life Ins. Co. of New York v. Alexander Ins. Ltd., 999 F.2d 318 (8th Cir. 1993), the panel awarded the cedent under a canceled reinsurance contract a refund of unearned premium, although the contract was silent as to such refunds. The district court vacated the award on the ground that the arbitrators had exceeded their authority. The Eighth Circuit reversed, noting that the contract "broadly empowered the arbitrators to use equity and customary industry practices to decide all questions and issues." 999 F.2d at 320.

More successful attacks on panels' authority have been based on express contractual limitations on arbitral authority. For example, in Western Employers Ins. Co. v. Jefferies & Co., 958 F.2d 258 (9th Cir. 1992), the arbitration agreement required the arbitrators to state their findings of fact and conclusions of law. The arbitrators, however, declined to do so. The court vacated the award, holding that "[b]y failing to provide Western with findings of fact and conclusions of law, the ... panel clearly failed to arbitrate the dispute according to the terms of the arbitration agreement," and therefore exceeded its authority. 958 F.2d at 262.

In addition, under the functus officio doctrine, courts have held that a panel's authority terminates when it has issued its final award, and that it lacks authority to revise that award. See Colonial Penn Ins. Co. v. Omaha Indem. Co., 943 F.2d 327 (3d Cir. 1991). There, a reinsurer repudiated its obligations under a reinsurance contract, and the panel ordered the reinsurer to pay $10 million in outstanding obligations. Further, under the mistaken impression that the reinsurer had funded the cedent's reserves, the panel ordered the reinsurer to release any claim to such amounts. After the cedent pointed out to the panel that the reinsurer had not funded its reserves, the panel issued a revised award that required the reinsurer to pay an additional $9 million, representing its share of the cedent's reserves, including IBNR. The Third Circuit reversed the district court's order confirming the second award, holding that, under the functus officio doctrine, the panel lacked the power to issue the second award.[4]

These cases show that where a contract gives an arbitration panel broad powers to resolve disputes, the panel's decision is unlikely to be vacated on the ground that the panel has exceeded its powers. Where a contract expressly limits the panel's authority, however, or where a panel exceeds procedural limitations on its authority, an award that exceeds such limits may well be vacated. Thus, at a minimum, both parties and arbitrators must be conscious of the provisions of the arbitration agreement.

B. Grounds for Modifying Awards

Under the FAA, a court may modify or correct an arbitration award:

> (a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.
>
> (b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.
>
> (c) Where the matter is imperfect in matter of form not affecting the merits of the controversy.

9 U.S.C. § 11.

Potentially the most significant of these grounds is the second, that the award includes a matter not submitted to the panel. This ground is illustrated by In re Employers Reinsurance Corp., 1990 U.S. Dist. LEXIS 14580 (D.N.J. 1990). There, the reinsurers asked the arbitration panel to rescind a treaty reinsuring Admiral's financial guarantee bond business. Although the panel denied rescission from inception, it granted rescission from a later date. The panel stated that this relief was based on Admiral's failure to disclose that its underwriters were taking payments that the reinsurers characterized as bribes.

Seeking to vacate the award, Admiral contended that the issue of its duty to disclose its knowledge of payments received by its underwriters had never been submitted to the panel. The court reviewed the parties' submissions, and agreed that the issue had not been submitted to the arbitrators. Relying on Section 11 of the FAA, the court vacated the award in part, and remanded to the panel. The court noted that the panel could direct the parties to submit post-hearing briefs, apparently allowing the panel to issue the same relief in a revised award.

III. Judicially Created Grounds for Vacating Awards

A. Manifest Disregard of Law

Several federal courts of appeals have held that a court may vacate an arbitration award if the award was made in manifest disregard of the law.[5] This doctrine originated in dictum in Wilko v. Swan, 346 U.S. 427 (1953), a securities case whose holding that claims under the securities laws are not arbitrable was later overruled by Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477 (1989). In ruling that arbitration would be a less effective means of enforcing the buyer's statutory rights than litigation, the Wilko Court observed that:

> Power to vacate an award is limited. While it may be true, as the Court of Appeals thought, that a failure of the arbitrators to decide in accordance with the provisions of the Securities Act would 'constitute grounds for vacating the award pursuant to section 10 of the Federal Arbitration Act," that failure would need to be made clearly to appear. In unrestricted submission, such as the present margin agreements envisage, the interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation.

346 U.S. at 436 (emphasis supplied). Thus, the Court implied without deciding that judges can set aside arbitration awards made in "manifest disregard" of the law.

The most widely followed interpretation of "manifest disregard" appears in a Second Circuit opinion:

> Although the bounds of this ground have never been defined, it clearly means more than error or misunderstanding

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> with respect to the law.... The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator. Moreover, the term "disregard" implies that the arbitrator appreciates the existence of a clearly governing legal principle but decides to ignore or pay no attention to it.

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, 808 F.2d 930, 933 (2d Cir. 1986). Hence, in a jurisdiction that follows this rule, an award can be vacated on grounds of manifest disregard where an arbitrator is aware of the proper law to apply, but deliberately ignores it.

Awards in reinsurance arbitrations, however, do not readily lend themselves to the manifest disregard standard. Panels in reinsurance arbitrations are generally charged with deciding contract disputes. In most cases, there is not a clear rule that a panel may manifestly disregard. For example, in Michigan Mutual Ins. Co. v. Unigard Security Ins. Co., 44 F.3d 826 (9th Cir. 1995), although the retrocessionaires sought rescission of their retrocessional contract, the panel simply relieved them of their future obligations, putting them in a better position than rescission would have given them. The retrocedent sought to vacate the award on the ground that it was in manifest disregard of the law. Noting that "'manifest disregard of the law' means something more than just an error in the law or a failure on the part of the arbitrators to understand or apply the law," the court upheld the award. 44 F.3d at 832. It ruled that the award was not in manifest disregard of the law, but rather was an appropriate remedy for the breach of contract the panel had found. 44 F.3d at 833. See also In re Executive Life Ins. co. of New York v. Alexander Ins. Ltd., 999 F.2d 318 (rejecting "manifest disregard" argument in absence of showing that arbitrators "expressly disregarded known law").

In another reinsurance arbitration case, the losing party argued that the arbitrators had ruled in manifest disregard of the law because they had failed to provide a "reasoned, legal, analysis" of their award. Transit Cas. Co. v. Trenwick Reins. Co., 659 F. Supp 1346 (S.D.N.Y. 1987). The court rejected this argument, noting that it is clear than an arbitrator need not provide such an analysis. 659 F. Supp at 1355.

It may also be argued that the typical reinsurance arbitration clause constitutes a contractual waiver of the manifest disregard ground for vacating an award. Many reinsurance contracts contain language such as the following: "The arbitrators shall consider this contract an honorable engagement rather than merely a legal obligation; they are relieved of all judicial formalities and may abstain from following the strict rules of law." Under such a provision, the parties have arguably authorized the panel to disregard the law. If the panel does so, the parties have arguably received exactly what they agreed to, and should not be free to seek to vacate the award because the panel has acted in accordance with the contract.

One court came close to adopting this theory, holding that the parties could not complain that a panel had considered equity and industry custom and practice when the arbitration agreement authorized them "to reach their decision from the standpoint of equity and customary practices of the insurance and reinsurance industry rather than from that strict law." In re Executive Life, supra, 999 F.2d at 319.

From a practical standpoint, the best way to assure that an award will not be attacked for manifest disregard of the law is to ask the panel not to provide a reasoned decision. Although the parties may prefer a reasoned decision for other reasons, such a decision may provide greater grounds for attack.

B. Public Policy/Illegality

A less frequently-cited ground for vacating an arbitral award is that the award would violate public policy, or that it would require an illegal act.

Although most federal courts that have considered the public policy ground for vacating arbitration awards have done so in connection with labor arbitrations, courts have considered the ground available in commercial arbitrations as well. As one court has put it, "[t]he public policy exception to the enforcement of arbitration awards allows courts to refuse to enforce arbitration awards where enforcement 'would violate "some explicit public policy" that is "well defined and dominant, and is to be ascertained by reference to the laws and legal precedents and not from general considerations of supposed public interests'"" Brown v. Rauscher Pierce Refsnes, Inc., 994 F.2d 775, 782 (11th Cir. 1993) (quoting United Paperworkers Int'l Union v. Misco, Inc., 484 U.S. 29 (1987)).

Some state courts have also held that the exception applies under their arbitration statutes. In California, for example, the Supreme Court has held that judicial review of an arbitration award is available where the entire contract or transaction at issue is alleged to be illegal. Moncharsh v. Heily & Blase, 10 Cal. Rptr.2d 183 (1992) (holding that judicial review of arbitration awards is unavailable except as permitted by statute or on limited public policy grounds). Further, the court recognized that "there may be some limited and exceptional circumstances justifying judicial review of an arbitrator's decision when a party claims illegality affects only a portion of the underlying contract." 10 Cal. Rptr. 2d at 203.

Under either federal or state law, review of an arbitral award for violation of public policy is extremely limited. Moreover, in the context of reinsurance arbitrations most awards will be unlikely to implicate public policy. Reinsurance contracts, after all, are private, and have few implications for public policy. Cf. Exxon Shipping Co. v. Exxon Seamen's Union, 11 F.3d 1189 (3d Cir. 1993) (arbitration award requiring reinstatement of seaman who had been found intoxicated on duty violated public policy).

Nevertheless, it is possible to imagine circumstances in which an award in a reinsurance arbitration could be challenged on public policy grounds. For example, an award granting a cedent coverage for extracontractual obligations stemming from a punitive damages award in a bad faith case might be characterized as providing insurance of punitive damages. In some states, such insurance is illegal.

A reinsurer who challenged such an award on public policy grounds, though, would likely face several arguments. For example, in defense of such an award, the cedent would question the characterization of the award as insurance of punitive damages. Further, the cedent might question whether the policy or rule against insurance of punitive damages makes the contract illegal or void so as to justify vacating an arbitration award. The cedent might also argue that a reinsurer who has agreed to an ECO provision and received

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premium under the contract should be estopped from claiming that public policy bars its enforcement.

In an arbitration governed by the FAA, the cedent may also argue that state policy against insurance of punitive damages may simply not be used to vacate an award. This argument would be based on cases holding that the FAA preempts inconsistent state laws. Thus, in Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S. Ct. 1212 (1995), the Supreme Court held that in an arbitration governed by the FAA, "if contracting parties agree to include claims for punitive damages within the issues to be arbitrated, the FAA ensures that their agreement will be enforced according to its terms even if a rule of state law would otherwise exclude such claims from arbitration." Cedents will no doubt draw the analogy to state law bans on insurance of punitive damages.

CONCLUSION

In short, courts in all U.S. jurisdictions have been most reluctant to vacate arbitration awards. This reluctance will probably be greater in reinsurance arbitrations than in other areas, both because reinsurance is strictly a matter of private agreement, and because many reinsurance contracts explicitly grant arbitration panels wide discretion. Nevertheless, reinsurance arbitration panels derive their authority from arbitration agreements. Parties remain free to fashion those agreements to suit their needs; arbitrators must conduct arbitrations in accordance with the parties' agreement.

APPENDIX

California Code of Civil Procedure
§ 1286.2. Grounds for vacation of award
Subject to Section 1286.4, the court shall vacate the award if the court determines that:
(a) The award was procured by corruption, fraud or other undue means;
(b) There was corruption in any of the arbitrators;
(c) The rights of such party were substantially prejudiced by misconduct of a neutral arbitrator;
(d) The arbitrators exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted; or
(e) The rights of such party were substantially prejudiced by the refusal of the arbitrators to postpone the hearing upon sufficient cause being shown therefore or by the refusal of the arbitrators to hear evidence material to the controversy or by other conduct of the arbitrators contrary to the provisions of this title.

Illinois Statutes Annotated Chapter 710.
§ 12. Vacating an award. (a) Upon application of a party, the court shall vacate an award where:
(1) The award was procured by corruption, fraud or other undue means;
(2) There was evident partiality by an arbitrator appointed as a neutral or corruption in any one of the arbitrators or misconduct prejudicing the rights of any party;
(3) The arbitrators exceeded their powers;
(4) The arbitrators refused to postpone the hearing upon sufficient cause being shown therefore or refused to hear evidence material to the controversy or otherwise so conducted the hearing, contrary to the provisions of Section 5, as to prejudice substantially the rights of a party; or
(5) There was no arbitration agreement and the issue was not adversely determined in proceedings under Section 2 and the party did not participate in the arbitration hearing without raising the objection; but the fact that the relief was such that it could not or would not be granted by the circuit court is not ground for vacating or refusing to confirm the award.

New York Civil Practice Law and Rules:
§ 751 1. Vacating or modifying award
(b) Grounds for vacating.
1. The award shall be vacated on the application of a party who either participated in the arbitration or was served with a notice of intention to arbitrate if the court finds that the rights of that party were prejudiced by:
(i) corruption, fraud or misconduct in procuring the award; or
(ii) partiality of an arbitrator appointed as a neutral, except where the award was by confession; or
(iii) an arbitrator, or agency or person making the award exceeded his power or so imperfectly executed it that a final and definite award upon the subject matter submitted was not made; or
(iv) failure to follow the procedure of this article, unless the party applying to vacate the award continued with the arbitration with notice of the defect and without objection.
2. The award shall be vacated on the application of a party who neither participated in the arbitration nor was served with a notice of intention to arbitrate if the court finds that :
(i) the rights of that party were prejudiced by one of the grounds specified in paragraph one; or
(ii) a valid agreement to arbitrate was not made; or
(iii) the agreement to arbitrate had not been complied with; or
(iv) the arbitrated claim was barred by limitation under subdivision (b) of section 7502.

Texas Civil Practice and Remedies Code:
§ 171.014. Vacating an Award

(a) Upon application of a party, the court shall vacate an award where:
(1) the award was procured by corruption, fraud or other undue means;
(2) there was evident partiality by an arbitrator appointed as a neutral or corruption in any of the arbitrators or misconduct or willful misbehavior of any of the arbitrators prejudicing the rights of any party;
(3) the arbitrators exceeded their powers;
(4) the arbitrators refused to postpone the hearing upon sufficient cause being shown therefore or refused to hear evidence material to the controversy or otherwise so conducted the hearing, contrary to the provisions of Section 171.005, as to prejudice substantially the rights of a party; or
(5) there was no arbitration agreement and the issue was not adversely determined in proceedings under Section 171.002 and the party did not participate in the arbitration hearing without raising the objection; but the fact that the relief was such that it could not or would not be granted by a court of law or equity is not ground for vacating or refusing to confirm the award.

[1] However, under the McCarran-Ferguson Act, a state statute barring arbitration will take precedence over the FAS if the state statute regulates the "business of insurance." See Stephens v. American Int'l Ins. Co., 66 Mutual Insurance Company, Inc., 969 F.2d 931, 934 (10th Cir.), cert. denied, 506 U.S. 1001 (1992).

[2] See 9 U.S.C. §§ 10, 11 (1970); Cal. Civ. Pro. Code §§ 1286.2, 1282.6 (1982 & Supp. 1995); Ill. Rev. Stat. ch. 710, para. 5/12, 5/13 (Smith-Hurd 1992); N.Y. Civ. Prac. L. & R. § 7511 (McKinney 1980); Tex. Civ. Prac. & Rem. Code Ann. §§ 171.014, 171.015 (West 1986).

[3] Courts disagree, however, as to whether they may hear challenges to arbitrators' impartiality prior to a proceeding to vacate an award. Compare In re Evanston Ins. Co. v. Kansa General Int'l Ins. Co. Ltd., No. 94 C 4957 (N.D. Ill. October 17, 1994) (reprinted in 5 Mealey's Litigation Reports: Reinsurance, No. 14 at A-1) (court may hear challenge to arbitrator in advance of hearing), with Old Republic Ins. Co. v. Meadows Indem. Co. Ltd., 870 F. Supp. 210 (N.D. Ill. 1994) (court may resolve claims of arbitral bias only in connection with proceeding to vacate award).

[4] In remanding to the district court, the Third Circuit noted that the lower court would have the power under the FAA to remand to the arbitration panel for a rehearsing. As a result, the appellate court opened a different procedural route to the revision of the first award.

[5] However, some circuits have held that courts may not vacate arbitral awards for manifest disregard of law. See, e.g., R.M. Perez & Assocs. Inc. vs. Welch, 960 F.2d 534, 539 & n.1, 540 (5th Cir. 1992) (Fifth Circuit limits review of awards to statutory grounds and has not adopted manifest disregard standard). Accord, McIllroy vs. Paine Weber, Inc., 989 F.2d 817, 820 n.2 (5th Cir. 1993).

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parties framed their intent. Unless and until someone has been through the process, it is more difficult to reconstruct the necessary evidence upon which to build the case.

At the *ARIAS* seminar in San Francisco, only a handful of attendees knew what a "bouquet" was in reinsurance parlance. When a treaty is a part of a bouquet, there may be extra contractual obligations which may not be apparent from review of the treaty wording alone.

Competitive forces often lead to treaties being leveraged. The type of leverage I am referring to is, "...if you write this substandard auto treaty for me, I will give you a share of our very profitable property quota share treaty." Five years later the reinsurer attempts to rescind the substandard auto policy; does that mean that the reinsurer is going to have to return all the premium and profit from the property quota share? Before the situation even gets that far, counsel should be asking the ceding company or reinsurer, has this treaty been leveraged in any way and what are the possible repercussions?

Recission is a remedy sought more frequently these days, although mostly in cases involving insolvencies; how can counsel best prepare its case to achieve that end?

The First Council considered the duty of utmost good faith in the disclosure of underwriting information in *Compagnie de Reassurance d'lle de France v. New England Reinsurance Corp.*[4]. The retrocessionaires wanted out! They sued for recission. The district court rescinded four treaties and the Court of Appeals virtually reversed every significant aspect of the district court's decision. The Appeals court defined "facultative." Did experts help the court in understanding the functions and market considerations for writing "facultative" reinsurance? If experts were used, was the information delivered to the court in a manner that the court could understand and use? For example, I recently read where a court in its opinion referred to reinsurance contracts as reinsurance "policies." In my experience, a contract of reinsurance has never been referred to as a policy; treaty, facultative, semi-automatic, bouquet, but not policy.

Although the court in the *Nerco*[5] case "reluctantly" upheld the decision of the lower court that the retrocedent's inadequate disclosure rose to the level of intentional misrepresentations, it remanded this issue to the district court to consider various defenses that the retrocedent might still have in spite of this finding. This is a case that begs for the use of experts and consultants who have experience with a reinsurer's use of intermediaries and MGA's. These professionals can enlighten the court on the customs and practices in the industry and help set standards upon which to find "intentional misrepresentations" and provide an articulate basis for recission.

Since the court for the most part embraced the duties of disclosure based on common law fraud, and the proving of the elements of fraud: misrepresentation of a material fact, knowledge of falsity and reliance, this could be made easier by the use of experts. The New York standard of proof is clear and convincing evidence.

In a final note involving Mission, *Quackenbush v. Albeille-Paix Reassurances*[6] the Superior Court of the State of California refused to enter judgment on the decision of the referees, who had been appointed by the parties to prepare a written decision. The referees found that Mission's disclosures in connection with the pool reinsurers had been substantially fraudulent, inadequate in virtually every way imaginable. The court in its two page order lamented that the referees basically "signed off" on a decision prepared by counsel for the retrocessionaires. Were experts used in the preparation of the written decision?

The use of experts and consultants can enhance counsel's ability in this complex area of reinsurance arbitration and litigation. Experts can conduct file review and analysis, assist in preparation and reviewing briefs, provide technical definitions, explanations and examples, conduct interviews and other investigative procedures as well as perform as arbitrators and provide court room testimony.

The author wishes to thank and acknowledge the use of David Grais's & Michael Zeller's publication, *American Reinsurance Law and Arbitration: 1995 in Review*, in the preparation of this article.

Therese Arana Adams is Principal consultant with *Arana Re-Insurance Consultants*.

1 *National American Insurance Co. v. Certain Underwriters at Lloyd's of London*, No. 94-55047, 1995 WL385396, Mealey's Litigation Reports: Reinsurance, Volume 6, Number 9, Sept. 13, 1995 (9th Cir. Aug. 24, 1995)

2 *Unigard Security Insurance Co. v. North River Insurance Co.*, 79 N.Y.2d 576, 594 N.E.2d571, 584 N.Y. 2d 290 (1992)

3 *North River Insurance Co. v. CIGNA Reinsurance Co.*, 52 F.3rd 1194 (3rd Cir. (N.J.), Apr. 13, 1995 (No. 93-5743, 93-5764)

4 *Compagnie de Reassurance D'lle de France v. New England Reinsurance Corporation*, 57 F.3d 56, (1st Cir. Jun 19, 1995) (Nos. 93-2338, 93-2339)

5 Id

6 *Quackenbush v. Albeille-Paix Reassurances*, No. C572 724 (Ca. Super. Ct. Dec. 28, 1995)

SEE RELATED ARTICLE ON PAGE 2

The Use of Consultants and Experts in the Arbitration Process

by Michael D. Isaacson

Those of us who have participated in the various ARIAS workshops have been hearing words such as "disinterested", "impartial", "unbiased" and "neutral" when referring to the arbitration panel. Proposals are being put forth for the selection of "neutral" panels with no party appointed arbitrators. We are also being told at workshops and organizational meetings that some arbitrators are uncomfortable with ex-parte communications, with "radio-silence" beyond the organizational meeting becoming a standard. Furthermore there are implications that discussions between counsel and arbitrator, if acting as advisor, are discoverable or need disclosure during panel deliberations. It has become difficult if not impossible for counsel to use "their arbitrator" in an advisory or sounding board captivity.

While some counsel may want to use their clients' personnel as consultants, I respectfully submit that this is not necessarily the best course of action. One should utilize an impartial outside reinsurance professional as consultant. The consultant will have an unbiased view of the case. Many times a client has taken a distinct view of a case and it would be difficult for an employee to counter that view. The consultant can be your sanity check, help in developing realistic approaches and strategies, and advise on damage control if the case is not going where you and your client anticipated.

We saw at the San Francisco workshop that approximately 2/3 of the participants voted contrary to the panel. Most of those who voted were attorneys who in a real case might have benefited from having open and free discussions with an unbiased reinsurance professional whose views should more closely reflect those of the panel.

In the arbitration process those of us who participate can all wear different hats. At times we may be a consultant assisting counsel and client prepare the strongest case possible or achieve the most advantageous settlement, or an expert helping to explain a particular issue for the benefit of the panel, or be the arbitrator or umpire working towards the just resolution of a dispute. If you cannot use your arbitrator as advisor in the context of an arbitration then it would probably be advisable to bring in, at the outset, a knowledgeable reinsurance consultant to assist in the case, especially today when many of us have worn the hat of an arbitrator, consultant, expert witness and umpire.

While the use of experts in the scenario presented at San Francisco may not have been necessary, since panel members had familiarity with facultative practices, there are plenty of cases where their testimony on specialized matters can be advantageous. While we recognize that some attorneys are reluctant to suggest experts in the context of an arbitration, most of us who practice as arbitrators are not going to penalize anyone for using an expert. We all recognize that we are professionals but may not be up to date on specific practices or may not have had direct experience in at least some of the issues that come up in an arbitration. Even the best intentioned insurance executive may not completely understand the nuances of a reinsurance transaction if he or she was not active in the reinsurance process or a reinsurance executive may not have had recent hands on experience. We are all the product of our experiences and having different viewpoints expressed can be useful. To achieve a reasoned decision the judicious use of experts can be beneficial.

Michael D. Isaacson, Principal, Re/Insurance Advisory International
A 27 year Domestic and International Insurance and Reinsurance Professional who has been involved as Arbitrator, Consultant, Expert and Umpire in Insurance and Reinsurance disputes with over $100,000,000 at issue.

ARIAS•U.S. invites guest articles and encourages you to share your opinions. Fax to : (914) 699-2025

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2. To promote just awards in accordance with industry practices and procedures.

3. To certify objectively qualified and experienced individuals to serve as arbitrators.

4. To provide required training sessions for those persons certified as arbitrators.

5. To propose model rules of arbitration proceedings and model arbitration clauses.

6. To foster the development of arbitration law and practice as a means of resolving national and international insurance and reinsurance disputes in an efficient, economical and just manner.

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b. Certification of a candidate requires the affirmative vote of at least two-thirds of the full membership of the Board of Directors.

c. A copyrighted list of certified arbitrators will be maintained by ARIAS•U.S. for use by its members and shall not be published or distributed outside of the membership.

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Certification Programs continued from page 9

4. **APPLICATION FOR CERTIFICATION**

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b. present and prior business affiliations.

c. number of **completed** insurance/reinsurance arbitrations as arbitrator or umpire and related information including, with respect to the three most recently completed arbitrations, the names of the other arbitrators and the date of completion.

d. number of **completed** insurance/reinsurance arbitrations as outside counsel and related information including, with respect to the three most recently completed arbitrations, the names of the arbitrators and the date of completion.

e. areas of specialty.

f. number of years of industry experience as defined in 2.a., above.

g. education – college and graduate.

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i. licenses, professional associations.

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l. statement by applicant that he/she will agree to abide by the By-laws of ARIAS•U.S., including the provisions covering arbitration of disputes; that the information provided is subject to verification; and that the applicant agrees that the information is accurate to the best of his/her knowledge, information and belief.

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ARIAS•U.S. is a not-for-profit corporation organized principally as an educational society dedicated to improving reinsurance and arbitration panels and procedures. The Society provides education for arbitrators, attorneys, insurers and reinsurers in practices and procedures which will improve the arbitration of commercial disputes. The Society, through seminars and publications, seeks to make the arbitration process meet the needs of today's insurance/reinsurance marketplace by:

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