ARIAS US

QUARTERLY

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EDITOR'S LETTER

As I opened my newspaper, I saw reports of the hacking of Colin Powell's emails and revelations about the medical histories of the tennis-playing Williams sisters, but every day we read of another instance where confidential electronically stored information held by the government, businesses, or individuals has been exposed. Like bees drawn to honey, it almost seems that efforts to keep data confidential attract counter efforts to reveal it. The only question is who or what is next.

Lest anyone believe we in the arbitration community are immune, keep in mind that attacks have occurred close to home. Insurance companies and law firms have all been victims. Cross reinsurance arbitrations off the list? No, that would be foolhardy. After all, isn't confidentiality one of the reasons parties choose arbitration over litigation?

One can only speculate about the repercussions of cyberattacks on our industry, but there's no question that the harm could be serious, so it's time to begin thinking about cybersecurity and arbitrations. Thus, we begin this edition of the ARIAS *Quarterly* with some consciousness raising. Dan FitzMaurice of the Day Pitney firm identifies the problem of cybersecurity and shows how data breaches occur. He explains some of the particular obligations of insurers and reinsurers to maintain confidentiality and concludes with a report on what ARIAS is doing to address the risks.

Our next article, by Bob Hall, explores case law dealing with some of the consequences of *ex parte* communications. Bob finds that there's no clear rule for determining whether or not *ex parte* communications will actually result in a penalty. To illustrate his point that the result can be jurisdiction-dependent, he looks at a recent opinion of the 6th Circuit that has generated some buzz in reinsurance circles. In the case of *Star Insurance Company et al. v. National Union Fire Insurance Company of Pittsburgh, PA*, Nos. 15-1403 & 15-1490, 2016 U.S. App. LEXIS 15306 (6th Cir. Aug. 18, 2016) (not recommended for full-text publication), the 6th Circuit, interpreting Michigan law, vacated an award because of improper *ex parte* communications between counsel and its client's party-appointed arbitrator.

At the least, the opinion raises a drafting issue regarding protocols for *ex parte* communications during the course of an arbitration. If you want to join the debate on whether the court got it right, be sure to also read Ron Gass's article on the decision in his Case Notes Corner article.

Speaking of debates, a long-running one in our industry concerns the latitude a cedent should have to allocate losses ceded to reinsurers. We don't purport to be able to settle the issue in these pages, but we're once again pleased to provide a forum for members to exchange their views. In this edition, Locke Lord partner Tom Bush presents an analysis of the case law.

We in ARIAS are quick to proclaim the advantages of arbitration over litigation. Especially as awards are subject to only limited judicial review, for arbitration to remain the best choice, parties must have confidence that the process will give them a fair shake. A fundamental safeguard against bias or partiality is the duty of arbitrators to make full

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and candid disclosures. We know that arbitrators must disclose their financial interests in a matter and their relationships with individuals and business entities connected to it, but what about their prior subject matter knowledge or experience? To address this unsettled question, Larry Schiffer of Squire Patton Boggs LLP and Tereza Horáková have written a thoughtful article discussing ethical considerations and codes as well as the case law.

After a party initiates arbitration, the respondent will sometimes default by failing to name its arbitrator in a timely manner or to participate in the proceedings. Under most contracts, the initiating party has the right to appoint a so-called "default arbitrator" to be the defaulting party's party arbitrator. An article discussing some aspects of this situation appeared in last year's 4th quarter edition of the ARIAS *Quarterly*; in this issue, Charlie Barr expands on the subject by sharing his ideas for best practices in default arbitrations. It's quite comprehensive, even suggesting ways to guarantee that those who accept an appointment as a default arbitrator will be paid their fees.

Our final piece in this edition is one of our regular features, The Arbitrators Corner. Sylvia Kaminsky and Eric Kobrick of the ARIAS Arbitrators Committee report on the Committee's projects, goals and objectives. Even if you're not an arbitrator, you'll want to learn what the committee has been up to.

As always, this issue of the *Quarterly* attempts to bring you articles that are interesting, informative, and of practical value to the members of ARIAS. I hope you've enjoyed them. The *Quarterly* depends entirely on articles written by our members. I'd like to thank all those who've responded to our call for articles in the past and to encourage you, our readers, to send us your articles in the future. If you'd like to discuss an idea you have for an article or need further information on submitting one, please contact me at tomstillman@aol.com. •

— Tom Stillman

Lest anyone believe we in the arbitration community are immune, keep in mind that attacks have occurred close to home. Insurance companies and law firms have all been victims.

ARIAS Out & About

On September 20, a panel of ARIAS representatives delivered a presentation at the Casualty Actuarial Society's Loss Reserving Seminar titled "Arbitration 101: What Every Actuary Should Know About Arbitration." The panel – Paul Braithwaite, Liz Sander, Steve Schwartz, Bob Sweeney and Alysa Wakin – spoke about the basics of reinsurance arbitration, and how actuaries get involved as fact witnesses, expert witnesses and arbitrators. There was lively exchange with the audience, and many of the actuaries there were obviously interested in arbitration.

On October 20, 2016, on Paris's Île de la Cité, at the New York State Bar Association International Section's Paris Conference, Christian Bouckaert of Bouckaert Ormen Passemard (Paris), Yves Hayaux-du-Tilly of Nader Hayaux & Goebel (Mexico City), Susannah Wakefield of Taylor Wessing LLP (London), and Edward K. Lenci of Hinshaw & Culbertson LLP (New York), addressed how reinsurance disputes are resolved in different nations and across national boundaries. Their presentation focused on arbitration under the laws of France, Mexico, England, Bermuda, and the U.S.A. They discussed, too, the role of organizations such the Association Internationale de Droit des Assurances ("AIDA"), ARIAS-Mexico and ARIAS-US. Their panel was one of almost thirty at the Conference. They hope to share their presentation with ARIAS-US in 2017.

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Cybersecurity & Data Security — p. 5

1 Daniel FitzMaurice, a partner at Day Pitney, represents clients in trials, arbitrations, and appeals of complex commercial disputes. He handles a wide variety of matters with an emphasis on insurance and reinsurance, corporate, banking, franchise, and financial transactions. He is actively engaged in ARIAS•U.S., having served on the board of directors and as chairman; he currently serves as a member of the Member Services Committee and as a member of the Strategic Planning Committee. He speaks frequently on issues relating to reinsurance, financial services, and trial practice.

Ex Parte Communications — p. 10

2 Robert Hall is an attorney, a former law firm partner, and a former insurance and reinsurance executive. He acts as an insurance consultant as well as an arbitrator of insurance and reinsurance disputes and as an expert witness. He is a veteran of more than 175 arbitration panels and is certified as an arbitrator and umpire by ARIAS · U.S. The views expressed in this article are those of the author and do not reflect the views of his clients. Copyright by the author 2016. Mr. Hall has authored over 100 articles and they may be viewed at his website: robertmhall.com.

Resonably Prudent — p. 16

3 Charles F. Barr is the former general counsel of several property/casualty and life/health/annuity international re/insurance groups, an intermediary, and two derivatives dealers. He is a CPCU and a former casualty underwriter, co-manager of workers' compensation underwriting, and manager of a runoff claims operation. He is an ARIAS-certified arbitrator, expert witness, and financial condition enhancement consultant. More is available on LinkedIn and at www.CBarrADR.com.

Affirmative Disclosure — p. 22

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5 Tereza Horáková was a summer law clerk in the West Palm Beach office of Squire Patton Boggs. A graduate of Charles University in Prague, Czech Republic, with a J.D. in Czech law, she is currently a dual degree J.D. candidate at Nova Southeastern University in Florida (2017).

Settlement Allocations — p. 28

6 Thomas F. Bush is a partner in Locke Lord LLP, based in Chicago. He represents insurers and reinsurers in arbitrations and complex litigation. He also concentrates on antitrust law, including litigation, investigations and merger review, and regularly advises global insurance companies on antitrust compliance. He is co-chair of Locke Lord's Antitrust Practice Group.

Arbitrator Awards — p.35

7 Ronald S. Gass is an attorney and an ARIAS•U.S. Certified Arbitrator and umpire and has participated in over 90 arbitrations. Most of his 28-year legal career has been devoted exclusively to his reinsurance and insurance practice involving a broad range of complex business issues, including coverage disputes arising from various lines of business such as asbestos and environmental liability, workers' comp carve-outs, medical malpractice liability, and property and catastrophe insurance. He also has significant experience with reinsurance collections, MGA transactions and disputes, surety reinsurance, reinsurance contract wordings and interpretation, reinsurance intermediary disputes, and commutations.

Cybersecurity and Data Security

What are the risks for insurance and reinsurance arbitration?

By Daniel L. FitzMaurice

At many insurance and reinsurance companies, the executives responsible for managing arbitrations realize they have a problem, a delicate one. The problem concerns arbitrators—namely, the security risks that arbitrators pose in relation to confidential information.

Depending on the nature of the dispute and how the parties present their cases, arbitrators may receive, transmit, store, and even generate sensitive information relating to the parties, policyholders, claimants, and others. Moreover, arbitrators are not immune to data breaches. Several federal and state statutes and regulations, including the Graham-Leach-Bliley Act and HIPAA, require that insurers protect the confidential information of customers and claimants. Insurers and reinsurers cannot ignore their legal obligations and the potential risks that arbitrators present regarding confidential information in electronic (cybersecurity) and paper (data security) form.

Identifying this exposure is, of course, just the beginning. The contours of this risk remain unclear. Do most arbitrators transmit encrypted emails over secure networks, and with devices protected by strong passwords, or are many using public Wi-Fi and unprotected devices? If an arbitrator loses a file or an electronic device, would he or she be likely to notify the parties in all potentially affected proceedings? Although it may be easier to infiltrate vendors than well-protected corporate systems, how likely are hackers to target arbitrators? What can the parties and counsel do to reduce these exposures? This article

Do most arbitrators transmit encrypted emails over secure networks, and with devices protected by strong passwords, or are many using public Wi-Fi and unprotected devices?

will discuss the challenge of cybersecurity and data security in the context of insurance and reinsurance arbitration.

How Data Breaches Occur

Data breaches result from many causes. According to an article in Property Casualty 360,[1] the top six causes of data breaches in 2015 were:

Percentage	Cause of Data Breach
31%	Phishing, hacking or malware
24%	Employee action or mistake
17%	External theft
14%	Vendor
8%	Internal theft
6%	Lost or improperly disposed data

A survey conducted by the Association of Corporate Counsel in 2015 found that employee error, including incorrectly transmitting confidential data and falling for phishing, was the leading cause of data breaches in companies. Moreover, the highest numbers of breaches reported in this survey were in healthcare companies, followed by insurance, manufacturing, and retail.

Securing Confidential Information

According to the 2016 Data Breach Investigations Report by Verizon, "[n]o locale, industry or organization is bulletproof when it comes to the compromise of data."[2] Although many insurance and reinsurance companies have long recognized the importance of cybersecurity and data security, developments in the past two years have been a clarion call to the industry. The following events, among others, have brought home the need for vigilance:

- November 2014: The National Association of Insurance Commissioners (NAIC) formed a special task force regarding the protection of information, including consumer information collected by insurance companies.
- December 2014: The New York Department of Financial Services announced plans to expand its information technology examination procedures with a greater focus on cybersecurity. Among other things, examinations will include evaluating insurers' management of third-party service providers.
- January 2015: Anthem learned that it had been the victim of a massive cyberattack. The hackers obtained private information regarding nearly 80 million members and former members of Anthem's health plans, including names, dates of birth, Social Security numbers, home addresses, email addresses, employment information, and income data.
- February 2015: The New York State Department of Financial Services (NYDFS) issued a Report on Cyber Security in the Insurance Sector ("NY Report").[3] The NY Report reflected the results of a survey that the department conducted of 43 insurance providers in 2013-2014. The department also met with insurers and reviewed enterprise risk management (ERM) reports that certain insurers filed. One of the concerns that the department raised was that 16% of the survey respondents do not conduct compliance audits of third-party service providers that handle the personal data of customers or employees.
- March 2015: Premera Blue Cross suffered a cyberattack that affected an estimated 11 million consumers. Columbian Mutual Life Insurance Company discovered that it had lost a flash drive containing personal information of present and former agents, customers, and beneficiaries. The NYDFS sent a letter to insurers requesting a comprehensive risk assessment of their cybersecurity.
- April 2015: The Cybersecurity (EX) Task Force of the National Association of Insurance Commissioners (NAIC) adopted the *Principles for Effective Cybersecurity Insurance Regulatory Guidance.*[4] One of the twelve guiding principles, Principle 8, calls for monitoring sensitive data in the hands of vendors: "Insurers, insurance producers, other regulated entitles and state insurance regulators should take appropriate steps to ensure that third parties and service provides have controls in place to protect personally identifiable information."
- October 2015: The NAIC Cybersecurity Task Force developed a "Cybersecurity Consumer Bill of Rights" for policyholders, beneficiaries, and claimants. This effort was intended to guide regulators in drafting model regulations to protect consumers and to assist consumers whose information is compromised.
- December 2015: The NAIC Executive Committee changed the name of the Cybersecurity Consumer Bill of Rights to the NAIC Roadmap for Cybersecurity Consumer Protections (Roadmap), and adopted the Roadmap.
- March 2016: The NAIC Cybersecurity Task Force introduced for public

comment a proposed Insurance Data Security Model Law. Among other things, the model law imposes obligations on the boards of directors of licensed insurance companies to approve the insurer's written information security program and oversee the development, implementation, and maintenance of the program.

This non-exhaustive list shows the extraordinary focus on information security in the insurance industry and that vendors fall squarely within this concern.

As the regulatory efforts described above attest, the need for security does not stop within the confines of insurance and reinsurance companies. Insurers and reinsurers frequently supply confidential information to third parties and may even provide direct access to their computer systems. For example, information technology (IT) vendors often possess troves of data from many corporate systems and, thus, serve as especially inviting targets for hackers. Many other third parties, however, may also have access to the confidential information of an insurance or reinsurance company and become sources of data breaches. For example, an enrollment vendor for a life, disability, accident, and health insurer allegedly posted online the personally identifiable information (including names, addresses, dates of birth, and Social Security numbers) of numerous customers.

Law firms are another vendor risk—e.g., cyber-criminals have targeted law firms in hopes of discovering embargoed press releases and insider information about upcoming mergers, acquisitions, and other corporate transactions that may affect stock prices. Although companies often inquire into the security protections in place at their outside law firms, what happens when companies and lawyers share confidential information with arbitrators?

Arbitrators = Potential Security Risks

Arbitrators are vulnerable to most, if not all, of the causes of data breaches identified above. Whether as arbitrators or simply as private individuals, they may be subjected to the leading causes of data breach: the cyberattacks of phishing, hacking, and malware. Arbitrators may also make mistakes with data, suffer external theft, and lose or improperly dispose of documents and devices containing data. Likewise, they may experience other causes of data breach, such as losses through sub-vendors (e.g., cloud storage). Thus, arbitrators who receive, store, transmit, or generate sensitive information constitute potential security risks.

What type of information is in jeopardy? Parties to arbitrations of disputes regarding insurance coverage, retrospective premiums, or reinsurance obligations often submit confidential information in documents and testimony, including:

- Medical (including psychiatric) reports and information in disputes arising from personal injury, abuse, worker's compensation, health, life, and disability claims, as well as such information in loss runs, and financial disagreements over these types of claims;
- Social Security numbers and employment and income information in insurance and reinsurance disputes regarding casualty, health, and disability claims, but also in matters involving life insurance and annuities;
- Financial information about insurance and reinsurance companies, including profits, losses, reserves, collateral, proprietary software, customer lists, trade secrets, and other information; and
- Deliberations, rulings, and awards in substantial arbitrations that might have material effects on the financial and regulatory reporting of companies as well as on the price of shares of publicly traded companies.

A survey conducted of the Association of Corporate Counsel in 2015 found that employee error, including incorrectly transmitting confidential data and falling for phishing, was the leading cause of data breaches in companies.

How realistic is this threat? Would anyone ever intentionally launch an attack in search of confidential information connected to an arbitration? It has already happened.

Thus, arbitrators may possess some of the very kinds of confidential material—personally identifiable information and corporate financial data that may be material to share values—that have been the subject of several well-publicized data breaches and cyberattacks.

How realistic is this threat? Would anyone ever intentionally launch an attack in search of confidential information connected to an arbitration? It has already happened. The Permanent Court of Arbitration in The Hague suffered a cyberattack in connection with the arbitration of a maritime border dispute between China and the Philippines. Although one can easily distinguish most commercial arbitrations from an international disagreement over China's claims of sovereignty, cybercriminals might seek access to types of confidential information that exist in insurance and reinsurance arbitrations.

Moreover, like law firms, arbitrators are readily identifiable targets through Internet searches and listings on websites. And, of course, arbitrators themselves can cause data breaches through various means, including losing files, drives, and other devices that may contain sensitive information.

ARIAS•U.S. and Securing Confidential Information

Recognizing the importance of this issue, ARIAS•U.S. invited Lt. General Edward Cardon, commander, The United States Army Cyber Command, to be the keynote speaker at its Spring Conference in May 2016. General Cardon's presentation about cyber threats and deterrence captivated the audience and generated more questions than any speaker at an ARIAS•U.S. conference in recent memory.

In 2016, the board of directors of ARIAS•U.S. formed a task force to address cybersecurity and data security in arbitration. Elizabeth Mullins, board chair, heads this task force. Three other board members participate—Scott Birrell, John Nonna, and James Rubin—as do Thomas Cunningham, Daniel FitzMaurice, John Jacobus, Michael Menapace, Brad Rosen, Larry Schiffer, and David Winters. With input from others on the task force, Tom Cunningham, Michael Menapace, and David Winters prepared an excellent draft of a reference guide about the transmission and storage of confidential information in arbitration and will publish a related article in the ARIAS•U.S. *Quarterly*. This draft guide and the broader topic of cybersecurity and data security in arbitration will be focal points at the ARIAS•U.S. Fall Conference.

In addition, Scott Birrell, John Jacobus, and other members of the Forms & Procedures Committee have revised key forms to address the need for security:

- The case protocols section of the Comprehensive Arbitration Scheduling Order (Form 4.1) was amended to include a new section 10, which provides: "Cyber Protections. The Parties have agreed to adopt the following measures to protect the data and case information exchanged in this proceeding from cyber breaches [insert encryption procedures or web-based portal for secure exchange of information]."
- A new section to the Confidentiality Agreement and Protective Order was added, providing that: "The parties have agreed to use the following reasonable methods to protect the data and other information in this proceeding from cyber breaches [insert mandated use of cyber protection software or encryption procedures]. Any breach or loss of data as a result of a cyber breach shall be reported to the other party(ies) as soon as reasonably possible, so that appropriate remediation measures may be undertaken."

What To Do? It Depends . . .

Differences in the subject matter, evidence, and content of the proceedings, as well as in the objectives and circumstances of the parties—and, of course, changes in technology—all militate against finding a universal solution to managing cybersecurity and data security in every arbitration. In some instances, the parties may be able to find

ways to present their dispute without ever exposing the arbitrators to any sensitive information. On other occasions, the parties may need to provide confidential information, but they may be able to ensure that any arbitrator access takes place exclusively in a secure area or through secure means.

Thus, the revised ARIAS • U.S. forms for scheduling orders and confidentiality agreements ask the parties to identify the applicable security measures but leave the specifics to be completed in each case. Likewise, the draft reference guide does not dictate behaviors, but offers many helpful suggestions for the parties and arbitrators to evaluate and possibly adopt. Although the particulars will differ, well-run arbitrations will have one element in common: the parties, counsel, and arbitrators must consider and adopt appropriate measures to manage the challenge of cybersecurity and data security in each proceeding. •

ENDNOTES

1. Jayleen R. Heft, *What Are the Leading Causes of Data Security Breaches?*, PROPERTY CASUALTY 360° (Apr. 12, 2016), http://www.propertycasualty360.com/2016/04/12/what-are-the-leading-causes-of-data-security-breac?page_all=1&slreturn=1469822762.
2. VERIZON, 2016 DATA BREACH INVESTIGATIONS REPORT at 3, available for download at http://www.verizonenterprise.com/verizon-insights-lab/dbir/2016/ (last visited Aug. 22, 2016).
3. *See Report on Cyber Security in the Insurance Sector*, N.Y. STATE DEP'T OF FIN. SERVS. (Feb. 2015), http://www.dfs.ny.gov/reportpub/dfs_cyber_insurance_report_022015.pdf.
4. *See* News Release: *NAIC Cybersecurity Task Force Adopts Regulatory Principles*, NAIC & THE CTR. FOR INS. POLICY RESEARCH (Apr. 17, 2015), http://www.naic.org/Releases/2015_docs/naic_cybersecurity_task_force_adopts_regulatory_principles.htm.

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Ex Parte Communications in Arbitrations and Their Consequences

Notwithstanding some recent, well-publicized cases involving ex parte *communications, the consequences of such communications are not well understood.*

By Robert M. Hall

Arbitration panels commonly adopt rules pertaining to *ex parte* communications concerning: (a) the time periods within which counsel may communicate with their party arbitrators; (b) counsel copying opposing counsel and party arbitrators on communications with the umpire; (c) party arbitrators copying the opposing party arbitrator on communications with the umpire; and (d) the umpire copying both party arbitrators on internal panel communications and both counsel and both party arbitrators on external communications. A common version of such rules has been codified in the ARIAS Code of Conduct, Cannon V. Notwithstanding some recent, well-publicized cases involving *ex parte* communications, the consequences of such communications are not well understood. The purpose of this article is to explore selected case law dealing with the consequences of *ex parte* communications.

Case Law under the Federal Arbitration Act and State Clones

The Federal Arbitration Act (FAA) governs the arbitration of issues involving interstate commerce. However, many states have enacted their own versions of arbitration laws that, typically, are very similar to the FAA. As a result, cases based on state law are relevant even if the insurance transaction involved is interstate commerce.

Cases in Which the Court Declined to Vacate an Order

There are many such cases. One case involving a reinsurance dispute is *Mutual Fire, Marine & Inland Insurance Co. v. Norad Reinsurance Co.*, 868 F.2d 52 (3rd Cir. 1989). During the course of the hearing, it became evident that one or more of the panelists had tried (unsuccessfully) to track down one of the individuals involved in the dispute. The losing party argued that this was an *ex parte* investigation by the panel

that constituted misbehavior by which that party was prejudiced pursuant to § 10(c) of the FAA. The court noted that the losing party had the burden of proving that prejudicial *ex parte* communications took place. The court ruled that this burden was not met:

> Even if we assume, as appellants contend, that the evidence they proffered establishes that the arbitrators engaged in some form of *ex parte* contacts, we nevertheless conclude that the arbitrators' award can stand because the appellants have failed to carry their burden of showing how these contracts prejudiced them. The mere assertion by appellants that the arbitrators used information obtained *ex parte* in order to render their decision . . . is not enough, in our view, to establish the requisite prejudice necessary for this court to vacate the arbitrator's (sic) award.[1]

Remmey v. PaineWebber, Inc., 32 F.3d 143 (4th Cir. 1994), involved an umpire with a joking and informal matter. Testimony suggested that the umpire might have had an *ex parte* discussion with one of the counsel about seating in a crowded hearing room. The court found that the losing side did not prove that such a conversation actually took place or that, even if it did, the losing side was prejudiced thereby:

> [A]ppellant has failed to show that any remarks regarding seating would have prejudiced her case. Failure to make such a showing bars vacature of the arbitral award because "the party seeking a vacation of an award on the basis of *ex parte* conduct must demonstrate that the conduct influenced the outcome of the arbitration." Indeed, the decision of who sits where during a proceeding is a classic discretionary call for a presiding offer. [Appellant's] attempt to elevate this innocuous matter into a basis for overturning the entire arbitral result is indicative of a scatter-shot attack on an adverse decision.[2]

A somewhat bizarre case on *ex parte* communications is *Global Gold Mining LLC v. Calder Resources*, Inc., 941 F. Supp. 2d 374 (S.D.N.Y. 2013). The losing party claimed it was prejudiced by its *ex parte* conversation with the sole arbitrator on the basis that the conversation gave the losing party a false impression of where it stood in the arbitration and, as result, such party made certain tactical decisions that did not result in a favorable order. Ignoring the irony of the situation, the court ruled that there was no prejudice to the losing party because: (a) the arbitrator's comments, if they in fact were made, were merely a present assessment that could change as the case developed; and (b) there was no assurance that different tactics would have produced a more favorable result.

Heartland Surgical Specialty Hospital, LLC v. Reed, 48 Kan. App. 237 (Ct. App. Kan. 2012), involved an arbitration between a hospital and a physician over a non-compete. The attorney for the physician had an 18-minute *ex parte* phone call with the single arbitrator, who thereafter dismissed all but one of the hospital's claims without a hearing. The hospital sought to vacate the arbitrator's ruling on *ex parte* and other bases, relying on Kansas arbitration statute "K.S.A. 5-412(a) and (b) which require the court to vacate an arbitration award where '(1) The award was procured by corruption, fraud or other undue means; [or] (2) There was evident partiality by an arbitrator appointed as a neutral or corruption in any of the arbitrators or misconduct prejudicing the rights of any party.'"[3] The court declined to vacate:

> It goes without saying that the arbitrator and [the physician's] counsel should not have engaged in any *ex parte* communications about what pleadings were to be filed or about any other similar subjects. [The hospital] argues then that there should be a strong presumption of prejudice sufficient to vacate the award. However, we are aware of no such presumption in Kansas

During the course of the hearing, it became evident that one or more of the panelists had tried (unsuccessfully) to track down one of the individuals involved in the dispute.

The appellate court noted that ex parte contacts between a party arbitrator and an umpire justify vacating the arbitration award.

> law. Rather, when a party files a motion to vacate an arbitration award on grounds of improper *ex parte* communication, the party must advance proof that any *ex parte* communication "affected or played a part in the decision rendered by the arbitrators."

. . . Based on the relevant facts from the record, which are undisputed, we fail to see that any *ex parte* communication affected the arbitrator's decision here.[4]

A complaint to a lawyer disciplinary board about *ex parte* communication was the issue in *In re Conduct of Merkel*, 341 Ore. 142 (2006). The attorney for one of the parties had issued subpoenas to two witnesses but they could not be physically present on the designated hearing date. The attorney called the arbitrator, without the participation of the other party's attorney, to ask if the arbitrator had a speakerphone and was willing to accept telephonic testimony. The arbitrator responded that he had a speakerphone and was willing to accept such testimony if opposing counsel did not object. The attorney thereafter informed opposing counsel, who objected and filed an ethics complaint. The relevant standard under the ethics code was whether the communication was on the merits of the dispute, meaning whether it "affects any legal right or duty of the parties." The court ruled that the conversation with the arbitrator was not on the merits and did not violate the ethics code:

> The conversation concerned the procedural issues of whether the arbitrator had speaker phone technology and the arbitrator's policy regarding telephone testimony, not whether [the opposing party] had a right to agree or to object to the presentation of a testimony by telephone. The accused did not ask for such a ruling, nor did the arbitrator make such a ruling. . . . It does not appear that the communication was "on the merits" of the pending proceeding.[5]

The arbitrator inadvertently neglected to rule on a claim in *A.M. Classic Construction, Inc. v. Tri-Build Development Co.*, 70 Cal. App. 4th 1470 (Ct. App. 1999). The arbitrator found for the subcontractor on the primary issue, but failed to rule on a claim necessary for the subcontractor to collect on the primary issue. The attorney for the subcontractor wrote to the arbitrator asking for such a ruling and enclosing a proposed order. The attorney then followed up with a call to the arbitrator. Both communications were *ex parte*. Thereafter, the arbitrator amended his original order to rule in favor of the subcontractor on the omitted issue. The opposing party moved to vacate based on the California arbitration statute. The court declined to do so:

> We agree the arbitrator should have advised appellants' counsel of the *ex parte* communication and that he would be issuing an amended arbitration award resolving the stop loss notice claim. In the absence of a showing that the arbitrator was improperly influenced or actually considered evidence outside the original arbitration proceedings such that appellants needed a further opportunity to be heard on the stop notice claim, appellants cannot demonstrate that the amended award was procured by corruption, fraud, undue means, or misconduct of the arbitrator within the meaning of section 1286.2, subdivisions (a), (b) or (c).[6]

Cases in Which the Court Vacated an Order

There are relatively few cases in which arbitration orders were vacated for *ex parte* communications. One such case is *Maaso v. Singer*, 203 Cal. App. 4th 362 (Cal. Ct. App. 2012). After an arbitration hearing, but while an order was pending, one of the party arbitrators faxed argument to the umpire and indicated a carbon copy to the opposing party arbitrator; although the arbitrator had the opposing party arbitrator's fax number, he sent the copy by ground mail to the opposing arbitrator's former address. Before the errant communication reached that arbitrator, the umpire issued an order in favor of the party whose arbitrator faxed the argument. The trial court vacated the order, finding the motive and actions of the arbitrator who sent the argument highly

questionable and that such actions improperly influenced the umpire's decision. The appellate court noted that *ex parte* contacts between a party arbitrator and an umpire justify vacating the arbitration award. The court upheld that lower court: "We agree with the trial court that an *ex parte* communication undermines the fairness and integrity of the arbitration process."[7]

Pacific & Artic Railway & Navigation Co. v. United Transportation Union, 952 F.2d 1144 (9th Cir. 1991), reviewed the district court's vacation of an arbitration order for fraud under the Railroad Labor Act. The court of appeals characterized its review of such an award as "among the narrowest known to the law."[8] The lower court had found as follows:

> In light of the entire record, including the procedural improprieties; egregious non-disclosures and unbelievable post facto explanations by the [arbitrator for the union and umpire], the [umpire's] assumption of an advocate's role and active assistance to the union in shaping the record so that it might support his awards; numerous *ex parte* communications between [the party arbitrator for the union and umpire]; [the umpire's] acceptance of gratuities and other favors from [the party arbitrator for the union] or union officials; the actual and demonstrated bias of [the umpire] and the irrational awards that are the product [of the umpire's] bias and favoritism, I conclude that the awards are tainted by the functional equivalent of fraud...[9]

Based on this record, the court of appeals affirmed the lower court's decision vacating the award.

An arbitration concerning a ship charter provided the backdrop for *Totem Marine Tug & Barge, Inc. v. North American Towing, Inc.*, 607 F.2d 649 (5th Cir. 1979). After the close of the arbitration hearing and during deliberations, the arbitrators determined that they needed verification of the earnings of the vessel in question and placed an *ex parte* call to the vessel owner. The panel adopted the figures supplied by the vessel owner without an opportunity by the opposing party to challenge such figures. The court vacated the award, holding:

> After the arbitration panel improperly extended the scope of the arbitration to include charter hire, the extent of Totem's liability hinged on the determination of the earnings of the [vessel]... The *ex parte* receipt of evidence bearing on this matter constituted misbehavior by the arbitrators prejudicial to Totem's rights in violation of 9 U.S.C.A. § 10 (c).[10]

Katz v. Uvegi, 187 N.Y.S.2d 511 (N.Y. Sup. Ct. 1959), involved an arbitration in which the panel ordered the respondent to leave the hearing room for a half hour, during which the petitioner provided testimony that the respondent was unable to rebut. The court declined to confirm the subsequent award, stating: "Arbitrators cannot conduct *ex parte* hearings or receive evidence except in the presence of each other and of the parties, unless otherwise stipulated."[11]

Alternative Standards for Addressing *Ex Parte* Communications

Breach of Arbitration Agreement

Star Insurance Co. v. National Union Fire Insurance Co., 2016 U.S. App. LEXIS 15306 (6th Cir.), involved an arbitration pursuant to Michigan law with a three-member arbitration panel. The panel adopted a scheduling order that cut off *ex parte* communications at the submission of the first brief on the merits. On the day the panel issued an interim final award, the party arbitrator and counsel for the reinsurer had an *ex parte* conversation; they had another two days later, and one more thereafter. The party arbitrator for the reinsurer and the umpire had a number of *ex parte* communications and issued two orders adverse to the cedent without the participation of the party arbitrator for the cedent, who, they were told, was sailing in northern Canada and out of reach. When the reinsurer filed briefs supporting its motion for costs, the cedent discovered the extensive *ex parte* contacts noted above and filed motions to stay the arbitration and to reconsider certain rulings, but the motions were denied.

When the panel issued a final order, the cedent filed a suit asking the court to vacate two of the panel's orders based on "misconduct" under Michigan's arbitration statute due to *ex parte* communications in violation of the panel's scheduling order and the arbitration agreement between the parties. The appellate court rejected the reinsurer's argument that the interim final award was actually a final order on the merits, thus allowing *ex parte* communications to resume. The court vacated the or-

The court observed that turning over such documents to counsel violated the ARIAS-U.S. Code of Conduct and Ethical Guidelines, the American Bar Association's Code of Ethics for Arbitrators in Commercial Disputes, and the New York State Rules of Professional Conduct and that the court has the power to discipline counsel for ethical violations.

ders issued without the participation of the cedent's party arbitrator:

> We hold that because [the reinsurer's counsel's] *ex parte* communications with [the reinsurer's party arbitrator] violated the plain terms of the parties' scheduling orders, [the cedent] need not demonstrate prejudice for us to vacate the Arbitration Panel's two awards.[12]

Nonetheless, the court went on to state that the timeline of events in the arbitration demonstrated prejudice.

Disqualification of Counsel

Another way to penalize *ex parte* communications between counsel and party arbitrator is demonstrated by *Northwestern National Insurance Co. v. Insco, Ltd.*, 2011 U.S. Dist. LEXIS 113626 (S.D.N.Y. Oct. 3, 2011). In this case, the reinsurer's party arbitrator provided 182 pages of internal panel emails, some dealing with issues still under deliberation by the panel, to the reinsurer's counsel. The court observed that turning over such documents to counsel violated the ARIAS-U.S. Code of Conduct and Ethical Guidelines, the American Bar Association's Code of Ethics for Arbitrators in Commercial Disputes, and the New York State Rules of Professional Conduct and that the court has the power to discipline counsel for ethical violations. The court found that these disclosures were not justified as an effort to obtain feedback from a party arbitrator or an effort to prove bias on the part of the opposing party arbitrator. The court further found that these disclosures tainted the arbitration proceeding, which justified disqualification of counsel in further proceedings. The court stated:

> [D]isclosure of the [panel emails] tended to taint the proceedings, and to the extent there is any doubt, it should be resolved in favor of disqualification. In an age in which electronic communications play a central role in arbitrator deliberations, it is imperative that such communications remain as protected as all other forms of private panel interactions. Deliberate action to obtain such records is a disservice to the integrity of the adversarial process, and is strictly and unambiguously prohibited. Allowing parties to obtain confidential panel deliberations would provide an unfair advantage in the legal proceedings and have a chilling effect on the ability of arbitrators to communicate freely.[13]

Ex Parte Panel Discussions with Experts

U.S. Life Insurance Co. v. Superior National Insurance Co., 591 F.3d 1167 (9th Cir. 2010) involved Phase II of a long-running arbitration. Phase II focused on the quality of the cedent's workers compensation claim handling of more than 12,000 files. The panel could not reach a decision based on the divergent opinions of the experts on 500 sample files, and it retained two experts ("reviewers") to assist.

The panel and the parties exchanged correspondence discussing what review process to use. Ultimately, the panel determined that the following process would be used: (1) the reviewers would review 162 of the 500-claim sample; (2) the reviewers would meet

with the panel for three days (hereinafter, "the *ex parte* meeting"), and no transcript would be prepared of the *ex parte* meeting; (3) reviewers would provide their conclusions in writing to the panel and the parties; (4) the parties could submit briefs responding to the reviewers' conclusions; (5) a two-day hearing would be held, during which the parties could question the reviewers, under oath, for five hours each as to their qualifications and the reasons for their conclusions, but not as to the *ex parte* meeting; and (6) the parties could submit post-hearing briefs to the panel.[14]

At the conclusion of this process, the panel decided, by majority vote, that the claims were properly handled. The reinsurer contended that the procedure adopted by the panel violated § 10 of the Federal Arbitration Act in that closing the meeting of the panel with the reviewers constituted a refusal by the panel to hear pertinent and material evidence in the form of commentary from counsel. The reinsurer also charged procedural misbehavior, all to the prejudice of the reinsurer.

Noting the broad protocols for the submission of evidence adopted by the parties, the court ruled that there was no procedural misbehavior:

> [A]fter discussions with counsel, the panel unanimously determined that it would hold an *ex parte* meeting with the reviewers, the reviewers' written conclusions would be shared, pre- and post-hearing briefing would be allowed, and questions regarding the reviewers' qualifications and conclusions would be permitted. Because of the broad authority granted by the protocols to the panel, we hold that this process does not constitute misbehavior. . . . It is noteworthy that [the reinsurer's] party arbitrator agreed to this process and that he did not mention arbitral misconduct or misbehavior in his dissent [on the merits].[15]

Similarly, the court ruled that there was no violation of substantive due process:

> The panel advised the parties of its dilemma and determined what process to use only after receiving input from counsel through extensive and detailed correspondence. The process employed ensured due process by allowing the parties to present their respective arguments regarding the reviewers' conclusions by (1) reviewing the written conclusions, (2) submitting briefing addressing these conclusions, (3) questioning the reviewers about their qualifications and conclusions, and (4) submitting post-hearing briefing. Although the parties were not privy to what occurred during the *ex parte* meeting, the panel gave the parties ample opportunity to discover and critique the reviewers' conclusions.[16]

Finally, the court found that the reinsurer had not demonstrated the necessary element of prejudice by the use of neutral experts or the procedures related thereto.[17]

Commentary

From the above case law, it is evident that there is no clear rule for determining whether *ex parte* communication will result in a penalty of some sort. In those jurisdictions that require a demonstration that the *ex parte* communication resulted in an adverse panel order, it will be very difficult to prove this unless the evidence is completely one-sided. If this is the case, it is likely that the *ex parte* communication will need to be coupled with other bad behavior, which is the source of a number of the cases that vacated panel orders.

Star Insurance Co., supra, dealing with breach of the arbitration agreement and scheduling order, and *Northwestern National Insurance Co., supra*, dealing with providing private panel emails to, and disqualification of, counsel, show more promise in deterring and punishing behavior that is far outside the bounds of arbitration ethics. •

ENDNOTES

1. 868 F.2d at 57.
2. 32 F.3d at 149.
3. 48 Kan. App. at 249.
4. *Id.* at 252 (internal citations omitted).
5. 341 Ore. at 147-8.
6. 70 Cal. App. 4th at 1476.
7. 203 Cal. App. 4th at 375.
8. 952 F.2d at 1147.
9. *Id.* at 1148.
10. 607 F.2d at 653.
11. 187 N.Y.S.2d at 518.
12. 2016 U.S. App. LEXIS 15306 at *43.
13. 2011 U.S. Dist. LEXIS 113626 at *36
14. 591 F.3d at 1171-2.
15. *Id.* at 1176-7.
16. *Id.* at 1175.
17. *Id.*

The Reasonably Prudent Default Arbitrator

A default arbitrator has obligations to the parties, the process, and the industry.

By Charles F. Barr

Becoming the second arbitrator appointed by petitioner in an insurance or reinsurance dispute involves numerous considerations in your dual role as disinterested judge and limited advisor to the party for which you were appointed. Following are suggestions and techniques for managing that role, informed by guidance from the ARIAS Code and this topic's rather scarce treatment in the literature. (*Best Practices … for Lapse in Arbitrator Appointment*; ARIAS *4Q2015*) These suggestions may help fulfill what I believe are the default arbitrator's obligations to the parties, the process, and the industry: to achieve a fair and businesslike outcome and provide a defense to any legal challenge to the award or the appointment.

A default arbitrator engagement is anything but normal or routine and presents unique considerations, both before you accept the appointment and while performing that role. The default might involve a non-U.S. reinsurer or a large policyholder that is perhaps acting *pro se* or not even participating.

Although a defaulting party that fails to merely name its arbitrator on time might not later undertake the more difficult step of challenging the default arbitrator's appointment or the panel's decision, such a challenge could happen if the stakes are high or the outcome is intolerable.

If the defaulting party participates in the arbitration with knowledgeable counsel, the proceedings are rather or-

A default arbitrator engagement is anything but normal or routine.

dinary. The major difference is that the party did not handpick its arbitrator based on his or her general knowledge, skills, and experience and his or her effectiveness in ensuring each party's arguments are considered during panel deliberations. But that doesn't mean the party cannot obtain those benefits by working with an arbitrator appointed on its behalf by the non-defaulting party. If the defaulting party does not retain counsel or does not participate, the default arbitrator's role increases in difficulty and importance.

The umpire might also not be the defaulting party's choice (possibly being agreed upon by the two arbitrators selected by petitioner or through a virtual coin toss), but the umpire is neutral. A party-appointed arbitrator need not be neutral and can be quite helpful to the party for which he or she was appointed.

When the defaulting party is *pro se* or non-participating, several steps can be taken to ensure a fair and impartial arbitration. A default arbitrator can still provide guidance and information to the defaulting party on a confidential, *ex parte* basis without impermissibly becoming surrogate legal counsel or engaging in delaying tactics, and can still ensure each party's case is understood in panel deliberations. This would facilitate the panel and process being able to appropriately impose a "reasonably prudent arbitration party" standard on a defaulting party.

If the defaulting party does not participate, both the default arbitrator and the panel should at least transmit information on a timely basis, and the default arbitrator can continue to offer *ex parte* guidance.

My criminal trial tactics professor, a policeman who became a criminal defense lawyer, provided perspective on the challenges of his practice. Few of his clients were innocent, and some of the crimes were despicable. He described his role as not just to represent the innocent, but to ensure that any conviction was achieved only if the law and rules were followed. The "not guilty" plea was rarely a factual statement of innocence—it instead required the government to convict in accordance with the rules and the process.

Similarly, with less drama and in a civil context, I believe the second role of a default arbitrator (in addition to that of judge) is to assist the party for which she was appointed, within reason and applicable limits, and to achieve a fair and impartial result in accordance with the contract and the evidence.

1. Appointment by the Non-Defaulting Party

After being advised by petitioner's counsel that respondent missed the appointment deadline, you may become the appointed arbitrator for respondent. That conversation should include the kind of neutral description of the dispute that parties jointly provide candidates for umpire and should avoid a discussion of either the merits (unknown to the new appointee at that time) or favorite umpire nominees. (Canon II Comment 1) This is likely your last substantive one-on-one discussion with petitioner's counsel.

The conversation can include a summary of the dispute and key issues and the identities of the parties, their counsel or contact person, petitioner's party-appointed arbitrator, and possibly key witnesses or experts. This is needed for your conflicts check and vetting of the appointment using the criteria in the ARIAS Code. (Canon I, Comments 3-4) If you were being appointed as party arbitrator for the petitioner and the appointment is one you "must refuse" (Comment 3) or "should decline" (Comment 4), you could reasonably conclude that those same reasons also disqualify you as default arbitrator for respondent. This ethical issue is likely beyond the notice or knowledge of a *pro se* party.

2. Contacting the Defaulting Party or its Counsel; Making a Record

A default arbitrator should promptly contact respondent's counsel or layman contact person and attempt to determine if the party intends to participate in the arbitration, with or without counsel. It is prudent to document all attempts at contact. The umpire may also attempt contact and can document that as well.

Your communications with the defaulting party could include: your contact information; the date and timing of, and reason for, your appointment; your qualifications; an engagement letter; an explanation of the arbitration process and the governing clause; a description of the dual role of a party-appointed arbitrator; a description of important next steps in the process (including umpire selection); an explanation of the ability to have confidential *ex parte* discussions until a cut-off date that is set by the panel; and a possible timeline

of key events. Petitioner's counsel likely provided some of this information in its demand letter.

If the defaulting party has counsel, this introduction should be smooth and followed by normal next steps. If the party does not have counsel (or if counsel is not familiar with arbitration or the re/insurance contracts in dispute), your outreach can be more substantive and educational as appropriate. Here you could strike a balance among the first two roles as party arbitrator and a possible third role:

(1) as one of three triers of fact and law;

(2) as a traditional party-appointed arbitrator able to engage in confidential, *ex parte* discussions (within limits, see e.g., ARIAS Canons II Comment 2 and V Comment 6); and

(3) perhaps as a tutor or explainer of the contracts, the arbitration process, the merits of the case, and the likely arguments. (If you are a lawyer, you could prudently disclaim any role as surrogate legal counsel.)

Typically the umpire creates a record that the defaulting party has been kept abreast of dates, events, and possible consequences of the arbitration via outreach from both the default arbitrator and the panel. This is prudent in order to deliver to the parties the prompt, fair, and impartial dispute resolution process agreed upon in the arbitration clause and which they expect from industry professionals on the panel.

In addition, it can be a prophylactic measure to establish the integrity of the arbitration and help defend it from any post-award challenge. The panel wishes to demonstrate that the proceeding delivered a well-considered decision based on an appropriate form of hearing and a presentation of sufficient evidence (at least by petitioner, in case respondent does not participate). Merely granting a default judgment based on petitioner's pleadings could be vulnerable to later legal challenge.

3. Not Thy Party's Counsel; Explaining Your Role; Cost Considerations.

Due to the panel's primarily judicial role, default arbitrators who are lawyers might regularly advise a *pro se* party that the arbitrator is not its legal representative. There are specific limits on a party-appointed arbitrator helping with preparation or briefing (Canon V, Comment 6), and you may question, but not advocate, at the hearing. (Canon VII Comment 5)

You can help set expectations for the defaulting party as to the timeline of major events during the arbitration. You could advise that without legal representation during motions, briefings, and hearings, the default party is vulnerable to very consequential events as a result of actions by the non-defaulting party, whose counsel will vigorously advocate for its client. Your best advice may be to urge the defaulting party to retain legal representation, even if a quick settlement is envisioned by respondent. *How* one loses can matter.

You could explain your primary responsibility is as a judge; you will be objective, fair, and just; and you hope a fair and impartial process, following the rules and practice, can be achieved. (Canon II Comment 2 and Canon VII)

You could explain the panel will discuss, within its confidential deliberations, the arguments presented by each party and the various components of any award (e.g., interest on amounts due, payment plans, whether to award attorneys' fees, costs or punitive damages, etc.). You can also explain that party-appointed arbitrators attempt to ensure the panel fully understands each party's case. But you may not commit to dissent or work for a compromise if you disagree with the majority's proposed award. (Canon II, Comment 3)

In arbitrations seeking to collect premium, the cost of the process or a party's financial distress can be the reason for the appointment default, for not retaining counsel, or for not participating. A default arbitrator can be cost-sensitive in his own approach to billing and payment for services rendered, including whether or not to seek a retainer to address credit and timing risk on fees and expenses. The default arbitrator could also favor consideration of umpire candidates not seeking a retainer (whether refundable or not), if important to the party.

If a *pro se* defaulting party has financial condition and expense issues, certain important documents, such as the hold harmless stipulation and the confidentiality agreement, might not be agreed prior to the organization meeting, as is customary. One alternative is that the panel itself might prepare the form proposed for execution, perhaps using ARIAS models. Since each party pays the fees of the arbitrator appointed by or for it and half of the umpire's, one possible cost-shifting opportunity is for the non-defaulting party's counsel to

When the defaulting party is pro se or non-participating, several steps can be taken to ensure a fair and impartial arbitration.

For cost management purposes or due to financial distress, the parties might agree to consider qualified umpire candidates based in part on hourly rates or retainer requests.

agree to prepare drafts of non-contentious agreements or orders. But that authorship could prove unhelpful if a draft order may be adverse. Thus, a default arbitrator might take the lead or participate in the drafting of certain orders, even though this would result in extra cost to the defaulting party. Even when the arbitration is contentious, the defaulting party might still seek cost savings via petitioner-prepared drafts and rely on the kindness of strangers.

4. Defending a Default Appointment

It is possible the defaulting party may object to a default appointment, perhaps when counsel is subsequently retained or the party realizes it lost a valuable benefit. The defaulting party might request your resignation, and there could even be an appeal to court. The law and practice suggest such a challenge will fail, whether brought immediately or post-award.

For two reasons, I believe a default arbitrator should not resign from the panel if both the appointment adhered to the letter of the arbitration clause *and* only the defaulting party requests the resignation. (Canon VII Comment 3) Remember, the ARIAS Code does require your resignation if requested by all the parties. (Canon IV, Comment 5)

First, the parties previously agreed by contract to the arbitration protocols, and the non-defaulting party is entitled to the benefit of that agreement. Second, I believe the panel's obligation to the parties, to the arbitration clause, and to the industry is to provide a fair, impartial, and prompt dispute resolution process as contracted, which should not be delayed or obstructed by a party that defaulted on its contractual rights, regardless of the reason. (Cannon V, Comment 8 c)

Another issue that can arise, especially for a *pro se* defaulting party, is whether the pace, content, or consequences of the arbitration might be affected simply because the defaulting party is *pro se*. I believe in the purity of the arbitration process and that it should proceed apace pursuant to the arbitration clause, subject to any agreed-upon modifications. (Cannon VII)

Hopefully, the substantive guidance provided by a default arbitrator to the defaulting party (short of becoming surrogate counsel), initially and via ongoing *ex parte* discussions, will prepare that party for the pace and content of, and steps in, the process. It strikes me as unfair to the parties, the process, and the industry if, whether inadvertently or subtly, the arbitration is slowed to accommodate a *pro se* party. (Canon VII) I believe a "reasonably prudent arbitration party" standard should be applied to all parties.

5. Selecting the Neutral Umpire

Party-appointed arbitrators follow the arbitration clause on the selection of an umpire, either reaching agreement or following the resolution protocol when not agreeing. That protocol is typically included in the arbitration clause, but the selection protocol can be first agreed upon or revised once the dispute is engaged. Each side often proposes a slate, strikes most of the other side's nominees, and utilizes some form of final selection, such as a virtual coin toss (e.g., choosing "odds" or "evens" and tying it to the last digit of the closing Dow Jones Industrial Average on a chosen date). Or the protocol might involve each party ranking the nominees, with the nominee having the lowest combined score selected as umpire.

For cost management purposes or due to financial distress, the parties might agree to consider qualified umpire candidates based in part on hourly rates or retainer requests.

6. Getting Paid and by Whom; To Deliver the Process

Promptly reaching out to the defaulting party and offering orientation and ongoing *ex parte* assistance might prompt the party to pay your invoice in a timely fashion. The umpire and legal counsel for the defaulting party are natural allies on payment issues. The panel can make payment of arbitrator and umpire invoices a condition of the final order and award.

If the defaulting party does not have counsel and is participating reluctantly (or not at all), you could attempt to educate the defaulting party on the benefits and indispensability of your role and

how your fees are for services rendered, not for achieving an outcome. You might seek a retainer to address credit or timing risk, possibly applying it to the last invoice or perhaps refunding it if not consumed by hours worked.

The ARIAS model hold harmless agreement addresses a different payment issue (in addition to indemnity and defense): the joint and several liability of the parties for expenses and hourly fees incurred by the panel during a challenge. Depending upon your payment concerns regarding routine hourly fees, you might suggest modifying the agreement to also cover unpaid regular fees of the umpire (half) and default arbitrator (all) incurred during the arbitration. Agreement by the non-defaulting party would naturally be essential.

Alternatively, the non-defaulting petitioner might entertain a request from you (and the umpire) for a stand-alone guarantee or assurance of fee payment. If either avenue is considered, the request could be viewed as one more business cost of the non-defaulting petitioner for obtaining relief via the arbitration process, which requires both a default arbitrator and an umpire. Payment is for the *process*, not for the result or to curry favor.

Payment of the defaulting party's fee obligation could either become an additional receivable (if the non-defaulting party is the payee of an award) or an offset (if the non-defaulting party is the net payer). Because any advance payment should ultimately be repaid by the defaulting party, a payment guarantee or advance of interim payments could be viewed as a temporary cost and timing component of the chosen dispute resolution process.

A guarantee of collection means a collection action must first fail before the guarantor must pay. A guarantee of payment means the arbitrator/umpire simply makes a demand on the non-paying party, then seeks prompt payment from the guarantor.

7. Hold Harmless Agreement = Release, Indemnity and Defense. And Payment?

The hold harmless agreement typically combines a release, an indemnity, and an obligation to either purchase or provide a defense. It protects two interests — the liability of the panel and any billable fees and expenses it incurs while defending against a challenge. An indemnity, however, is only as good as the indemnitor, which can be an issue with a defaulting or impecunious party. This makes the joint and several liability of the ARIAS form (for panel defense and indemnity and for panel fees and expenses incurred while defending) quite beneficial, since one financially sound party makes the protection work.

If the defaulting party refuses to participate in the arbitration, or participates but won't sign the agreement, this initially shifts the entire cost of indemnity, defense, and panel fees incurred while defending to the non-defaulting party that signs the agreement. It also means the non-signing, defaulting party has not released the panel, leaving it a potential plaintiff and further increasing both the potential need for, and cost of, protection from liability and fees incurred while defending.

In this situation, the agreement's language addressing third parties' suits might be modified to guarantee or advance regular arbitration fees and to contemplate their recoupment via the award as an additional receivable or payable with an offset.

The non-defaulting party may dislike being held responsible for another party's regular fee obligation, even though joint liability is baked into the ARIAS agreement for third-party claims. The practicalities are that the parties are institutions with resources and the ability to advance payments and seek recoupment, while the panel consists of individuals with less capacity for credit and timing risk. Further, the arbitration process exists for the non-defaulting petitioner to achieve what it considers to be justice — and justice requires a panel and a process. Lastly, the proceeding may be shorter than traditional if the defaulting respondent is non-participating, *pro se,* or less contentious. Thus, a guarantee or advancement of regular arbitration fees could be viewed as simply another (hopefully limited) cost of doing business and achieving justice via the chosen dispute mechanism.

8. Document the Process and Evidence Supporting the Decision

A respondent's vigorous defense ensures a fulsome process and record, even if the order does not include a reasoned award. A respondent defaulting on its arbitrator appointment might retain counsel, might defend *pro se,* or might not participate at all. In the latter two instances, you can help ensure the integrity of the process, make a record of the reach-out, and help ensure the decision resulted from the evidence. A respondent might not mount a fulsome defense, but the record will show it could have and that the order and any award were well considered.

A default arbitrator should very carefully consider the issues, responsibilities, and choices associated with this unique appointment first when deciding whether to accept it and, later, while performing that role. •

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Law Committee
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The Arbitrator's Affirmative Disclosure Duty

Does it extend to prior subject matter-related involvement?

By Larry P. Schiffer & Tereza Horáková

Because of the limited possibility of judicial review, the *sine qua non* of arbitration is trust in the arbitration process. One means of ensuring trust in the arbitration process is the arbitrators' duty of full and candid disclosure during and after the arbitrator selection process.

It is essential that arbitrators be free from bias and evident partiality. Lack of an arbitrator's impartiality, or, more pointedly, a finding of evident partiality, is one of the few grounds upon which a court can vacate an arbitral award under the Federal Arbitration Act (FAA).[1] While it is well-settled that arbitrators must disclose any financial interest in the proceeding or any relationship to persons or parties connected to the proceeding, other potential disclosure obligations remain less-explored territory.

A question that has arisen at various ARIAS·U.S. meetings, including at the ethics breakout sessions during the 2016 Spring Conference, is whether arbitrators have a duty to disclose prior information or experience in the subject matter of the current dispute that would otherwise not be disclosed through disclosure inquiries or umpire questionnaires. In other words, do arbitrators have an affirmative duty to disclose prior subject matter-related involvement?

Arbitrators, like judges, may hear disputes over similar issues. Judges are not precluded from presiding over cases involving the same or similar contracts or the same or similar parties or the same issues they presided over in the past. Similarly, arbitrators are not precluded from presiding over disputes involving similar or the same issues or contracts or clauses that they presided over previously.[2] The issue for arbitrators, however, is whether that subject matter experience is something that should be affirmatively disclosed and, if so, to what extent.

This article examines the issue by: (a) looking at the disclosure duty in general; (b) comparing disclosure language in various arbitration rules, codes of ethics, and conduct; (c) discussing the parties' expectation that arbitrators have industry expertise; and (d) presenting an overview of relevant case law.

The Need for Disclosure

Total candid and full disclosure is the cornerstone of any arbitral proceeding. Two intertwined reasons are particularly representative of the need for disclosure.

First, arbitration awards are subject to limited judicial review. It is inherent in the nature of arbitration as a speedy, informal, and effective dispute resolution method that arbitrators are not held to the same standards as judges. Nonetheless, arbitrators wield similar or even broader powers, with free rein to decide both the law and the facts.[3] Without an appellate court safeguarding against abuse, parties must have sufficient information obtained from the arbitrators' disclosures to make informed decisions about whom to entrust with their dispute.

Second, arbitrators, unlike judges, are not selected by an objectively random or blind assignment process through court procedures, but solely by the parties.[4] This allows the parties to select a decision-maker with expertise and familiarity with the subject matter of the dispute. On the other hand, these benefits are trade-offs for lessened protection than that afforded in litigation. It is therefore the parties themselves that function as gatekeepers charged with guarding against favoritism, prejudice, or appearance of bias, and they cannot perform this duty without full disclosure of all relevant information.[5]

Disclosure Language

Disclosure language is usually found in arbitration rules, codes of ethics or conduct, and guidelines for arbitrators. The language typically contains a formulation of a general duty to disclose information, such as information that "others could reasonably believe would be likely to affect their judgment,"[6] that could "give rise to justifiable doubt as to the arbitrator's impartiality or independence,"[7] or that "might preclude the arbitrator from rendering an objective and impartial determination in the proceeding."[8] Similar phrases are found in the rules of international arbitration forums.[9]

The disclosure language primarily focuses on relationships between the arbitrator candidate and the parties, parties' counsels, potential witnesses, or co-arbitrators. The duty sometimes extends to household members, employers, partners, or business associates. The relationships and interests covered by the disclosure duty, both past and present, include mostly financial and personal ones, but also business, professional, social, or property interests.

Focusing on the *ARIAS·U.S. Code of Conduct* (the Code), Comment 1 to Canon I provides that "[t]he foundation for broad industry support of arbitration is confidence in the fairness and competence of the arbitrators." Canon I, Comment 3 sets forth circumstances in which a candidate for appointment as an arbitrator must refuse to serve. Among them are relationships and interests like "material financial interest in a party that could be substantially affected by the outcome of the proceedings," "the candidate currently serves as a lawyer for one of the parties," and "the candidate is nominated for the role of umpire and is currently a consultant or expert for one of the parties."[10]

Canon IV of the Code provides that "[c]andidates for appointment as arbitrators should disclose any interest or relationship likely to affect their judgment. Any doubt should be resolved in favor of disclosure." This provision gives wide discretion to the arbitrator candidate to disclose what the candidate subjectively believes will likely affect the candidate's judgment.

Mentions of disclosure of subject matter-related information in the various rules and code formulations are scarce.

Mentions of disclosure of subject matter-related information in the various rules and code formulations are scarce. One guidance note for arbitrators advises them to disclose where the arbitrator acted in "a related case"[11] where the relatedness could be construed as to the subject matter of the dispute. Another ethics code recommends disclosure of the "nature and extent of any prior knowledge [that arbitrators] may have of the [current] dispute."[12] Finally, one organization lays out an illustrative list of information to be disclosed, which includes professional interests and "their implications, where these involve issues similar to those addressed in the dispute in question" and other activities such as "active participation in public interest groups or other organizations which may have a declared agenda relevant to the dispute in question."[13]

The comments to Canon IV of the Code require arbitrator candidates to disclose "relevant positions taken in published works or in expert testimony" and "any past or present involvement with the contracts or claims at issue."[14] The ARIAS·U.S. Umpire Questionnaire model form also requires disclosure of

published articles and expert testimony related to the subject matter of the arbitration.[15] In practice, question 6 of the umpire questionnaire, in the appropriate case, may be modified to add additional questions concerning the arbitrator candidate's prior experience as an arbitrator or party with the subject matter of the arbitration. But expanding the umpire questionnaire does not address whether there is an affirmative duty to disclose.

Case Law

The starting point for any inquiry into an arbitrator's disclosure duty is *Commonwealth Coatings Corp. v. Continental Casualty Co.*[16] In this case, the U.S. Supreme Court vacated an arbitral award based on an undisclosed conflict of interest due to a prior business relationship between the neutral arbitrator and the victorious party.[17] The arbitrator served as an engineering consultant for the victorious party and had been paid about $12,000 over several years.[18] The close business connections were not revealed by anyone until after the award had already been rendered.[19]

In the plurality opinion, the Court held that for an arbitration award not to be vacated for evident partiality under the FAA, the arbitrators must disclose to the parties any dealing that might create an impression of possible bias.[20] Justice White, in his concurring opinion, attempted to delineate the scope of the duty to instances where an arbitrator has a "substantial interest" in the dispute.[21] Justice White did not, however, provide any guidance as to what constitutes a substantial interest or address subject matter interests.

Consequently, the federal courts have varied greatly in the interpretation and application of the nebulous disclosure duty. When construing the evident partiality standard on setting aside awards under the FAA, some courts have adopted the "impression of bias" test, while others have opted for the "reasonable person" approach. Nonetheless, very few courts have addressed the issue of disclosure of prior subject matter engagements. The cases discussed below provide a chronological overview of the extent to which the courts have examined this issue.

In *Reed & Martin v. Westinghouse Electric Corp.*, the Second Circuit Court of Appeals found no evidence of partiality where a neutral arbitrator failed to disclose that his law firm had had dealings with a third party electric company, and the latter had been litigating contract clauses identical or similar to those involved in the present arbitration.[22] The court held that the disclosure duty did not "mandate that the arbitrator provide the parties with his complete and unexpurgated business biography," and that there was no evidence of any taint whatsoever on the part of the arbitrator that could be construed to impugn his impartiality.[23]

In *Graphic Arts International Union v. Haddon Craftsmen*, *a* Pennsylvania federal court affirmed an arbitral award arising from a dispute between a labor organization and a company engaged in the graphics art industry.[24] Here, a sole arbitrator failed to disclose his associations with others in the graphic arts industry.[25] In particular, the arbitrator rendered legal assistance to firms engaged in that field.[26] The court confirmed the award, holding that the failure to timely object to the arbitrator's nondisclosure by the challenging party constituted a waiver of this objection.[27] Nonetheless, even if there were no waiver, the court stated that the mere fact that the arbitrator had represented other parties in the graphic arts industry did not impugn his integrity.[28] It noted that "[m]any arbitrators have at one time served in a representative capacity for a company or a union" and "[i]ndeed, it is the arbitrator's expertise and knowledge of the law of the shop that insulates his award from judicial second-guessing."[29]

Importantly, the court distinguished the case from *Commonwealth Coatings*. In *Commonwealth Coatings*, the arbitrator had prior dealings with one of the parties to the arbitration. In this case, the relationship was with members of the same industry.[30] Second, *Commonwealth Coatings* did not "compel disclosure of every prior association that might remotely suggest bias," but only those that create evident partiality.[31] The court concluded by finding that the arbitrator's prior dealings with other participants of the same industry fell outside the scope of the disclosure duty as set out in *Commonwealth Coatings.*[32]

Another case addressing the issue is *Federal Vending, Inc. v. Steak & Ale, Inc.*, decided by a Florida federal court.[33] Here, one of three arbitrators failed to disclose that in a recent prior arbitration involving Federal Vending as a party, he upheld the validity of Federal Vending's form-contract liquidated damages clause.[34] The validity of that same clause was at issue in the current arbitration and the arbitrator again upheld it.[35] The court held that because the validity of the damages clause was a recurring issue, both parties had a right to know that one of the arbitrators had recently upheld its validity, and the arbitrator should have disclosed it.[36] Nevertheless, the failure to disclose was not so egregious as to require vacatur, and the court upheld the award.[37]

In its analysis, the court stated that

while a failure to disclose may by itself not be enough to require setting aside an award, the courts should always scrutinize the nature of the undisclosed information.[38] If the information creates the impression of partiality, the award must be set aside, irrespective of where the information is derived.[39] The key to the court's determination was that the facts did not suggest partiality in favor or against either party, but rather simply that the arbitrator in an earlier arbitration considered a particular issue and made a legal determination on the merits.[40] The fact that an arbitrator "might decide the same issue the same way in a later arbitration does not mean that he has a bias for or against either party."[41] The court concluded that the facts of the case did not suggest an impression of partiality, and remarked that the opposing party failed to demonstrate any actual prejudice from the nondisclosure, or how it would have tried the case differently had it possessed the information.[42]

In *STMicroelectronics v. Credit Suisse*, the Second Circuit Court of Appeals upheld an award under the FINRA arbitration rules.[43] Credit Suisse argued that the neutral arbitrator was biased because the arbitrator failed to sufficiently disclose his previous testimony as an expert on legal issues similar to those in the present case.[44] The court held that an arbitrator's pre-existing views about potentially relevant legal issues are inherent to arbitration where the most sought-after arbitrators "are those who are prominent and experienced members of the specific business community in which the dispute to be arbitrated arose."[45] This is all the more true for neutral arbitrators chosen for their industry connections.[46] The court further held that "a party might like to know that information when shopping for arbitrators, but its absence cannot form a ground for vacating an arbitral award."[47]

In *Scandinavian Reinsurance Co. v. St. Paul Fire & Marine Insurance Co.*, the Second Circuit reversed the district court's ruling and affirmed an award in a dispute concerning the interpretation of a reinsurance contract.[48] Here, two arbitrators (an umpire and a party-appointed arbitrator) failed to disclose their concurrent participation in another similar arbitration proceeding in which they were serving in the same capacity.[49] Apart from being presided over by two common arbitrators, the two arbitrations shared other similarities, such as that they overlapped in time, dealt with comparable legal issues,[50] involved related parties, and included a common witness.[51] Both arbitrations were conducted by arbitrators who were members of ARIAS·U.S.

The two common arbitrators failed to disclose their concurrent service in the disclosure questionnaires.[52] Moreover, the umpire represented in the umpire questionnaire that he had never had any involvement with the subject matter of the dispute.[53]

The court found that this did not constitute evident partiality.[54] It held that the overlapping arbitral service did not, without more, constitute a material relationship that would be indicative of bias and partiality on the part of the arbitrator.[55] The court acknowledged the similarities between the two arbitrations and stated that "the fact that one arbitration resembles another in some respects does not suggest to us that an arbitrator presiding in both is somehow therefore likely to be biased in favor of or against any party."[56] For a relationship to be material, and therefore require disclosure, the appropriate inquiry

The courts have never held that the participation of an arbitrator who has had involvement with the issue or subject matter in dispute in a generic sense constitutes bias or a conflict.

is how strongly the undisclosed information indicates a possibility of bias and a material conflict of interest, not how closely the relationship relates to the particular facts of the arbitration.[57]

In *Dealer Computer Services v. Michael Motor Co.*, the Fifth Circuit Court of Appeals reversed the district court's ruling and confirmed the arbitration award in a contract interpretation dispute.[58] Here, the neutral arbitrator failed to disclose in the disclosure questionnaire the details of her participation in a previous arbitration involving Dealer Computer Services and another automobile dealership that considered similar contractual language and heard from the same damages expert as in the present proceeding.[59] The questionnaire was available to both parties online, which was the agreed-upon means of disclosing information.[60] The court held that the disclosure was suffi-

cient in light of the parties' reasonable duty to investigate and that the opposing party's failure to act constituted a waiver.[61] Even without the details of the prior arbitration, the disclosure put the opposing party on notice of a potential conflict, as it was disclosed via the agreed-upon method.[62]

In a very similar situation in *Dealer Computer Services v. Dave Sinclair Lincoln-Mercury St. Peters*, a Texas federal court found that the arbitrator's nondisclosure did not constitute evident partiality and upheld the arbitration award.[63] In this case, the neutral arbitrator failed to sufficiently disclose that he had adjudicated the same legal and factual issues in a prior arbitration involving Dealer Computer Services and another automobile dealership.[64] In the course of the present arbitration, the opposing party repeatedly complained about the arbitrator's appointment because of the arbitrator's prior engagement.[65] The court ruled that arbitrators are not required to disclose all details of their prior arbitrations and that, because the opposing party had actual knowledge of the undisclosed facts, it could not establish evident partiality based on the arbitrator's nondisclosure.[66]

The Expectation of Subject Matter Expertise

It is important to acknowledge that parties to industry arbitrations use industry arbitrators precisely because they have experience with the subject matters in dispute. This subject matter expertise expectation is embedded in nearly all arbitration clauses in reinsurance agreements. The general qualification criteria for arbitrators in most reinsurance contracts specify that the arbitrators be active or former officers of insurance or reinsurance companies or Lloyd's Underwriters, or words to similar effect. That nearly every arbitration clause found in a reinsurance agreement mandates industry experience at a reasonably high level makes it clear that subject matter expertise is not only expected, but required.

The courts have never held that the participation of an arbitrator who has had involvement with the issue or subject matter in dispute in a generic sense constitutes bias or a conflict. Indeed, one court recognized the expected industry connections between arbitrators in industry-based arbitrations and the expertise these arbitrators have:

> The more experience the panel has, and the smaller the number of repeat players, the more likely it is that the panel will contain some actual or potential friends, counselors, or business rivals of the parties. Yet all participants may think the expertise-impartiality tradeoff worthwhile; the Arbitration Act does not fasten on every industry the model of the disinterested generalist judge.[67]

More recently, the same court said the following:

> As we observed in *Sphere Drake,* however, private parties often select arbitrators precisely *because* they know something about the controversy. . . Arbitration need not follow the pattern of jury trials, in which a factfinder's ignorance is a prime desideratum. Nothing in the parties' contract requires arbitrators to arrive with empty heads.[68]

The rub, however, is the difference between subject matter experience with an issue in a generic sense and specific experience with the same contract, same clause, and same underlying dispute. Canon I, Comment 4(d) of the Code requires that a candidate, before accepting appointment as an arbitrator, consider whether the candidate's "involvement in the contracts or claims at issue such that the candidate could reasonably be called as a fact witness" would likely affect the candidate's judgment and, if so, should decline the appointment. Canon IV, Comment 2(c) requires only that the candidate disclose "any past or present involvement with the contracts or claims at issue." Nothing in the Code requires disclosure of involvement with the generic subject matter of the dispute. "Knowledge acquired in a judicial capacity does not require disqualification; likewise with knowledge acquired in arbitration."[69]

Conclusion

So far, the courts have mainly shied away from defining the contours of any affirmative duty to disclose prior subject matter involvement. While they have never explicitly acknowledged the duty, they have not rejected it (although a few have intimated that disclosure of the information should have taken place). On the one hand, the courts caution against placing an excessive disclosure burden on arbitrators that would be both impractical and counterproductive. On the other hand, the courts emphasize the need to engage in case-specific analysis when asked to vacate an award because of nondisclosure and take into consideration all circumstances when considering the ramifications of nondisclosure.

As a result, it seems that an award may be vacated where the arbitrator's failure to disclose prior subject matter-related experience constitutes a material conflict of interest that rises to a finding of evident partiality. The courts balance

out the very high deference shown to arbitral awards on the one hand, and "aggravating factors" on the other hand, such as the actual prejudice caused by the nondisclosure or the possibility of a different strategy that the aggrieved party was deprived of asserting.

From reviewing these cases, however, where none of the courts vacated the challenged arbitration award, it seems that courts have not found occasion to extend the disclosure duty to cover subject matter-related involvements for purposes of vacatur. While a number of courts expressly stated that disclosure should have been made, the specific factual circumstances of those disclosure failures were not consistent with the FAA's evident partiality standard. The door, however, remains open, and until the courts shed more light on the issue, the matter of an arbitrator's affirmative duty to disclose specific subject matter involvement remains unclear. While we await further judicial pronouncements, arbitrators who have had subject matter involvement that goes beyond generic experience with an issue or clause should consider the admonishment in Canon IV that "[a]ny doubt should be resolved in favor of disclosure." •

ENDNOTES

1. Under the Federal Arbitration Act, a court may vacate an arbitration award "where there was evident partiality or corruption in the arbitrators, or either of them... ." 9 U.S.C. §10(a)(2).
2. *See Sphere Drake Ins. Ltd. v. All American Life Ins. Co.*, 307 F. 3d 617, 621 (7th Cir. 2002).
3. *Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 393 U.S. 145, 149 (1968).
4. *Positive Software Sols., Inc. v. New Century Mortg. Corp.*, 476 F.3d 278, 286 (5th Cir. 2007) (Wiener, J. dissenting).
5. *Id.*
6. ARIAS·U.S. Code of Conduct, Canon IV, Comment 1 (Nov. 13, 2015).
7. American Arbitration Association (AAA) Commercial Arbitration Rules and Mediation Procedures, R-17 (Oct. 1, 2013). The same or very similar language appears in the London Court of International Arbitration (LCIA) Arbitration Rules, Art. 5 (Oct. 1, 2014); the United Nations Commission of International Trade and Law (UNCITRAL) Arbitration Rules, Article 11 (2013); Permanent Court of Arbitration (PCA) Arbitration Rules, Section II (Dec. 17, 2012); Stockholm Chamber of Commerce (SCC) Arbitration Rules, Article 14 (Jan. 1, 2010); World Trade Organization Rules on Conduct, paragraph VI. (Dec. 11, 1996).
8. Financial Industry Regulatory Authority (FINRA) Code of Arbitration Procedure, Rule 12405.
9. For example, the International Commercial Chamber (ICC) Arbitration Rules provide that "[e]very arbitrator must be and remain impartial and independent" and that "[t]he prospective arbitrator shall disclose in writing to the Secretariat any facts or circumstances which might be of such a nature as to call into question the arbitrator's independence in the eyes of the parties, as well as any circumstances that could give rise to reasonable doubts as to the arbitrator's impartiality." ICC Arbitration Rules, Article 11 (Jan. 1, 2012).The International Institute for Conflict Prevention and Resolution (CPR) Administered Arbitration Rules provide that each arbitrator shall disclose "any circumstances that might give rise to justifiable doubt regarding the arbitrator's independence or impartiality." CPR Administered Arbitration Rules, Rule 7.3 (Jul. 1, 2013). The International Bar Association (IBA) Guidelines on Conflict of Interest in International Arbitration state that "[i]f facts or circumstances exist that may, in the eyes of the parties, give rise to doubts as to the arbitrator's impartiality or independence, the arbitrator shall disclose such facts or circumstances to the parties." IBA Guidelines on Conflict of Interest in International Arbitration, General Standard 3 (Oct. 23, 2014).
10. ARIAS·U.S. Code of Conduct, Canon I, Comments 3(a), (c), (d).
11. ICC Guidance Note to Parties and Arbitral Tribunals on the conduct of the arbitration under the ICC Rules of Arbitration, Section III(A)20 (May 10, 2016).
12. CPR Code of Ethics for Arbitrators in Commercial Disputes, Canon II (2005).
13. WTO Rules on Conduct, paragraph VI., Annex 2 (Dec. 11, 1996).
14. ARIAS·U.S. Code of Conduct, Canon IV, Comment 2(a), (c).
15. ARIAS·U.S. New Umpire Questionnaire, at Q. 6.
16. *Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 393 U.S. 145 (1968).
17. *Id.* at 150.
18. *Id.* at 146.
19. *Id.*
20. *Id.* at 149.
21. *Id.* at 151-52.
22. *Reed & Martin, Inc. v. Westinghouse Elec. Corp.*, 439 F.2d 1268, 1275 (2d Cir. 1971).
23. *Id.*
24. *Graphic Arts Int'l Union, Local 97-B v. Haddon Craftsmen, Inc.*, 489 F. Supp. 1088 (M.D. Pa. 1979).
25. *Id.* at 1093.
26. *Id.*
27. *Id.*
28. *Id.* at 1094.
29. *Id.*
30. *Id.*
31. *Id.*
32. *Id.* at 1094-95.
33. *Fed. Vending, Inc. v. Steak & Ale, Inc.*, 71 F. Supp. 2d 1245 (S.D. Fla. 1999).
34. *Id.* at 1246.
35. *Id.*
36. *Id.* at 1249.
37. *Id.* at 1250.
38. *Id.* at 1249.
39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.*
43. *STMicroelectronics, N.V. v. Credit Suisse Sec. (USA) LLC*, 648 F.3d 68 (2d Cir. 2011).
44. *Id.* at 77.
45. *Id.*
46. *Id.*
47. *Id.*
48. *Scandinavian Reinsurance Co. Ltd. v. St. Paul Fire & Marine Ins. Co.*, 668 F.3d 60, 64 (2d Cir. 2012).
49. *Id.*
50. The two main issues were 1) whether a finite retrocessional agreement should be enforced according to the express terms of the agreements or whether the agreement should be interpreted in light of the parties' intentions at the formation of the agreement; and 2) interpretation of the contract language regarding the creation of experience accounts. *Id.* at 69.
51. *Id.* at 70.
52. *Id.* at 66.
53. *Id.*
54. *Id.* at 73.
55. *Id.* at 74.
56. *Id.* at 75.
57. *Id.* at 75-76.
58. *Dealer Comput. Servs. v. Michael Motor Co.*, 485 F. App'x 724, 725 (5th Cir. 2012).
59. In particular, the arbitrator checked a box next to the statement: "I HEREBY DISCLOSE THE FOLLOWING." She also checked the box next to the statement that provided: "SEE DISCLOSURE DATED MAY 23, 2008." In her disclosure memorandum, she stated, "I served on panel [sic] of three arbitrators that considered a dispute between Dealer Computer Services, Inc. and another party. I do not believe that my service on that panel creates a conflict with my serving in this case." The questionnaire she completed contained "YES" and "NO" boxes for each question. For the question: "[h]ave you, any member of your family, or any close social or business associate ever served as an arbitrator in a proceeding in which any of the identified witnesses or named individual parties gave testimony?", the arbitrator inserted a question mark ("?") in between the answer boxes. She checked the "YES" box for the question: "[h]ave any of the party representatives, law firms, or parties appeared before you in past arbitration cases?" *Id.* at 726-28.
60. *Id.* at 726.
61. *Id.* at 728.
62. *Id.*
63. *Dealer Comput. Servs. v. Dave Sinclair Lincoln-Mercury St. Peters, Inc.*, No. H-13-2006, 2013 U.S. Dist. LEXIS 156778, at *10 (S.D. Tex. Nov. 1, 2013).
64. Specifically, the defendant argued that Dealer Computer Services was represented by the same counsel, used the same expert witness, and that the arbitrator adopted the damages model of Dealer Computer Services over the same arguments. *Id.* at 4.
65. *Id.* at 5.
66. *Id.*
67. *Sphere Drake Ins. Ltd. v. All American Life Ins. Co.*, 307 F. 3d at 620.
68. *Trustmark Ins. Co. v. John Hancock Life Ins. Co.*, 631 F. 3d 869, 873 (7th Cir. 2011) (citations omitted).
69. *Id.* (citations omitted).

A Framework for Assessing Settlement Allocations among Reinsurers

Should a reinsurer be bound by a cedent's allocation of a settlement?

By Thomas F. Bush

In an article written in 2010, Robert and Debra Hall asked: "Are standards emerging for allocation to reinsurers via follow the settlements?"[1] Six years later, the answer appears to be yes. Court decisions over that time, primarily but not only the New York Court of Appeals' 2013 decision in *USF&G Co. v. American Re-insurance Co.*,[2] have provided the beginning of a framework for assessing whether a reinsurer should be bound by a cedent's allocation of a settlement.

The Problem

An allocation issue arises in the following scenario. A cedent faces a policyholder's claims for coverage of losses spanning multiple coverage periods, as frequently happens with environmental damages or asbestos liability. The reinsurance coverage differs from year to year with respect to the identity of the reinsurers and/or the terms and limits of coverage, and within any year, the reinsurance might exclude some of the claims that the policies cover. The cedent and the policyholder agree to settle for a lump sum payment in return for a release of all claims. The lump sum is allocated, either as part of the settlement or unilaterally by the cedent after the settlement, among the coverage periods of its several policies and between claims that are covered by reinsurance and claims that are not. The cedent bills each reinsurer for its share of the reinsured claims allocated to the policies that the reinsurer covers. The question is whether the reinsurers are bound by the cedent's allocation.

This issue rests on an application of the follow-the-settlements clause, which appears in most reinsurance contracts. Under this clause, the reinsurer agrees to be bound by the cedent's settlement, provided that the settlement is made in good faith and the claim is not clearly beyond the coverage of the policy.[3] Courts have held consistently that this rule applies not only to the cedent's decision to settle and to the settlement amount, but also to the allocation of the settlement amount among policies and coverages.[4]

Application of the rule to settlement allocations, however, presents a special problem, because as the *USF&G* court

recognized, "in that context the interests of cedent and reinsurer will often conflict."[5] The cedent generally has an interest in an allocation that maximizes its reinsurance recovery, while the reinsurer has the opposite interest. Given this conflict of interests, reinsurers likely do not intend to grant cedents unbounded discretion to select an allocation. On the other hand, the court concluded, "there seems to be no good alternative to giving a measure of deference to a cedent's allocation decisions. To review each decision would invite long litigation over complex issues that courts may not be well equipped to resolve, creating cost and uncertainty and making the reinsurance market less efficient."[6]

USF&G resolved this problem by placing a limitation on the deference owed to the cedent's allocation: "In our view, objective reasonableness should ordinarily determine the validity of an allocation."[7] Most of the other courts that have addressed the issue considered the objective reasonableness of the allocation, but some courts also have considered a subjective standard that addresses the cedent's motivation for selecting the allocation. Both standards are discussed below.

What Does Objective Reasonableness Mean?

The *USF&G* court gave a general overall definition of objective reasonableness: "The reinsured's allocation must be one that the parties to the settlement of the underlying insurance claims might reasonably have arrived at in arm's length negotiations if the reinsurance did not exist."[8] In applying a reasonableness standard, courts have considered a few distinct issues.

Zero Allocations

Many of the cases applying a reasonableness standard will look at unreinsured claims that are released without being allocated any part of the lump sum payment. The allocation of zero dollars raises the question of whether the reinsurer is being charged with amounts that should be allocated to these unreinsured claims.

For example, in *USF&G* the court considered the cedent's decision to allocate no part of the settlement to bad faith claims, which were not covered by the reinsurance contracts, and found a triable issue of reasonableness, given evidence of "the possibility of a jury verdict — possibly a very large one — against it on the bad faith claims."[9] Similarly, in *New Hampshire Insurance Co. v. Clearwater Insurance Co.,*[10] New York's Appellate Division found an issue in the reasonableness of an allocation of no amounts to claims that were not covered by reinsurance. The court did not rule that the zero allocation was necessarily unreasonable. "It may be that the allocation could be justified on the ground that the claims given no allocation were highly unlikely to prevail, or so small in value that relative to the [covered] claims as to be immaterial," but that determination required a fully developed record.[11] The premise of these rulings is that, in an arms-length negotiation, the policyholder would not reasonably agree to give up a valuable claim for nothing, so a justification is needed for the zero allocation.

Potentially Groundless Claims

The converse of this premise is also true: in an arms-length negotiation, the cedent would have no reason to pay a significant amount of money (more than nuisance value) to settle a claim for which it faces no realistic risk of liability. Hence, an allocation is not objectively reasonable if it allocates amounts to reinsured claims without evidence showing a risk of the cedent's liability for the claims.

Any party seeking to apply a subjective standard will have to explain why it is appropriate, and that is a hard case to make.

If the cedent faces no risk of liability on a claim, its payment of the claim would be *ex gratia,* and under the established understanding of follow-the-settlements, the reinsurer would not be bound by the settlement.[12] Allocations present no reason to apply the *ex gratia* rule differently, but they do present a greater risk of such payments. When claims are settled separately, a cedent ordinarily has no incentive to make an *ex gratia* payment. The cedent's incentives are different, however, when multiple claims are settled for a lump sum. The cedent, like any settling defendant, will want the broadest release possible in return for its payment and thus will seek a release of all claims that the policyholder might assert, whether or not it faces a real risk of liability on any particular claim. The cedent then has an incentive to allocate amounts of the lump sum to claims covered by reinsurance, without regard to whether it faces a real risk of liability on the claims.

Unreasonable Amounts

In addition to considering whether or not any sum is allocated to a settled claim, courts also have considered

The cedent's subjective motivations do not provide a strong reason to relieve the reinsurer of its obligation to cover the loss.

whether the amounts allocated to specific claims are unreasonable. In *USF&G,* the court held that a settlement allocation could be challenged with evidence indicating that "inflated values" were assigned to claims covered by reinsurance.[13] That evidence was that the amounts allocated were more than twice the amounts that the claimants' expert had asserted.[14] In the absence of an explanation of the allocated amount, the cedent would not reasonably have settled a claim for more than the amount that its policyholder was attempting to prove.

The *USF&G* court also suggested that the amount allocated to a reinsured claim could be found unreasonable based on a comparison with the amounts allocated to other claims. The court referred to the "relative valuation" of certain claims, noting that while some claims subject to reinsurance arguably had inflated values, other claims that fell below the attachment of the reinsurance coverage arguably had artificially low amounts allocated to them.[15] If differences in the amounts allocated to two different sets of claims cannot be explained by the factors that the parties would consider in an arms-length negotiation of each of the two sets of claims—primarily the risk of liability and the amount of exposure on each claim—then the different amounts could be grounds for finding an allocation unreasonable.

Assumptions on Number of Events

Allocation issues often arise in cases where the cedent and the insured disputed the number of insured events or occurences. In a case decided in 2007, *Allstate Insurance Co. v. American Home Assurance Co.*,[16] a lump-sum settlement of claims for environmental damages at multiple sites was allocated among reinsurers based on an assumption about the number of events at each site. That assumption was inconsistent with the positions taken by both the cedent and the insured during the litigation that led to the settlement. New York's Appellate Division found this allocation "unreasonable" and held the reinsurer not bound to follow it.[17] The court did not expressly consider whether this inconsistent assumption about the number of events could reasonably have resulted from an arms-length negotiation, but the implication of the opinion is that it could not, and hence it would fail the standard of objective reasonableness.

Reinsurance Contract Terms

In any application of a follow-the-settlements clause, a reinsurer is not bound by the settlement of a claim that is excluded by the terms of the reinsurance contract or in excess of that contract's limits.[18] Courts applying a reasonableness standard to allocations have enforced this rule by holding that a reinsurer can be allocated a share of a settlement only for a claim that is within the coverage terms of the reinsurance contract and only for an amount that is within the contract's limits.[19]

Settlement Agreement Allocation

An allocation is frequently, but not always, memorialized in the settlement agreement between the cedent and the policyholder. In disputes over such allocations, one party frequently points out that the amount allocated to a reinsurer is either consistent or inconsistent with the underlying settlement. Courts applying an objective reasonableness standard have given little if any weight to the matter of consistency. The Third Circuit explained: "We are reluctant to adopt a rule whereby an insurer could insulate its allocation from challenge by its reinsurers simply by getting its, essentially indifferent, insured to agree to it."[20]

The *USF&G* court agreed with this conclusion and "put the point more strongly" with the observation that "in many cases claimants and insureds . . ., far from being indifferent, will enthusiastically support insurers' efforts to fund a settlement at reinsurers' expense. They will do this for the simple reason that insurers, like everyone else, are apt to be more generous with other people's money than their own."[21]

The courts are not unanimous on this point. At least one court declined to hold a reinsurer bound by the cedent's allocation due to its inconsistency with the allocation in the settlement.[22] The majority of courts, however, have found that consistency with the underlying settlement is essentially irrelevant.[23]

Does a Subjective Standard Apply?

Language in some judicial opinions suggests that the cedent's motivation is relevant to determining whether its allocation binds a reinsurer. A leading example is *Travelers Casualty & Surety Co. v. Insurance Co. of North America,*[24] in which the Third Circuit stated that a reinsurer is not bound when a cedent "makes allocation decisions primarily for the purpose of increasing its reinsurance recovery." Similarly, the District Court in *Utica Mutual Insurance Co. v.*

Clearwater Insurance Co.,[25] phrased the issue as whether the cedent acted with "disingenuous or dishonest failure" or "with gross negligence or recklessness" towards the reinsurer's interests.

It is not clear that these courts intended to establish a different standard for reviewing allocations, because they draw inferences of a cedent's motivation primarily from its ability or inability to present an objectively reasonable explanation for its allocation.[26] Nonetheless, the language in the opinions of these courts suggests a possibility that subjective factors can determine whether a reinsurer is bound by an allocation regardless of its objective reasonableness.

The New York Court of Appeals appears to have rejected a subjective standard in *USF&G,* stating that "the cedent's motive should generally be unimportant. When several reasonable allocations are possible, the law, as several courts have recognized, permits a cedent to choose the one most favorable to itself."[27] However, *USF&G* settles this issue only for reinsurance contracts governed by New York law. When the law of another state applies, the parties still have the opportunity to argue that a subjective standard should determine whether a reinsurer is bound by a cedent's allocation.

Any party seeking to apply a subjective standard will have to explain why it is appropriate, and that is a hard case to make. If a settlement allocation meets the standard of objective reasonableness (as the courts have applied that standard), then the reinsurer is being asked to cover a loss that is within the foreseeable array of risks that it agreed to assume. In particular, it is being asked to pay a claim that meets the terms and limits of the reinsurance contract, and its allocated share falls in the range that could have resulted from an arms-length negotiation of each separate allocated share. The cedent's subjective motivations do not provide a strong reason to relieve the reinsurer of its obligation to cover the loss.

Conversely, if the settlement allocation does not meet the standard of objective reasonableness, then the reinsurer is being asked to cover a loss that is not within the foreseeable array of risks that it agreed to assume. Either the loss does not meet the terms and limits of the reinsurance contract, or the reinsurer's allocated share does not fall in the range of outcomes that could have resulted from arms-length negotiations of the settled claims. The cedent's subjective good faith is not a compelling reason to hold the reinsurer liable for that loss.

Another problem with a subjective standard is its inherently indeterminate nature. The courts that have suggested a subjective standard have cautioned that a cedent is not required to put a reinsurer's interest entirely above its own when allocating a settlement.[28] A cedent may consider its own interest in obtaining reinsurance coverage, so long as it does not make that its "primary"[29] objective or act with "gross negligence or recklessness." Effectively, the cedent must not consider its own interests too much. That standard makes an allocation potentially open to challenge in any case where the cedent does not choose the allocation most favorable to a reinsurer. Whether courts or arbitrators choose to apply such a standard in contracts not governed by New York law remains to be seen. •

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ENDNOTES

1. The article can be found at http://www.robertmhall.com/publications.htm.
2. 20 N.Y.3d 407, 420, 985 N.E.2d 876, 882 (2013). For a detailed analysis of the opinion written soon after its issuance, *see* C. Scibetta, Follow the Settlements and Allocation after *USF&G v. American Re . . .* The "Objectively Reasonable" Standard, 20 ARIAS-U.S. Quarterly 2 (2013).
3. *North River Ins. Co. v. Ace Am. Reinsurance Co.,* 361 F.3d 134, 140 (2d Cir. 2004).
4. *See USF&G,* 20 N.Y.3d at 419, 985 N.E.2d at 881; *North River Ins. Co. v. Ace Am. Reinsurance Co.,* 361 F.3d 134, 140-141 (2d Cir. 2004); *Commercial Union Ins. Co. v. Seven Provinces Ins. Co.,* 9 F. Supp. 2d 49, 67-68 (D. Mass. 1998); *but see Employers Reinsurance Corp. v. Newcap Ins. Co.,* 209 F. Supp. 2d 1184, 1190-91 (D. Kan. 2002) (declining to apply the follow-the-settlements doctrine to a cedent's allocation decision that was not part of its settlement agreement).
5. 20 N.Y.3d at 41, 985 N.E.2d at 881.
6. *USF&G,* 20 N.Y.3d. at 419, 985 N.E.2d at 881-882.
7. *Id.* at 420, 985 N.E.2d at 882.
8. *Id.* at 420, 985 N.E.2d at 882-883.
9. *Id.* at 423, 985 N.E.2d at 884.
10. 129 A.D.3d 99, 7 N.Y.S.3d 38 (N.Y. App. Div. 2015).
11. *Id.* at 114, 7 N.Y.S.3d at 49-50.
12. *American Ins. Co. v. North Am. Co. for Prop. & Cas. Ins.*, 697 F.2d 79, 81 (2d Cir. 1982).
13. USF&G, 20 N.Y.3d at 424, 985 N.E.2d at 885.
14. Id., 985 N.E.2d at 885.
15. Id. at 425, 985 N.E.2d at 886.
16. 43 A.D.3d 113, 837 N.Y.S.2d 138 (N.Y. App. Div. 2007).
17. *Id.* at 121-24, 837 N.Y.S.2d at 144-46.
18. *Excess Ins. Co. v. Factory Mut. Ins. Co.,* 3 N.Y.3d 577, 583, 822 N.E.2d 768, 771 (2004); *Bellefonte Reinsurance Co. v. Aetna Cas. & Sur. Co.,* 903 F.2d 910, 913 (2d Cir. 1990).
19. *Travelers Cas. & Surety Co v. Certain Underwriters at Lloyd's,* 96 N.Y.2d 583, 596-97, 760 N.E.2d 319, 328 (2001); *North River Ins. Co. v. Ace Am. Reinsurance Co.,* 361 F.3d 134, 142 (2d Cir. 2004); *Utica Mut. Ins. Co. v. Clearwater Ins. Co.,* 2016 WL 254770 at *6 (N.D.N.Y. Jan. 20, 2016); *Travelers Indem. Co. v. Excalibur Reinsurance Corp.,* 2013 WL 1409889, at *7-8 (D. Conn. April 8, 2013).
20. *Travelers Cas. & Surety Co. v. Ins. Co. of N. Am.,* 609 F.3d 143, 159 n. 25 (3d Cir. 2010).
21. 20 N.Y.3d at 421, 985 N.E.2d at 883. Prior to *USF&G,* one New York court relied significantly but not entirely on the inconsistency of a post-settlement allocation with the underlying settlement to hold that a reinsurer was not bound by the allocation. *See Allstate Ins. Co. v. American Home Assur. Co.,* 43 A.D.3d 133, 121-22, 837 N.Y.S.2d 138, 144-45 (N.Y. App. Div. 2007).
22. *Oklahoma ex rel. Holland v. Employers Reinsurance Corp.,* 2007 WL 2703157, at *5 (W.D. Okla. Sept. 13, 2007).
23. *See North River Ins. Co. v. Ace Am. Reinsurance Co.,* 361 F.3d 134, 141 (2d Cir. 2004); *Lexington Ins. Co. v. Clearwater Ins. Co.,* 28 Mass. L. Rptr. 519, at *4 (Mass. Super. July 26, 2011).
24. *Travelers Casualty,* 609 F.3d at 158.
25. 2016 WL 254770 at *4 (N.D.N.Y. Jan. 20, 2016); *accord Hartford Acc. & Indem. Co. v. Columbia Cas. Co.*, 98 F.Supp.2d 251, 258 (D. Conn. 2000).
26. *See Travelers Casualty,* 609 F.3d at 158-64; *Utica National,* 2016 WL 254770 at *4-6.
27. 20 N.Y.3d at 421, 985 N.E.2d at 883.
28. *Travelers Casualty,* 609 F.3d at 158; *Utica National,* 2016 WL 254770 at *4. *USF&G* cites the Third Circuit's *Travelers Casualty* opinion as precedent for its objective reasonableness standard, notwithstanding the references in the opinion to the cedent's motivation. *See* 20 N.Y.3d at 421, 985 N.E.2d at 883.
29. *See* notes 20 and 25.

What has the Committee Been Up To?

By Sylvia Kaminsky & Eric Kobrick, Arbitrators Committee Co-Chairs

Beginning in this edition of the *Quarterly*, the Arbitrators' Committee will report in each issue on the projects, goals, and objectives it is working on to advance the concerns of arbitrators in seeking to promote, improve and foster the arbitration process as a means for the efficient, economic and just resolution of insurance and reinsurance disputes.

Our year-end report of 2015 activities appeared in the Fourth Quarter 2015 ARIAS *Quarterly*. The work of the committee in 2016 is summarized below. If anyone is interested in more detailed information, please contact any of the committee members.

The committee also urges all arbitrators, as well as ARIAS's other constituencies, to let us know of any matters it believes this committee should address. Without ideas, input, and feedback from the membership as to your issues within the ARIAS community that you believe should be on the radar screen of this committee, the committee cannot address those matters. In other words, we need to hear from you to best serve you.

This year, the committee has taken the following actions:

- Spearheaded an effort to encourage the ARIAS Board of Directors to make changes to the Bylaws providing for two additional board seats for arbitrators who are not currently employed by companies, reinsurers or law firms. This change was passed by more than a two-thirds majority vote and will go into effect for the election this November.
- After extensive work by our sub-committee (Mark Wigmore, Fred Marziano, and Jim Sporleder, with the work of former committee member Andrew Rothseid), the committee submitted proposed changes to the Code of Conduct to the Ethics Committee. One of the more material proposed changes provides that the code specifically apply to not only arbitrators but to parties and law firms as well. Both committees will be meeting together to discuss their differing views on the changes and see if common ground on the suggested revisions can be achieved. If not, the committee will discuss submitting its position to the board for approval.
- In conjunction with the changes to the Code of Conduct, another subcommittee (Charles Erhlich, Lydia Kam Lyew, and Aaron Stern, following up on the work of former committee members Marty Haber and Peter Gentile) worked diligently to finalize proposed changes to the umpire questionnaire and the neutral arbitrator questionnaire. These suggested revisions have been submitted to the Forms Committee for review and comment. The committee is waiting on feedback from the Forms Committee, at which point it will consider the next step to effectuate agreed upon changes and/or consider submitting its suggested revisions to the Board for approval.
- Committee member Fred Marziano is working with the Member Services Committee to address recertification procedures. The arbitrator community has expressed considerable concern over the cost, fees and requirements to maintain ARIAS certification. The committee agreed that a formal, comprehensive review of what is actually needed to achieve the goals of the arbitrator community while satisfying the entire membership and

how to get there at a more reasonable cost is in order. One factor suggested by the committee was to extend recertification requirements beyond two years, although this is unlikely to happen due to several factors. The committee further considered sentiments expressed by arbitrators that their attendance at conferences, which is required for certification, is not only down and economically disproportionate for a large majority of the arbitrator community, but also fails to recognize the depth of experience and knowledge that the arbitrator community already possesses. The Arbitrators' Committee will liaison with the Education Committee to work on arbitrator education and training programs. The committee has been advised that there are several other ARIAS committees paying attention to issues related to certification requirements. The committee will closely monitor this issue.

- The committee members continue to work to provide Arbitrator Tool Kit updates. Members are also contributing articles to the *Quarterly*. A subcommittee (Roger Moak and Connie O'Mara) is working to compile a list of best practices for use by arbitrators during the arbitration process.
- At the Spring Conference, committee members Sylvia Kaminsky and Lydia Kam Lyew participated in a breakout session with Certified Arbitrator Andrew Rothseid and Royce Cohen, Esq. focusing on resources available for research regarding legal matters and industry developments that are available to the ARIAS community. The panel members prepared an extensive resource directory that will appear on the newly revamped ARIAS website.

The committee looks forward to hearing from you. Please let us know if you think we are doing a good job or where we may be falling short. We urge you to join us in addressing these and other issues so that together we can meet the goals of ARIAS and promote improvements in the arbitral process. •

Newly Certified Arbitrators

Andrew S. Nadolna, is as an arbitrator and mediator at JAMS in New York City. Previously, Andrew was in claims leadership positions at AIG, including most recently 5 years as Global Head of Casualty Claims where he was responsible for an organization of 1800 people that paid roughly $9B per year in claims throughout the U.S., Canada, the U.K. and continental Europe, Australia, Singapore, and Hong Kong. His oversight at AIG included hundreds of thousands of claims worldwide involving general liability (including umbrella and excess at all layers), pollution, mass tort, medical malpractice, personal and advertising injury, and construction defect, as well as workers compensation, Defense Base Act, employers' liability, and commercial auto. Andrew has significant experience with nearly every form of insurance claim under almost every form of liability policy including primary and excess policies (all layers), occurrence, claims made, integrated occurrence, occurrence reported, Bermuda and London forms, fronted deductible, and other complex risk transfer arrangements. Prior to AIG, Andrew was an insurance defense and insurance coverage lawyer first with Querrey & Harrow and then with Bollinger, Ruberry & Garvey. He is a graduate of UCLA and earned his J.D. from Syracuse University School of Law.

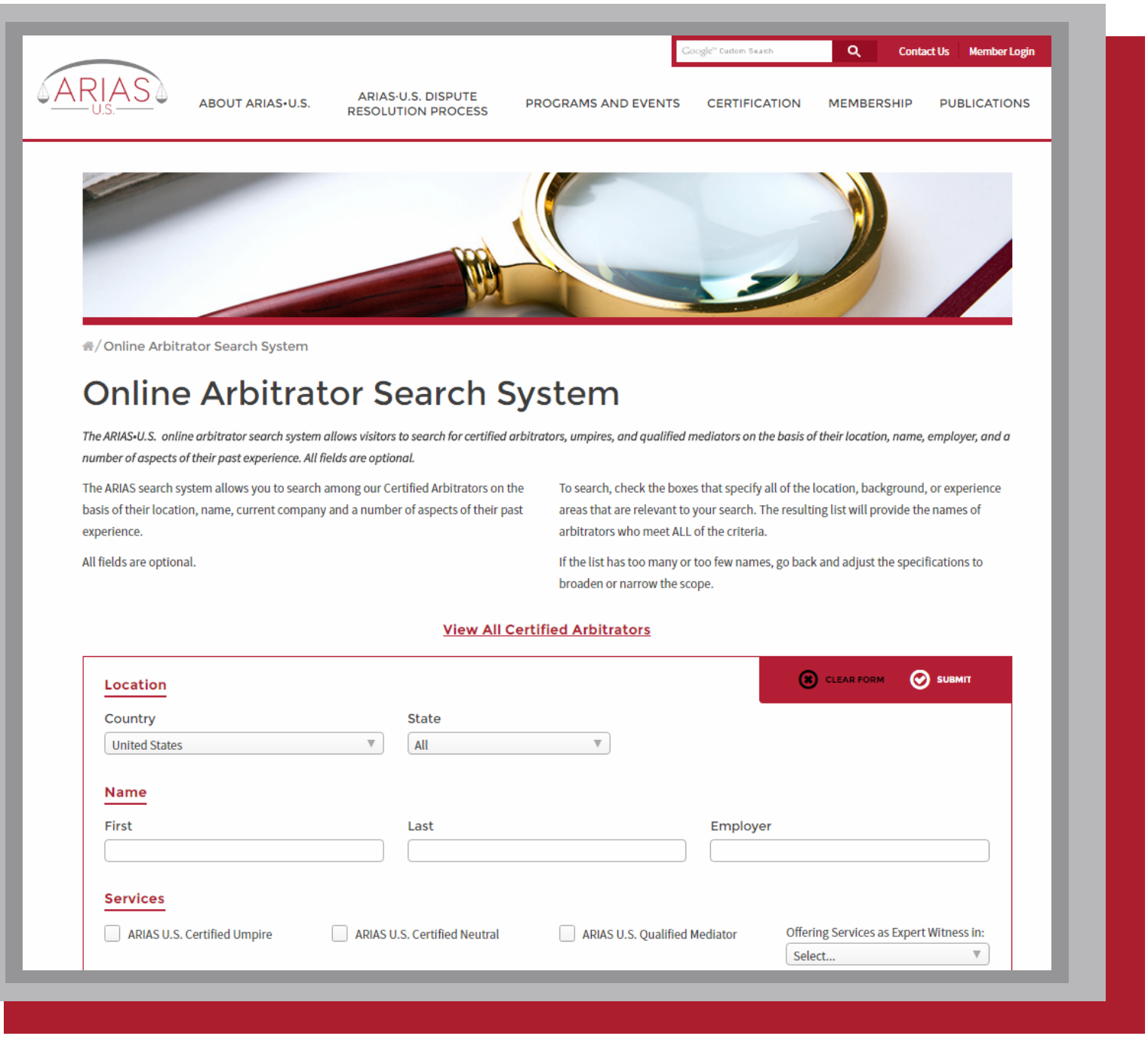
Newly Approved Neutral Arbitrators

John A. Damico

Lawrence O. Monin

Andrew S. Nadolna

Finding an Arbitrator Just Got Easier!



Arbitration Awards and *Ex Parte* Communications

The Sixth Circuit vacated arbitration awards for violations of panel scheduling orders' explict ban on ex parte communications.

By Ronald S. Gass

It is not unusual for an arbitration panel to hold a hearing on the merits, rule on some, but not all, of the substantive issues raised by the parties in the form of an *interim* final award, and retain jurisdiction to decide any residual questions requiring the presentation of additional evidence. For example, the parties may need to present further proof of the exact amount of contract damages or awarded attorneys' fees. During this post-hearing period before a tripartite panel renders its final award, questions may arise regarding the status of *ex parte* communications between the parties and their party-appointed arbitrators.

In reinsurance arbitrations, *ex parte* communications are typically addressed during the panel's organizational meeting and primarily focus on two situations: first, whether and when *ex parte* communications will cease during prehearing motions practice (e.g., after the motion briefing is complete or after the opposition brief is filed); second, when *ex parte* communications will cease prior to the hearing on the merits (e.g., upon the filing of the parties' initial or reply prehearing briefs). Rarely do the parties or the panel address in advance the question of when *ex parte* communications will *resume* in the event that the panel issues an interim final award. This issue was the subject of a recent U.S. Court of Appeals for the Sixth Circuit decision involving post-interim final award *ex parte* communications between a party arbitrator and the appointing party's counsel.

Meadowbrook Insurance Group was a cedent of National Union Fire Insurance Company of Pittsburgh, Pennsylvania under a 1999 treaty reinsuring Meadowbrook's workers' compensation insurance programs. In 2007, a dispute arose between the parties, with

In reinsurance arbitrations, ex parte communications are typically addressed during the panel's organizational meeting and primarily focus on two situations.

National Union claiming that Meadowbrook was overbilling under the treaty, and as a consequence, it refused to pay Meadowbrook's ceded claims. Unable to resolve their disagreement, Meadowbrook filed an arbitration demand in 2011 pursuant to the treaty's arbitration clause, which called for a tripartite arbitration panel.

At the August 2012 panel organizational meeting, a ban on *ex parte* communications was discussed, and the panel ultimately ruled that such communications would cease with the filing of the parties' initial prehearing briefs. This was subsequently memorialized in a panel scheduling order that provided: "*Ex parte* communications with any member of the Panel shall cease upon the filing of the parties' initial pre-hearing briefs." The same ban was reiterated in March 2013 when the panel issued a First Amended Scheduling Order. Neither order addressed when or whether *ex parte* communications could resume.

The parties' initial and reply prehearing briefs were filed in June 2013, and the hearing was held before the panel in mid-July 2013. On July 23, 2013, the panel issued an interim final award in favor of National Union, awarding approximately $1.584 million in damages plus $1.951 million in interest plus National Union's costs and attorneys' fees. It also mandated further proceedings to determine the full scope of Meadowbrook's liability for any other programs not otherwise addressed in the monetary award and ordered Meadowbrook to submit a listing of all programs with supporting documentation regarding its retained risk, with any disputes to be decided by the panel. In response to the panel's award, Meadowbrook filed a supplemental brief on August 6, 2013, which National Union moved to strike on August 9, 2013.

In support of its request for attorneys' fees, National Union submitted its counsel's timesheets on August 12, 2013. They revealed three communications between its attorney and its party-arbitrator — one conversation on the day the interim final award was issued, one two days later for a half-hour, and one on August 7, 2013. The umpire and National Union's party arbitrator discussed and issued an order "For the Panel" on August 12, 2013 ,granting National Union's motion to strike and requiring Meadowbrook to comply with the interim final award by August 14, 2013, all during the time in August when Meadowbrook's party arbitrator was out of the country on vacation and reportedly unavailable.

The August 12 order also modified a provision of the interim final award by clarifying that Meadowbrook was to file a detailed list of *all* programs, not merely those with outstanding balances, and *all* supporting documentation referring or relating to the percentage risk alleged to have been retained by Meadowbrook. This prompted an emergency motion by Meadowbrook on August 13, 2013, seeking clarification and additional time to respond. Later that same day, the umpire and National Union's party arbitrator denied Meadowbrook's motion with regard to the request for clarification but granted it with regard to the extension of time request, again through a "For the Panel" order and without receiving input from Meadowbrook's vacationing party arbitrator.

What ensued was a complex series of legal actions initiated by Meadowbrook that spanned the next several years, first in Michigan state court, then in Michigan federal district court, and before the panel. The following summary highlights the key events.

On August 13, 2013, Meadowbrook filed a state court action seeking, *inter alia*, to vacate the panel's interim final award. Meanwhile, on August 19, 2013, it filed a motion for reconsideration before the panel.

On August 21, 2013, Meadowbrook filed another motion with the panel to stay all arbitration proceedings, alleging impermissible *ex parte* communications that so tainted the panel that the award would most likely need to be vacated.

On August 29, 2013, the umpire responded with an order denying Meadowbrook's motions to stay and for reconsideration and granting National Union's bill of costs. He stated that the organizational meeting transcript and the two scheduling orders "readily es-

tablish" that the *ex parte* ban came to an end upon the panel ruling on the merits of the dispute (i.e., when the panel issued the interim final award).

The next day, Meadowbrook's party arbitrator filed a five-page dissent arguing that the majority had erred in its conclusion that no impermissible *ex parte* communications occurred and that these communications violated the clear intent of the panel's scheduling orders. In response, the umpire sent an e-mail reiterating his view that *ex parte* communications were precluded only until the conclusion of the hearing.

On September 4, 2013, National Union responded to Meadowbrook's submission on the other potentially at-issue programs and determined that there were now 16 overbilled programs (not 6, as it had previously asserted), increasing its damages claim from $1.584 million to about $25.013 million.

In early September 2013, after the state court action was removed to Michigan federal district court at National Union's behest, Meadowbrook sought to stay the arbitration largely on the basis of the *ex parte* communications between National Union's counsel and its party arbitrator as documented in the attorney's timesheets. Although the district court did subsequently grant the requested stay, that injunction, on appeal to the Sixth Circuit, was dissolved on jurisdictional grounds, i.e., the panel had yet to render a *final* award.

In May 2014, the parties' arbitration resumed. Meadowbrook filed a motion seeking to disqualify National Union's party arbitrator and disband the panel, but it was denied by the panel majority. In July 2014, the panel issued its *final* award, ordering Meadowbrook to pay National Union an additional $8.994 million plus interest, a yet-to-be-determined amount for Meadowbrook's overbilling in relation to three workers' compensation programs, and National Union's attorneys' fees and costs. In an appendix to that award, the panel majority asserted that the August 7, 2013, *ex parte* communication was not inappropriate and that the majority remained "steadfast in its rejection of Meadowbrook's allegations of improper behavior" on the part of National Union's party arbitrator. In a dissent, Meadowbrook's party arbitrator argued that the panel's final award had the effect of expanding Meadowbrook's liability from roughly $1.5 million, as National Union had demanded in its prehearing brief, to over $25 million.

With the July 2014 final award in hand, Meadowbrook returned to Michigan federal district court with a new complaint seeking vacatur of both awards under Michigan Court Rule 3.602(J), based largely on the three post-prehearing briefing *ex parte* communications between National Union's counsel and its party arbitrator. In response, National Union sought to confirm the panel's two awards. In October 2014, the district court essentially denied Meadowbrook's appeal and, in March 2015, granted National Union's motion to confirm the awards, stating in both orders that Meadowbrook had failed to allege improprieties sufficient to vacate them. In April 2015, National Union sought to amend the district court's judgment to increase the actual amount of its damages claim; however, that motion was denied by the district court in January 2016. Both parties filed appeals before the Sixth Circuit.

Despite the complex procedural history of this arbitration and ensuing litigation, the Sixth Circuit swiftly zeroed in on the federal district court's order confirming the panel's interim and final awards, reversing and vacating both of them. It found that the district court erred on both the facts and the law when it held that the *ex parte* communications between National Union's counsel and its party arbitrator, all of which occurred *after* the parties filed their prehearing briefs, did not violate the panel's two scheduling orders barring such communications once those briefs were submitted to the panel. Citing Michigan Court Rule 3.602(J)(b), which provides, "On motion of a party, the court *shall vacate* an award if: . . . (b) there was . . . misconduct prejudicing a party's rights" (emphasis added), the Sixth Circuit found that this provision "most clearly encompasses such *ex parte* communications" and

What ensued was a complex series of legal actions initiated by Meadowbrook that spanned the next several years, first in Michigan state court, then in Michigan federal district court, and before the panel.

Michigan courts, according to the Sixth Circuit, had taken the view that although ex parte communications between a party and an arbitrator may not categorically be grounds for vacating an arbitration award, "such communications do void an award if they violate the parties' arbitration agreement."

that they "clearly violated the parties' scheduling orders."

In analyzing the relevant Michigan case law, the court addressed the question of whether Meadowbrook had the burden of proving that those *ex parte* communications had actually prejudiced it. Michigan courts, according to the Sixth Circuit, had taken the view that although *ex parte* communications between a party and an arbitrator may not categorically be grounds for vacating an arbitration award, "such communications do void an award if they violate the parties' arbitration agreement." The Sixth Circuit answered in the affirmative the narrow question of whether National Union's *ex parte* contacts with its counsel violated the parties' agreement to arbitrate, citing the panel organizational meeting proceedings and the two scheduling orders memorializing the *ex parte* communications ban after the prehearing briefs were filed. Because the three separate contacts occurred *after* those prehearing briefs were submitted, the court held that "[t]hose *ex parte* communications clearly violated both scheduling orders" and that Meadowbrook need not demonstrate prejudice for it to vacate the awards.[1]

National Union argued that there was a "gap" in the scheduling orders because they stipulated when *ex parte* communications would cease, but not when they would resume. National Union pointed to the majority's final award appendix and its view that "in the reinsurance arbitration field 'it is generally recognized and understood that once a panel issues a dispositive ruling on the merits of a matter following a hearing, absent a panel order to the contrary, the preclusion on *ex parte* communications ceases and the parties are free to communicate with their appointed arbitrators.'"[2] National Union claimed that the panel's interim final award disposed of all issues of liability between the parties and was "a ruling on the merits."

The Sixth Circuit found this argument to lack merit for three reasons: (1) National Union's reading of the scheduling orders was inconsistent with their plain and unequivocal language; (2) the interim final award was not a "final" ruling on the merits and, as the dissenting arbitrator had observed, left "critical issues" unresolved, which was why the court had earlier dissolved the district court's injunction (i.e., the arbitration was not complete); and (3) the majority's view of what constituted standard operating procedures in reinsurance arbitrations must be tempered by the dissenting arbitrator's equally credible view that the *ex parte* communications in question "unequivocally" violated the scheduling orders' bans. Because the district court failed to cite any Michigan case law in support of its orders confirming the panel awards and was apparently under the impression that there had been only one *ex parte* contact and not three, the Sixth Circuit held that it erred on both the facts and the law and should have vacated those awards.

This interesting case highlights an important arbitration practice issue rarely addressed in advance by panels during the organizational meeting or in arbitration scheduling orders: if an interim final award is issued, when may *ex parte* communications between the party arbitrators and their appointing parties and counsel resume, if at all?

At the outset of an arbitration, it will be difficult if not impossible to predict whether there will be one (or more) interim final awards before the panel's concluding final award. When an interim final award is issued, perhaps a prudent course would be for the panel to address explicitly the resumption (or not) of *ex parte* communications somewhere in the award or in a separate

contemporaneous order after assessing whether the interim award truly disposed of the merits or leaves the door open for further substantive proceedings. Whether *ex parte* communications should continue to be banned or resumed for limited, or unlimited, purposes ought to be discussed among the three arbitrators at the appropriate time, and if there are any doubts about the right course, they should consider raising the question with the parties and seek their input. It is essential that the arbitrators, parties, and their counsel all remain on the same page regarding the status of *ex parte* communications following an interim final award and strive for transparency on this issue.

In light of the Sixth Circuit's ruling in the wake of five years of hard-fought arbitration and extensive state and federal court litigation, the resumption of *ex parte* communications can no longer be left up to the individual arbitrator's discretion and what he or she believes is the current "common practice" in the reinsurance industry. The demonstrated risk of court vacatur of the award and the resultant time and expense the parties must endure by having to start over from scratch are now simply too great.

SUGGESTED READING

Star Insurance Company v. National Union Fire Insurance Company of Pittsburgh, PA, Nos. 15-1403 & 15-1490, 2016 U.S. App. LEXIS 15306 (6th Cir. Aug. 18, 2016) (not recommended for full-text publication).[3] •

ENDNOTES

1. In rejecting the need for Meadowbrook to demonstrate prejudice in this case, the Sixth Circuit alluded to several other troubling factors influencing its decision in addition to the three post-prehearing briefing *ex parte* communications: (1) the majority's order striking Meadowbrook's supplemental brief without first hearing from Meadowbrook's party-arbitrator, who at the time was out of the country on vacation and unavailable; and (2) when the majority issued its final award about a year later, the fact that Meadowbrook found itself liable for millions more than it had anticipated when the arbitration commenced. As the court observed, "Put simply, this was an arbitration in which 'the coincidences all br[oke] one way.'"
2. In an interesting footnote, the Sixth Circuit took issue with National Union's argument based on Rule 15.5 of the ARIAS-U.S. Rules for the Resolution of U.S. Insurance and Reinsurance Disputes, citing in pertinent part: "The prohibition on ex parte communications shall remain in effect until the Panel issues its final award." http://www.arias-us.org/index.cfm?a=440 (n.d.) (emphasis added) (accessed Aug. 25, 2016). Acknowledging that this rule was not in effect when the parties entered into arbitration in 2011, the court observed that it nevertheless belied the claim that the ex parte contacts in question "comported with common practices in the reinsurance-arbitration field."
3. Whether an unpublished decision like Star Insurance may be cited as precedent in the Sixth Circuit or other federal circuits depends largely on those courts' local rules; however, it does offer a glimpse into how a federal appellate court might approach a similar ex parte communication question. According to the Squire Patton Boggs Sixth Circuit Appellate Blog, that court has a "long history of using unpublished opinions" which, "if relevant, can and should be cited in appellate briefs in the Sixth Circuit with a few caveats." One of those important caveats is that "[u]npublished decisions are not binding on subsequent panels, and so should not be favored over older published decisions," i.e., they are not binding precedent; however, "their reasoning may be 'instructive' or helpful." Colter Paulson, Case Management in the Sixth Circuit: Unpublished Opinions, Squire Patton Boggs Sixth Circuit Appellate Blog, at http://www.sixthcircuitappellateblog.com/news-and-analysis/case-management-in-the-sixth-circuit-unpublished-opinions/ (Oct. 17, 2011) (accessed Aug. 25, 2016) (citing 6th Cir. cases).

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Scott M. Seaman, co-chair of Hinshaw & Culbertson, LLP's National Insurance Services Practice Group (ISPG) and author of Allocation of Losses in Complex Insurance Coverage Claims (4th Ed. Thomsen Reuters 2015) and Edward Lenci, chair of the ISPG's Reinsurance section will discuss the Viking Pump case and the significant issues and rulings rendered in the case. They will discuss the ramifications of the case and how it relates to some of the trends we are seeing with respect to these important coverage issues.

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