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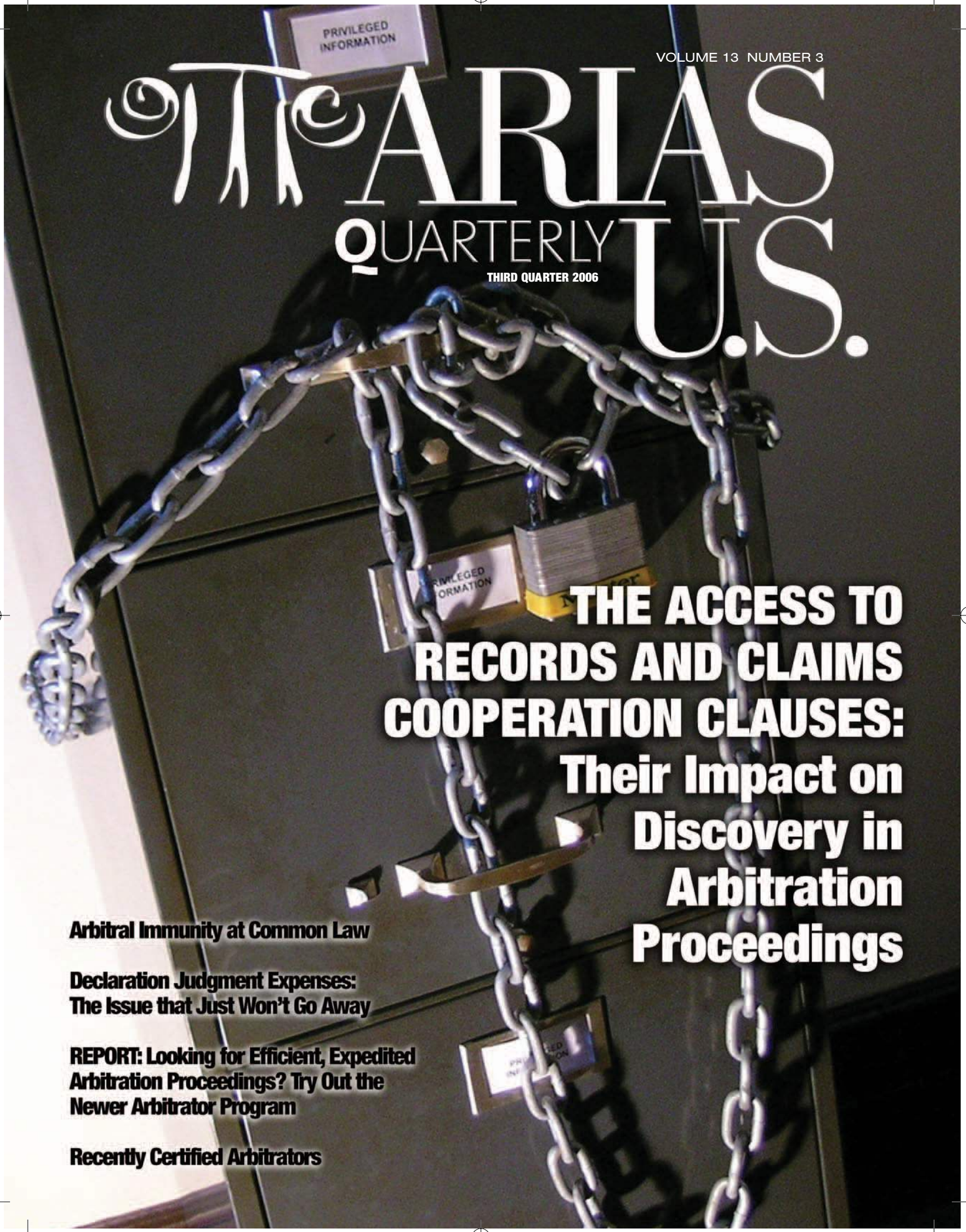

THE ACCESS TO RECORDS AND CLAIMS COOPERATION CLAUSES: Their Impact on Discovery in Arbitration Proceedings

Arbitral Immunity at Common Law

Declaration Judgment Expenses: The Issue that Just Won't Go Away

REPORT: Looking for Efficient, Expedited Arbitration Proceedings? Try Out the Newer Arbitrator Program

Recently Certified Arbitrators

editor's comments

T. Richard Kennedy

Readers of the Quarterly will note that with this issue we are departing from our previous policy of limiting articles to those dealing with the process of arbitration, such as procedures, powers of arbitrators and administrative issues. We previously have turned away surveys of court decisions on substantive law issues. The concern has been that focus on case law would be deemed ARIAS-US teaching that such authorities should be followed by arbitrators in interpreting and applying insurance and reinsurance contract provisions. To the contrary, most arbitration clauses relieve the arbitrators from adherence to strict rules of law in favor of applying standards of industry custom and practice.

Your Editors, supported by the Board of Directors, now believe that the Quarterly should serve to raise the level of knowledge of our members in all areas of reinsurance dispute resolution, both procedural and substantive. We now accept articles dealing with issues of substantive law, provided they are well researched and balanced presentations of the law and do not advocate a position as to what the law should be. We will continue to welcome and to seek to emphasize articles that provide information on improving the arbitration process.

A well researched and balanced survey of case law appears in our lead article, depicted on the cover, by Attorneys Michele L. Jacobson, Robert Lewin, and Royce F. Cohen. In *The Access to Records and Claims Cooperation Clauses: Their Impact on Discovery in Arbitration Proceedings*, the authors review the court decisions on the accessibility of a reinsured's privileged documents to its reinsurer either through the Access to Records and Claims Cooperation clauses, alone, or in conjunction with the application of the "common interest" doctrine.

In *Arbitral Immunity at Common Law*, Robert M. Hall discusses court decisions which generally uphold immunity of arbitrators from liability for damages for acts within the scope of their arbitral powers. Interestingly, the author observes that the typical hold harmless agreement insisted on by most arbitrators provides even broader protection than that provided by common law.

A third survey of court decisions is set forth in Thomas Klemm's article entitled, *Declaratory Judgment Expenses: The Issue that Just Won't Go Away*. The author discusses the arguments on both sides of the issue and the few decided cases on the subject. He postulates that a "countless number" of declaratory-judgment expense decisions are made in arbitration awards in which the court decisions are "routinely ignored" by the arbitrators.

A major feature introduced in this issue is information taken from *Law Committee Reports*, which appear on the ARIAS•U.S. website. As noted by Committee Chair Elaine Caprio Brady, the *Reports* provide a means of keeping members informed of significant cases, legislation and regulations affecting arbitration or reinsurance practices. The value of the Reports can be seen from the four excellent case summaries included in this issue.

Elaine Caprio Brady also reports in this issue on the Newer Arbitrator Program recently instituted by ARIAS•U.S. The program provides the industry with a much-needed, expeditious and cost efficient procedure for resolving disputes involving lower dollar values.

The Quarterly exists for benefit of ARIAS•U.S. members. Please let us know what you like or don't like about the publication, and particularly your ideas as to how we can improve.

I look forward to seeing each of you at the Annual Meeting.

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Editorial Policy

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

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

Manuscripts should be submitted as email attachments to trk@trichardkennedy.com .

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feature

The Access to Records and Claims Cooperation Clauses: Their Impact on Discovery in Arbitration Proceedings


Michele L. Jacobson


Robert Lewin


Royce F. Cohen

Michele L. Jacobson and Robert Lewin are partners in the Litigation Department of Stroock & Stroock & Lavan LLP's New York office. Royce F. Cohen is an associate in that department. The authors concentrate in complex insurance and reinsurance matters.

Michele L. Jacobson, Robert Lewin, and Royce F. Cohen
Stroock & Stroock & Lavan LLP

INTRODUCTION

A fair amount of discussion has been devoted to the scope of discovery in reinsurance arbitrations. Specifically, challenges have been levied against the assertions of privilege made by the parties to arbitrations, with discovery motion practice becoming all too commonplace. One of the more controversial arguments being raised is that the Access to Records and Claims Cooperation clauses preclude the assertion of privilege by the ceding company. This argument is rooted in the language of such clauses, which generally provide for access to "all records."[2]

This article examines the current state of the law regarding the accessibility of a reinsured's privileged documents to its reinsurer either through the Access to Records and Claims Cooperation clauses, alone, or in conjunction with the application of the "common interest" doctrine.

I. THE ACCESS TO RECORDS AND CLAIMS COOPERATION CLAUSES

The "Access to Records" clause, also referred to generically as an "inspection" or "audit" clause, is one of the most, if not the most, significant contract rights that a reinsurer has under a reinsurance agreement.[3] A standard provision, contained in virtually all reinsurance agreements, the Access to Records clause permits the reinsurer "to ascertain whether the insurer is ceding business to the treaty and is calculating reinsurance premium in accordance with the terms and conditions of the agreement, to ensure the accuracy of the insurer's loss reserves, to identify the unreported losses, and to assess the skills and experience of the insurer's underwriters and claims personnel as well as managers."[4] Inspection is one of the few methods, if not the only method, reinsurers have to evaluate the business being ceded to them under their reinsurance contracts.

A typical Access to Records clause provides as follows:

> The Reinsurer or its designated representatives shall have access at any reasonable time to all records of the Company which pertain in any way to this reinsurance.[5]

The most prevalent view is that the provision allows the reinsurer to examine "those records pertaining to business written under the contract in which the provision appears. Eligible data include underwriting and claim files, as well as financial records for use in premium auditing."[6] Specifically, the reinsurer relies on these provisions to ensure accurate claims handling, as well as substantiating specific financial and claims information.[7]

The Access to Records clause and the Claims Cooperation clause are similar in nature and import; oftentimes, the two concepts appear together in one clause.[8] Like the Access to Records clause, the Claims Cooperation clause requires the sharing of information between the reinsured and its reinsurer. A Claims Cooperation clause in a reinsurance contract requires the cedent to "cooperate" with its reinsurer in the handling of claims. The clause obligates the reinsured to be "forthright in making available to its reinsurer all factual knowledge or documentation in its possession relevant to the underlying claim or the handling of that claim."[9]

A typical Claims Cooperation clause provides as follows:

> When so requested in writing, the Company shall afford the Reinsurer or its representatives an opportunity to be associated with the Company, at the expense of the Reinsurer, in the defense of any claim, suit or proceeding involving this reinsurance, and the Company and the Reinsurer shall cooperate in every respect in the defense of such claim, suit or proceeding.[10]

The Claims Cooperation Clause is critical to the reinsurer because it "enables the reinsurer to evaluate the risks it is assuming by familiarizing itself with the cedent's underwriting and claims philosophies, practices, procedures, guidelines, and so forth."[11] The reinsurer's "intimate access to the inner workings of the reinsured" forces the reinsurer to have a "commensurately higher duty to exercise good faith in its [transactions] with the reinsured."[12]

In recent years, reinsurers have been exercising their rights to inspect with more frequency. One commentator's perspective is as follows:

> [I]n the past, the reinsurers relied on the 'utmost good faith' of their ceding companies to ensure that terms of contracts were adhered to, that contracts were properly administered and that full and proper disclosure was made prior to inception and at renewal. Sadly they have now found out that in some cases their trust was misplaced and that their reliance has been abused and taken advantage of, causing significant losses, which could not have been anticipated....[13]

Concomitant with the increase in reinsurers' audits is the growing suspicion on the part of cedents when the right is exercised. Reinsurers often invoke the Access to Records clause when they are concerned by the underwriting practices of the ceding company following a serious loss or sequence of losses.[14] This arouses distrust on the part of the cedent, being viewed as a delay mechanism in the payment of large losses.

Hence, "[t]he reinsurer refuse[s] to pay the claims until an audit has verified their validity, and the cedent refuses to permit the audit until the accounts are current.[15] Each party contends that the other is in breach of contract and that it is entitled to refuse further performance until the breach is cured."[16] Frequently, matters reach arbitration panels in this posture, and the reinsurer conducts what amounts to a *de facto* audit through the discovery process. One of the most hotly debated issues in arbitration proceedings is whether, and to what extent, a reinsurer should be able to inspect the cedent's privileged documents as part of the discovery process.

II. PRIVILEGE AND THE ACCESS TO RECORDS/CLAIMS COOPERATION CLAUSES

The principle that an inspection clause does not abrogate the cedent's attorney-client privilege is noted in numerous reinsurance treatises.[17] Commentators have noted that a contractual obligation to furnish the reinsurer with all records relating to the reinsurance agreement or claims thereunder should not trump the attorney-client privilege, which is fundamental to our judicial system.[18] To find that the clause creates a contractual waiver of the privilege, even when the documents are sought in a reinsurance coverage dispute between the parties, would "completely eviscerate the attorney-client privilege."[19]

Yet, one commentator has noted that "[b]y agreeing to full access to records, the cedent has arguably agreed to disclose its attorney reports, which are . . . generally considered to be the client's documents rather than the attorney's."[20] This highlights a tension between a fundamental principle underpinning our legal system and the contractual language contained in Access to Records and Claims Cooperation clauses. Arbitration panels are routinely being confronted with motions relating to the assertion of the attorney-client and work product privilege in the production of documents, and whether the Access to Records clause alters the application and availability of these privileges. While arbitration panels are not bound by the strict rules of law, and are free to tailor discovery as they deem fit, a review of case law is instructive.[21]

The "Access to Records" clause, also referred to generically as an "inspection" or "audit" clause, is one of the most, if not the most, significant contract rights that a reinsurer has under a reinsurance agreement.

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The rationale for the privilege is that "safeguarding communications between attorney and client encourages disclosures by the client to the lawyer that facilitate the client's compliance with the law and better enable the client to present legitimate arguments should litigation arise."

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A. Attorney-Client Privilege

The attorney-client privilege is a cornerstone of our legal system and serves to ensure that parties can fully benefit from representation. The privilege is premised on the understanding that clients need to speak fully and freely to counsel, secure in the knowledge that the attorney will not expose their confidences. As the United States Supreme Court has explained:

> Its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice.[22]

The New York Court of Appeals has similarly illustrated the importance of the attorney-client privilege:

> 'The adversarial nature of our legal system puts a premium on free and unconstrained access to legal advice and, in so doing, re-emphasizes how essential it is that we do not slacken in our support for the strong public policy favoring confidentiality of attorney-client communications.'[23]

The rationale for the privilege is that "safeguarding communications between attorney and client encourages disclosures by the client to the lawyer that facilitate the client's compliance with the law and better enable the client to present legitimate arguments should litigation arise."[24] The slightest possibility that the attorney might expose the client's confidences defeats the accessibility of free and unconstrained legal advice.[25]

The elements of the attorney-client privilege are well settled: "(1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) unless the protection is waived."[26] In addition, communications between an attorney's agent and the attorney or the client are privileged, as long as the communications are made for the purpose of facilitating the attorney's legal advice to the client.[27] Of course, "[t]he hallmark of a privileged communication is that it must be disclosed by the client to the attorney [or the attorney to the client] with a 'reasonable expectation of confidentiality.'"[28] There is substantial concern within the legal community regarding waivers to the attorney-client privilege and the slippery slope that may destroy these historical protections.[29]

B. Work Product Doctrine

The work product doctrine protects from disclosure any documents created in anticipation of litigation by or for a party or a party's representative.[30] The United States Supreme Court has held that the work product doctrine also applies to documents created by agents working for attorneys, provided that the documents were created "in anticipation of litigation."[31] In reaching this conclusion, the Supreme Court stated:

> At its core, the work-product doctrine shelters the mental processes of the attorney, providing a privileged area within which he can analyze and prepare his client's case. But the doctrine is an intensely practical one, grounded in the realities of litigation in our adversary system. One of those realities is that attorneys often must rely on the assistance of investigators and other agents in the compilation of materials in preparation for trial. It is therefore necessary that the doctrine protect material prepared by agents for the attorney as well as those prepared by the attorney himself.[32]

Specifically, "the mental impressions, conclusions, opinions or legal theories of an attorney or other representation of a party are protected."[33] In particular, factual, investigative reports are considered work product and protected from disclosure as long as they were created in anticipation of litigation rather than in the ordinary course of business.[34]

Documents protected by the work product doctrine are discoverable only in very rare and extraordinary circumstances. One of the differences between attorney-client privileged materials and work product is that the latter may be produced upon a showing of "undue hardship" or "substantial need" whereas the former is immune from

discovery.[35] Case law demonstrates that courts uniformly protect parties' interests in maintaining the sanctity of privilege.[36]

C. Construction of Reinsurance Contracts

Also of importance, and of competing concern to this inquiry, is the principle that, if a contract is unambiguous, it is to be enforced as written. Under New York law, for example, a "court's role is limited to interpretation and enforcement of the [contractual] terms agreed to by the parties."[37] "[I]t does not include the rewriting of [the parties'] contract and imposition of additional terms."[38] A court "may not, under the guise of interpretation, fashion a new contract for the parties by adding or excising terms and conditions if to do so would contradict the clearly expressed language of the contract."[39] If the "language is clear, unequivocal and unambiguous, the contract is to be interpreted by its own language."[40] "A contract is unambiguous if the language it uses has a 'definite and precise meaning, unattended by danger of misconception in the purport of the [agreement] itself, and concerning which there is no reasonable basis for a difference of opinion.'"[41]

As set forth above, Access to Records clauses generally provide for access to "all" records pertaining to the reinsurance contract at issue. As certain commentators have noted, "[b]y agreeing to full access to records, the cedent has arguably agreed to disclose its attorney reports, which are . . . generally considered to be the client's documents rather than the attorney's."[42] Based upon a plain reading of the Access to Records clause, reinsurers have argued that the right to inspect "all records" does not mean, and cannot mean, only those documents that the cedent considers to be non-privileged. Thus, they argue, "all" means "all."[43] As a consequence, reinsurers have argued that cedents cannot rewrite their contracts to deny access to privileged records.[44]

D. The Current State of the Law

While not without controversy, courts have found that the Access to Records and Claims Cooperation clauses have built-in limitations with respect to privileged documents, and those limitations are defined by existing law and the reasonable expectations of the parties. The three reported decisions on the topic are *North River Ins. Co. v. Philadelphia Reins. Corp.*,[45] *U.S. Fire Ins. Co. v. Phoenix Assurance Co.*[46] and, most recently, *Gulf Ins. Co. v. Transatlantic Reins. Co.*[47] Each of these cases has arrived at the same conclusion:[48] a cedent's privileged communications are protected from disclosure to reinsurers even if that communication concerns the underlying claim and the parties have agreed to an inspection clause.[49]

1. North River Ins. Co. v. Philadelphia Reins. Corp.[50]

In *North River*, CIGNA Re refused to pay its reinsured, North River Insurance Company ("North River") for defense costs paid to North River's policyholders. CIGNA Re argued that defense costs were not covered under the direct policies, and that North River should have contested payment of such costs in the underlying arbitration. Cigna Re requested the production of attorney-client communications in the underlying arbitration. In support of its demand, Cigna Re argued that the operation of the Claims Cooperation clause contained in the reinsurance agreement, and/or the common interest doctrine permitted it access to North River's attorney-client communications in the underlying arbitration.

The court rejected the cooperation clause argument, holding that:

> Although a reinsured may contractually be bound to provide its reinsurer with all documents or information in its possession that may be relevant to the underlying claim adjustment and coverage determination... it does not through a cooperation clause give up wholesale its right to preserve the confidentiality of any consultation it may have with its attorney concerning the underlying claim and its coverage determination.[51]

CIGNA Re also argued that the documents withheld from disclosure "were not created with a reasonable expectation of confidentiality," because North River had previously produced a number of other attorney-client documents to CIGNA Re.[52] North River contended, however, that the documents previously produced were part of North River's official claim file. The

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A court "may not, under the guise of interpretation, fashion a new contract for the parties by adding or excising terms and conditions if to do so would contradict the clearly expressed language of the contract."

Under the common interest doctrine, however, the disclosure of privileged material to a third party will not result in waiver if the parties share a common interest in the case.

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documents that were withheld were segregated from the official claims files and maintained at a different location.[53] The court rejected CIGNA Re's argument, holding that "[t]hose documents, as opposed to the attorney-client documents already produced, were from their creation treated with a greater degree of secrecy and expectation of confidentiality."[54] Accordingly, North River was not held to have waived its attorney-client privilege by virtue of the operation of the Claims Cooperation clause contained in the reinsurance certificate.

2. U.S. Fire Ins. Co. v. Phoenix Assurance Co.[55]

A reinsured, U.S. Fire sued its reinsurer, Phoenix, to collect payment on losses suffered from its insured's asbestosis-related claims. After the parties exchanged document demands, U.S. Fire moved for a protective order seeking to exclude from disclosure its attorney-client privileged information regarding those claims. Phoenix argued that the cooperation clause constituted a waiver of U.S. Fire's attorney-client privilege.[56]

The New York Supreme Court held (and was affirmed by the New York Supreme Court Appellate Division, First Department) that upon a reinsurer's anticipatory breach of its duty to indemnify its reinsured, the reinsured is 'freed from its obligations under the cooperation clause to the extent necessary to reasonably protect itself against the breach.'[57] The court further held that privileged communications and attorney work product are not "records" for the purpose of an inspection clause.[58] "Thus, attorney-client privilege was not waived by the promise of open 'records' alone given the parties' contractual dispute."[59]

3. Gulf Ins. Co. v. Transatlantic Reins. Co.[60]

In *Gulf*, the parties entered into a reinsurance agreement that contained an Access to Records clause. Soon after entering into the reinsurance agreement with its reinsurer, Gulf was sued by a non-party, First Union, in connection with an underlying policy. Periodically, Gulf sent its reinsurers updates on the status of the litigation with First Union. Ultimately, the First Union lawsuit was settled, and Gulf then sought a settlement contribution from its reinsurers. Invoking the Access to Records clause, the reinsurers requested privileged documents from the underlying First Union litigation. Although Gulf produced certain documents, it refused to produce counsel's files. As a result, the reinsurers refused to pay their share of the First Union settlement and Gulf commenced a lawsuit.

The New York Supreme Court found that the "Access to Records clause does not limit in any way the Reinsurers' right to documents, whether based on privilege or any other ground. By failing to limit the Reinsurers' access contractually, Gulf has permitted them to review such documents."[61] Thus, the court found that Gulf had no supportable basis for denying defendants discovery of privileged documents.[62]

The Appellate Division, First Department reversed the lower court's decision. It held that the "[a]ccess to records provisions in standard reinsurance agreements, no matter how broadly phrased, are not intended to act as a per se waiver of the attorney-client or attorney work product privileges."[63] The court explained that regardless of whether parties had a common interest in the outcome of an underlying litigation, this common interest does not automatically waive the parties' attorney-client privilege[64] (though the party asserting the privilege has the burden of proving each element of the privilege claimed). While the court may determine that certain documents are outside the purview of privilege, a contract provision can never be considered a blanket waiver of privilege in all circumstances.[65] "To hold otherwise would render these privileges meaningless."[66]

III. THE COMMON INTEREST DOCTRINE

As reflected in the cases cited above, another argument being raised in favor of the production of privileged materials is that the reinsured and its reinsurer share a "common interest" such that the production of privileged documents is proper.[67] Generally, a party waives privilege if privileged information is disclosed to a third party.[68] Under the common interest doctrine, however, the disclosure of privileged material to a third party will not result in waiver if the parties share a common interest in the case.[69] The common interest doctrine generally applies:

> [W]here parties are represented by separate counsel that engage in a common legal enterprise . . . What is important is not whether the parties theoretically share similar interests but rather whether they demonstrate actual cooperation toward a common legal goal.[70]

The common interest doctrine is utilized to "extend the protection of attorney-client privilege to communications shared with individuals with a common interest" or parties facing a common litigation opponent.[71] "[A]s a threshhold matter, the common interest doctrine [only] applies to ... those materials [that] are otherwise privileged...."[72] If there is no applicable privilege to shield a document from disclosure, the common interest doctrine cannot be invoked to prevent its disclosure.[73] "The purpose behind this rule is 'to protect the free flow of information from [the] client to [the] attorney' when a number of clients share a common interest in litigation."[74] The common interest doctrine is employed to defend against an argument that, by sharing privileged documents with parties outside of the privilege "umbrella," a party has waived its privileges vis à vis all other parties. Thus, the common interest doctrine is an exception to the rule that "material which is otherwise privileged is discoverable if it has been disclosed to a third party."[75]

A. The Common Interest Doctrine in the Insurance Context

In construing the effect of the tripartite relationship between an attorney, an insurer, and a policyholder, courts have reached varying conclusions as to how the common interest doctrine applies. The common interest doctrine has been recognized in the policyholder/insurer context when the insurer has retained and paid for counsel for the policyholder. This allows an insurer whose interests are aligned with the policyholder to have access to privileged communications between the policyholder and its counsel without waiver of the privilege.[76]

In *Pittston Co. v. Allianz Ins. Co.*,[77] the insurer sought to compel discovery of documents generated in the course of an underlying litigation for which the policyholder sought indemnity.[78] The insurers, however, had refused to take part in the litigation because they contended that the claim was not covered under the policy.[79] In light of the insurer's refusal to participate in the underlying litigation, the court held that the insurers and their policyholder did not share a common interest:

> To permit insurers unrestrained access to attorney-client communications and work product where those insurers refused to take part in litigation despite notice and an opportunity to participate would distort the "common interest" doctrine.[80]

Based upon the circumstances under which the policyholder acted in the underlying litigation, the court held that the policyholder had communicated with its attorneys with a reasonable expectation of privacy without unity of interest with its insurers. Accordingly, the court held the documents generated from such communications were privileged and could be withheld from discovery. Many courts have held similarly where an insurance company has not made a coverage determination, i.e. where it has reserved its rights.[81]

In an unusual application of the common interest doctrine, the Illinois Supreme Court held, in *Waste Mgmt., Inc. v. Int'l Surplus Lines Ins. Co.*, that the insured's documents were not protected from disclosure to their insurer even though they once shared a common interest, but no longer did.[82] In Waste Mgmt., the insurers agreed to indemnify the insureds for certain costs arising from third-party claims.[83] In a later declaratory judgment action between the insureds and their insurer, a discovery dispute arose over documents the insureds claimed to be protected by the attorney-client privilege and the work product doctrine.[84] The insurers sought the production of the defense counsel's files from the underlying litigations, which the insureds stated were protected by either the attorney-client privilege or the work product doctrine.[85]

The Illinois Supreme Court decided that the documents were not protected because of both the cooperation clause contained in the insurance policy and the common interest doctrine.[86] Holding that the attorney-client privilege was unavailable under the common interest doctrine, the court emphasized its

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In construing the effect of the tripartite relationship between an attorney, an insurer, and a policyholder, courts have reached varying conclusions as to how the common interest doctrine applies.

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applicability in the insurance context:

> [U]nder the common interest doctrine, when an attorney acts for two different parties who each have a common interest, communications by either party to the attorney are not necessarily privileged in a subsequent controversy between the two parties. This is especially so where an insured and his insurer initially have a common interest in defending an action against the former, and there is a possibility that those communications might play a role in a subsequent action between the insured and his insurer.[87]

The Illinois Supreme Court concluded that the insurers and the insureds shared a common interest "in defeating or settling the claim against insureds" and "the communication by insureds with defense counsel is of a kind reasonably calculated to protect or to further those common interests."[88] *Waste Management*, however, has been criticized by other courts, which have held that the common interest doctrine applies only at the time "where an attorney actually represents both the insured and the insurer - joint representation - and accordingly both clients are working together with a single attorney toward a common goal."[89]

B. The Common Interest Doctrine in the Reinsurance Context

Courts have found a common interest to exist between cedents and their reinsurers under certain circumstances.[90] Whether or not a common interest exists between a reinsured and its reinsurer is a fact-driven inquiry. Courts have refused to rigidly apply the common interest doctrine simply because the parties share a cedent-reinsurer relationship.[91] Rather, the existence or non-existence of a "common interest" turns on the facts of a particular case and the circumstances of the dispute at issue.[92]

In *Minnesota School* Boards,[93] for example, the court found that an insurer's disclosure of work product materials to its reinsurance broker did not waive privilege.[94] The plaintiff-insured contended that its insurer, the Employers Insurance Company of Wausau, waived the privilege by disclosing the documents in question to its reinsurers (and reinsurance broker).[95] Employers maintained that it did not waive privilege when it provided privileged documents pursuant to a request by "interested and concerned reinsurers due to their common interest in evaluating and minimizing the exposure arising from the [Minnesota School Boards Association Insurance Trust] suit."[96] The insured contended that Employers had no common interest with its reinsurance broker, and thus had waived any work product privilege these documents might have had. The court found that "[s]ince [a] broker/intermediary is merely a conduit for the relay of correspondence to the reinsurer, disclosure of privileged information to the broker/intermediary is consistent 'with the purpose of maintaining the secrecy of [privileged] information from current or potential adversaries.'"[97] Accordingly, the court found that the insurer's disclosure of privileged documents to its reinsurers did not waive privilege, even though the disclosure was made via a reinsurance broker.[98]

"[T]he interests of the ceding insurer and the reinsurer may [however] be antagonistic in some respects and compatible in others. In cases where a court does *not* find a common interest, disclosure of privileged material to a reinsurer constitutes a waiver."[99] In *North River Ins. Co. v. Columbia Cas. Co.*,[100] for example, the cedent, hoping to persuade its reinsurer to fulfill its payment obligation, disclosed certain privileged documents to its reinsurer.[101] In a lawsuit with a different reinsurer, the court held that the documents were protected from production only if the cedent and the first reinsurer had engaged in a "common legal enterprise."[102] Since the ensuing dispute between the cedent and its first reinsurer demonstrated that there was no common legal enterprise, the privilege was deemed waived.[103]

Critically, disclosure to the first reinsurer waived the privilege as to all others: "Having waived the privilege as to one third-party, North River cannot now resurrect it as a barrier to discovery . . ."[104]

Similarly, in *Reliance Ins. Co. v. Am. Lintex Corp.*,[105] the court found that Reliance Insurance Company failed to establish that it shared a common legal interest with its reinsurer "that warrant[ed] the extension of the attorney-client privilege to the document in question."[106] In that case, Reliance had forwarded to its reinsurer its attorney's legal opinion regarding the underlying claim to its reinsurer. American Lintex Corp., the insured, contended that the document in question was not protected by the attorney-client privilege.[107] Reliance, in turn, argued that the attorney-client privilege applied because "[Reliance] and its reinsurers share[d] a 'unity of interest.'"[108] The court rejected Reliance's argument, and ordered Reliance to produce the document in question, noting that "[t]he existence of this [insurer-reinsurer] relationship alone is not a sufficient basis upon which to find that the attorney-client privilege shields from disclosure the [document in question]."[109] Accordingly, the disclosure of privileged material to one's reinsurer is not without peril; the maintenance of privilege may later depend upon a court's determination as to whether, under those facts and circumstances, the reinsured shared a common interest with its reinsurer.[110]

In coverage disputes with cedents, reinsurers have often sought production of privileged materials from underlying coverage contests between cedents and their policyholders. Reinsurers have argued that they share a "common interest" with their cedents with respect to the underlying insurance claim and are therefore entitled to obtain privileged documentation because they are within the scope of the privilege.[111] This argument amounts to an "offensive" rather than "defensive" use of the common interest doctrine, and is generally combined with Access to Records clause arguments.

In *North River Ins. Co. v. Philadelphia Reins. Corp.*,[112] for example, the reinsurer argued that because of the common

interest doctrine, it could compel the production of the reinsured's attorney-client communications in the underlying arbitration. The court found that the common interest doctrine applies when multiple persons are represented by the same attorney. Under those circumstances, "communications made to the shared attorney to establish a defense strategy remain privileged as against the rest of the world."[113] Rejecting the reinsurer's argument, the *North River* court found that:

> As a matter of general privilege law, there is no automatic waiver of the attorney-client privilege merely because an insured and its insurer have a "common interest" in the outcome of a particular issue. That waiver may be found only when there has been a dual representation of both parties, or the privilege has otherwise been waived by, for example a party's conduct, or by contract.[114]

Accordingly, the court affirmed the magistrate judge's decision that the common interest doctrine did not entitle the reinsurer to discover its reinsured's attorney-client communications.[115]

In another twist on the common interest doctrine, the court in *U.S. Fire Ins. Co. v. Phoenix Assurance Co.*,[116] found that the common interest doctrine barred the reinsurer from obtaining privileged documents from its reinsured. There, the reinsurer alleged that the cedent had waived privilege by providing the reinsurer with privileged documents in the past. Thus, the reinsurer was attempting to show that, by previously sharing privileged documents, the reinsured could no longer assert privilege vis a vis the reinsurer during their reinsurance coverage dispute. The court held that there was no waiver of privilege by the previous sharing of documents because, in the past, the cedent and the reinsurer shared a common interest. Accordingly, the court held that the reinsured's attorney-client and work product materials were protected from discovery. [117]

CONCLUSION

Increasingly, arbitration panels are being confronted with complex discovery disputes and attendant motion practice. The scope and extent of discovery are contested, with issues concerning attorney-client and work product privilege at the forefront of the controversies. While the Access to Records clause is a very important contractual right, it also has become a tool for discovery in the adversarial process. While arbitration panels are not bound by the strict rules of law, courts have not granted reinsurers unlimited access to a cedent's privileged materials even if the parties have agreed to a broad inspection clause permitting access to "all records." Further, even though a reinsurer and a cedent may at times share a common interest, courts have not interpreted the Access to Records/Claims Cooperation clause alone, or in conjunction with the application of the "common interest" doctrine to provide unfettered access to the cedent's privileged documents. ▼

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2 Interestingly, if arbitration panels give reinsurers access to "all records," including privileged materials, discovery would be broader than that permitted under the Federal Rules of Civil Procedure, which expressly permit parties to withhold certain categories of privileged documents from production. See Fed. R. Civ. P. 26(b). Generally, arbitrations are exempt from the federal rules concerning discovery. *See In re Arbitration Between Hawaiian Elec. Indus., Inc. and Hei Power Corp.*, No. M-82 (JM), 2004 WL 1542254, slip op. at *1 (S.D.N.Y. July 09, 2004) (the "hallmark of arbitration - and a necessary precursor to its efficient operation — is a limited discovery process.").

3 *See generally* Graydon S. Staring, *Law of Reinsurance* § 15:8 (2004).

4 Robert W. Strain, *Reinsurance Contract Wording* 42 (3d ed. 1998).

5 Brokers and Reinsurance Markets Association, Contract Wording (samples found in Contract Wording Documents: Access to Records, BRMA 1D) (last modified Spring 2005) *available at* http://www.brma.org/contracts/index.htm.

6 Strain, *supra* note 4, at 575-76.

7 *See* Robert W. Hammesfahr, Lori S. Nugent & Margaret A. Reetz, *Reinsurance Claims*, Chapter 6, § 6.4D2 (2004).

8 Barry R. Ostrager & Mary Kay Vyskocil, *Modern Reinsurance Law and Practice* § 6.04 (2d ed. 2000).

9 *Id.* at § 6.03.

10 Brokers and Reinsurance Markets Association, *supra* note 5, at BRMA 8A.

11 Eugene Wollan, *Handbook of Reinsurance Law* § 5.05 (2003) (*citing* Eugene Wollan, *Less Known Right*, John Linear Rev. (Summer 1998)).

12 Strain, *supra* note 4, at 575-76.

13 Wollan, *supra* note 11, at § 5.05 (*citing* Staring, *supra* note 3, at § 15:8 (1993)).

14 Robert Carter, et al., *Reinsurance* 352 (4th ed. 2000).

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While arbitration panels are not bound by the strict rules of law, courts have not granted reinsurers unlimited access to a cedent's privileged materials even if the parties have agreed to a broad inspection clause permitting access to "all records."

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15 One formulation of the Access to Records clause provides that the reinsurer may not inspect records unless its accounts are current: The Reinsurer or its duly accredited representatives shall have access to the books and records of the Company on matters reasonably relating to this reinsurance at all reasonable times for the purpose of obtaining information concerning this Contract or the subject matter hereof. Except as provided in the following sentence, access to premium records is restricted to within ___ years of the expiration of this Contract. The Reinsurer shall be permitted access to premium records subsequent to the aforementioned period only on the condition that either a) there are no balances payable hereunder by the Reinsurer which are overdue as provided in the Remittance Article of this Contract or b) the Reinsurer has funded all balances due hereunder in an interest-bearing trust fund or with a Letter of Credit as hereinafter provided. Should the Reinsurer choose option (b) of the foregoing paragraph, the Reinsurer agrees to provide the Company a Trust Agreement established at Morgan Guaranty Trust Company of New York, New York, or at a mutually agreed successor Trustee, or a clean, irrevocable, and evergreen Letter of Credit, issued by Morgan Guaranty Trust Company of New York, New York, or by a mutually agreed Bank, of which the Company shall be the beneficiary, which shall secure in full all balances due from the Reinsurer to the Company with respect to this Contract. Such Trust Agreement and/or Letter of Credit shall be established under the laws of the state of New York, and meet all requirements of the state regulatory authorities applicable to the Company. The Reinsurer is responsible for all costs associated with providing such Trust Agreement and/or Letter of Credit as required under this Article.
Brokers and Reinsurance Markets Association , supra note 5, at BRMA 1F.

16 Wollan, *supra* note 11.

17 *See, e.g.*, Ostrager & Vyskocil, *supra* note 8, at § 6.04 ("Reinsurers have unsuccessfully argued that they are entitled to concededly privileged materials pursuant to either the inspection or claims cooperation clauses of a reinsurance agreement.)"; Staring, supra note 3, at § 15:8 ("An audit clause is not a general search warrant . . . . The clause has been held . . . not to be a waiver by the reinsured of the privilege of its communications with its attorneys.")

18 Of course, a party may waive its attorney-client privilege. *See, e.g., Columbia/Hca Healthcare Corp. Billing Practices Litigation v. Columbia/HCA Healthcare Corp.*, 293 F.3d 289, 293 (6th Cir. 2002) ("As a general rule, the attorney-client privilege is waived by voluntary disclosure of private communications by an individual or corporation to third parties. In addition, a client may waive the privilege by conduct which implies a waiver of the privilege or a consent to disclosure. The prevailing view is that once a client waives the privilege to one party, the privilege is waived en toto. However, as evidenced by the instant case, some courts have recognized that a client may 'selectively' waive the privilege.") (internal citations omitted).

19 Wollan, *supra* note 11 (internal citation omitted).

20 Hammesfahr, Nugent & Reetz, *supra* note 7, at §6.4D2.

21 *See In re Arbitration Between Northwestern Nat'l Ins. Co. and Generali Mexico Compania*, No. 00 CIV. 1135 (NRB), 2000 WL 520638 at *10 (S.D.N.Y. May 1, 2000); see also Ostrager & Vyskocil *supra* note 8, at § 14.03[d] ("[t]here is no per se right to discovery in arbitrations."); *Moore's Federal Practice and Procedure* § 26.51 (1993). In addition, federal courts have consistently refused to vacate arbitration awards based on the arbitrators' rejection of broad discovery. *See In re Arbitration Between Metalex Corp. and Sunline Shipping Co., Ltd.*, No. 00 Civ. 3097 (MBM), 2000 WL 1793195 at *2 (S.D.N.Y. December 6, 2000) (refusing to vacate an arbitration award based on the arbitrators' rejection of broad discovery).

22 *Upjohn Co. v. U. S.*, 449 U.S. 383, 389 (1981).

23 *Madden v. Creative Services, Inc.*, 84 N.Y.2d 738, 745 (1995) (internal citation omitted.).

24 *Cavallaro v. U.S.*, 284 F.3d 236, 245 (1st Cir. 2002).

25 See Madden, 84 N.Y.2d at 745.

26 *Banner v. City of Flint and Hamilton*, Nos. 01-1118, 01-1401 and 02-1297, 2004 WL 771672 at **6 (6th Cir. April 8, 2004); *Cavallaro*, 284 F.3d at 245; *U.S. v. Martin*, 278 F.3d 988, 999 (9th Cir. 2001).

27 *See, e.g., In re Grand Jury Proceedings*, 220 F.3d 568, 571 (7th Cir. 2000); *Boettcher v. Fournie Farms, Inc.*, 243 Ill. App. 3d 940, 945-46 (1993)("communications between an insured and an insurer, where the insurer is under a duty to defend, are privileged"); *In re Grand Jury Subpoenas*, 265 F. Supp. 2d 321, 330-31 (S.D.N.Y. 2003) (communications between lawyers and public relations consultants held privileged).

28 *Carrier Corp. v. Home Ins. Co.*, No. 35 23 83, 1992 WL 139778 at *4 (Conn. Super. June 12, 1992).

29 In September 2004, the American Bar Association established its Task Force on the Attorney-Client Privilege to evaluate issues and recommend policy related to the attorney-client privilege and work-product doctrine. On August 9, 2005, the House of Delegates adopted the following resolution:

RECOMMENDATION 111

RESOLVED, that the American Bar Association strongly supports the preservation of the attorney-client privilege and work product doctrine as essential to maintaining the confidential relationship between client and attorney required to encourage clients to discuss their legal matters fully and candidly with their counsel so as to (1) promote compliance with law through effective counseling, (2) ensure effective advocacy for the client, (3) ensure access to justice and (4) promote the proper and efficient functioning of the American adversary system of justice; and

FURTHER RESOLVED, that the American Bar Association opposes policies, practices and procedures of governmental bodies that have the effect of eroding the attorney-client privilege and work product doctrine and favors policies, practices and procedures that recognize the value of those protections.

FURTHER RESOLVED, that the American Bar Association opposes the routine practice by government officials of seeking to obtain a waiver of the attorney-client privilege or work product doctrine through the granting or denial of any benefit or advantage.

30 *See* Fed. R. Civ. P. 26(b)(3) (2006).

31 *U. S. v. Nobles*, 422 U.S. 225, 238-39 (1975).

32 *Id.*

33 *Stampley v. State Farm Fire & Cas. Co.*, No. 00-1540, 2001 WL 1518787 at *2 (6th Cir. November 20, 2001).

34 *See, e.g., Breneisen v. Motorola, Inc.*, No. 02 C 50509, 2003 WL 21530440 at * 4-5 (N.D. Ill. July 3, 2003) ("investigative factual summaries" protected).

35 *Upjohn Co.*, 449 U.S. at 385.

36 Of course, documents that a party claims to be privileged must be adequately described in order to allow other parties to evaluate the privilege being asserted. Rule 26(b)(5) of the Federal Rules of Civil Procedure, for example, requires that:

> [w]hen a party withholds information otherwise discoverable under these rules by claiming that it is privileged or subject to protection as trial preparation material, the party shall make the claim expressly and shall describe the nature of the documents, communications, or things not produced or disclosed in a manner that, without revealing information itself privileged or protected, will enable other parties to assess the applicability of the privilege or protection.
>
> Fed. R. Civ. P. 26(b)(5).

37 *Salvano v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 85 N.Y.2d 173, 182 (1995).

38 *Id.*

39 *Evans v. Famous Music Corp.*, 302 A.D.2d 216, 217-18 (1st Dep't 2003), aff'd, 1 N.Y.3d 452 (2004); *See Goodstein Constr. Corp. v. City of N. Y.*, 111 A.D.2d 49, 52 (1st Dep't 1985), *aff'd*, 67 N.Y.2d 990 (1986).

40 *R/S Assocs. v. N. Y. Job Dev. Auth.*, 98 N.Y.2d 29, 32 (2002) (citing Springsteen v. Samson, 32 N.Y. 703, 706 (1865)); *Modugu v. Continuum Health Partners, Inc.*, 3 A.D.3d 422, 423 (1st Dep't 2004) ("'[A] written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms.'") (internal citation omitted.).

41 *Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 570-71 (2002) (*citing Breed v. Ins. Co. of N. Am.*, 46 N.Y.2d 351, 355 (1978)), rearg. denied, 46 N.Y.2d 940 (1979).

42 Hammesfahr, Nugent & Reetz, *supra* note 7, at §6.4D2.

43 *Gulf Ins. Co. v. Transatlantic Reins. Co.*, Index No. 601602/03 (N.Y. Sup. Ct. May 26, 2004) (holding that "all records of [Gulf] that pertain in any way is an extremely expansive provision, without any limitation").

44 *See generally Davis v. Dawson, Inc.*, 15 F. Supp. 2d 64, 107 (D. Mass. 1998) ("where ... the parties are sophisticated business entities ... it is not appropriate ... to rewrite their agreement"); *Assisted Living Ass. of Morrestown, L.L.P. v. Morrestown Tp.*, 31 F. Supp. 2d 389, 398 (D.N.J. 1998) ("'courts [may not] remake a contract better than the parties themselves have seen fit to enter into...'" (*quoting James v. Federal Ins. Co,* 5 N.J. 21, 24 (1950)).

45 797 F. Supp. 363 (D.N.J. 1992).

46 Index No. 7712/91, slip op. (N.Y. Sup. Ct. August 7, 1992), (published in Mealey's Litigation Reports, *Reinsurance*, Vol. 4, #4 (1993)), *aff'd*, 193 A.D.2d 559 (1st Dep't 1993).

47 13 A.D. 3d 278 (1st Dep't 2004).

48 There has been at least one situation where the court ordered the production of an insured's privileged documents to the reinsurer because the privilege logs were inadequate.

See Travelers Cas. and Surety Co. v. Constitution Reins. Corp., Case No. 01-71057, slip op., A. Cohn (E.D. MI. June 13, 2003). There, Travelers refused to produce 30,000 pages of documents claiming that they were privileged. Travelers submitted a 276-page privilege log in support of this claim. Constitution Re moved for an order compelling production of the documents arguing that it had a "common interest," with Travelers, entitling it to access to all of Travelers records. The Court held that Travelers had to produce the documents because, "no one reading can possibly understand the nature of the document, the recipient of the document or the sender of the document . . . [n]o human being can go through 30,000 documents on a privilege log and deal with it. If I appointed a Special Master, it would take him forever, and besides that, the privilege log is inadequate because they haven't been properly categorized." *Traverlers Cas.*, Hr'g Tr. 18, April 23, 2003.

49 *See North River Ins. Co.*, 797 F. Supp. at 363; *U.S. Fire Ins. Co.*, Index No. 7712/9, slip op. (N.Y. Sup. Ct. August 7, 1992); *Gulf Ins. Co.*, 13 A.D.3d 278; *see also Metropolitan Life Ins. Co. v. AETNA Cas. & Surety Co.*, 730 A.2d 51, 63 (Conn. 1999).

50 797 F. Supp. at 363.

51 *Id.* at 369.

52 *Id.*

53 *Id.*

54 *Id.*

55 Index No. 7712/9, slip op. (N.Y. Sup. Ct. August 7, 1992).

56 *Id.* at F-3.

57 *Id.* at F-4. (internal citation omitted.)

58 *Id.*

59 *Id.*

60 *Gulf Ins. Co.*, 13 A.D. 3d at 278.

61 *Gulf Ins. Co.*, Index No.601602/03 (N.Y. Sup. Ct. May 26, 2004).

62 *Id.*

63 *Gulf Ins. Co.*, 13 A.D. 3d at 279 .

64 *Id.* at 280 ("Production of documents under those circumstances does not prevent the assertion of privilege of similar documents in an adversary situation.").

65 *Id.*

66 *Id.* at 279 (citing North River Ins. Co., 797 F. Supp. at 363).

67 Hammesfahr, Nugent & Reetz, *supra* note 7, at §6.4D2b.

68 *In re Air Crash Disaster at Sioux City, Iowa*, 133 F.R.D. 515, 518 (N.D. Ill. 1990).

69 *U. S. v. Schwimmer*, 892 F.2d 237, 243 (2d Cir. 1989).

70 Ostrager & Vyskocil, *supra* note 8, at § 15.02[a] (citing North River Ins. Co. v. Columbia Cas. Co., No. 90 Civ. 2518 (MLJ), 1995 WL 5792 (S.D.N.Y. January 5, 1995)).

71 *Hydranautics v. Filmtec Corp.*, No. 93CV0476WJAH, 2003 WL 23358200, at *3 (S.D. Cal. Aug. 25, 2003); *See also U.S. ex rel. Bagley v. TRW, Inc.*, 212 F.R.D. 554, 556 (C.D. Cal. 2003) (recognizing that the attorney-client privilege extends to communications between realtor and government under the "common interest doctrine"); *Lectrolarm Custom Systems, Inc. v. Pelco Sales, Inc.*, 212 F.R.D. 567, 572 (E.D. Cal. 2002) (holding "common interest doctrine" applies to communication between insured and insurer, because they had a "commonality of interest" in the underlying suit); *Katz v. AT & T Corp.*, 191 F.R.D. 433, 433-34 (E.D. Pa. 2000) (holding parties with shared interest in actual or potential litigation against a common adversary may share privileged information without waiving their right to assert the privilege); *Ken's Food, Inc. v. Ken's Steak House*, 213 F.R.D. 89 (D. Mass. 2002) (recognizing that communication between client or client's lawyer with lawyer representing another in matter of common interest are privileged under the "common interest doctrine"); *Minnesota School Boards Ass'n Inc. Trust v. Employers Ins. Co. of Wausau*, 183 F.R.D. 627, 632 (N.D. Ill. 1999) (holding disclosure of communication by insurer to reinsurer did not waive attorney-client privilege under the "common interest doctrine"); *Bank Brussels Lambert v. Credit Lyonnais (Suisse) S.A.*, 160 F.R.D. 437, 447 (S.D.N.Y. 1995) (recognizing common interest "doctrine applies where parties are represented by separate counsel but engage in common legal enterprise").

72 *Front Royal Ins. Co. v. Gold Players, Inc.*, 187 F.R.D. 252, 258 (W.D. Va. 1999) (holding that the insurer's internal claim file and correspondence with its reinsurer were not privileged, but that the witness statements were privileged and thus protected under the common interest doctrine).

73 *Allendale Mutual Ins. Co. v. Bull Data Systems, Inc.*, 152 F.R.D. 132, 140 (N.D. Ill 1993) (holding that the work product or the attorney client privilege did not apply to the documents in question, so the issue of whether the common interest doctrine was applicable was not reached).

74 *Travelers Cas. and Surety Co. v. Excess Ins. Co. Ltd.*, 197 F.R.D. 601, 606-07 (S.D. Ohio 2000) (citing U.S. v. Schwimmer, 892 F.2d at 243-44).

75 *Front Royal Ins. Co.*, 187 F.R.D. at 257-58; *Minnesota School Board*, 183 F.R.D. at 632; *U. S. Fire Ins. Co. v. General Re*, No. 88 Civ. 6457 (JFK), 1989 WL 82415, at *3 (S.D.N.Y. 1989).

76 *North River Ins. Co. v. Columbia Cas. Co.*, No. 90 Civ. 2518 (MJL), 1995 WL 5792 at *4 (S.D.N.Y. January 5, 1995).

77 143 F.R.D. 66 (D.N.J. 1992).

78 *Id.*

79 *Id.*

80 *Id.* at 70.

81 *See, e.g., Northwood Nursing & Convalescent Home, Inc. v. Continental Ins. Co.*, 161 F.R.D. 293 (E.D. Pa 1995); *North* River Ins. Co., 1995 WL 5792 at *4..

82 144 Ill. 2d 178 (Ill. Sup. 1991).

83 *Id.*

84 *Id.*

85 *Id.*

86 *Id.* at 192.

87 *Id.* at 193 (internal citations omitted).

88 *Id.* at 194.

89 *Int'l. Ins. Co. v. Newmont Mining Corp.* 800 F. Supp. 1195, 1196-1197 (S.D.N.Y. 1992); In *re Imperial Corp. of Am.*, 167 F .R.D. 447, 452 (S.D. Cal. 1995) (Waste Management "has been criticized and rejected by most courts that have had the opportunity to visit the issue presented there"); *Bituminous Cas. Corp. v. Tonka Corp.*, 140 F.R.D. 381, 386-87 (D. Minn. 1992) (finding the Illinois Supreme Court's extension of the common interest doctrine "unsound"); *See also Pittston Co. v. Allianz Ins. Co.*, 143 F.R.D. 66, 70 (D.N.J. 1992); *Remington Arms Co. v. Liberty Mut. Ins. Co.*, 142 F.R.D. 408, 417-418 (D. Del. 1992).

90 *Front Royal Ins. Co.*, 187 F.R.D. at 258.

91 *McLean v. Continental Cas. Co.*, No. 95 CIV. 10415 (HB HBP), 1996 WL 684209, slip op. (S.D.N.Y. November 25, 1996)

92 Ostrager & Vyskocil, *supra* note 8, at § 6.04.

93 183 F.R.D. at 627.

94 *Id.* at 631.

95 *Id.*

96 *Id.*

97 *Id.*

98 *Id.*

99 *North River Ins. Co.*, 1995 WL 5792 at *4.

100 1995 WL 5792.

101 *See id.*, at *2.

102 *See id.*, at *3.

103 *See id.*, at *8.

104 *Id.*; *See also Reliance Ins. Co. v. Am. Lintex Corp.*, No. 00 CIV 5568 (WHP KNF), 2001 WL 604080, slip op. at * 4 (S.D.N.Y. June 01, 2001) (disclosure to reinsurer waived privilege as to cedent's insured).

105 2001 WL 604080.

106 *Id.* at * 4.

107 *Id.*

108 *Id.*

109 *Id.*

110 There has been at least one case where a reinsurer attempted to cite North River for the proposition that "a reinsurer to ceding insurer relationship was insufficient to find that they 'shared a common interest.'" Employer Reins. Corp. v. Laurier Indemnity Co., No. 8:03CV1650T26MSS, 2006 WL 532113, slip op. at * 2 (M.D. Fla. March 3, 2006). In Employer Reins. Corp., plaintiff Employer Re, moved to compel the production of privileged documents from Swiss Re, a non-party reinsurer. Employer Re argued that disclosure of privileged documents to Swiss Re waived the attorney-client privilege because the Common Interest Doctrine does extend to the reinsurer/cedent relationship. Id. The Court disagreed finding that "[i]n this case, Swiss Re and [Laurier] share a common interest. If those interests actually rather than hypothetically diverge at some point, [Employer Re] can renew its motion." Id. Thus, the common interest doctrine prevented the waiver of privilege in this instance but it is uncertain for how long .

111 Ostrager & Vyskocil, supra note 8, at § 15.01[b].

112 797 F. Supp. at 367-68.

113 *Id.* at 363.

114 *Id.* at 367-68.

115 *Id.*

116 Index No. 7712/9, slip op. at F-5.

117 *Id.*

feature

Arbitral Immunity at Common Law

Robert M. Hall

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...We are persuaded by these policy concerns and agree that the nature of the function performed by arbitrators necessitates protection analogous to that traditionally accorded to judges.

Mr. Hall is a former law firm partner, a former insurance and reinsurance executive and acts as an insurance consultant as well as an arbitrator and mediator of insurance and reinsurance disputes. The views expressed in this article are those of the author and do not reflect the views of his clients. Questions or comments may be addressed to the author at bob@robertmhall.com

I. INTRODUCTION

Most reinsurance arbitrators will not accept an appointment without a contractual hold harmless from any action against them in their role as arbitrators as well as an agreement by the parties to pay any costs of the arbitrators in defending themselves from suit. The purpose of this article is to examine the immunity already provided to arbitrators at common law.

II. CASE LAW SUPPORTING ARBITRAL IMMUNITY

There is a great deal of case law supporting arbitral immunity. The theory behind it is explained in *Austern v.Chicago Board of Options Exchange*, 898 F.2d 882 (2nd Cir.1990) at 885-6:

> Absolute immunity, "justified and defined by the functions it protects and serves, not by the person to whom it attaches," has long shielded judges from damages liability for actions taken in the exercise of their judicial functions. This comparatively sweeping form of immunity has also been extended to executive branch officials who perform either quasi-judicial functions, or prosecutorial functions "intimately associated with the judicial phase of the criminal process." As with judicial immunity, which "protect[s] the finality of judgments [by] discouraging inappropriate collateral attacks . . . [and] also protect[s] judicial independence by insulating judges from vexatious actions prosecuted by disgruntled litigants," the scope of quasi-judicial immunity is defined not by the identity of the actor but by the nature of the function performed, namely freeing the adjudicative process and those involved therein from harassment or intimidation.
> . . . We are persuaded by these policy concerns and agree that the nature of the function performed by arbitrators necessitates protection analogous to that traditionally accorded to judges. Furthermore, we note that "individuals . . . cannot be expected to volunteer to arbitrate disputes if they can be caught up in the struggle between litigants and saddled with the burdens of defending a lawsuit." Accordingly, we hold that arbitrators in contractually agreed upon arbitration proceedings are absolutely immune from liability in damages for all acts within the scope of the arbitral process (citations omitted).

See also *Morgan Phillips, Inc. v. JAMS/ Endispute, LLC*, 140 Cal. App.4th 795 (2006).

Similar expressions of a broad arbitrator immunity can be found in many cases *see e.g. Olsen v. National Association of Securities Dealers*, 85 F.3d 381, 382 (8th Cir.1996) *International Medical Group v. American Arbitration Assoc.*, 312 F.3d 833, 843 (7th Cir.2002); *Cort v. American Arbitration Association,* 795 F.Supp. 970, 972-3 (N.D.Cal.1992); *Hill v. Aro Corporation*, 263 F.Supp. 324, 326 (N.D.Ohio1967); *Airco v. Rapistan Corp.*, 446 N.W.2d 372, 376-7 (Minn.1989); *Stasz v. Charles R. Schwab*, 121 Cal.App.4th 420, 430-1 (2004).

This immunity has been extended to organizations which sponsor arbitrations as well. *See e.g. Cory v. New York Stock Exchange*, 691 F.2d 1205, 1211 (6th Cir.1982); Austern, supra at 886.

To the argument that broad arbitral immunity encourages misbehavior or failure to reveal relationships indicative of bias, courts commonly respond that the remedy is to seek vacatur of the panel's ruling pursuant to the Federal Arbitration Act. *See e.g. Olson, supra* at 383; *Corey*, supra at 1210-12; *Feichtinger v. Eaton Conant*, 893 P.2d 1266, 1268 (Alas.1995); Airco, supra at 378; Stasz supra at 438-9; *Pullara v. American*

Arbitration Association, 2006 Tex.App.Lexis 4081 *6 (2006).

III. LIMITS ON ARBITRAL IMMUNITY

Notwithstanding broad language used in the case law cited above, courts have commented on the limits of arbitral immunity. For instance, non-feasance (as distinct from mis-feasance), was the issue in *Ernst, Inc. v. Manhattan Construction Company of Texas*, 551 F.2d 1026 (5th Cir.1977). An architect, McCauley, was placed in the role of arbitrator of disputes between the owner of the building and the contractor constructing it. McCauley failed to make timely decisions over matters in dispute or any decisions at all. The court found the architect liable for damages stating:

> [T]he question is not the insulation of McCauley from suit because of a decision it made but, more accurately phrased, its immunity from suit for failing, or delaying, in making decisions.
> . . . In his role as interpreter of the contract and as private decisionmaker, the arbitrator has a duty, expressed or implied, to make reasonably expeditious decisions. Where his action or inaction, can fairly be characterized as delay or failure to decide rather than timely decisionmaking (good or bad), he loses his claim to immunity because he loses his resemblance to a judge. He simply defaulted on a contractual duty to both parties.[1]

Similarly, the court speculated that an arbitration sponsoring organization might be liable to return sponsoring fees if it failed to organize and administer an arbitration. *International Medical Group, Inc. v. American Arbitration Association*, 312 F.2d 883, 843-4 (7th Cir.2002).

Several courts have observed that clear lack of jurisdiction might be a basis for lack of arbitral immunity. *Larry v. Penn Truck Aids, Inc.*, 94 F.R.D. 708, 724 (E.D.Pa.1982); Stasz, supra at 432-4. A case in point is *New England Cleaning Services, Inc. v. American Arbitration Association*, 199 F.3d 542 (1st Cir.1999). In that case, grievances were subject to arbitration through the American Arbitration Association under a collective bargaining agreement. The union filed for an arbitration and the AAA proceeded despite the employer's claim that the collective bargaining agreement had been terminated prior to the filing of the arbitration. The employer obtained a court ruling that supported its position on the termination of the collective bargaining agreement and the employer sought damages from the AAA. The court ruled in favor of the AAA stating:

> [The employer] points out that the district court determined that the AAA lacked jurisdiction or authority to adjudicate the dispute and contends that therefore the AAA was not protected by arbitral immunity. Judicial immunity applies, however, unless there is a "clear absence of jurisdiction. We see no reason not to adopt the same parameter for arbitral immunity.
> . . . Adopting [the employer's] position would require arbitral organizations, not courts or arbitrators, to themselves resolve what might well turn out to be significant threshold legal issues long before the hearing. In this case, the AAA would have had to decide not merely whether there was a facially valid demand, but the legal effect of the demand and whether an arbitrator in fact had jurisdiction to determine whether [the employer's] termination of the Agreement was effective. . . . We think it abundantly clear that resolution of the arbitrability issue was not facially obvious. Forcing the AAA itself to preliminarily address potentially complex legal issues would not only impose an unwelcome burden but would interfere with the organization's neutrality and likely add further cost and delay to the arbitral process (citations omitted).[2]

The matter was put more succinctly by the court in *International Medical Group*, *supra* at 842: "But it is not the responsibility of the AAA or even the arbitrator to determine whether a particular agreement creates a duty for the parties to arbitrate a particular grievance. Unless the parties clearly and unmistakably provide otherwise, the question of arbitrability is to be decided by a court, not by an arbitrator (citation omitted)."

IV. WHAT BENEFITS ARE NOT PROVIDED BY COMMON LAW IMMUNITY?

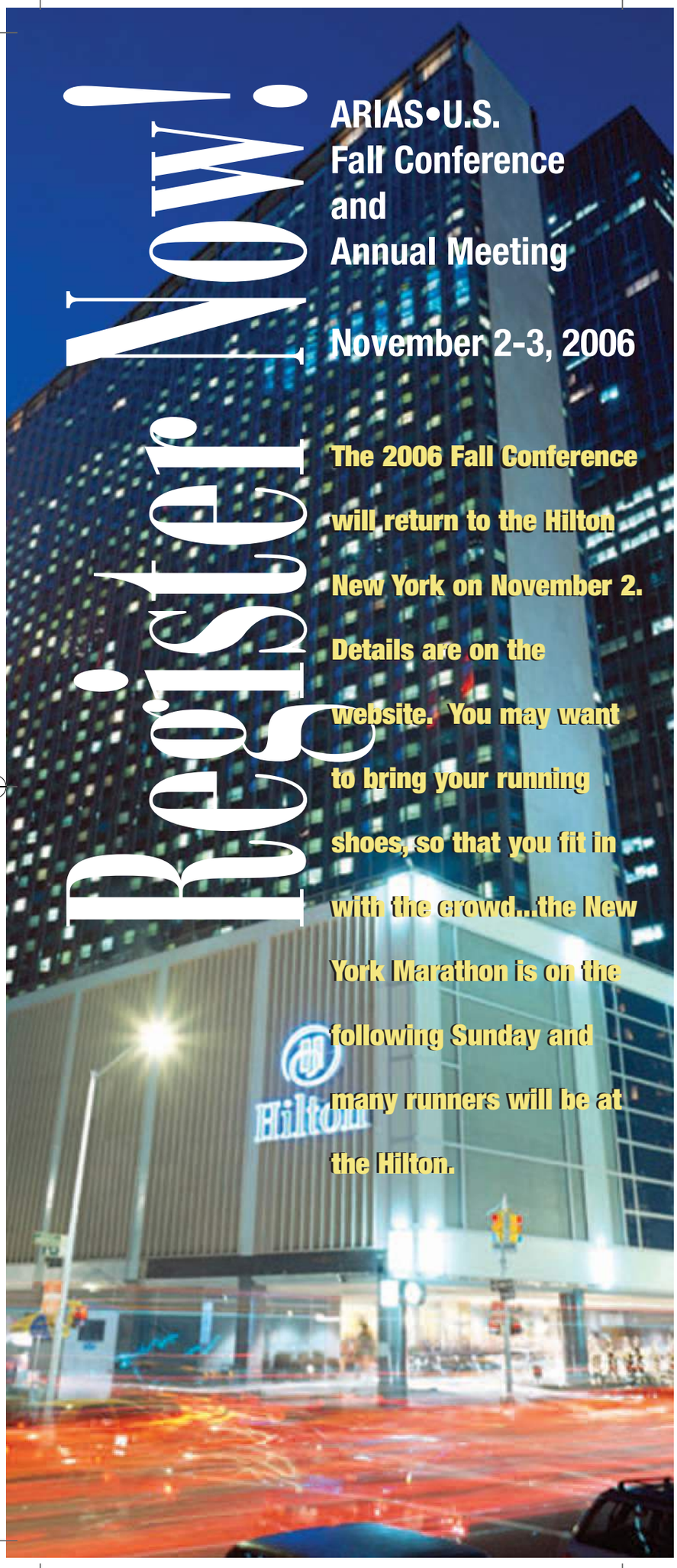
The contractual hold harmless generally required by reinsurance arbitrators goes beyond common law immunity in several ways. Theoretically, it could cover non-feasance or lack of jurisdiction. More practically, contractual hold harmless generally includes the cost of asserting a defense and, in some cases, the value of the time the arbitrator spends in defending himself or herself. In addition, a contractual hold harmless at the outset of the organizational meeting provides an on the record buy-in by the parties which is hard to deny when the arbitration develops in unexpected and unfavorable ways. As a result, contractual hold harmless agreements serve a useful purpose from the arbitrator's standpoint.

V. CONCLUSION

Arbitrators, and organizations that sponsor arbitrations, enjoy immunity from suits in much the same manner as judges. While this immunity may not apply to very unusual allegations (e.g. non-feasance and facial lack of jurisdiction), the contractual hold harmlesses in common use by reinsurance arbitrators may cover such gaps. In addition, these hold harmlesses have the benefit of covering the costs of defending suits. ▼

1 551 F.2d at 1033.

2 199 F.2d at 545-6.



news and notices

Board Certifies Three New Arbitrators, Rosen Added to Umpire List

At its meeting in New York on June 15, the Board of Directors added **Jonathan Rosen** to the ARIAS Umpire List, bringing the total to 78.

At the same meeting, the Board approved certification of three new arbitrators. The following members were certified; their respective sponsors are indicated in parentheses.

Mark Fisher (Martin Haber, Keith Kaplan, James Veach)

David D. Knoll (Hugh Alexander, John Binning, Brian Donnelly, William Wilson, Rodney Moore)

William H. Tribou, III (Charles Foss, Robert Green, Mark Wigmore) ▼

September Workshop Fills Quota in Twenty Minutes

Registration opened at 10:00 a.m. on July 19 to fill the 27 student arbitrator positions in the September Workshop. Twenty minutes later all positions were filled. The registration system remained open for another 30 hours to build a group of seven for the waiting list.

Executive Director Bill Yankus commented that this was the fastest sign-up to-date for these events. ▼

Website Arbitrator Search System Revamped

In an effort to give the "Search for Arbitrator" system a tighter focus on those with the most extensive experience in each area, all arbitrators have been re-surveyed, asking them to indicate up to 20 areas in which they have the most significant experience. Previously, there was no limit to the number of areas indicated and many who have worked across many fields during their careers included the full range of their backgrounds. By repopulating the database with just the most significant areas for each arbitrator, the search results lists will be shorter and will include those who would bring the most experience to any dispute resolution. ▼

November 1-2 set for the 2007 Fall Conference

The dates for next year's Fall Conference and Annual Meeting are November 1-2, 2007. Again, the event will be located at the Hilton New York Hotel. ▼

feature

Declaratory Judgment Expenses: The Issue that Just Won't Go Away

Thomas Klemm
Funk & Bolton, P.A.

Thomas Klemm

The scenario is all too familiar in the reinsurance industry. An insured, facing millions of dollars in tort liability, files a declaratory judgment action ("DJ") to determine whether its insurer is obligated to indemnify and defend the insured. In some cases, the insurer itself files the DJ to determine the issue. In either event, the stakes are usually high. Failure at this stage (either failure in raising the DJ or failure in defending it) could subject the insurer to incredible indemnity obligations; success could save the insurer from such costs. The insurer often commits significant resources to the DJ. Although insurers win some and lose some, most cases are settled before judgment is rendered. In any of these scenarios, the legal expenses incurred defending or prosecuting the DJ are often submitted to reinsurers for reimbursement often giving rise to disagreements on whether the reinsurer is obligated to reimburse the insurer for such expenses. Although more recent contracts may specifically address this issue, the issue remains a topic of hot debate under thousands of reinsurance contracts written before DJs were as common and costly as they have become.[2]

I. The Arguments

The arguments from both sides are well known. From the ceding company's perspective, actions taken and positions asserted in a DJ typically benefit the ceding company and its reinsurers. A preemptive DJ filed by the insurer may also provide further advantages.[3] Surely, ceding companies argue, equity and principles of utmost good faith demand reinsurers to pay, because if the insurer had prevailed, the reinsurer would have benefited. Likewise, reinsurers benefit to the extent that the ceding company obtains favorable settlement by litigating coverage.

The reinsurers counter that they are in the business of reinsurance - that is, reinsuring specific risks covered by their reinsurance contracts. DJ expenses are not the traditional defense costs covered by reinsurance agreements (e.g. expenses related to the insurer's investigation or defense of a claim against the insured), but a normal business expense insurance companies incur as part of the cost of doing business (i.e., overhead). As such, reinsurers argue that DJ expenses are not covered by reinsurance agreements.

II. The Cases

Although arbitrators have been dealing with the issue of DJ expenses for years, often producing varied results,[4] relatively few court cases have addressed the issue. Due to the relatively sparse case law, the few cases addressing the issue provide valuable insight and warrant close scrutiny.

In the oldest, and perhaps most influential case, *Affiliated FM Ins. Co. v. Constitution Reins. Corp.*,[5] the insured sought a declaration that its insurer owed a duty of defense and indemnity regarding a series of employment discrimination claims. The court found in favor of the insurer, and a later appellate court affirmed the decision. After these direct insurance decisions were rendered, the ceding company billed its reinsurer for its share of the related DJ expenses. The reinsurer objected to the DJ expense billing claiming that such expenses were not covered by the reinsurance contract. In the litigation that followed, the trial court granted summary judgment in favor of the reinsurer. The case was then appealed.

During the appeal, the ceding company argued that "commentators have spoken with one voice" on the DJ expense issue and that they "uniformly have concluded that the reinsurer is contractually obligated" to indemnify the ceding company.[6] Finding

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Due to the relatively sparse case law, the few cases addressing the issue provide valuable insight and warrant close scrutiny.

Tom Klemm is an associate in Funk & Bolton's Reinsurance Practice Group, headquartered in the firm's Philadelphia office.

The most important aspect of the Affiliated FM case is probably not the jury verdict requiring the payment of DJ expenses, but instead the court's ruling to admit extrinsic evidence regarding custom and practice to interpret the contract language.

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these sources were "not dispositive" and that there was no "case law addressing this issue directly," the court turned to the language of the reinsurance contract.[7] The court focused specifically on the certificate language which covered "expenses [other than office expenses and payments to any salaried employee] incurred by the [insurer] in the investigation and settlement of claims or suits. . . ."[8] Finding the word "expenses" ambiguous, the court admitted extrinsic evidence to determine the ambiguity.[9] The trial court was presented with "evidence of [the reinsurer's] practice" in dealing with DJ expense issues. Remanding the case, however, the appellate court held that "evidence of custom and trade practice" also would be admissible and persuasive evidence regarding the ambiguity issue.[10] On remand, the jury found in favor of the ceding company.

The most important aspect of the *Affiliated FM* case is probably not the jury verdict requiring the payment of DJ expenses, but instead the court's ruling to admit extrinsic evidence regarding custom and practice to interpret the contract language. While the appellate court emphasizes that the decision was based on the ambiguous nature of the contract, it is unclear whether the finding of ambiguity was, in fact, critical (i.e., would the court have reviewed extrinsic evidence even upon concluding the contract was unambiguous?). Courts often feel compelled to find ambiguity because, as a general rule, extrinsic evidence is not admissible to interpret an unambiguous contract. Courts and scholars have been wrestling with this issue for decades. Segments of *Affiliated FM* highlight these complexities. Indeed, the appellate court's language clearly implies that ambiguity is required before admitting extrinsic evidence:

> "Where, as here, the contract language is ambiguous, evidence of trade usage is admissible to determine the meaning of the agreement."[11]

> "Where, as here, the contract language is ambiguous, evidence of custom and trade practice may be admitted to arrive at an interpretation . . . ."[12]

The appellate court, however, also cites a quotation to the Restatement of Contracts noting that "[t]here is no requirement that an agreement be ambiguous before evidence of usage or trade can be shown . . . ."[13] Thus, it is not entirely clear whether ambiguity was a condition precedent to the admission of this kind of evidence.

Though debate continues, extrinsic evidence generally cannot be admitted to contradict an unambiguous document, but it can be utilized in the initial determination of whether a document is ambiguous. As one scholar notes, "[i]n determining whether contract language is ambiguous, a court is not limited to the face of the contract itself" and it "may look at the circumstances surrounding the making of the contract and at any relevant usage of trade, course of dealing, and course of performance. . . ."[14] This conceptually difficult premise might best explain why the Affiliated FM court seemed eager to simply declare the language ambiguous - since all courts and scholars agree extrinsic evidence can be used to interpret an ambiguous contract. No clear consensus exists on whether trade usage and custom is admissible in determining whether a contract is ambiguous.

Given that the court in *Affiliated FM* focused on the specific language in the contract, it is not entirely surprising that a court construing different contract language would reach an entirely different result. Finding no ambiguity existed under facultative certificates issued by a reinsurer, the Second Circuit in *British Int'l Ins. Co. Ltd. v. Seguros La Republica, S.A.* granted summary judgment in favor of the reinsurer, holding that it was not liable for DJ expenses.[15] Unlike *Affiliated FM,* the certificates at issue were silent as respect expenses. Instead, each certificate stated only that "[t]his Certificate of Reinsurance is subject to the same risks valuations, conditions, [and] endorsements . . . as are or may be assumed, made or adopted by the by the reinsured, and loss, if any, hereunder is payable pro rata with the reinsured . . . ."[16] Distinguishing *Affiliated FM* based on specific contract language, the Second Circuit held the contract language was unambiguous and did not require the reinsurer to pay DJ expenses.

A close reading of the case reveals that the discrepancy between *Affiliated FM* and *British Int'l Ins*. may not have been so much a lack of ambiguity in *British Int'l Ins*., but how that lack of ambiguity was presented. The

court appeared troubled by the fact that the insurer simply pronounced the language as being "so broad" that it is "impossible to interpret without resort to industry custom."[17] As the court stated, a "party relying on ambiguity is normally obligated to show that a word, phrase, or provision could suggest more than one meaning."[18] Here, the insurer did "not propose multiple meanings" and thus the court was "not persuaded that this argument sufficiently establishes an ambiguity . . . ."[19] While the ceding company in Affiliated FM "articulate[d] multiple meanings that the contract language will sustain," the ceding company in British Int'l Ins. did not.[20]

In *British Int'l Ins*., the cedent argued that "even in the absence of ambiguity" regarding the reinsurance contract "industry custom and practice may be used to supplement the terms expressed in the contract."[21] Even though the cedent did "not formulate the circumstances in which a term may be thus implied, or why this case requires that result" the court concluded the "record evidence of custom and practice" was "insufficient to raise the legal issue."[22] In other words, there was no evidence that any specific custom or practice existed or that either party was aware of it. As the court stated, the cedent's evidence failed to prove that the "omitted term is fixed and invariable" in the reinsurance industry, and it also failed to "establish either that the party sought to be bound was aware of the custom, or that the custom's existence was so notorious that it should have been aware of it."[23]

The cedent's follow the fortunes argument was similarly rejected. The court ruled that the doctrine had no application since the DJ expenses did not involve a risk insured by the underlying insurance policies. Instead, "invocation of the doctrine required a showing that [the ceding company's] own declaratory judgment expense in litigating against its policyholders is potentially within the coverage of the underlying policies;" and, as the court stated, this could "not be done."[24]

It is important to note that although the *British Int'l Ins*. and *Affiliated FM* courts reached different conclusions, they applied the same basic analytical process to resolve the issue. As the two cases show, courts focus first and foremost on the specific contract language to determine whether there is any ambiguity. If there is no ambiguity, then the court likely will decide the issue as a matter of law. If, however, an ambiguity is found, then the court may allow extrinsic evidence to address the ambiguity. A court's ruling as respects ambiguity or the lack thereof, however, does not guarantee a specific result on the merits. In other words, finding an ambiguity exists does not mean the ceding company will prevail. Conversely, the absence of an ambiguity does not ensure judgment in the reinsurer's favor.

Indeed, two federal district courts have held that the unambiguous expense provisions in reinsurance contracts unambiguously required the payment of DJ expenses. In *Employers Reinsurance Corp. v. Mid-Continent Casualty Co*., the contract language obligated the reinsurer to reimburse the ceding company's "claim expenses."[25] This definition, based on a supplementary provision, included "all expenses which [the ceding company] incurs with respect to any claim it investigates."[26] Noting this contract language was "more expansive" than that found in *Affiliated FM,* the *Employers Reinsurance* court ruled that "a plain reading" of the contract language "indicates that it covers [the ceding company's] declaratory judgment fees and expenses."[27]

A similar result occurred in *Employers Ins. Co. of Wausau v. American Re-Insurance Co*.[28] The contract at issue stated that: "[t]he Reinsurer shall be liable for its proportion of allocated loss expenses. . . ."[29] The term "allocated loss expense" was defined to include "all expenses incurred in the investigation and settlement of claims or suits. . . ."[30] The court ruled that such language encompassed "expenses incurred in declaratory judgment actions attempting to avoid coverage for a claim."[31] Due to the unambiguous nature of the contract, there was "no question" that the reinsurer was obligated to pay DJ expenses.[32]

In a more recent decision, the federal district court in California relied upon extrinsic evidence to interpret ambiguous contract language. In *Fireman's Fund Ins. Co. v. General Reinsurance Corp*., the court held that the reinsurer was obligated to pay DJ expenses and ruled in the ceding company's favor.[33] In this case, the ceding company, Fireman's Fund, issued five insurance policies to a series of chemical/oil companies. Gen Re, in turn, reinsured these policies under five facultative certificates.

Each of the insureds became involved in substantial pollution and/or asbestos claims, and each company eventually initiated a DJ against Fireman's Fund to determine coverage. In these proceedings, Fireman's Fund incurred substantial expenses, and it ceded a portion of these costs to Gen Re. These claims were rejected and a lawsuit commenced.

Each reinsurance certificate obligated Gen Re to pay its "its proportion of expenses . . . incurred by [the ceding company] in the investigation and settlement of claims or suits. . . ."[34] Fireman's Fund presented evidence that "DJ expenses were routinely and knowingly paid by reinsurers," including Gen Re.[35] Gen Re challenged this claim and argued that Fireman's Fund's evidence was based on the practice of a single company and thus did not qualify as evidence of industry practice or custom.[36] Gen Re further suggested that "even if DJ expenses were routinely paid by reinsurers, payment of those expenses was not knowing."[37]

Finding the Gen Re certificate language to be "virtually identical to the language" in *Affiliated FM*, the court relied upon *Affiliated FM* and held the term "expenses" was ambiguous. For this reason, the court allowed extrinsic evidence to be introduced to determine the parties' intent.[38] William J. Gilmartin proved to be Fireman's Fund star witness - and the key to the court's decision. According to Mr. Gilmartin's testimony, which the court deemed "highly credible," between the 1960's and 1980's reinsurers reimbursed cedents for

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For those keeping score (and lawyers always keep score!), the court decisions (including the recent Fireman's Fund decision) are four to one in favor of the cedents. The recent decisions arguably reflect a trend in that direction.

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payment of DJ expenses as a matter of custom and practice.[39] Based on this testimony, and evidence that Gen Re had routinely paid DJ expenses, the court found that at the time of the certificates' issuance "there was a nearly universal custom and practice in the reinsurance industry of paying DJ expenses under certificates containing language substantially the same or similar to the language contained in the Certificates here."[40]

The pivotal nature of Mr. Gilmartin's testimony is particularly significant because he was a witness on the losing side in *British Int'l Ins.*[41] The *Fireman's Fund* court determined that, along with finding the contract language unambiguous (i.e., not requiring the review of industry custom and practice), the *British Int'l Ins. court* found Gilmartin's testimony regarding industry practice "unpersuasive."[42] In the *British Int'l Ins.* case, there were several flaws. First, Mr. Gilmartin "did not aver" that "reinsurers always and invariably" paid DJ expenses. Instead, his testimony "can be read" as saying that payments of DJ expenses "were made ex gratia when reinsurers believed that the coverage litigations advanced their common interest, but not otherwise."[43] Thus, it does represent an invariable practice. Second, Mr. Gilmartin failed to testify that "the language contained in the reinsurance certificates issued by other reinsurers was similar to the language in the certificates at issue in that case."[44] As such, it could not be said that a given custom or practice applied to the contractual language at issue. Third, there was "no allegation of actual or constructive knowledge on the part of the reinsurer or evidence that the practice was so notorious in the industry that the reinsurer must have been aware of it."[45]

In *Fireman's Fund*, all of these deficiencies were overcome. Mr. Gilmartin's testimony could not "reasonably be read to say that reinsurers only paid DJ expenses when it suited their interest."[46] Likewise, in this case, Mr. Gilmartin "clearly stated that his opinion concerning the custom and practice of other reinsurers is based on his experience regarding payment of DJ expenses under facultative reinsurance certificates containing the same or similar language to that at issue here."[47] This testimony was based on an entire understanding of the reinsurance industry and not just one company - the court had previously stated that Mr. Gilmartin was not only aware of the custom and practice of CNA's reinsurance department (where he was employed) "but also of the reinsurers to which CNA ceded risk, including Gen Re."[48] Finally, the evidence suggested that Mr. Gilmartin "never encountered a single instance in which DJ expenses were denied under similar language . . . ."[49] This was "sufficient to establish constructive knowledge based on a notorious custom and usage in the industry."[50]

The *Fireman's Fund* court had other ways to distinguish *British Int'l Ins.* The court explained that the language in the certificates in *British Int'l Ins.* was "significantly different" from the language here.[51] Indeed, the *British Int'l Ins.* court had distinguished itself from the earlier *Affiliated FM* decision (which, as mentioned, had language almost identical to that in *Fireman's Fund*). Unlike the ambiguous "expenses" language found in *Affiliated FM* and *Fireman's Fund*, the *British Int'l Ins.* court interpreted a clause which made no reference whatsoever to "expenses."[52] Thus, the Fireman's Fund court found British Int'l Ins. inapplicable and distinguishable.[53]

Gen Re's only real counter argument was quickly brushed aside. It argued that reinsurers around the world were unaware of the "custom and usage" regarding DJ expenses, and as such this evidence should not be considered.[54] The court disagreed noting that reinsurers had both constructive and actual knowledge of the custom and usage. The court explained that, "[w]here a custom and usage is essentially universal, as the evidence shows it was here, a party is presumed to have knowledge of it."[55] It further stated that it "simply is not credible that reinsurers were unaware for decades that they were paying DJ expenses along with their share of the loss . . . ."[56]

III. Will the Issue Ever Go Away?

For those keeping score (and lawyers always keep score!), the court decisions (including the recent *Fireman's Fund* decision) are four to one in favor of the cedents. The recent decisions arguably reflect a trend in that direction. The court's broad, sweeping statements in *Fireman's Fund* regarding coverage of DJ expenses under reinsurance contracts will no doubt feature prominently in future arguments by cedents. These

statements, however, must be viewed in the context of the specific contract language at issue. Again, the lesson to be learned from all of the reported court decisions is that contract language matters.

The case law, however, is only part of the story. Since most reinsurance disputes are decided in confidential arbitrations and those decisions typically never see the light of day, there are no doubt countless numbers of DJ expense decisions that cannot be adequately analyzed. Even where anecdotal evidence of arbitration results emerge, it is difficult to know how or why a particular arbitration panel reached the result it did. Further, it is not uncommon for the DJ expense issue to be one of several issues and maybe even the least important (in terms of the actual dollar amount involved).

In these undisclosed opinions there is no way to determine the extent to which arbitration panels are influenced by case law. Indeed, some court decisions are widely considered "wrong" by industry insiders and are routinely ignored by arbitrators. Parties and their counsel, however, are well advised not to ignore the case law regarding DJ expenses - particularly those decisions in which the courts have undertaken a lengthy, detailed analysis of the issue.

In the end, reinsurers that dispute any obligations to pay DJ expenses are unlikely to change their minds - irrespective of the developing case law or arbitration results. While many reinsurers may acknowledge liability for DJ expenses, in situations where their contracts contain expense provisions similar to those involved in the cases discussed above, and where the parties fail to compromise on the issue, it appears that the issue is not going away any time soon. ▼

1 Tom Klemm is an associate in Funk & Bolton's Reinsurance Practice Group. He is currently licensed to practice law in Maryland and the District of Columbia. The Reinsurance Practice Group is headquartered in the firm's Philadelphia office at 1717 Arch Street, Suite 4600, Philadelphia, PA 19103. Mr. Klemm would like to thank Bryan Bolton (head litigation partner) and Daryn Rush (head reinsurance partner) for their significant contributions regarding this article.

2 As with so many other aspects of reinsurance law, the DJ issue did not become a volatile one until the asbestos/toxic tort claims of the 1980's. *See* Modern Reinsurance Law and Practice (2nd ed.), Barry Ostrager & Mary Kay Vyskocil (2000) § 7.03. *See also Fireman's Fund Ins. Co. v. General Reinsurance Corp.*, No. C-03-04406 JCS (N.D. Cal. Aug. 5, 2005) at *12 ("[H]ighly credible" witness notes that the question of DJ expenses was "first raised by reinsurers in the early 1980s . . . in response to rising costs associated with asbestos and pollution claims.").

3 A ceding company can choose when and where to raise its declaratory judgment including whether to file in state or federal court. Given that state laws differ widely on insurance law principles, forum selection should not be undervalued.

4 *See* Eugene Wollan, Handbook of Reinsurance Law, (2003) § 2.05[C] ("[O]pinions [regarding DJ expenses] throughout the industry, including those of members of reinsurance arbitration panels, vary widely.").

5 *Affiliated FM Ins. Co. v. Constitution Reins. Corp.*, 416 Mass. 839 (1994).

6 *Id.* at 842.

7 *Id.* at 842-43.

8 *Id.* at 841 n.4.

9 *Id.* at 845-46 ("Where, as here, the contract language is ambiguous, evidence of trade usage is admissible to determine the meaning of the agreement."); ("Where, as here, the contract language is ambiguous, evidence of custom and trade practice may be admitted to arrive at an interpretation . . . .").

10 *Id.* at 846.

11 *Id.* at 845.

12 *Id.* at 846.

13 *Id.* at n.9.

14 E. Allan Farnsworth, Farnsworth on Contracts § 7.12a (1990) at 279-80; *see also Western States Constr. Co. v. United States,* 26 Cl. Ct. 818 (Ct. Cl. 1992) (collecting sources).

15 *British Int'l Ins. Co. Ltd. v. Seguros Republica*, SA, 342 F.3d 78 (2d Cir. 2003).

16 *Id.* at 80.

17 *Id.* at 82.

18 *Id.* (internal citations omitted).

19 *Id.*

20 *Id.* at 83.

21 *Id.*

22 *Id.*

23 *Id.* at 84 (internal citations omitted).

24 *Id.* at 85.

25 202 F. Supp. 2d 1221, 1235 (D. Kan. 2002) *affirmed in part* 358 F.3d 757, 768 (10th Cir. 2004).

26 *Id.* at 1236.

27 *Id.*

28 256 F. Supp. 2d 923 (W.D. Wisc. 2003).

29 *Id.* at 924.

30 *Id.*

31 *Id.* at 925.

32 *Id.*

33 *Fireman's Fund Ins. Co. v. General Reinsurance Corp.*, No. C-03-04406 JCS (N.D. Cal. Aug. 5, 2005).

34 *Id.* at 2-8. Five reinsurance certificates were involved, but this common language can be found in all of them.

35 *Id.* at 11.

36 *Id.*

37 *Id.*

38 *Id.* at 16 citing *Affiliated FM Ins. Co. v. Constitution Reins. Corp.*, 416 Mass. 839, 841 n.4 (1994).

39 *Fireman's Fund Ins. Co. v. General Reinsurance Corp.*, No. C-03-04406 JCS (N.D. Cal. Aug. 5, 2005) at 12.

40 *Id.* at 13. While Gen Re presented contrary testimony, the court was not impressed. For example, one of Gen Re's witnesses could only testify that "in the twenty-four years he has been employed at Gen Re, it has been Gen Re's position that DJ expenses are not covered under its facultative reinsurance certificates . . . ." *Id.* However, as the court pointed out, his career did not begin until 1981, the time when the DJ issue was starting to explode. Another witness testified that "it was the intention of involved underwriters that the coverage afforded under the certificates was limited to the risk assumed by the cedent under policies issued to insureds." Id. at 13-14. The court found this testimony "unconvincing" because the witness had failed to lay the "factual foundation in support of his statement purporting to describe" the underwriters intentions. Id. at 14.

41 Gilmartin also provided testimony in *Affiliated FM* after the Massachusetts Supreme court overruled the summary judgment motion for the reinsurer. (Declaration of William J. Gilmartin ¶8, May 31, 2005).

42 *Fireman's Fund Ins. Co. v. General Reinsurance Corp.*, No. C-03-04406 JCS (N.D. Cal. Aug. 5, 2005) at 18.

43 *Id.*

44 *Id.* at 18-19.

45 *Id.* at 19.

46 *Id.*

47 *Id.*

48 *Id.* at 12-13.

49 *Id.* at 19.

50 *Id.*

51 *Id.* at 18.

52 *Id.* citing *British Int'l Ins. Co. Ltd. v. Seguros Republica*, SA, 342 F.3d at 80, 83.

53 *Fireman's Fund Ins. Co. v. General Reinsurance Corp.*, No. C-03-04406 JCS (N.D. Cal. Aug. 5, 2005) at 18.

54 *Id.* at 17.

55 *Id.*

56 *Id.* at n.3.

members on the move

In each issue of the Quarterly, we list member announcements, employment changes, re-locations, and address changes, both postal and email, that have come in over the quarter, so that members can adjust their address books and Palm Pilots.

Do not forget to notify us when your address changes. **If we missed your change here, please let us know at info@arias-us.org**, so it can be included in the next issue.

Recent Moves and Announcements

Paul Thomson has a new location at 81 Bay Avenue, Halesite, NY 11743-1206, email reassess@verizon.net

Paul Aiudi is now Second Vice President & Senior Counsel at St. Paul Travelers, One Tower Square - 5MS, Hartford, CT 06183, phone 860-277-6549, fax 860-277-3292, email paiudi@stpaultravelers.com .

Bill Tribou is now located at 24 Brookfield Ave., P.O. Box 147, Schroon Lake, NY 12870, phone 518-532 7452, email SLBrookloon@aol.com .

Clem Dwyer has moved. URSA Advisors, LLC can be found at 1170 U.S. Highway 22, Bridgewater, NJ 08807, phone 908-722-1622, fax 908-722-1699, email cdwyer@ursa.com .

Dewey Clark has a new address at 44 Schindler Ct., Lawrenceville, NJ 08648. Everything else stays the same.

Klaus-Heinz Kunze is back in New York at 230 West 56th St., Apt. 56B, New York, NY 10019, phone 646-649-3515, fax 646-407-6654, email kkunze1@nyc.rr.com .

Susan Mack has gone to Florida to become a Senior Vice President and General Counsel with The Main Street America Group, a mutual holding company for property-casualty insurance companies. She plans to continue her current practice as a reinsurance arbitrator and umpire. The company is at 4601 Touchton Road East, Suite 3400, Jacksonville, FL 32246, phone 904-380-7446, fax: 904-380-7441, email macks@msagroup.com .

Peter Gentile is focusing his new business venture on litigation support services including, arbitration, mediation and expert witness work. His office is at 13 Braeburn Drive, New Canaan, CT 06840, phone 203-966-7698, cell 203-246- 6091, fax 203-966-3983, email pagentile@optonline.net .

John Dattner made the move from Trumbull, Connecticut to Delaware in August. Here is his new contact information: John W. Dattner, Disputes Resolved, LLC, 374 Cassell Court, Wilmington, DE 19803, phone 302-475-2373, fax 302-475-8980, cell 302-507-3238, email jdattner6163@verizon.net .

Ken Pierce is now at Morgan Stanley, Global Capital Markets, 1585 Broadway, 4th Floor, New York, NY 10036, phone 212-761-5343, cell 917-455 9138, fax 646 290-3027, email Kenneth.Pierce@morganstanley.com .

Charlie Foss, former ARIAS-U.S. President and Chairman, is retiring after 31 years with The Travelers and has moved his arbitration practice to Cape Cod. Charlie's new contact information is: 4 Freeman Lane, Orleans, MA 02653, phone 508-240-0518, fax 508-240-0528, email charliefoss@comcast.net.

Will Fawcett is now at AXA Liabilities Managers, where he is Deputy Chief Legal Officer. His contact information is 17 State Street, 36th Floor, New York, NY 10004, phone 212-493-9330, cell 443-980-6740, email William.Fawcett@AXALiabilitiesManagers.com .

Soren Laursen, who is managing the run-off of Crum & Forster's surety business, has not moved, but his address has a bad zip code in the ARIAS Directory, so here is the complete address. Crum & Forster, 305 Madison Avenue, Morristown, NJ 07962. All other information is accurate.

While we're correcting the Directory, **Bina Dagar's** profile was missing her numbers of arbitrations. She has three as an arbitrator. Be sure to write it in if you use the printed pages for looking up arbitrators.

The only other mistake we know about is the misspelling of **Mintz, Levin, Cohn**, *et al* in the Corporate Member section. There should be no "e" at the end of Levin.

New Email Addresses

Debra Roberts debra.roberts@cox.net .

Diane Nergaard dnergaard@eriksenllc.com .

Marty Cohen martbcohen@comcast.net .

John Howard jhhoward@bellsouth.net .

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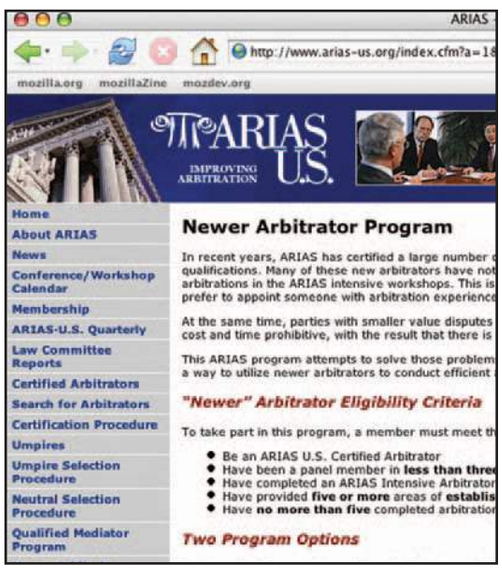
Elaine Caprio Brady
Liberty Mutual Insurance Company

These days, with the cost of outside counsel, arbitrators and consultants, a company can expend at least $250,000 or more in transaction costs to arbitrate a relatively straightforward reinsurance dispute. At the same time, many companies must contend with aged or disputed reinsurance recoverables of $250,000 or less that are prime candidates for potential arbitration. Because the cost of resolving such matters may likely equal the amount that could potentially be awarded, disputes can languish and recoverables go uncollected. In order to provide a solution to this "catch-22" situation, ARIAS-U.S. has instituted an exciting new program that provides the industry with an expedited and efficient procedure to resolve lower dollar-value reinsurance disputes. Since the program utilizes certain ARIAS-U.S. arbitrators who have less than three completed arbitrations, it also provides the opportunity for such arbitrators to continue to acquire arbitration experience and for such companies and outside counsel to become acquainted with the knowledge and expertise of these newer arbitrators.



In order to take advantage of this program, both parties must first agree to adhere to the Newer Arbitrator Program guidelines in lieu of the procedures contained in the arbitration clauses of the relevant reinsurance contract(s).[1] Next, the parties must choose whether to resolve their dispute with an expedited proceeding using a) a single arbitrator, or b) a three-member panel.[2] The parties would then contact Bill Yankus, Executive Director at info@arias.org or 914-966-3180, ext. 116 regarding the selection of the Newer Arbitrator for the single arbitrator proceeding, or of the Newer Arbitrator umpire in the three-member panel, if the parties are utilizing the ARIAS Umpire Selection Procedure.[3]

With the single arbitrator proceeding:

- The Newer Arbitrator is selected by ARIAS•U.S. using the ARIAS Umpire Selection Procedure;
- There is no discovery, unless the parties agree otherwise;
- The dispute is submitted to the Newer Arbitrator on briefs and documentary evidence only, unless the parties agree otherwise; and
- The decision is rendered within three months from the date the arbitrator is selected.

In the three-member panel proceeding:

- Each party selects an arbitrator from the Newer Arbitrator List (website);
- The umpire is appointed pursuant to either the ARIAS-U.S. Umpire Selection Procedures utilizing the Newer Arbitrator List or is selected by the two party-appointed Newer Arbitrators;
- The parties may utilize certain streamlined discovery parameters limiting the production of documents, the amount of depositions to three per party and interrogatories and requests for admission to ten per party;
- *Certain Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes* apply to this dispute;
- If both parties agree at or before completion of the Organizational Meeting, there is no hearing and the dispute is resolved based on summary disposition; and
- The decision is rendered six months from the date the panel is constituted.

This article provides only a brief summary of the program. For the complete set of Newer Arbitrator Program guidelines and instructions, please review the Newer Arbitrator Program section of the ARIAS-U.S. website, www.arias-us.org . ▼

1 The Newer Arbitrator Program guidelines can also be incorporated into an arbitration clause for new reinsurance contracts and/or during the contract renewal process for existing contracts.

2 The single arbitrator proceeding is suggested for disputes with a value of up to U.S. $250,000, while the three-member panel proceeding is suggested for disputes with a value up to U.S. $1,000,000.

3 ARIAS•U.S. has created a list of eligible "Newer Arbitrators" who have agreed to participate in the program.

Elaine Caprio Brady is Senior Corporate Counsel in the Legal Department of Liberty Mutual Insurance Company. She is a member of the Board of ARIAS•U.S.

Report

Elaine Caprio Brady

Recently Certified Arbitrators

Ceceil D. Bykerk

David D. Knoll

Cecil D. Bykerk

Cecil Bykerk was Executive Vice President and Chief Actuary at Mutual of Omaha Insurance Company, prior to starting his consulting career in 2004. Prior to his 25-year tenure at Mutual of Omaha, he was Director of the Actuarial Science Program at the University of Nebraska from 1975 to 1979. He began his professional career at Metropolitan Life in 1970. He has served as vice president and on the Executive Committee for the Board of Governors of the Society of Actuaries and on the Board of Trustees of the AAA. He is past chairperson of The Actuarial Foundation.

Mr. Bykerk was appointed to the Actuarial Standards Board in 2003 moving up to Chair at the beginning of 2006. He served on the Board and as Chair of the National Association of State Comprehensive Health Insurance Plans (NASCHIP) during 1996-1998, returning to the Board in 2005 and is now serving as Treasurer. He served as Chair of the International Actuarial Association's Education Committee from 1999 through 2004.

More recently, Mr. Bykerk served as Chair of the Nebraska Life and Health Guaranty Association, as well as serving on the Board of Directors of the National Organization of Life and Health Guaranty Associations including serving as Treasurer. During his career, Mr. Bykerk has been actively involved regarding Genetic Testing and Major Medical insurance, having made presentations to various professional, academic and regulatory bodies, and writing articles and white papers. Mr. Bykerk received his bachelor's degree from the University of Denver in 1966, and his master's degree from the University of Nebraska Lincoln in 1968. He currently serves as Executive Director of three high risk pools, Alaska, Iowa and Montana.

David D. Knoll

David Knoll is co-chair of the Insurance Industry Practice Group of Winstead Sechrest and Minick, PC, a Texas-based business law firm focusing on clients in the financial services, real estate and technology industries. With a career spanning over 35 years, Mr. Knoll has extensive experience representing clients in the insurance industry, both as in-house and outside counsel. After serving a four-year tour of duty with the United States Army Judge Advocate General's Corps following law school, he moved to Houston, Texas to join the Law Department of American General Insurance Company, and served as Vice President, General Counsel and Secretary of The Variable Annuity Life Insurance Company. He has been in the private practice of law with a significant corporate and regulatory insurance practice since 1984, during which he also served as Vice President, General Counsel and Secretary of Columbia Universal Life Insurance Company.

Mr. Knoll possesses extensive experience in life and property/casualty insurance, company mergers and acquisitions, reorganizations, redomestications and demutualizations. He has represented clients in well over 100 bulk assumption reinsurance and loss portfolio transfer reinsurance transactions, and has directed and participated in the representation of clients in the arbitration of disputes arising out of these agreements. He has also advised clients on claims, market conduct, and agent matters, and represented them in matters pending before insurance regulatory authorities, including holding company transactions, extraordinary dividends, licensing issues; surplus lines qualification; withdrawal plans, rehabilitation and enforcement matters, and market conduct and financial examination disputes.

For the past several years, Mr. Knoll has served as a Vice Chair of the Insurance Regulation Committee of the Trial Tort and Insurance Practice Section of the American Bar Association, is a member of the Federation of Regulatory Counsel, and the Texas Bar Association. He has written a chapter, "The Corporate Lawyer in the Insurance Industry," in *Winning Legal*

Profiles of all certified arbitrators are on the web site at www.arias-us.org

Strategies for Insurance Law, an authoritative, insider's perspective on the best practices of insurance companies to stay in compliance with state regulations, published by Aspatore Books.

When not practicing law, Mr. Knoll enjoys golf, gardening, and singing in the second bass section of the Houston Symphony Chorus.

Charles T. Locke

Charles Locke is an attorney with over thirty years experience in insurance and reinsurance, both as an insurance executive and in private practice. He commenced his career at Mutual of Omaha and its New York affiliate, Companion Life Insurance Company where he served as General Counsel and Senior Vice President from 1974 until 1984. His responsibilities included supervision of litigation, regulatory compliance, and mergers and acquisitions in the individual and group life and health areas. He presently serves as a Director and Chairman of the Audit and Compensation Committee of Companion Life Insurance Company.

In 1984, Mr. Locke became a founding partner in the law firm of Locke & Herbert in New York concentrating exclusively on life, health, disability, property-casualty and reinsurance matters. Approximately half of his practice is devoted to litigation in the Federal and State courts as well as arbitration. The balance of his practice is focused on corporate regulatory, insolvency and transactional matters, including the formation and licensing of several New York domiciled life insurers and numerous mergers, acquisitions and reorganizations of U.S. and Bermuda insurers and reinsurers.

Mr. Locke has been active in industry associations including the Association of Life Insurance Counsel, ABA (Past Vice Chair, Life Insurance Committee, TIPS Section) and New York State Bar Association (Chairman, Life, Health and Accident Insurance Committee, 1984-1988). He received his B.A. from the University of Vermont and law degree from St. Mary's University School of Law where he served as an editor of the *Law Review*. He is a co-author (1990) of the chapter entitled "Regulation of Life Insurance Companies" contained in the multi-volume Treatise *New York Insurance Law* (Matthew Bender). He is a member of the New York Federal Bars and the Bars of New York, Connecticut and Texas.

William H. Tribou, III

William Tribou recently retired as Vice President of the St. Paul Travelers Companies after more than thirty years in the insurance industry. In his latest position with Travelers, Mr. Tribou was responsible for environmental, ceded reinsurance operations, as well as management of the Coverage In Place Unit within the Special Liability Group. He previously was head of the Legal Division in the Special Liability Group, and he served in various capacities in the corporate law department for six years before joining SLG. Prior to passing the Connecticut Bar in 1983, Mr. Tribou held various underwriting positions in the group life, health and disability field with Travelers, Phoenix Mutual and The Hartford Insurance Group.

Mr. Tribou is particularly well versed and experienced in direct and reinsurance claim issues, especially with respect to environmental, asbestos, cumulative injury and other long tail liabilities. He also has experience in employment, contract and merger and acquisition law within the insurance industry.

Mr. Tribou is a graduate of Lafayette College. He received his J.D. with Honors from the University of Connecticut School of Law and an M.A. with Honors in Graduate Scholarship in American Studies from Trinity College in Hartford. He lives with his wife in the Adirondack Mountains of New York where he is involved in many civic and outdoor activities.

in focus

Charles T. Locke

William H,. Tribou, III

Law Committee Case Summaries

A Message from Elaine Caprio Brady

Shortly after I became Chairman of the ARIAS•U.S. Law Committee in January of 2006, the committee jointly developed an objective to continuously advise our members of significant cases, legislation, regulations and statutes affecting arbitration or reinsurance practices.

In March of 2006, the committee began drafting and publishing summaries of recent U.S. cases addressing arbitration and reinsurance-related issues in a section of the ARIAS•U.S. website entitled "Law Committee Reports." The cases to be summarized are either identified by the committee, or are brought to the attention of the committee or its chairman by individual members. Individual members are also welcome to submit summaries of cases, legislation, statutes or regulations for potential publication.

As of the middle of September, 2006, there were 16 published case summaries and one regulatory summary on the website in Law Committee Reports. We encourage members to review the existing summaries and to routinely peruse this section for new additions. In the near future, we anticipate adding summaries of certain reinsurance-related legislation, statutes and regulations.

All of the ARIAS•U.S. Law Committee members have contributed to the development, implementation and success of the Law Committee Reports.

The committee members are: Linda Dakin-Grimm, Steven A. Gaines, Eric Haab, Michele L. Jacobson, Paul Janaskie, Sylvia Kaminsky, Robert A. Kole, Tracey W. Laws, Natasha Lisman, Andrew Magwood, Rick Rosenblum, Mary Kay Vyskocil and Michael T. Walsh.

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

***Dynegy Midstream Services LP v. Trammochem*, 451 F.3d 89 (2006)**

Court: 2d Circuit U.S. Court of Appeals

Date decided: June 13, 2006

Issue decided: Whether the Federal Arbitration Act authorizes nationwide service of process

Submitted by: Michele L. Jacobson and Beth K Clark*

In *Dynegy Midstream Services LP v. Trammochem*, the United States Court of Appeals for the Second Circuit held that Section 7 of the Federal Arbitration Act (the "FAA"), 9 U.S.C. § 7, does not authorize nationwide service of process. The Court also held that, as such, it did not have personal jurisdiction over a Texas resident with no contacts in New York, in a proceeding brought under Section 7 of the FAA to compel compliance with a subpoena issued by an Arbitration Panel sitting in New York.

Respondent-appellee, Trammochem chartered a vessel from Respondent-appellees A.P. Moller and Igloo Shipping, A/S (the "vessel owners") to carry cargo from Houston, Texas to Antwerp, Belgium. The vessel was chartered pursuant to a contract called the Charter Party. The Charter Party contained an arbitration clause requiring disputes arising thereunder to be arbitrated in New York City.

Petitioner-appellant, Dynegy Midstream Services ("DMS"), was hired to provide certain facilities and supplies on the vessel prior to its voyage. After the vessel arrived in Belgium, a dispute arose between Trammochem and the vessel owners, because the cargo arrived contaminated. Their dispute was submitted to arbitration in New York City, pursuant to the Charter Party.

An expert report was prepared in the arbitration that concluded that DMS' short-flare system was the likely cause of the contamination. A.P. Moller, therefore, tried to vouch in (or implead) DMS into the arbitration; DMS refused to participate. Thereafter, the Arbitration Panel issued a subpoena to DMS requiring that it produce documents related to its short-flare system in Houston, Texas. Respondents served the subpoena on DMS' registered agent in Houston, Texas.

Fearing that if it complied with the subpoena it would be bound by the Arbitration results, DMS ignored the subpoena. Consequently, Respondents filed a motion to compel DMS to comply with the subpoena, pursuant to section 7 of the FAA, in the United States District Court for the Southern District of New York. DMS fought the motion on the grounds that the district court lacked personal jurisdiction over it, because it had no contacts with New York. The district court granted the motion to compel compliance with the subpoena duces tecum despite DMS' lack of contacts with the forum.

DMS subsequently appealed the order of the district court to the United States Court of Appeals for the Second Circuit, arguing that the district court lacked personal jurisdiction over it, and that the FAA does not authorize the issuance of documents-only subpoenas . In reversing the district court, the Second Circuit first analyzed whether it had appellate jurisdiction over a district court's order compelling compliance with an arbitration subpoena. The Second Circuit held that "where, as here, an order compelling compliance disposes of all

issues before the district court, it is a final order and immediately appealable."

Next, the Second Circuit reviewed de novo the district court's decision that it had personal jurisdiction over DMS. In doing so, the Second Circuit first reviewed Section 7 of the FAA, which provides the method of service for arbitrators' subpoenas. Specifically, Section 7 provides that a subpoena "shall be served in the same manner as subpoenas to appear and testify before the court."[1] 9 U.S.C. § 7. Turning to Rule 45(b)(2) of the Federal Rules of Civil Procedure, which governs the service and enforcement of subpoenas in federal court, the Second Circuit noted that Rule 45(b)(2) does not provide for nationwide service of process. Instead, the Court pointed out, Rule 45(b)(2) geographically *limits* both service of process and enforcement proceedings. Similarly, the Court noted that Fed. R. Civ. P. 37(a), another federal rule governing enforcement of subpoenas, provides that a proceeding to compel a non-party to comply with discovery must be made in the court in the district where the discovery is being taken. Fed. R. Civ. P. 37(a). The Second Circuit then observed that, like Rule 45, Rule 37 does not provide for nationwide service of process; rather, it contains territorial limitations.

Rejecting the district court's holding, the Second Circuit concluded that nothing in Section 7 of the FAA suggests that Congress intended nationwide service of process. Moreover, the Court observed that Section 7 of the FAA permits enforcement of arbitrators' subpoenas only in "the district court for the district in which such arbitrators, or a majority of them, are sitting." Accordingly, since the Arbitration Panel was sitting in New York, the FAA required that any enforcement actions be brought there. However, since the district court lacked personal jurisdiction over non-party DMS, and the FAA did not authorize nationwide service of process, the district court could not enforce the arbitrators' subpoena.

The Second Circuit recognized that, as a result of its ruling, Section 7 of the FAA authorizes the issuance of unenforceable subpoenas. The Second Circuit found that this "gap in enforceability" may have been intended by Congress to limit non-parties' required participation in arbitrations. Accordingly, the Court declined to adopt the compromise position adopted by the District Court for the Northern District of Illinois in *Amgen, Inc. v. Kidney Center of Delaware County*, 879 F. Supp. 878, 882-83 (N.D. Ill. 1995), which authorizes attorneys to issue subpoenas to non-parties located far from the situs of the arbitration that can be enforced by the district court in the district where the non-party resides. In rejecting this compromise position, the Second Circuit noted that Section 7 of the FAA only permits arbitrators , and not litigants, to issue subpoenas.

In the end, the Second Circuit pointed out that Trammochem and the vessel owners chose to arbitrate in New York rather than in Texas, where the activities giving rise to the arbitration took place. The parties, thus, had to live with their choice, and the result that they could not enforce a subpoena against DMS, a Texas resident with no contacts with New York (a fact undisputed in the litigation). The Court held, "[t]he parties to the arbitration here chose to arbitrate in New York even though the underlying contract and all of the activities giving rise to the arbitration had nothing to do with New York; they could easily have chosen to arbitrate in Texas, where DMS would have been subject to an arbitration subpoena and a Texas district court's enforcement of it. Having made one choice for their own convenience, the parties should not be permitted to stretch the law beyond the text of Section 7 and Rule 45 to inconvenience witnesses."

Since the Court lacked personal jurisdiction over DMS, it did not address the question of whether Section 7 of the FAA permits the issuance of documents-only subpoenas.

** Michele L. Jacobson is a partner in the litigation department of Stroock & Stroock & Lavan, LLP's New York Office. Beth K. Clark is an associate in that department.*

Employers Insurance Company of Wausau v. Century Indemnity Company, 443 F.3d 573 (2006)

Court: 7th Circuit U.S. Court of Appeals

Date decided: April 4, 2006

Issues addressed: Authority of Arbitrators to Decide Procedural Questions

Submitted by: Andrew A. Magwood*

The United States Court of Appeals for the Seventh Circuit recently held that whether a reinsurer could be required to participate in a joint arbitration with its reinsured and other reinsurers was a procedural matter to be decided by the arbitrator.

Wausau reinsured Century under various reinsurance agreements. Century paid losses under some of its reinsured policies and demanded a consolidated arbitration with Wausau and other reinsurers. While Wausau conceded that its reinsurance agreements with Century obligated it to arbitrate, it claimed that it was not required to participate in a joint arbitration with the other reinsurers. Wausau argued that it was entitled to a separate arbitration for both its first and second reinsurance agreements and that these arbitrations should be separate from any arbitration with any other reinsurer. The District Court held that Wausau was required to appoint an arbitrator according to its agreements and submit

CONTINUED ON PAGE 26

the question of consolidation to the arbitration panel. The Court affirmed the order of the District Court.

The Court, relying on *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002); and cases from the First and Fourth Circuits (*Shaw's Supermarkets, Inc. v. United Food and Commercial Workers Union, Local* 791, 321 F.3d 251 (1st Cir. 2003); *Dockser v. Schwartzberg*, 433 F.3d 421 (4th Cir.2006), held that consolidation was not an issue of "arbitrability;" or a threshold question to be determined by the courts before the arbitration proceeds on its merits. Instead, this was merely a "procedural" question which was not to be decided by the courts but should be submitted pursuant to their agreement, to the arbitrators. The Court explained, "It does not involve whether Wausau and Century are bound by an arbitration clause or whether the arbitration clause covers the [disputed] policies. Instead, the consolidation question concerns grievance procedures—i.e., whether Century can be required to participate in one arbitration covering both the Agreements, or in an arbitration with other reinsurers."

The Court noted that at the arbitration, because the arbitrators had the authority to decide procedural issues, Wausau could raise the issue of having two separate arbitrations and Century could raise the issue of consolidating arbitration with its other reinsures. Accordingly, the Court refrained from determining how many arbitrations should be held, and required Wausau to appoint an arbitrator and submit the issue of consolidation to the arbitration panel.

**Andrew A. Magwood practices insurance law and is licensed in Connecticut and California.*

National Casualty Company v. First State Insurance Group, 430 F.3d 492 (1st Cir. 2005)

Court: 1st Circuit U.S. Court of Appeals

Date decided: December 2, 2005

Issue addressed: Whether an arbitration award should be vacated where the prevailing party refused to comply with the arbitrators' order to produce certain documents relevant to the arbitration.

Submitted by: Michael T. Walsh and Jennifer A. Dowd *

The First Circuit Court of Appeals in *National Casualty Company v. First State Insurance Group*, 430 F.3d 492 (1st Cir. 2005), upheld a refusal to vacate an arbitration award that was granted despite the cedent's refusal to produce documents relevant to the arbitration.

National Casualty served as reinsurer to First State on several of First State's insurance policies covering asbestos non-product liability claims. First State settled a number of contested claims under the underlying insurance policies and ceded those payments to National Casualty as a single occurrence. National Casualty then compelled arbitration against First State regarding whether First State's cede on a singe occurrence basis was appropriate.

During the arbitration, National Casualty requested that First State provide it with documents detailing First State's internal legal assessment of the claims which would presumably reveal the basis on which First State had settled the underlying claims. The panel ordered First State to produce the documents, and warned that the panel may draw negative inferences if First State failed to do so. First State refused to produce the documents, claiming attorney-client privilege and attorney work product protection.

After the panel denied National Casualty's request to delay the hearing in order to permit the parties to brief the issue of the prejudicial effect of withholding the documents, National Casualty filed a claim in the U.S. District Court for the District of Massachusetts seeking to enjoin further arbitration proceedings. The panel ruled in First State's favor while that claim was pending. National Casualty amended its Complaint in the District Court case, seeking to overturn the panel's award, arguing that First State's refusal to follow the panel's production order constituted a breach of contract which voided the arbitration clause and terminated the panel's jurisdiction. The District Court denied the motion to vacate and National Casualty appealed.

The First Circuit Court of Appeals upheld the District Court's decision, finding that the panel's failed attempt to compel production from First State did not prejudice Northern Casualty and thus, did not amount to a "refusal to hear evidence" under the FAA so as to warrant misconduct-based vacatur. The Court noted that under section 10(a)(3) of the FAA, "[v]acatur is appropriate only when the exclusion of relevant evidence 'so affects the rights of a party that it may be said that he was deprived of a fair hearing.'" *See Hoteles Condado Beach v. Union De Tronquistas Local* 901, 763 F.2d 34 (1st Cir. 1985).

The Court looked to the reinsurance contract and determined that it relieved the arbitrators of the "strict rules of law" and released them from "all judicial formalities." The Court found that the panel's drawing of an inference against First State in this case offset any unfairness to National Casualty, and that the procedural device of offering First State the choice between production and a negative inference was well within the discretion afforded to the panel by the parties under the FAA. The Court also found that National Casualty's argument that the panel could not have decided in First State's favor if it did, in fact, draw a negative inference was without merit.

Furthermore, the Court held that the question of whether First State's failure to comply with the arbitration panel's production order constituted a breach of contract and thus terminated the panel's jurisdiction was a procedural matter. In the Court's

view, National Casualty was seeking "a court hearing on the effect of another arbitrating party's selection among procedural options [production or negative inference] offered by an arbitrator, during a discovery dispute, in the course of an arbitration both parties agreed to enter." In the absence of express contractual terms to the contrary, courts have jurisdiction to decide the validity and scope of the arbitration clause, and arbitrators have jurisdiction over all matters within the scope of a valid clause. *First Options of Chicago v. Kaplan*, 514 U.S. 938 (1995). Therefore, under the terms of the reinsurance contract and in accordance with the intent of the FAA, the Court held that it was precluded from deciding this procedural matter. *See Marie v. Allied Home Mortgage Corp.*, 402 F.3d 1 (1st Cir. 2005).

** Michael T. Walsh and Jennifer A. Dowd are members of the firm of Boundas Skarzynski Walsh & Black, LLC, resident in the New York office.*

Stolt-Nielsen SA v Celanese AG, 430 F.3d 567 (2nd Cir. 2005)

Court: 2nd Circuit U.S. Court of Appeals

Date decided: November 21, 2005

Issues addressed: FAA Section 7; Arbitrators' Power to Compel Testimony from Third Parties

Submitted by: Steven Gaines*

In *Stolt-Nielsen SA v Celanese AG*, 430 F.3d 567 (2nd Cir. 2005), the 2nd Circuit interpreted Section 7 of the Federal Arbitration Act (the "Act").[2] Section 7 of the Act provides in relevant part:

> The arbitrators selected either as prescribed in this title or otherwise, or a majority of them, may summon in writing any person to attend before them or any of them as a witness and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case.... Said summons shall issue in the name of the arbitrator or arbitrators, or a majority of them, and shall be signed by the arbitrators, or a majority of them, and shall be directed to the said person and shall be served in the same manner as subpoenas to appear and testify before the court; if any person or persons so summoned to testify shall refuse or neglect to obey said summons, upon petition the United States district court for the district in which such arbitrators, or a majority of them, are sitting may compel the attendance of such person or persons before said arbitrator or arbitrators, or punish said person or persons for contempt in the same manner provided by law for securing the attendance of witnesses or their punishment for neglect or refusal to attend in the courts of the United States.

The arbitrators followed the statute, summoning non-party witnesses to give testimony and produce records. The appellants argued that while the arbitrators followed the statute, what was really being accomplished amounted to pre-hearing depositions and pre-hearing document discovery of non-parties, which in appellants view was not allowable under the Act.[3] The appellants pointed out that the hearing was actually held during the period set aside for discovery, and about 10 months prior to the actual time set for the hearing on the merits, feeling the timing of the order was critical.

The 2nd Circuit said there was no limitation as to when hearings could be held,[4] and cited many reasons why hearings might be held on one or more occasions prior to the main hearing on the merits for things like: admissibility of evidence, motion for interim relief, enforceability of an arbitration clause, whether a claim is barred by relevant statues of limitations, preservation of status quo, privilege, authenticity, protection or conservation of property, and disposition of perishable goods. As the Court ultimately stated:

> In sum, we again leave to another day the question whether Section 7 authorizes arbitrators to issue discovery-type subpoenas to those who are not parties to the arbitration. We decide only that Section 7 unambiguously authorizes arbitrators to summon non-party witnesses to give testimony and provide material evidence before an arbitration panel, and that is precisely what occurred in this case.

** Steven Gaines is an ARIAS•U.S. Certified Arbitrator. He is a lawyer, licensed in Washington and California.*

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1 It also provides that a district court in the district where the arbitrators sit may enforce the subpoena by compelling attendance or punishing a non-attendee for contempt. Id.

2 The Court spent a great deal of time discussing whether the District Court even had jurisdiction to hear the motions (holding it did), and whether the Court of Appeals even had an appealable issue (holding it did, partially because of pendent jurisdiction).

3 The arbitrators had earlier tried to go that route, but failed to get the District Court to go along with it.

4 In fact, the Court said if the arbitrators had just waited until the date of the hearing on the merits, heard this matter, then adjourned for 10 months, no one would have even thought about raising the issue.

ARIAS U.S.

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

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

An Invitation...

The rapid growth of ARIAS•U.S. (AIDA Reinsurance & Insurance Arbitration Society) since its incorporation in May of 1994 testifies to the increasing importance of the Society in the field of reinsurance arbitration. Training and certification of arbitrators through educational seminars, conferences, and publications has assisted ARIAS•U.S. in achieving its goals of increasing the pool of qualified arbitrators and improving the arbitration process. As of early September 2006, ARIAS•U.S. was comprised of 481 individual members and 102 corporate memberships, totaling 990 individual members and designated corporate representatives, of which 294 were certified as arbitrators.

The Society offers the Umpire Appointment Procedure, based on a unique software program created specifically for ARIAS•U.S., that randomly generates the names of umpire candidates from the list of ARIAS arbitrators who have served on at least three completed arbitrations. The procedure is free of charge. It is described in detail on the website.

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

New in 2003 was the "Search for Arbitrators" feature on the website that searches the detailed background experience of our certified arbitrators. The search results list is linked to their biographical profiles, containing specifics of experience and current contact information.

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

In March of 2006, the Society published Volume VII of the *ARIAS•U.S. Directory, with Profiles of Certified Arbitrators*. The organization also publishes the *Practical Guide to Reinsurance Arbitration Procedure,* and *Guidelines for Arbitrator Conduct*. These publications, as well as the *Quarterly* review, special member rates for conferences, and access to intensive arbitrator training, are among the benefits of membership in ARIAS.

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

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

Sincerely,

Mary A. Lopatto
Chairman

Thomas L. Forsyth
President

ARIAS U.S. Membership Application

AIDA Reinsurance & Insurance Arbitration Society
PO BOX 9001
MOUNT VERNON, NY 10552

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

914-966-3180, ext. 116
Fax: 914-966-3264
Email: info@arias-us.org

NAME & POSITION _____

COMPANY or FIRM _____

STREET ADDRESS _____

CITY/STATE/ZIP _____

PHONE _____ FAX _____

E-MAIL ADDRESS _____

Fees and Annual Dues:

	INDIVIDUAL	CORPORATION & LAW FIRM
INITIATION FEE	$500	$1,500
ANNUAL DUES (CALENDAR YEAR)*	$250	$750
FIRST-YEAR DUES AS OF APRIL 1	$167	$500 (JOINING APRIL 1 - JUNE 30)
FIRST-YEAR DUES AS OF JULY 1	$83	$250 (JOINING JULY 1 - SEPT. 30)
TOTAL (ADD APPROPRIATE DUES TO INITIATION FEE)	$_____	$_____

* Member joining and paying the full annual dues after October 1 is considered paid through the following calendar year.

NOTE: Corporate memberships include up to five designated representatives. Additional representatives may be designated for an additional $150 per individual, per year. Names of designated corporate representatives must be submitted on corporation/organization letterhead or by email from the corporate key contact and include the following information for each: name, address, phone, fax and e-mail.

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