VOLUME 14 NUMBER 2

ARIAS QUARTERLY U.S.

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Would Greater Use of Mediation Improve U.S. Reinsurance Dispute Resolution? It Seems to be Working Elsewhere.

Winning First and then Going to War: The Role of Federal Courts in the Panel Appointment Process

Caught in the Draft

ARIAS 2007 Spring Conference Report

Follow The Settlements: Bad Claims Handling Exception

editor's comments

T. Richard Kennedy

Costs and delays in arbitration, particularly where large sums are involved, can readily approach those incurred in litigation. This is not surprising, given the need for parties and their counsel to pour through voluminous documents, interrogate numerous witnesses, and otherwise to prepare carefully their respective cases, followed by an extensive hearing before an arbitration panel. What is surprising has been the reluctance of the U.S. reinsurance industry, confronted by such costs and delays, to make greater use of mediation as a means not only of reducing costs and delays, but also of preserving productive commercial relationships.

In our lead article, *Would Greater Use of Mediation Improve U.S. Reinsurance Dispute Resolution? It Seems to be Working Elsewhere*, Neal Moglin, Dan Sails and Jan Schroeder discuss successful use of mediation processes in English reinsurance disputes and benefits that could accrue to the U.S. reinsurance industry through increased use of mediation. The authors suggest ways to bring about greater use of mediation in U.S. reinsurance disputes

Again in this issue, we feature an article discussing disputes in the process of arbitrator selection. In *Winning First and Then Going to War: The Role of Federal Courts in the Panel Appointment Process*, William Maher and Mark Abrams suggest a growing practice among reinsurance disputants and their counsel to gain an advantage in makeup of the arbitration panel. The role of federal courts in resolving deadlocked appointment processes is discussed by the authors, as well as suggestions for avoiding the costly and time consuming practice of seeking judicial involvement in the panel appointment process.

We are fortunate to have in these pages another interesting article by Eugene Wollan, who – in his usual whimsical style – offers some very practical advice regarding drafting of reinsurance contracts in *Caught in the Draft*.

Robert M. Hall, in *Follow the Settlements: Bad Claims Handling Exception*, reviews court decisions discussing the showing a reinsurer must make to establish that bad faith handling by the cedent is an exception to the follow the settlements doctrine.

Have a great summer!

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VOLUME 14 NUMBER 2

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

Would Greater Use of Mediation Improve U.S. Reinsurance Dispute Resolution? It Seems to be Working Elsewhere.


Neal Moglin


Dan Sails


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Neal Moglin
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Jan Schroeder

While the overall use of mediation in the US has increased steadily over the past ten to fifteen years, the US reinsurance industry has been reluctant to follow this trend. When US reinsurers and cedents think about mediation, it tends to be in the context of jump-starting moribund settlement discussions. In marked contrast, the London market has embraced mediation as a viable and cost-effective means of resolving disputes. The authors of this note believe that while mediation may not be possible or even appropriate in every case, it can offer significant benefits, and for this reason, believe that parties should at least consider the use of mediation in every dispute (regardless of jurisdiction or venue).

I. Mediation Generally

A. Benefits of Mediation

A number of factors make mediation attractive. The most obvious benefit of mediation is its potential to save parties considerable amounts of time and money. Of equal importance, however, is the flexibility that mediation gives parties to resolve disputes on any basis they see fit. While courts and arbitration tribunals have some latitude to "serve equity" (particularly in the US), they are nevertheless expected to resolve disputes on the basis of the evidence, the law and in appropriate cases, industry custom and practice; they are not generally at liberty to fashion relief that is based, in whole or in part, on the wider commercial concerns of the parties such as the preservation of their on-going business relationships. Indeed in England, arbitration panels are expected in almost all circumstances to issue "reasoned awards" stating the bases for their decisions. Mediators, on the other hand, are not constrained by the facts or the law applicable to a given dispute. Indeed, while some mediators remain wedded to the "evaluative" school of mediation, the best mediators are experts in "blue sky," facilitative thinking which the authors believe is better suited to bringing about negotiated resolution. This is particularly true of cases where there is an ongoing trading relationship between the parties which they wish to preserve or develop; where the amount at stake is so large that neither side can afford an "all or nothing" result; or conversely where the amount at stake is so small that the parties cannot easily justify the costs of an "all singing all dancing" proceeding[1] — in short, the three circumstances in which mediation itself is most appropriate.

It cannot be overstated that mediation is not suitable for all disputes. Mediation may not be useful where, for example, a party is intent upon proving (or disproving) the allegations central to the dispute "as a matter of principle" or corporate pride. Similarly, mediation would not normally be appropriate in a case where one or both parties are seeking to establish a legal precedent. In every case, however, the parties should, at least, consider whether their dispute could potentially be resolved (or at least narrowed) via mediation.

B. Growth in the Use of Mediation

1. *United States*

As the costs of civil litigation in the US have increased, companies have become more

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The authors wish to thank Vikram Sidhu (Lovells New York) and Christina Rosch (Lovells Dusseldorf) for their invaluable assistance in preparing this article.

receptive to the idea of exploring alternative dispute resolution mechanisms in appropriate cases. While arbitration has been and remains the ADR methodology of first resort in the US, there is growing concern that arbitration has come to resemble traditional (i.e., courtroom) litigation in a number of respects including the length of the process, the costs involved and the tone of the proceedings. This last item is of particular importance for ongoing trading partners who have at least some interest in preserving their commercial relationships with one another. These facts, coupled with the fact that a growing number of US courts have adopted mandatory mediation rules, are the primary reasons that the number of US cases submitted to mediation has risen over the past decade or so.[2]

In certain areas (such as employment) mediation has become so widely used that it has spawned the development of networks of mediation service providers with particular expertise in resolving disputes in those specific areas. The existence of these networks of well-known specialist mediators has, in turn, made practitioners in those areas more confident in the mediation process and more willing to consider mediation as an ordinary part of their case evaluations. As is discussed in greater detail below, the fact that the London Market is now served by a network of mediators with expertise in the resolution of reinsurance disputes is one of the key reasons that the London Market has accepted mediation to a greater extent than its US counterparts.

In 2001, the National Conference of Commissioners for Uniform State Laws and the American Bar Association jointly promulgated the Uniform Mediation Act ("UMA") - giving mediation in the US a "further assist." The UMA, which has been adopted by nine states thus far, is a set of mediation rules that, like the Federal Arbitration Act, attempts to remove some of the uncertainties surrounding mediation. The most important provisions of the UMA address the confidentiality of the process and the enforceability of mediated agreements.[3]

2. *Continental Europe/ Germany*

European countries like Germany have also embraced the general concept of alternative dispute resolution. Indeed, PricewaterhouseCoopers recently reported that 83% of the German companies surveyed have had experience with some form of ADR process including mediation.[4] This is, in part, due to German law courts' having adopted the general principle set forth in articles 278 and 279 of the EC Code of Civil Procedure. Those principles require European law courts to be alive to the possibility of settling disputes (or parts of disputes) amicably at every stage of the proceedings. In addition to this general directive, German law requires parties to certain types of disputes to undertake ADR before commencing formal legal proceedings. For example, section 305; paragraph 1 of the German Insolvency Code requires a petitioner to submit proof of a failed attempt at ADR as a condition precedent to initiating proceedings against an insolvent party. Similar requirements exist for disputes involving small amounts of money.

More recently, German courts have been testing the effectiveness of requiring litigants to submit to institutionalized (*gerichtsnahe*) mediation or mediation facilitated by a judge-mediator. These proceedings are non-binding, and the judge mediators do not have authority to rule on the issues in dispute. Despite (or perhaps because of) the non-binding nature of these proceedings and despite the fact that they typically last only a few hours, it has been reported that a high proportion of cases submitted to this process have settled on the day of the mediation. This initiative has, as a consequence, led to an increased appreciation of mediation in Germany.

Despite this, it is still common for German companies to limit themselves to "traditional" forms of ADR (i.e., arbitration or direct negotiations), although attitudes regarding mediation are undeniably changing, specifically amongst larger companies. Indeed, a number of associations (Vereine) have been established in Germany to promote mediation through the sharing of experience and networking. More recently, German lawyers and commentators have been advocating for the development of a statutory framework (not unlike the UMA) to address questions of confidentiality, enforceability and the effect of mediation on statutes of limitation.

3. *England*

Without diminishing in any way the progress that has been made in the US and on the Continent, it is undisputed that of the three jurisdictions profiled in this article, mediation has been most enthusiastically and uniformly embraced in England. This is due, primarily, to the support that mediation has received from the English judiciary since the 1990s and in particular, the revision of England's civil procedure rules in 1996. The revised rules oblige the courts to consider ADR generally as part of their case management function and to specifically encourage parties to engage in mediation where appropriate. The courts have also made clear that lawyers have an obligation to discuss the possibility of using ADR with their clients at an early stage in proceedings. The impact of the revised rules has been dramatic. As one measure of this, the number of mediation instructions received by the Centre for Dispute Resolution in England ("CEDR") has quadrupled since these changes to the rules took effect.

Interestingly, while English courts (and generally English arbitrators) encourage parties to mediate their disputes (in appropriate cases); they will not force mediation on unwilling parties. In part this is due to a concern that enforced mediation would violate the parties' right of access to the courts, which is enshrined in the European Convention of Human Rights. On a more practical level though, the English courts have explicitly recognized that compelling parties to mediate against their will would be a futile exercise. The key to the success of mediation is the fact that it is a process which the parties have voluntarily elected to undertake in the joint hope that it will lead to a resolution of their disputes. If a party is implacably opposed to mediation, an order forcing it to do so would serve only to increase the parties' costs and delay the resolution of the matter: As the adage goes, you can lead a horse

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Posing these same questions at the outset of every US arbitration would provide arbitration panels with a way of initiating open dialogues with parties about mediation (and settlement generally) without the risk that their efforts will be misconstrued as a "signal" that they have prejudged the merits of the dispute.

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to water but you cannot make it drink.[5]

That is not to say, however, that English courts and arbitration panels do not "robustly" encourage the use of mediation.[6] Indeed, English courts and arbitration panels can and do make orders requiring parties to take serious steps to consider ADR and, where settlement is not reached, can require the parties to report on the steps taken and provide suggested reasons for why those steps were unsuccessful[7]. In this connection, it is important to remember that unlike their US counterparts, English courts and arbitration panels have a further and potentially more efficient tool to encourage successful mediation — costs. While US courts and arbitration panels can and do award costs in appropriate cases, this is more the exception than the rule. In contrast, English courts and tribunals are expected to order the losing party to pay the successful party's costs. In cases where the successful party has unreasonably refused to mediate a dispute, however, it is not uncommon for an English court or arbitration panel to reduce or eliminate that party's costs award or, in an extreme case, to order the winner to pay some of the losing party's costs.

II. Reinsurance Mediations

A. Use of Mediations in Reinsurance Disputes

It is difficult to obtain reliable, empirical data as to the numbers of reinsurance mediations taking place in the US, England or Continental Europe. This is primarily because reinsurance disputes are traditionally resolved within the framework of confidential, ad hoc arbitrations, the results of which are rarely reported. Indeed, absent motion practice relating to some aspect of a panel award, a settlement or a mediated result, it is impossible to know how individual disputes have been resolved, let alone create a meaningful census of such outcomes. Moreover, mediation is itself a form of settlement and thus tends to be a private and unreported event. That said, the authors' experience, which is supported by anecdotal evidence obtained from other reinsurance practitioners, indicates that while there has been increased interest in mediation in the past several years, mediation is still far less well utilized to resolve reinsurance disputes in the US than it is in England.[8] The question that must be asked then is why this is the case?

One reason may be the greater willingness of English practitioners to submit reinsurance disputes to the courts for resolution. While reinsurance disputes are still frequently submitted to arbitration, it is more common than it is in the US for reinsurance cases to be filed in court.[9] This is significant because as noted previously, the parties to an English court proceeding are required to consider mediation (or some other form of ADR) and English judges have considerable scope to "encourage" parties to avail themselves of this process. As a result, reinsurers and cedents that submit their disputes to the courts receive far greater encouragement to engage in mediation than they would in a US arbitration.

Moreover, at least some English arbitration panels follow the lead of that country's courts in "encouraging" parties to consider mediation at an early stage in a dispute and while others may not go this far, all would, at a minimum, be supportive of the idea of mediation. One possible reason for this is that English arbitration tribunals are typically chaired by experienced barristers who may be more willing to follow the courts' lead on mediation than non-lawyers or industry executives. In the US, where arbitration panels are typically chaired by current or retired reinsurance executives, there is a palpable reluctance to actively encourage parties to consider mediation or settlement generally — perhaps out of concern that either side will "read" something into such a recommendation regarding the merits of the dispute itself. This attitude is consistent with the reluctance we have seen on the part of clients (on both sides of the Atlantic) to "make the first move" towards mediation or even settlement for fear that this will be seen by the other side as a sign of weakness-particularly in cases where one side or the other is seeking "all or nothing relief" like rescission. Having the recommendation come from a court or panel as a "normal" or at least familiar part of the proceedings has done much to eliminate this "perception" problem in England and the authors believe that a similar result could be achieved in the US if US reinsurance arbitrators would, as a *matter of course*, take a more activist role in encouraging parties to at least consider mediation.

One way to "normalize" this process in the US would be for ARIAS US to amend its form

Organizational Meeting Agenda/Checklist to include the same sorts of questions that litigants are asked at the outset of disputes in England. As previously noted, the English Commercial Court requires parties in all disputes to set out whether they have considered ADR internally, and whether they have discussed it with the other parties, prior to the first Case Management Conference. Posing these same questions at the outset of every US arbitration would provide arbitration panels with a way of initiating open dialogues with parties about mediation (and settlement generally) without the risk that their efforts will be misconstrued as a "signal" that they have prejudged the merits of the dispute. Additionally, adding a discussion about mediation to the ARIAS Organizational Meeting Agenda would require parties to consider (up front) certain practical questions regarding mediation including timing (i.e., at what point in the process would the parties expect mediation to occur), whether the parties expect formal arbitration proceedings to be stayed during the pendency of any potential mediation, whether additional time needs to be built into the overall schedule to accommodate this and what if any reports will be given to the Panel regarding the outcome of the process.[10]

Increased demand for mediation would, in turn, spark the development of a more extensive network of experienced industry mediators than currently exists in the US. It is worth noting that while ARIAS•US has, over the course of the past 12 years, trained and certified over 320 specialist industry arbitrators, its "Qualified Mediator List" currently contains fewer than 10 names. While it is true that ARIAS has only been qualifying mediators for a year (a significant fact in its own right), the number of industry practitioners, certified or not, who claim to have expertise as mediators is small. In contrast, likely as a consequence of the increased use of mediation in England, that country has an established pool of well known specialist reinsurance mediators, many of whom now act full time, or close to full time in that capacity. Each of these individuals has a detailed knowledge of the market, and each is well known to (and trusted by) the reinsurance community. The level of comfort that English practitioners have in their mediators (and, correspondingly, in the process as a whole) is directly related to the fact that they have had numerous opportunities to work with them. Any significant reinsurance mediation will almost inevitably involve a member of this "pool" and, as a consequence, they have become known and trusted commodities. This, in turn, has helped foster the overall acceptance of mediation in the English reinsurance community.

That said, it must be noted that there are certain unique features of the English dispute resolution process which may, in and of themselves, encourage reinsurers and cedents involved in disputes in that country to explore mediation more readily than they would in the US. For one thing, reinsurance arbitration panels in the US rarely require the losing party to pay the winner's costs.[11] This may incentivize parties to press on to a hearing in the hopes of obtaining a complete "win" rather than "settle" for a negotiated result. In contrast, an English arbitration panel can be expected to make costs awards just as an English court would do. Such awards generally require the losing side to pay the winner's legal fees and, as noted above, can be used to penalize either party to the extent that party has unreasonably failed to mediate. This feature of the English system sometimes acts as a powerful incentive in bringing parties to the negotiating table, particularly in close cases.

Another feature of the English system that may play a role in encouraging early consideration of mediation is the English approach to discovery. In England, a party is only required to voluntarily disclose those documents upon which it relies or which support or undermine a party's case. A party is not generally required to voluntarily disclose documents which might lead another party to a train of enquiry which would advance the receiving party's case or damage the case of the disclosing party. Likewise, a party's scope for obtaining additional disclosures from its opponent is generally limited in English proceedings to documents or classes of documents which support its case or undermine that of its opponent and then only where the requesting party can describe such documents with particularity. Similarly, English tribunals (like English courts) permit depositions only in rare cases where they are needed to preserve the testimony of witnesses who will not be available for trial or hearing. In the US, the scope of discovery permitted in reinsurance arbitrations is left almost entirely to the discretion of the tribunal. That said, document requests seeking the disclosure of a wide range of documents "which may lead to the discovery of admissible evidence" and depositions of witnesses with relevant knowledge are generally allowed.

The result of these differences is that discovery in England is completed more quickly, and with less need for tribunal intervention than is the case in the US. As a consequence, parties to an English reinsurance arbitration are generally in a position to assess the merits of their respective cases and come to a view on mediation at an earlier point in the proceedings than their US counterparts. This can be important in cases in which overall litigation expense (including the expense associated with engaging in wide ranging discovery) forms a significant proportion of either side's "potential downside" in the dispute. In such cases, the parties must choose between the potential benefits of completing discovery (recognizing that the other side may be less open to settlement once the expenses associated with discovery are incurred) and entering into a mediation without all of the relevant facts in hand. One way of avoiding this "Hobson's choice" would be to adopt a mediation protocol that requires the parties to share potentially relevant documents in advance of the mediation. Much as would happen in an English proceeding, adopting such a protocol would encourage parties to consider mediation earlier than they might otherwise do. One example of such a protocol has been promulgated by the International Institute for Conflict Prevention and Resolution and is discussed in greater detail below.[12]

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B. The Future of Reinsurance Mediations In the US

Encouraging more cedents and reinsurers to avail themselves of mediation will require something of a shift in the way the process is viewed in the US. In England, mediation is viewed as an integral part of the resolution of reinsurance disputes. In the US, mediation is generally thought of, if at all, as a way to facilitate settlement negotiations - usually at a point where the parties are at an impasse. Moreover, at least some US practitioners are of the view that mediation is only appropriate once a case reaches a "tipping point" of some sort (such as when a party wins or loses a key interim motion or discovers a helpful or damaging piece of evidence *via* discovery). This is indicative of a mindset which tends to view mediation as an "evaluative" extension of a dispute - another phase in the adversarial process that will either be "won or lost" on the merits. While this view may have some validity in the context of traditional settlement overtures, one of the aims of mediation is to separate the prospects of reaching a commercial compromise in a dispute from the merits of the dispute itself. For mediation to work it must be approached commercially and dispassionately.

One recent development may help change the way the US reinsurance community views (and uses) mediation. In mid-2006, the International Institute for Conflict Prevention and Resolution promulgated the International Reinsurance Industry Dispute Resolution Protocol (the "CPR Protocol").[13] The CPR Protocol attempts to give parties a level playing field on which to conduct their negotiations. It provides a timetable of less than 6 months for parties to exchange statements regarding their respective positions, engage in limited (and controlled) document disclosure and conduct principal to principal negotiations. Such negotiations between principals should, of course, not be overlooked in seeking to settle a dispute even outside the protocol as, if successful, they can represent a very cost effective means of achieving a commercially sensible settlement. However, in the event those fail, the protocol provides a framework for "escalation" of the dispute to formal mediation including, where requested, assistance in selecting a mediator. While the protocol can be used as an ad hoc process, the protocol's mission statement clearly envisages companies incorporating the protocol into their reinsurance agreements on a going forward basis. For a more in-depth analysis of the CPR Protocol, the reader is encouraged to review: Vince Vitkowsky, "The CPR International Reinsurance Industry Dispute Resolution Protocol," Mealey's Litigation Report Reinsurance, February 1, 2007.

III. Conclusion

As noted above, anything that encourages reinsurers and cedents in the US to consider mediation as a routine part of their analysis of disputes should, over time, result in a larger percentage of such disputes being resolved via this commercial process. As our English colleagues can attest, encouraging parties to engage in mediation is the key to industry acceptance. While it is true that certain unique features of the English legal system have contributed to the overall growth of mediation in that country, the benefits of mediation transcend market and jurisdictional boundaries and are as relevant for US disputes as they are for English ones. With an appropriate amount of encouragement and open mindedness from the US reinsurance industry (and the arbitrator community in particular), mediation could, over time, become a more integrated and useful part of the dispute resolution process.

1 In such cases, parties may also wish to consider employing one of the streamlined arbitration procedures developed by ARIAS. *See* "Chapter VI: Streamlined Arbitration Procedures" of the ARIAS•US Practical Guide to Reinsurance Arbitration Procedure.

2 *See, e.g.*, E.D.N.Y. Local Civil Rule 83.11 ("Judges and Magistrate Judges may designate civil cases for inclusion in the mediation program, and when doing so shall prepare an order to that effect....In all civil cases designated by the Court for inclusion in the mediation program, attendance at one mediation session shall be mandatory: thereafter, attendance shall be voluntary."); S.D.N.Y. Local Civil Rule 83.12 ("The assigned Judge or Magistrate Judge may determine that a case is appropriate for mediation and may order that case to mediation with or without the consent of the parties.").

3 With respect to this last point, it is somewhat ironic that the increased use of mediation in the US as a means of resolving disputes has been accompanied by a corresponding increase in mediation-related litigation, specifically with respect to the enforcement of mediated outcomes. See James R. Coben & Peter N. Thompson, *Disputing Irony: A Systematic Look at Litigation About Mediation*, 11 Harv. Negotiation L. Rev. 43, 47-48 (Spring 2006) ("[F]or the years 1999 through 2003,...when general civil case loads were relatively steady or declining nationwide, mediation litigation increased ninety-five percent, from 172 decisions in 1999 to 335 in 2003.").

4 See PricewaterhouseCoopers, *Konfliktbearbeitungsverfahren im Vergleich* (April 2005).

5 This stands in contrast to the approach taken by at least some US courts in requiring parties to at least attempt to resolve their differences via mediation. See supra note 2 and accompanying text.

6 *Halsey v Milton Keynes General NHS Trust* [2004] 1 WLR 3002.

7 In normal practice, any such reports are submitted after the substantive dispute has been resolved to avoid having the court or tribunal prejudiced by the facts of the mediation. Holding these reports until the end of the dispute has the further advantage of minimizing the risk that one party or the other will use the mediation process as an opportunity to grandstand rather than as a legitimate opportunity to settle the case.

8 Because mediation is generally less well developed in Continental European countries like Germany than it is in the US, and because fewer reinsurance disputes are venued in Europe, mediation is used even less frequently to resolve European reinsurance disputes than American ones.

9 In some instances, this is done by agreement to permit the parties to bring in third party defendants (such as the broker or MGU) in circumstances where those third parties could not be required to arbitrate. In other cases, this is due to the fact that the final treaty wording or slip does not specify arbitration.

10 *See* note 7 and accompanying text.

11 But *see Reliastar Life Ins. Co. of N.Y. v. EMC Nat. Life Ins. Co.*, 473 F.Supp.2d 607 (S.D.N.Y. 2007) (vacating portion of arbitral award granting attorney's fees despite arbitrators' finding arbitration was brought in bad faith. The Court allowed the arbitrator's award of costs to stand but found that the wording of the reinsurance agreements at issue prohibited an award of attorneys fees.).

12 Not surprisingly, this protocol grew primarily out of efforts in the London reinsurance market to promote the commercial resolution of reinsurance disputes.

13 The CPR Protocol states as its purpose the following: "The companies adopting this Protocol wish to avoid unnecessary delays, financial burdens, animosity and uncertainties of arbitration and litigation in connection with disputes between reinsurers and ceding companies. They believe that such disputes are best resolved promptly, privately and efficiently through confidential negotiation and, if necessary, mediation."

news and notices

Board Certifies 13 New Arbitrators; Emory White, Therese Adams, John T. Andrews, Jr., and Peter A. Gentile Added to Umpire List

At its meeting in **New York on March 8**, the Board of Directors added Emory White to the ARIAS Umpire List, bringing the total to 85.

At the same meeting, the Board approved certification of four new arbitrators, bringing that total to 321. The following members were certified; their respective sponsors are indicated in parentheses.

David A. Grefe (David W. Smith, Cathryn Curia, Jennifer Mangino)

Debra J. Hall (Richard White, Jerome Karter, Paul Dassenko)

Constance D. O'Mara (Thomas Allen, Mark Megaw, Cliff Hendler)

Richard L. Voelbel (Frank Barrett, Robert Mangino, Ronald Gass)

Then, at its meeting in **Boca Raton on May 9**, the Board of Directors added **Therese Adams**, **John T. Andrews, Jr.**, and **Peter A. Gentile** to the ARIAS Umpire List, bringing the total to 88.

At that meeting, the Board approved certification of nine new arbitrators, bringing that total to 330. The following members were certified; their respective sponsors are indicated in parentheses.

Paul Aiudi (Mark Wigmore, Charles Foss, Andrew Pinkes)

John T. Andrews, Jr. (Franklin Haftl, Thomas Tobin, Charles Havens)

Allan H. Dunkle (John McKenna, Jan Woloniecki, Jens Juul)

Ralph Hemp (Daniel Schmidt, James Phair, Eugene Wollan, Frank Barrett)

Joseph Loggia (Paul McGee, Colin Gray, David Thirkill)

Edward J. McKinnon (Anthony DiPardo, Timothy Stalker, Paul Dassenko, Malcolm Burton, Patricia Kirschling)

Gail P. Norstrom (Charles Foss, Jeffrey Morris, Robert Green)

Michael D. Price (Brian Brown, Jonathan Bank, Peter Gentile)

Leonard Ian Sleave (Steven Richardson, Andrew Maneval, Susan Grondine)

Biographies of some of these new arbitrators can be found in the "Recently Certified Arbitrators" pages of this Quarterly.

September Workshop Set for California

The next Intensive Arbitrator Training Workshop will take place in California at the Marriott Hotel in Marina del Rey on September 10-11, 2007.

The Marriott Marina del Rey overlooks the famous Marina and the Pacific Ocean. It is a short ride from Los Angeles International Airport and recently underwent a major renovation.

In the mock arbitrations sessions, the law firms that will each present arguments in one of the three hearing rooms are **Sidley Austin LLP, Milbank, Tweed, Hadley & McCloy LLP,** and **Barger & Wolen LLP**.

Details about the workshop, which is for members only, are on the website calendar and were mailed to members in June. Registration will begin on July 18 at 10:00 a.m. on the website.

Board Approves Four More Qualified Mediators

At its meeting on March 8, the Board of Directors approved four more applicants as ARIAS•U.S. Qualified Mediators. The four were **Bruce Carlson**, **Robert J. Federman**, **Jim Leatzow**, and **Elizabeth M. Thompson**.

The Qualified Mediator Program was established last May to provide a means for ARIAS•U.S. Certified Arbitrators with mediation training to be easily contacted for service in mediation of disputes.

Successful mediation generally requires a mediator who has been professionally trained in consensual dispute resolution or has substantial experience in the field. While ARIAS•U.S. does not provide this training, it now recognizes the qualifications of its arbitrators who have been so trained.

The Qualified Mediator Program area of the website includes a full explanation of how this recognition may be obtained, along with links to the contact information of those who have qualified.

All Members Asked to Send Cell Numbers

As the use of cell phones has proliferated, many members have been providing their cell numbers with their contact information. As a result, we have adjusted the member database to accommodate them and will be publishing them next year in the membership directory. To populate that field during the upcoming year, we would like everyone to send his/her cell number to Christina Claudio at claudio@cinn.com .

In addition, the arbitrator profile format on the website is now able to accommodate cell phone numbers as a separate field. All certified arbitrators who would like to include cell numbers along with their other contact information are asked to send them to Christina, as well. Unless otherwise requested, the numbers will be placed in the Current Employment section.

ARIAS Membership Passes 1,100

Hardly noticed in the swirl of activity surrounding the Spring Conference was the fact that the total number of individual members and designated corporate representatives passed the 1,100 mark. It was only last October that membership reached 1,000.

Sponsors Asked to Check Guidelines

Executive Director Bill Yankus requests

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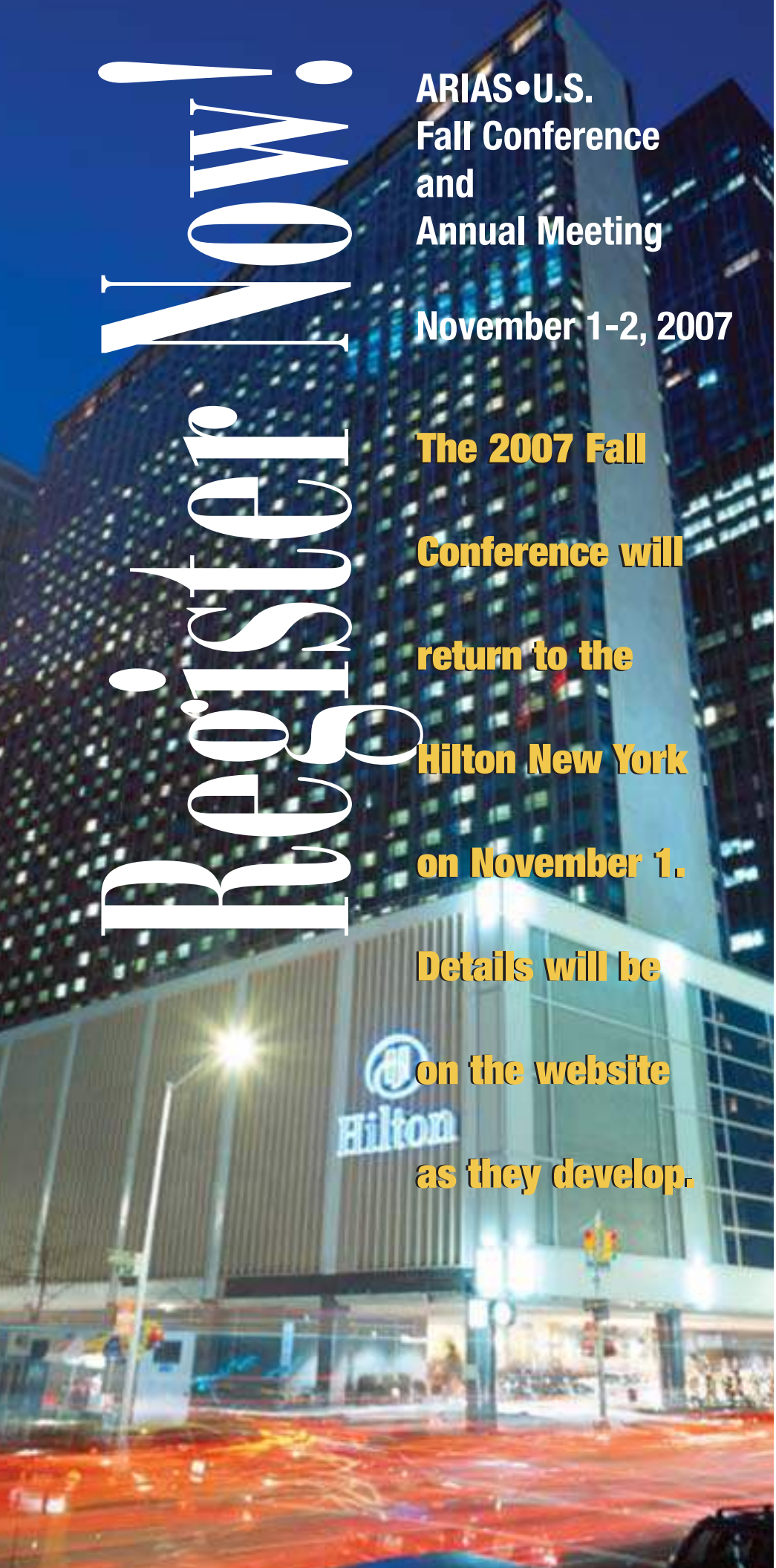

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that anyone who is asked to nominate or second a candidate for certification first review the guidelines for sponsorship. Some very specific comments are required in the sponsor letters. The information most often left out is a comment about the candidate's reputation. When such a comment is missing, the letter is not accepted and certification can be delayed.

Full details are available in the Certification Procedure area of the website.

ARIAS CLE Attendance Verification Procedures Expanded

At the request of the New York State CLE Board, ARIAS has changed its procedures for verifying attendance at the Spring and Fall Conferences.

Previously, participation in the conference sessions had relied on an honor system. If someone had specified the workshop he/she wished to attend, it was assumed that they did attend. Also, when everyone went to lunch, it was assumed that they all came back and attended the afternoon session, rather than just coming back later to sign out. Such assumptions are no longer allowed.

As part of the process for re-accrediting ARIAS as a provider of CLE training, the CLE Board required that, in the future, everyone seeking CLE credit must sign in and out at each workshop or breakout session. Also, at lunchtime on the full day of the Fall Conference, everyone must sign out upon leaving the morning session and sign in again when returning for the afternoon session.

The ARIAS staff will monitor the process to ensure that credit is only given to those who are attending for the full time of respective sessions. Certificates of attendance will be based on the sign-in sheets and will be sent to attendees after the conference. Credit will not be given for partial attendance at any session, in accordance with CLE rules. Anyone who does not sign out at the end of the day will not receive credit.

Executive Director Bill Yankus asks attorneys to help facilitate this process by taking responsibility for remembering and observing these rules. ▼

feature

Winning First and then Going to War: The Role of Federal Courts in the Panel Appointment Process

William A. Maher
Marc L. Abrams

In the Art of War, Sun Tzu states that "victorious warriors win first and then go to war, while defeated warriors go to war first and then seek to win." Perhaps following the admonition of the great Chinese strategist, participants in reinsurance arbitrations are increasingly seeking to "win first" - by devoting significant resources to the formation of the arbitration panel - and then later "going to war" in the course of the arbitration. As more companies and their counsel follow this approach, it is unsurprising that reinsurance arbitrations are finding their way into federal court where parties seek the protection of the judiciary against the perception (or reality) that their opponents are "gaming" the panel appointment system. In this article we examine judicial involvement in the arbitral appointment process, and, in particular, discuss the basic rules for invoking the protection of a federal court as well as three recently decided cases where parties to reinsurance agreements have sought federal court protection to resolve deadlocked appointment processes. We also provide several points of guidance for parties and practitioners seeking (or seeking to avoid) judicial involvement in the panel appointment process. Finally, we discuss the ARIAS Umpire Selection Procedure as a means for avoiding the costly and time consuming practice of petitioning a federal court.

I. The Basic Rule: When Can a Party Petition a Federal Court To Supervise the Appointment Process?

The starting point for determining when a federal court can intervene in the arbitral appointment process is the Federal Arbitration Act (the "FAA"). This statute provides that if an arbitration agreement contains a provision setting forth "a method of naming or appointing an arbitrator or arbitrators or an umpire," then this method must be followed. 9 U.S.C. § 5. If, however, no method is provided in the arbitration agreement, if the parties fail to "avail" themselves of the method specified by the agreement, or "if for any other reason" there is a "lapse" in the naming of an arbitrator or umpire, then a federal court is obligated to designate the arbitrator or umpire "as the case may require." Id.

Federal courts have construed the FAA to allow themselves to designate an arbitrator or umpire when faced with two particular fact patterns: (i) where the arbitration agreement specifies a procedure for selecting an umpire but one of the parties refuses to comply, thereby delaying the arbitration; or (ii) where there is a "lapse" or a "deadlock" in the appointment process - oftentimes, because the arbitration clause does not contemplate the particular impasse that has arisen. *See e.g., In re Salomon Inc.*, 68 F.3d 554, 560 (2d Cir. 1995); *Pacific Reinsurance Management Corp. v. Ohio Reinsurance Corp.*, 814 F.2d 1324 (9th Cir. 1987). On the other hand, there is a typical fact pattern where a federal court will refuse to involve itself in the appointment process: i.e., where one party issues a pre-hearing objection to a candidate proposed by the other party on grounds of bias or partiality. In this particular situation, the federal court will usually dismiss the petition for lack of jurisdiction on the grounds that it "cannot entertain an attack upon the qualifications or partiality of arbitrators until after the conclusion of the arbitration and rendition of an award." *Barlow v. Healthextras Inc.*, 2006 U.S. Dist. Lexis 86007 (D. Utah Nov. 13, 2006).

In the past several months, federal courts have issued three separate opinions examin-

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William A. Maher

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William A. Maher is a founding member of Wollmuth Maher & Deutsch LLP where he leads the firm's Reinsurance Dispute Resolution practice. Marc L. Abrams is counsel at the same firm and practices in the areas of reinsurance, insurance and general commercial litigation.

Accordingly, the Court denied the ceding company's petition and ordered the parties to proceed to umpire selection through the drawing of lots, although the Court did retain jurisdiction over the case "until such time as an umpire is selected."

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ing the three fact patterns discussed above - all in the context of reinsurance arbitrations. These cases are discussed below.

II. Recent Case Law Developments

The *Global Reinsurance Corp v. Certain Underwriters at Lloyd's, London*, 2006 U.S. Dist. Lexis 91446 (S.D.N.Y. Dec. 16, 2006), case serves as a useful example of when a Court will choose not to designate a panel member in a reinsurance arbitration. In that matter, the parties entered into two reinsurance agreements which contained standard arbitration clauses requiring the party-appointed arbitrators to designate an umpire within thirty days and, in the event there were disagreement, to each select an umpire candidate, one of whom would be designated as the umpire through the drawing of lots. *Id*. at *3. Based on these terms, the party-appointed arbitrators each nominated umpire candidates, both of whom received and completed umpire questionnaire forms. *Id*. at *3-*4.

Shortly after receiving the completed umpire questionnaire forms, the ceding company issued objections to the reinsurers' umpire candidate contending that the candidate: (i) had previously been employed by a co-reinsurer who was not a party to the arbitration; (ii) had acted as a consultant and expert witness for various syndicates affiliated with the reinsurers; (iii) had been appointed by the reinsurers' original counsel as an arbitrator for one of the reinsurers, presumably on a matter unrelated to the pending arbitration; and (iv) had no experience as an umpire and limited experience as an arbitrator. *Id*. at *5-*6. Just six days after voicing these objections, the ceding company petitioned the Court to reject the reinsurers' candidate and to appoint its own nominee as the umpire. .

The Court was not sympathetic to the ceding company's claims. Although under the FAA, the Court had the authority to select an umpire if there were a "lapse" and the arbitration agreement "did not provide a mechanism for filling the void," the time period between when the ceding company notified the reinsurers of its objections and when it petitioned the Court - apparently a total of six days - did not constitute a "lapse" within the meaning of the FAA. *Id*. at *9. The reinsurance agreements also provided "the mechanism for filling the void" insofar as they allowed for umpire selection through the drawing of lots. Finally, there could be no argument that a "lapse" existed based on the lack of qualifications of the reinsurers' umpire candidate because this claim appeared "to be an end-run around well-established Second Circuit precedent prohibiting courts from entertaining an attack upon the qualifications or partiality or arbitrators until after the conclusion of the arbitration and the rendition of an award." *Id*. at *10. Accordingly, the Court denied the ceding company's petition and ordered the parties to proceed to umpire selection through the drawing of lots, although the Court did retain jurisdiction over the case "until such time as an umpire is selected." *Id*. at *11-*12.

In contrast to the *Global Reinsurance Corp. matter, the recently decided case of AIG Global Trade and Political Risk Insurance Company v. Odyssey America Reinsurance Corp*., 2006 U.S. Dist. Lexis 73258 (S.D.N.Y. Sep. 21, 2006), serves as a useful example of when a Court will fashion an umpire appointment remedy. In that case, the Court considered two separate reinsurance agreements under which each party would select a slate of three candidates, each party would then strike two of the other party's candidates and the umpire would be selected from the remaining two candidates randomly.[2] *Id*. at *4-*13. In accordance with the first reinsurance agreement, both sides exchanged their slates of candidates, at which point the reinsurer issued objections to all of the cedent's candidates claiming that they were improperly connected to the cedent and its affiliates. *Id*. Nonetheless, the parties continued with the appointment process by each striking two candidates and proceeding to "coin toss," which the cedent won - prompting the cedent to designate its candidate as umpire and the reinsurer to reassert its objections. In particular, the reinsurer objected to the umpire on the grounds that: (i) the umpire's law firm represented the cedent in several bankruptcy matters; and (ii) counsel for the cedent had selected the umpire to serve as a party appointed arbitrator for an unrelated company in an unrelated matter. Id. at *12-*14. Rather than proceeding under a cloud of objections, the designated umpire withdrew of his own accord resulting in an impasse: i.e., the parties could not agree on whether a new coin toss was warranted or whether the cedent could unilaterally designate a replace-

ment umpire from its slate even though the reinsurer had previously struck these candidates. *Id*.

The umpire appointment process under the second reinsurance agreement proceeded in the same manner. Once again, the reinsurer objected to the cedent's candidates, the cedent won the "coin toss" and the reinsurer objected again on the grounds that the umpire candidate maintained "significant contacts" with the cedent, the cedent's counsel and the cedent's party-appointed arbitrator. And once again, given the cloud of objections, the designated umpire withdrew his candidacy, leaving the parties deadlocked as to nominating a replacement candidate. *Id*.

At the outset, the Court indicated its authority to designate and appoint the umpires in both arbitrations because the reinsurance agreements were silent as to the selection of a replacement umpire in the event of a withdrawal. *Id*. at *16-*17. Having established jurisdiction over both disputes, the Court rejected the ceding companies' assertion that they could nominate the replacement candidates from their own slates by virtue of the fact that they had won both coin tosses. Rather, the replacement candidates had already been stricken by the reinsurers and "nothing in the [reinsurance] agreement authorizes such a remedy to cure the resignation of an umpire." *Id*. at *17-*18. The Court then switched gears, finding in *dicta* that the reinsurers' objections to the designated umpires were "not well taken" because "pre-award challengers to arbitrators based on evident partiality are not allowed" and had the umpires not resigned on their own volition "those umpires would be serving and [the reinsurers'] objections concerning the partiality of the umpires would not have been considered until after an award had been rendered, in proceedings to vacate or confirm." *Id*. at *18. Nonetheless, because the umpires "resigned of their own volition" there were umpire vacancies not contemplated by the reinsurance agreements, necessitating the Court's supervision over the umpire appointment process. Based on these rulings, the Court ordered an accelerated appointment process whereby in each arbitration: (i) the parties would each nominate a slate of three umpire candidates; (ii) if necessary, each party would interpose objections to the other party's slate of candidates; and (iii) the Court would then choose from the slates of candidates, or if necessary, designate an umpire "without regard" to the lists.[3] *Id*. at *18-*20.

Clearwater Insurance Company v. Granite State Insurance Company et al., 2006 U.S. Dist. Lexis 74771 (N.D. Cal. Oct. 2, 2006), serves as another useful example of federal court intervention in the panel appointment process. In that matter, the Court confronted a series of arbitration clauses similar to those in the *AIG Global Trade* matter, each requiring the two arbitrators to reach agreement on an umpire, and in the event that there was no agreement, "each of them shall name two, of whom the other shall decline one and the decision shall be made drawing lots." *Id*. at *3-*4. After the party-appointed arbitrators deadlocked on umpire appointment, the reinsurer petitioned the federal court claiming that: (i) the ceding companies had refused to exchange slates of candidates; and (ii) the federal court should order the parties to proceed promptly with the selection of an umpire candidate. In response, the cedents argued that: (i) the Court lacked standing to hear the matter insofar as both parties were "ready and willing" to engage in the appointment process; (ii) the Court should order the parties to resume discussions about appointing a panel including the distribution of umpire questionnaires; and (iii) the Court should stay the proceeding pending the cedents' motion to consolidate before a Massachusetts arbitration panel. *Id*. at *4-*5.

At the outset, the Court rejected the cedents' "standing" argument. According to the Court, even if both parties stood "ready and willing" to engage in the arbitration process, an actual controversy existed given that the parties had "failed to proceed" in forming a panel, with each party blaming the other for that failure. *Id*. at *7-*8. The Court then rejected the cedents' consolidation motion, stating that the issue of consolidation was for the Massachusetts arbitration panel to decide. Id. Finally, the Court agreed to supervise control over the appointment process, ordering the parties: (i) to exchange slates of two candidates thirty days from the order; and (ii) to strike one candidate on the other side's slate with lots to be drawn seven days after the exchange of slates. In an effort to make sure that the appointment process was resolved expeditiously, the Court concluded that "should the arbitrators fail to name umpires despite these explicit instructions,

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At the outset, the Court indicated its authority to designate and appoint the umpires in both arbitrations because the reinsurance agreements were silent as to the selection of a replacement umpire in the event of a withdrawal.

Third, even though a federal court is unlikely to entertain the pre-hearing challenge of an umpire based on bias or partiality, it may - under certain circumstances - consider other pre-hearing challenges to the qualifications of an umpire, especially if they are based on express contractual requirements appearing in the reinsurance agreement.

the parties are ordered to submit the arbitrators' slates for each case, with curriculum vitae attached," and "upon the application of either party, the Court will select umpires from those slates." *Id*. at *8-*10. In sum, the *Clearwater* case provides a useful example of how a party can use a federal court to move the appointment process forward given some kind of impasse.

III. Practice Guidelines for Seeking or Avoiding Federal Court Supervision

Based on the authorities discussed above as well as other relevant case law, we offer the following observations for parties seeking - or seeking to avoid - federal court supervision over the appointment process.

First, the three cases discussed above evidence that parties are seeking the involvement of federal courts as a means of supervising the selection of umpire candidates. But federal courts will not always accept such an invitation. As mentioned above, where a party is merely challenging the partiality or bias of an umpire candidate during the appointment process, federal courts are unlikely to offer their involvement; instead, many of these courts will hope that the uncertainty of going forward with an arbitration proceeding that is subject to a potential post-hearing challenge will coerce the parties into resolving their differences. *See, e.g., Barlow*, 2006 U.S. Dist. Lexis 86007 (suggesting an arbitrator voluntarily withdraw because "[i]t would be unfortunate for [the plaintiff] to go through the time and expense of arbitrating his disputes only to face a potentially valid challenge to [the arbitrator's] impartiality after issuance of the arbitration award"); *Old Republic Ins. Co. v. Meadows Indemnity Co*., 870 F. Supp. 210 (N.D. Ill. 1994) ("The parties (and the arbitrators) are certainly aware that the arbitration award is subject to judicial review following the arbitration").[4]

Moreover, in two of the recent cases examined above, courts have expressed impatience with parties' attempts to challenge umpire appointments on a pre-hearing basis, even if the proposed umpires have ties to one the parties or its counsel. Notably, in the *AIG Global* mater, the Court went out of its way to critique the pre-award challenge of umpire candidates on partiality grounds stating that had the umpire candidates not resigned of their own accord, they "would have been serving" with any objections reserved until rendition of an award. And, even after agreeing to supervise the umpire appointment process itself, the *AIG Global* Court rejected the reinsurers' proposal that future umpire candidates "be without pre-existing relationships with any of the parties, their affiliates, counsel or party arbitrators." *AIG Global*, 2006 U.S. Dist. Lexis 73258, at *20. In a similar manner, The *Global Reinsurance* Court explicitly rejected the claim that the reinsurers were "gaming the system" by selecting affiliated candidates, stating that "disqualifying an arbitrator because he or she had prior professional dealings with one of the parties would make it difficult at best, to find a qualified arbitrator at all." 2006 U.S. Dist. Lexis 91446 at *11.

Second, the cases discussed above indicate that certain parties - frustrated by the perception (or reality) that their opponents are "gaming the system" - are resorting to "self help" measures, whereby these parties will attempt to unilaterally create appointment "requirements" that do not explicitly appear in the reinsurance agreement. Regardless of the apparent equities supporting these "self help" measures, federal courts typically will reject them. *See Mutual Marine Office, Inc. v. Insurance Corporation of Ireland*, 2005 U.S. Dist. Lexis 11584 (S.D.N.Y. 2005) (refusing to enforce unilaterally imposed requirement that parties appoint an U.S. based umpire because arbitration provision did not restrict "in any way the type of arbitrator that the parties may nominate"); *AIG Global Trade*, 2006 U.S. Dist. Lexis 73258 (discussed above); *Argonaut Midwest Ins. Co. v. General Reinsurance Corp*., 1998 U.S. Dist. Lexis 12497 (N.D. Ill. Aug. 6, 1998) (refusing to entertain a pre-hearing challenge to a party-appointed arbitrator who was an active reinsurance or insurance officer when appointed, but subsequently retired his position as an officer before an umpire was chosen).

Third, even though a federal court is unlikely to entertain the pre-hearing challenge of an umpire based on bias or partiality, it may - under certain circumstances - consider other pre-hearing challenges to the qualifications of an umpire, especially if they are based on express contractual requirements appearing in the reinsurance agreement. The case of *Jefferson-Pilot Life Insurance Company v. LeafRe Reinsurance Company*, 2000 U.S. Dist. Lexis 22645 (N.D. Ill. Oct. 26, 2000), illustrates this point nicely. In that case, the court considered

whether a party could challenge the appointment of arbitration candidates on a pre-hearing basis where the AAA had appointed candidates who were not active or retired officers of a health or life insurance company, despite a requirement in the operative reinsurance agreement to the contrary. Ruling to allow a pre-hearing challenge, the Court reasoned that the party challenging the appointment had not petitioned the Court "to undertake the difficult task of determining whether an arbitrator is impermissibly biased" but had instead "merely" asked to be "entitled to a benefit explicitly conferred by a provision of an agreement negotiated in an arm's length transaction between two sophisticated parties." *See also First State Ins. Co. v. Employers Ins.*, Civ. No. 99-12478-RWZ (D. Mass. Feb. 23, 2000) (making a pre-hearing determination that an attorney was barred from serving as an arbitrator because he had served as one of the party's counsel and was not "disinterested" as required by the contract); *Certain Underwriters at Lloyd's v. Continental Casualty Co.*, 1997 U.S. Dist. Lexis 11934 (N.D. Ill. 1997) (discussing parties' limited rights to pre-hearing challenges that emanate from general contract principles); *American Centennial Ins. Co. v. Commonwealth Ins. Co.*, 1987 U.S. Dist. Lexis 8542 (S.D.N.Y. 1987) (ordering replacement of non-active, party-appointed arbitrator based on requirements of reinsurance agreement).

Nonetheless, courts in other jurisdictions have rejected any distinction between challenging an arbitrator on bias grounds and doing so based on an arbitrator's improper qualifications, holding that either challenge must wait until the issuance of an arbitral award. For instance, in *Gulf Guaranty Life Ins. Co. v. Connecticut General Life Ins. Co.*, 304 F.3d 476 (5th Cir. 2002), the Fifth Circuit reversed its district court, ruling that the lower court had no authority to strike the appointment of an arbitrator prior to the hearing, even though the candidate was an executive of a reinsurance company and the arbitration agreement required appointment of an executive of a life insurance company. Id. at 491 ("a court may not entertain disputes over the qualifications of an arbitrator to serve merely because a party claims that enforcement of the contract by its terms is at issue, unless such claim raises concerns rising to the level that the very validity of the agreement is at issue"); *Aviall, Inc. v. Ryder System, Inc.*, 110 F.3d 892 (2d Cir. 1997) (refusing to entertain a pre-hearing challenge on bias grounds, and stating, in *dicta*, that "it is well established that a district court cannot entertain an attack upon the *qualifications* or partiality of arbitrators until after the conclusion of the arbitration and rendition of an award") (emphasis added). As always, any party considering a pre-hearing challenge on the basis of an arbitrator's qualifications should consult the law of the relevant federal jurisdiction.[5]

Fourth, the *Global Reinsurance* matter provides useful insight for anyone intending to petition a federal court on the ground that its opponent is delaying the formation of an arbitration panel. In particular, this case suggests that a Court will evaluate whether a "lapse" exists (thereby allowing it to exercise jurisdiction) based on whether there is a delay in the appointment process - as measured from when the moving party formally objects to the non-moving party's dilatory conduct. *See, e.g., Global Reinsurance Corp*, 2006 U.S. Dist. Lexis 91446 (discussed above); *Travelers Indem. Co. v. Gerling Global Reinsurance Corp.*, 2001 U.S. Dist. Lexis 6684 (S.D.N.Y. 2001) (no lapse under the FAA where "the parties amicably attempted to resolve the discrepancies between the various reinsurance agreements and had to contend with motion practice regarding the disqualification of counsel"). In sum, any party facing an opponent that is "dragging its heels" during the appointment process would be well advised to formally raise this objection as soon as possible.

IV. Avoiding the Courts: The ARIAS Umpire Selection Procedure

The most obvious means of resolving a lapsed appointment process if for the parties to propose (and subsequently agree upon) umpire candidates who have well deserved reputations of honesty, integrity and objectivity and who have no prior relations with the parties. But where the parties are unable to reach such an agreement, given the the costs and expenses associated with petitioning a federal court, parties would be well advised to take advantage of the ARIAS Umpire Selection Procedure (the "Procedure"). Under the Procedure, the ARIAS•U.S. Executive Director's office randomly selects twelve names from

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Nonetheless, courts in other jurisdictions have rejected any distinction between challenging an arbitrator on bias grounds and doing so based on an arbitrator's improper qualifications, holding that either challenge must wait until the issuance of an arbitral award.

As parties continue to vigorously attempt to "win" the arbitration during the panel appointment process, the Procedure would appear to offer a "best case" solution acceptable to both sides.

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the Umpire List (or if the parties so choose, from the Arbitrator or Newer Arbitrator Lists), the first ten of whom will be contacted by the parties and asked to complete umpire questionnaires. Assuming that all ten of the candidates are available for appointment, the eleventh and twelfth candidates will not be contacted, and each side will select five candidates from the list of ten. After the parties narrow down these "lists of five" by designating three candidates from the other sides' list and then ranking them, an umpire candidate is chosen - either based on a choice that is common to each party or a points system based on a ranking process.[6] Although the Procedure appears to foreclose the possibility of a party "stacking the deck" with partial candidates it is our understanding that the Procedure is not frequently used, perhaps because the Procedure does require the parties to take a "leap of faith" insofar as they lose some degree of control over the appointment process.

As parties continue to vigorously attempt to "win" the arbitration during the panel appointment process, the Procedure would appear to offer a "best case" solution acceptable to both sides. Nonetheless, parties who do agree to select an umpire in accordance with the Procedure would be well-advised to address the issue of whether (or not) certain candidates randomly designated by the ARIAS•U.S. Executive Director should automatically be stricken from the list - for instance, candidates who formerly held executive positions for one of the parties to the arbitration - or whether any candidate randomly selected by the Executive Director is presumptively able to serve as an umpire candidate.[7] Unless the parties have the foresight to reach agreement on these issues, they may end up re-creating many of the disputes that the Procedure is designed to thwart. ▼

2 Although the second reinsurance agreement contained a slightly different umpire appointment procedure, the parties agreed to follow the "slate, strike and spin" procedure outlined above.

3 Parties facing the issue of appointing a replacement candidate should also consider *National Am. Ins. Co. v. Transamerica Occidental Life Ins. Co.*, 328 F.3d 462 (8th Cir. 2003), where a party refused to appoint a replacement arbitrator after its original arbitrator resigned, arguing instead that the entire panel should have been replaced and reformed. Rejecting this argument, the Eighth Circuit held that the party could not "abort the arbitration process" by seeking an entirely new panel - rather, it could only name a single replacement arbitrator especially since "the parties engaged in active discovery for over a year under the supervision of the previous panel which issued numerous discovery orders in the matter."

4 One exception to this rule can occur when a party issues a pre-hearing challenge to an arbitrator on the basis of actual and overt misconduct and impropriety. *See Old Republic Ins. Co.*, 870 F. Supp. at 212 (discussing cases).

5 Moreover, the general rule that federal courts will not review the partiality of an arbitrator on a pre-hearing basis may be inapplicable when the reinsurance agreement expressly calls for a federal court to appoint the umpire. For instance, in *Travelers Indemnity Co. v. Everest Reinsurance Co., 2004 U.S. Dist. Lexis 30074 (D. Conn. 2004)*, the reinsurance agreement expressly required that if the parties were unable to agree on an umpire candidate, the federal court would select the umpire from a list of six candidates submitted by the parties. The reinsurance agreement also required that the umpire be "disinterested" and have expertise in the custom and practice of the insurance and reinsurance industry. Based on these clauses, the Court examined the qualifications and neutrality of the six umpire candidates, choosing one candidate based on his perceived neutrality and the strength of his qualifications.

6 The Procedure as well as the ranking system are described in detail at http://www.arias-us.org/index.cfm?a=25.

7 This article does not expressly take a position on whether candidates who formerly have held executive positions with the parties should be pre-struck from the list. We are merely suggesting that the parties "have the conversation" before committing to the Procedure. Moreover, any attempt to pre-strike candidates who have merely served as arbitrators for the parties would appear to be ill advised, especially since the parties could strike such candidates under the Procedure itself.

members on the move

In this issue of the Quarterly, we list member announcements, employment changes, re-locations, and address changes, both postal and email, that have come in since the Directory closed, so that members can adjust their address directories and PDAs.

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

Recent Moves and Announcements

In April, **Stephanie Dunn** moved to Charlotte, North Carolina, where she is now Second Vice President, Assistant General Counsel at Transamerica Reinsurance. She can be reached at 401 N. Tryon, Charlotte, NC 28202, phone 704-344-2749, email Stephanie.Dunn@Transamerica.com .

John Cashin has been appointed Head of Legal, Compliance and Risk Management for the International Businesses of Zurich Insurance Company, effective June 1, 2007.

Brian Guthrie has moved over to Saul Ewing LLP, where he can be found at 1500 Market Street, 38th Floor, Centre Square West, Philadelphia, PA 19102, phone 215-972-7125, fax 215-972-4168, cell 215-313-0506, bguthrie@saul.com .

Moving across town in Chicago, **Michael Hassan** has joined Butler Rubin Saltarelli & Boyd LLP and can be reached there at 70 West Madison Street, Suite 1800, Chicago, IL 60602, phone 312-696-4487, fax 312-444-9294, email mhassan@butlerrubin.com .

Jack Koepke's new address and numbers are Neusser Str. 24, 50670 Cologne, Germany, phone +++49 221 946 42628, cell +++49 17230 89858.

Timothy McCaffrey has moved; he is now located at 41 Dorethy Road, West Redding, CT 06896, phone 203-938-7099, fax 203-938-7078.

Edward Muhl has relocated to 123 Muirfield Drive, Ponte Vedra Beach, FL 32082, phone 703-628-1616.

John Chaplin and Compass Consulting, LLC have moved to 651 Marten Road, Grantham, NH 03753, but his mailing address is P.O. Box 118 (same zip code). His fax is 603-863-5406...phone and email unchanged.

Michael Studley has retired from John Hancock and set up his own business as an arbitrator. He can be reached at 781-749-0326 or michaelstudley@gmail.com .

Paul Aiudi has migrated south from Hartford to become Assistant General Counsel at American International Group, Inc. He can be reached at 70 Pine Street, New York, NY 10270, phone 212-770-6540, fax: 212-344-6271, email: paul.aiudi@aig.com .

John Diaconis's new email address is jsd@rutherfordchristie.com .

Marvin Cashion has a new e-mail address and cell number: marvcashion@gmail.com, and cell 786-514-5224.

Lovells announced recently that as of May 1, the firm is **Lovells LLP**.

Meanwhile, **David Grais** and **Kathryn Ellsworth** have formed **Grais & Ellsworth LLP**.

Royal & Sun Alliance has become **Arrowpoint Capital Corporation**.

Also, of course, **Employers Re** is now part of **Swiss Re**.

Directory Errors

(please correct these listings in your copy)

The address of **Christopher Troy** and **Jonathan MacBride** of Rogut McCarthy Troy LLC was out of date in the membership directory. The correct address is 100 West Elm Street, Suite 400, Conshohocken, PA 19428.

Also, **David Grefe's** fax number and email address were wrong in the directory. They should have been fax 828-277-1934 and email dgrefe@charter.net .

The directory showed old information for **Cecil Bykerk**. His current contact information is CDBykerk Consulting LLC, 9643 Oak Circle, Omaha, NE 68124-2767, phone 402-501-8701, fax 402-393-1645, cell 402-639-2385, email oakoffice1@cox.net .

John Tickner's listing included old information, as well. His current contact information is phone 818-884-6292 cell 818-961-6663, fax 818-884-0950, email: johntickner@att.net .

The worst error was the omission of **Paul Bates**, entirely. There is no explanation for why his data did not convert over to the directory. Please be sure to write his listing in the Individual Member section. His contact information is Bates Barristers, 34 King Street East, 12th Floor, Toronto, ON M5C2X8, Canada, phone 416-869-9898 x21, fax 416-869-9405, email pbates@batesbarristers.com .

John Dore's listing is almost right. He moved from Suite 900 to Suite 1900, but the move is not reflected in his listing.

Instead of the P.O. box, the best address for everyone at **Lewis & Ellis, Inc.** is 2929 N. Central Expressway, Suite 200, Richardson, TX 75080. Also, for everyone there, the phone number is 972-850-0850.

The phone number and email address for **Lena Heynes** were wrong. They should be +46 8 458 5621 and lena.kjellenberg-heynes@siriusgroup.com .

Charley Havens's correct summer address and phone number are 1000 Beach Road #396, Vero Beach, Florida 32963, phone 772-231-8691.

Michael Collins was listed twice. That would not be so bad, except that the first one is an old address. Please cross that out in your directories. The second address in Islesboro, Maine, is fine, but to send anything by the postal service up there, you need to indicate PO Box 1156.

feature

Caught in the Draft

Eugene Wollan

Eugene Wollan

Most of us have private thoughts about jobs we would consider particularly thankless if we had to do them. I don't mean some of the really obvious ones, like following the elephants with a shovel and pail in the circus parade, or officiating at a grudge match between two bitter Little League rivals coached by particularly large, muscular, and volatile fathers, or writing an article explaining in simple words Finnegan's Wake or the General Theory of Relativity. I'm referring to sub-areas of our own particular professions or occupations.

For example, I would personally consider it a fate worse than perpetual root canal to spend a career practicing tax law, even though I am well aware that there are many lawyers out there who not only do it but actually enjoy it. I'm sure there are psychiatrists who hate the sight of blood, and race car drivers who won't get into an airplane, and French gourmet chefs who wouldn't go near a lasagna with a ten-foot ladle. I've even had a buddy in the Army who thought nothing of leaping out of an airplane (would you believe they're actually called "Jumping JAGs"?) but wouldn't ride in a tank.

One job that many folks in the world of insurance and reinsurance consider thankless is the drafting of contract wording. Little do they know.

One job that many folks in the world of insurance and reinsurance consider thankless is the drafting of contract wording. Little do they know.

Little do they apparently realize how challenging and demanding a task that can be, not to mention how much can turn on the drafter's choice of a particular turn of phrase, or a word, or even a punctuation mark. Just a few examples:

- The policy excludes "fault, defect, error or omission in design, plan or specification." Now suppose the comma were omitted after "design."
- The policy excludes "Loss by . . ." certain enumerated perils. Now suppose it excluded "Loss directly or indirectly caused by, resulting from, or in any way contributed to by . . ." these same enumerated perils.
- The policy covers (or, for that matter, excludes) damage to "property in the care, custody, and control of the insured." Now suppose that "and" were transformed to "or."
- The policy covers (or excludes) the cost for removal of "debris of the insured property." Now suppose that "of" became "on."
- The policy covers "all risks of loss." Now suppose it covered simply "all loss."

I guess there's no need to belabor the point.

Apart from such simple matters as choice of words, the drafter has the responsibility of making certain the language is very clear (I really hate the redundant cliché "clear and unambiguous") and that the document is internally consistent. A few more examples:

- The arbitration clause in a reinsurance treaty directs that all disputes be arbitrated. But then the Service of Suit clause makes the reinsurer subject to suit in a particular jurisdiction. It should not be necessary for a judge to have to figure out which clause controls.
- The suit clause in a standard fire policy requires any suit to be brought within two years, "subject to any applicable local statute." This is intended to refer to any statutory extension of that time (for example, the New York Standard Fire Form at one time required suit within twelve months, but the Legislature extended that time by law to two years). Nevertheless, the argument has been made, and accepted by

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

some courts, that the quoted phrase incorporates by reference the local statute of limitations for contract action generally, usually six years.

- Will anyone not familiar with "the Bellefonte issue" please raise a bashful hand? Obviously the drafter of that facultative certificate could have done a slightly better job of clarifying whether expenses were "within" or "in addition to" the limits.

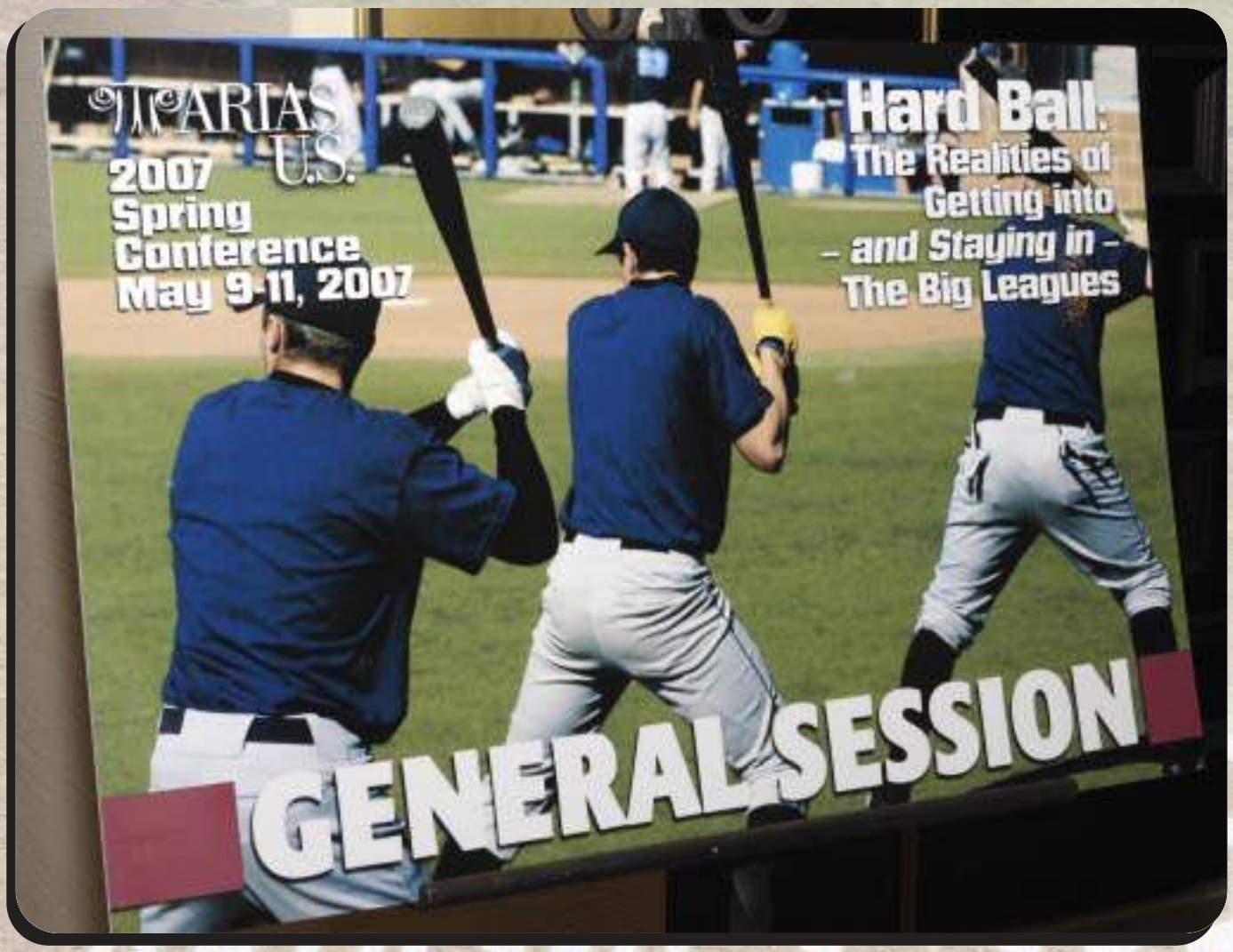
Speaking of "intent," permit me here to ventilate a pet theory of mine that is particularly well illustrated by the Bellefonte situation. The theory goes like this: The "intent of the drafter" is really a legal fiction, because the very fact that the wording requires clarification indicates that this particular problem or interpretation never occurred to the drafter, who therefore had absolutely no "intent" on the subject. What the courts or arbitrators are really doing when they purport to discern the "intent of the drafter" is speculating on what the drafter would have intended, consistently with the overall tenor and purpose of the document, if he or she had given the question a moment's thought. Ask yourself, for example: when the U.S. Supreme Court considers whether the Fifth Amendment protection against self-incrimination applies to mandatory drug or DNA testing, is it applying the actual "intent" of those hallowed Framers or is it extrapolating their general intent to a new situation they could not possibly have considered?

Probably the most common context nowadays in which the "intent of the drafter" become paramount is a court's application of the principle that any ambiguity is to be construed against the drafter ("contra proferentem," said he, to show off). There was a time when this automatically meant "against the insurer," and that certainly remains the case in many areas, including for example personal lines and auto insurance, where the policy continues to be a contract of adhesion (take-it-or-leave-it). But when it comes to other areas like property insurance on major industrial and commercial risks, and to reinsurance treaties, the shoe is often on the other proverbial foot, because the drafter is now so often the broker or the intermediary acting as agent for the insured or cedent. And this is certainly as it should be.

The days are - or should be - long past when the policy or treaty was - or could be - put together by a low-level clerk sitting in a windowless, dungeon-like cubicle with a few old forms, a pair of scissors, and a paste pot or roll of scotch tape. Nowadays, more and more insurers and reinsurers are actually soliciting the assistance of experienced outside counsel in drafting their forms. This too is as it should be, and I speak as a dispassionate observer, not as one of those outside counsel. (Yeah, right!)

The days are - or should be - long past when the policy or treaty was - or could be - put together by a low-level clerk sitting in a windowless, dungeon-like cubicle with a few old forms, a pair of scissors, and a paste pot or roll of scotch tape.

FINAL SCORE AT SPRI



When the walk-ins and cancellations were tallied, the final attendance at this year's ARIAS Spring Conference in Boca Raton came in at 421...a record for a spring conference and significantly higher than the 350 who attended at The Breakers last year. In addition, 72 spouses and guests attended, along with 15 children, for a grand total of 508.

The conference theme was "Hard Ball: The Realities of Getting into - and Staying in - The Big Leagues." The backdrop of the stage for the three days was a 20-foot-wide photograph of Chicago's Comisky Park during a night game.

The five "innings" of mock arbitrations proved to be a highly successful format as spirited discussions developed between the presenting attorneys and among the three panelist in each of the five sessions. Panelists for each inning were chosen by drawing three baseballs, with names of Certified Arbitrators on them, from a lottery drum. Even though the 20 "draftees" had volunteered to be selected, they did not know which of the five issue-specific scenarios they would be involved with and did not know which party would appoint them or whether they would be chosen as the umpire. All conference attendees had been sent the five scenarios in advance, so everyone was well prepared to understand and appreciate the five different issues being debated.

After attorneys presented arguments on each side of a disputed issue, the panelists asked them questions about their positions, then deliberated "in private," before announcing their decisions. During these deliberations, microphones brought the panelists' words to the audience and cameras in the back of the room projected their images onto two large screens on either side of the stage, so their privacy was somewhat compromised.

Apart from the mock sessions, themselves, the conference featured opening panels about The Pros & Cons of Mediation, featuring a team with extensive experience in the

NG TRAINING WAS 421

Chairman Mary Lopatto opened the conference.

A lighter moment in a serious discussion of mediation.

field, followed by an introduction to The Big Leagues by a group of big league players. Anyone wishing to receive a PDF of the conference program, with the complete schedule and biographies of faculty and draftees should send a request to claudio@cinn.com.

For the first time at an ARIAS conference, attending children were acknowledged with the awarding of Junior Arbitrator t-shirts to all who qualified (by being a child).

Of course, an ARIAS Spring Conference would not have been complete without the golf and tennis tournaments during the Thursday afternoon break. Chaired by Paul Walther and Eric Kobrick, respectively, the tournaments attracted 100 golfers and 25 tennis players, setting new records, as well.

A highlight of the three-day event was a banquet in the Grand Ballroom on Thursday evening, where prize winners of the afternoon's golf and tennis tournaments were announced.

Next year's Spring Conference will take place at the magnificent Ritz Carlton Hotel on Amelia Island, Florida, where every guest room has a balcony and a view of the ocean and the meeting room facilities are outstanding. Mark the date...May 7-9, 2008! You won't want to miss this event. Details are on the website calendar as they develop. ▼

Mediation panel moderator Chuck Ehrlich.

"Sign in and sign out each day for CLE credit!"

- Bill Yankus

"...and a sports bag to carry it all!"

Below, Networking at the breaks.

Right: Big League players describe the arbitrator selection process.

Below: Big screens at the sides brought speakers up close.

Big League panel moderator David Grais.

Without looking, Joe Schiavone picks an arbitrator.

Questions from the floor.

Mock session in progress with Howard Denbin, Daniel Brehm, and Roger Moak; Jeffrey Leonard and Michelle Jacobson argue the dispute.

Below: Gathering to discuss what was learned on the first day

Spring Conference Faculty Close-ups

Top Row, left to right:
Thomas More Ryan, Steven C. Schwartz, and Ann L. Field

Middle row, lef to right:

Joseph J. Schiavone, Jeffrey M. Rubin

Bottom row, left to right:

Jeffrey S. Leonard, Stephen W. Schwab and Michele L. Jacobson

Left: Golf winners

Below: Tennis winners

The farm team lines up for their instructions

Super Arbitrator Returns!... Marty Haber in his lucky shirt!

Coaches Joy Langford and Ann Field prepare the players

feature

Follow the Settlements: Bad Claims Handling Exception

Robert M. Hall

The exception has been articulated basically in two ways. The first focuses on a "reasonable, business like investigation" of the claim and the second on "gross negligence or recklessness" in handling the claim.

Mr. Hall is a former law firm partner, a former insurance and reinsurance company executive and acts as an insurance consultant as well as an arbitrator and mediator of insurance disputes.

Robert M. Hall

I. Introduction

Follow the settlements provisions in reinsurance contracts are intended to prevent reinsurers from second guessing the claim handling decisions of cedents. Such provisions are subject to a number of exceptions, however. The purpose of this article is to explore case law concerning one of these exceptions: bad claim handling by the ceding company.

II. Articulation of the Exception

The exception has been articulated basically in two ways. The first focuses on a "reasonable, business like investigation" of the claim[1] and the second on "gross negligence or recklessness" in handling the claim.[2] The case law in which this exception has been applied provides some insight into the nature and degree of errors necessary to apply the exception to the follow the settlements doctrine. Case law may also provide practical distinctions between the two articulations of the rule.

III. Case Law

A. Cases Denying Exception to the Rule

Aetna Casualty and Surety Co. v. Home Insurance Co., 882 F. Supp. 1328 (S.D.N.Y. 1995) was a dispute in which the cedent, Aetna, issued a series of excess policies to Robins which were impacted by Dalkon Shield litigation. The excess policies did not include a defense obligation but during the course of the litigation, Aetna agreed to provide a defense on covered claims without stating explicitly whether or not claims expenses would be within limits. Home signed off on this agreement.

Subsequent litigation between Aetna and Robins concerning the claims within limits issue was settled by Aetna in a fashion favorable to Robins. Home resisted payment of expenses arguing that claims expenses should be within limits. The court found that Aetna's settlement was reasonable and businesslike and that Home was obligated to follow it:

> [S]ubject to the ceding company's duty of utmost good faith, and the requirement that investigations such as the one conducted by [the Aetna claims examiner] be reasonable and businesslike, the doctrine leaves it to the ceding company to make the settlement decision in the first instance, which settlement is then binding upon the reinsurers. . . . [I]t is the reasonableness of Aetna's interpretation of the scope of coverage at the time of the settlement that is dispositive of the reinsurer's obligations to the reinsured.[3]

American Marine Insurance Group v. Neptunia Insurance Co., 775 F. Supp. 703 (S.D.N.Y. 1991) involved a hull and machinery policy and whether or not the reinsurance contract covered a compromised total loss pursuant to a follow the fortunes clause. On a summary judgment motion, the court found that the contract did cover such a loss and commented on the reinsurer's obligation as follows:

> [C]ompromised total loss was within the scope of the reinsurance policy; for plaintiff to avoid the grant of summary judgment it must show that the settlement was unreasonable and the product of dishonesty or unbusinesslike conduct. Because plaintiff has failed to show that

there exist genuine issues of material fact, defendant is entitled to judgment as a matter of law, and its cross-motion for summary judgment is granted.[4]

The reinsurer argued that the cedent was obligated to prove every fact necessary for the insured to recover against the cedent in *Insurance Company of the State of New York v. Associated Manufacturers' Mutual Fire Ins. Corp.*, 74 N.Y.S. 1038 (S.C. N.Y. App. Div. 1902 *aff'd* 174 N.Y. 541 (1903). The court found no evidence in the record that the claim was improperly adjusted or paid.

B. Case Finding Exception to the Rule

American Employers' Ins. Company v. Swiss Re America Corp., 275 F. Supp.2d 29 (D. Mass. 2003)[5] was a summary judgment action by which the cedent sought a declaration that its settlement with its insured over multiple polluted sites was reasonable and should be covered pursuant to a follow the settlements clause. The underlying policies were multi-year but the facultative certificates were annual. The insured never argued that limits should be annualized but the cedent, in its settlement value calculations, did so.

Following mediation on 10 sites, the cedent and insured settled with respect to those sites and another 27 sites about which the cedent had no information. $2.8 million of the settlement was allocated to the 27 sites. The court found no basis for annualizing the limits and that the reinsurer was not obligated to follow the settlements with respect to the $2.8 million allocated to the 27 sites:

> The reinsurer's burden is a high one, as it must show not mere negligence, but gross negligence or recklessness. Swiss Re has met its burden here. AEIC's failure to obtain any documentation on the twenty-seven sites to which it allocated $2.8 million of its settlement with [the insured] is wholly inconsistent with its obligation to its reinsurer to settle claims in good faith.[6]

The settlement of pollution claims at 51 sites, bad faith claims and a buyout of 31 policies provided the factual backdrop for *Hartford Accident & Indemnity v. Columbia Casualty Co.*, 98 F. Supp. 2d 251 (D. Conn. 2000). However, the settlement was allocated, for purposes of reinsurance recovery, to one site where the cedent deemed a "sudden and accidental" loss had occurred. The reinsurer argued that this allocation was designed to maximize recovery under the excess of loss reinsurance and there was some evidence in the record to support this. The court denied the cedent's motion for summary judgment:

> While mere negligence would not support a finding of bad faith sufficient to avoid application of the "follow the fortunes" doctrine, the Court is unable to conclude on this disputed record, that Columbia's evidence, if credited, could not support a finding of gross negligence. ("Bad faith requires an extraordinary showing of disingenuous or dishonest failure to carry out a contract. The standard is not mere negligence, but gross negligence or recklessness.") (citation omitted) While Hartford contends that its allocation of the entire settlement to the Newsom Site was completely reasonable, the above facts could support inferences from which a factfinder could conclude that Hartford's conduct manifested gross negligence or recklessness. Such disputes as to the proper inferences to be drawn from these facts and circumstances requires determination by a jury.[7]

Suter v. General Accident Insurance Co. of America, 2006 U.S. Dist. Lexis 48209 (D. N.J.) involved a series of excess insurance policies covering Pfizer which manufactured the Shiley heart valve. A small percentage of these valves fractured after implantation and normal use as a result of a manufacturing defect. Pfizer settled a class action by those injured by the failure of the valve as well as many individuals seeking recovery for anxiety that their valves might fail in the future.

Pfizer used the date of implantation of the valve as the date of loss but several court cases assigned the date of fracture as the date of loss. The cedent, however, adopted

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The reinsurer's burden is a high one, as it must show not mere negligence, but gross negligence or recklessness. Swiss Re has met its burden here. AEIC's failure to obtain any documentation on the twenty-seven sites to which it allocated $2.8 million of its settlement with [the insured] is wholly inconsistent with its obligation to its reinsurer to settle claims in good faith.

Case law is useful in demonstrating the situations in which this exception to follow the settlements principle may be applied. However, case law to date is not definitive in demonstrating the practical differences between the two ways in which the exception is articulated i.e. a "reasonable, business-like investigation" or the absence of "gross negligence or recklessness."

CONTINUED FROM PAGE 25

Pfizer's point of view which increased the number of covered losses. In addition, the cedent apparently disregarded case law that anxiety about possible future injury is not "bodily injury" covered by general liability policies. The only way in which the cedent's attachment point could have been reached was to include the anxiety claims in the loss. The cedent did not attempt to determine whether underlying limits had been exhausted and the court found that such limits had not been exhausted.

On this record, the court ruled that the reinsurer need not follow the cedent's settlement of the Pfizer claim:

> The application of "follow the settlements" doctrine is subject to the requirement that the reinsured make a reasonable, businesslike investigation (citation omitted). What is a reasonable, businesslike investigation of course must depend on the facts of each case. The factual findings support the conclusion that [the cedent's] investigation of the Pfizer claim was superficial, relying as it did on Pfizer's position and opinions of Transit's counsel, which were even at times inaccurate. The defendant has demonstrated that [the cedent] did not make the kind of reasonable and businesslike investigation that the circumstances required.8

IV. Conclusion

Case law is useful in demonstrating the situations in which this exception to follow the settlements principle may be applied. However, case law to date is not definitive in demonstrating the practical differences between the two ways in which the exception is articulated *i.e.* a "reasonable, business-like investigation" or the absence of "gross negligence or recklessness."

Whichever articulation is used, however, it is likely that this line of cases will add a new element to coverage disputes, *i.e.*, closer scrutiny of the manner in which claims are investigated and settled by ceding companies. To the extent that case law limits this rule to truly incompetent and/or dishonest claims adjusting and settlement, it should not uncut but place reasonable limits on the cedent's judgment calls which are protected by the follow the settlements doctrine. ▼

The views expressed in this article are those of the author and do not reflect the views of his clients. Copyright 2007 by the author. Questions or comments may be addressed to Mr. Hall at bob@robertmhall.com.

ENDNOTES

1 *See Aetna Casualty and Surety Co. v. Home Ins. Co.* 882 F. Supp. 1328, 1347 (S.D.N.Y.1995); *Suter v. General Accident Ins. Co. 2006 U.S.* Dist. Lexis 48209 *73 (D.N.Y.); *American Marine Ins. Group v. Neptunia Ins. Co.*, 775 F. Supp. 703, 708 (S.D.N.Y. 1991); *Ins. Co. of State of N.Y. v. Associated Manufacturers' Mutual Ins. Corp.*, 74 N.Y.S. 1038 (S.C. App. Div. 1902) *aff'd* 174 N.Y. 541 (1903).

2 *See American Employers' Ins. Co. v. Swiss Reinsurance America Corp.*, 275 F.Supp. 29, 39 (D. Mass. 2003); *Hartford Accident & Indemnity Co. v. Columbia Cas. Co.*, 98 F.Supp.2d 258, 260 (D. Conn. 2000).

3 882 F. Supp. 1328 at 1351.

4 775 F. Supp. 703 at 709.

5 This decision was vacated and remanded on other grounds 413 F.3d 121 (1st Cir. 2005).

6 275 F. Supp.2d 29 at 39.

7 98 F. Supp. 2d 251 at 260.

8 2006 U.S. Dist. Lexis 48209 *84.

SAVE THE DATE May 7-9, 2008 SAVE THE DATE May 7-9, 2008

The ARIAS 2008 Spring Conference will be located at the beautiful Ritz-Carlton Hotel on Amelia Island. The island is located on the Atlantic Ocean in Florida, near the border with South Carolina. All 444 rooms have balconies and an ocean view; it offers an 18-hole golf course, nine tennis courts, and a dramatic new 26,000 square-foot, state-of-the-art spa facility just completed in December 2006. The excellent conference facilities are perfectly sized for ARIAS sessions. **Details will be on the website calendar as they develop**.

You will not want to miss this event!

SAVE THE DATE May 7-9, 2008 SAVE THE DATE May 7-9, 2008

in focus

Recently Certified Arbitrators

Paul R. Aiudi

David A. Grefe

Paul R. Aiudi

Paul Aiudi recently joined American International Group, Inc. as an Assistant General Counsel in its Corporate Law Department, where he works within that department's group responsible for the resolution of reinsurance disputes.

Prior to joining AIG, Mr. Aiudi was a 2nd Vice President and Senior Counsel in the Travelers Companies' Reinsurance Legal Group. In this capacity, Mr. Aiudi had in-house legal management responsibility over numerous ceded and assumed reinsurance disputes and provided legal counsel to Travelers' various reinsurance groups. He has also been an Assistant Vice President and Assistant General Counsel in the Law Department of The Hartford Financial Services Group, Inc., where he served as legal counsel to The Hartford's assumed reinsurance operations. Prior to his in-house legal career Mr. Aiudi was in private practice, serving as an associate at Day, Berry & Howard (now Day Pitney LLP) in Hartford, Connecticut.

Mr. Aiudi received a Bachelor of Arts degree from Marist College in 1987 and his Juris Doctor from The University of Notre Dame in 1991. He has been a speaker at several reinsurance industry seminars, including those sponsored by ARIAS and Mealey's. He has also been an Instructor at The University of Connecticut School of Law where he taught an LLM course entitled "Principles of Reinsurance." ▼

David A. Grefe

David Grefe is a seasoned business executive with over 20 years of successful experience in multiple phases of management including operations, mergers and acquisitions, organizational development and global systems development. He is a certified public accountant and has spent more than 25 years working in the property and casualty insurance and reinsurance industry. He began his career at Peat, Marwick, Mitchell and Co., where he specialized in auditing major insurance companies as well as a large, privately held insurance agency. In 1979, Mr. Grefe joined The St. Paul Companies as a financial reporting analyst. In 1981 he was promoted to Accounting Officer and in 1982, Senior Accounting Officer, with responsibility for all SEC/GAAP financial and regulatory reporting for The St. Paul, as well as due diligence for all mergers and acquisitions, accounting policy and procedure formulation, and investment accounting and reporting.

In 1985, Mr. Grefe was transferred to New York City and promoted to Chief Financial Officer of St. Paul Re and initially had responsibility for all financial functions, I/T and ECRA run-off management. In 1998, he assumed the additional title of Chief Administrative Officer and was promoted to Executive Vice President, ultimately assuming responsibility for Claims, Legal and Contract Wording, Human Resources, Facilities Management and Client Services on a worldwide basis. During Mr. Grefe's tenure he was responsible for managing several acquisitions, including integration and restructuring initiatives for the global reinsurance organization. He developed the infrastructure to support the profitable growth of a $2 billion organization that ultimately expanded to 13 offices in the U.S., Europe, Asia and Australia.

Mr. Grefe is skilled in domestic and international problem solving, negotiation, compliance and corporate governance. He has significant experience on both the primary and reinsurance side of the business and supervised several large disputes while in charge of St. Paul Re's legal department and is familiar with arbitrations and commutations apart from his ARIAS training. Mr. Grefe has been active in industry associations, including the RAA Accounting Committee. He received his B. S. in Business Administration from the University of Minnesota. ▼

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

in focus

Lawrence C. Magnant

Lawrence Magnant learned early about "utmost good faith" as a trainee and later on a broker at Lloyds of London. A 1971 graduate of Lafayette College, he took a position as a reinsurance broker with Leslie and Godwin Ltd. Enrolled at night, he received lectures in Property & Pecuniary Insurance at the Chartered Insurance Institute. Mr. Magnant returned to New York to join a regional reinsurance broker. Two years latter, he was asked to open the NY office for Seattle-based John F. Sullivan Company.

At age 32, with 8 years of significant business development, Mr. Magnant started Magnant Re Intermediaries, Inc. This young and successful firm was brought into Towers Perrin eight years later. He experienced the development on new property and casualty insurance charters and specialty underwriters of WC and Medical Malpractice. Specialty firms engaged him in various lines including: crop hail writers in Texas, Dental Malpractice in California, European Retro Facilities, Japanese Earthquake, US Long Haul, and the standard lines of US based ceding companies.

In 1991, Mr. Magnant was recruited by General Re to bring "in house" the ceded programs for the aviation giant USAIG and surplus lines notable General Star and Genesis. As a Director and Executive Vice President of General Re Intermediaries, he fostered the development of significant US ceding companies with catastrophe reinsurance requirements of up to $500 million.

In June of 2004, with the freedom of an early retirement, Mr. Magnant selected an interesting business model. Armed with years of experience, reinsurance intermediary licensure and trusted by clients, he started Two Rivers Re Corp. Located in Virginia, Two Rivers contracts with Towers Perrin for supporting services. Clients enjoy the comfort of a seasoned broker with the security of a national firm.

As a recently certified arbitrator, Mr. Magnant looks forward to bringing his experience with multiple reinsurance platforms to the forums of dispute resolution.

Edward J. McKinnon

Edward J. McKinnon is the President of Claims Resource Management, Inc. He has thirty-eight plus years of professional experience in the insurance industry. He attended the University of Maryland and Merrit College in Oakland, California, and served with the U.S. Army Intelligence Corps from 1966 - 1969, including service in Vietnam in 1968.

Mr. McKinnon began his insurance career in 1969 with the General Adjustment Bureau as a multi-line claims adjuster, handling all types of claims from auto and homeowners to large commercial property and casualty losses. From 1973 - 1988 he was employed with the Harbor Insurance Company, holding various positions until his retirement in 1988 as Senior Vice President and member of the Harbor Insurance Board of Directors. In 1988, upon his retirement from Harbor, Mr. McKinnon founded Claims Resource Management, Inc. ("CRMI"). CRMI employs 30 plus claim professionals and support staff. It offers claims services to property, casualty and professional liability insurers and self insurers.

Mr. McKinnon participates in several professional activities, including the Excess/Surplus Lines Claims Association, of which he is a Past President and former member of the Board of Directors, and is a member of the Federation of Insurance & Corporate Counsel, with previous service as a Chair, Vice Chair and Committee and Faculty Member since 1993. He is also a Registered Professional Adjuster. Ed has acted as a Panelist and/or Speaker on multiple panels, with topics ranging from Insurance Expert Witnesses to Mold and Contamination.

Over the years, Mr. McKinnon has written various articles. One article was published in a 1994 edition of *For The Defense*, the magazine of the DRI, which dealt with "claim files." He published an article for Daubert Online in July 2006, a DRI newsletter, which dealt with claims experts. Also, his writings have appeared in Declarations, the magazine published by the Excess/Surplus Lines Claim Association. ▼

Lawrence C. Magnant

Edward J. McKinnon

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in focus

Constance D. O'Mara

Michael D. Price

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Constance D. O'Mara

Connie O'Mara, of O'Mara Consulting, LLC, provides specialized consulting services to insurers, reinsurers, and law firms on a wide variety of claims management issues, and reinsurance reporting issues. Prior to starting her consulting practice, Ms. O'Mara served as President of the Brandywine Group of Insurance and Reinsurance Companies (a division within ACE INA Holdings), including President of Century Indemnity Company, ACE American Reinsurance Company, and Century Reinsurance Company. The portfolio she managed was composed of both domestic and international direct and assumed business from inactive companies included in the INA Holdings group of companies. This position was the culmination of a long and varied career at CIGNA P&C and then ACE Companies which began in 1985 when she joined what was then CIGNA P&C as a home office claim supervisor.

In the course of her career, Ms. O'Mara has handled both direct claims and assumed claims. She was promoted to management positions where she managed claims staff handling direct asbestos, environmental and long-term exposure claims. Her career also includes the management of claims staff handling all assumed claims, domestic and international, from the former CIGNA Re portfolio. In 2002, she was appointed General Counsel and Senior Vice President, Brandywine Division, ACE-USA and managed both in-house and staff counsel offices handling coverage litigation and ceded arbitrations on behalf of the Brandywine group of companies. During her career, she has handled, investigated, negotiated, managed and supervised litigation of thousands of claims. She has also participated in and overseen the audit of files handled by claim service organizations and cedents and she has established audit protocols and documentation procedures to satisfy a variety of purposes including reinsurance contract-specific needs as well as state and federal regulatory requirements.

Her expertise and leadership roles in managing long-tail claims has included speaking engagements with the IADC, (where she is a member and vice chair on the Insurance Executive Committee), the EECMA, CICLA (Complex Insurance Claims Association), and American Conference Institute's Advanced National Forum on Environmental Insurance Coverage and Claims. She has also been active in the Coalition for Litigation Justice and political efforts to reform Superfund. Her current consulting practice includes serving as an expert witness on claims handling issues as well as the evaluation of complex claims using risk assessment analysis for allocation issues. ▼

Michael D. Price

Michael Price currently serves as President and Chief Executive Officer and is a member of the board of directors of Platinum Underwriters Holdings, Ltd. Platinum, an NYSE listed company with approximately $5 billion of assets, is a leading provider of property, casualty, and finite risk reinsurance.

Prior to joining Platinum, Mr. Price held several senior level positions in the (re)insurance industry including Chief Operating Officer of Associated Aviation Underwriters Incorporated, an industry leading aerospace specialist underwriting manager, Chief Underwriting Officer of Swiss Re (Americas) and Underwriters Reinsurance Company, and President of London Life and Casualty Reinsurance Corporation.

Mr. Price began his career with Milliman & Robertson, a nationally recognized actuarial consulting firm. He is a Fellow of the Casualty Actuarial Society (FCAS) and holds the Associate in Risk Management (ARM) designation of the Insurance Institute of America. He is a graduate of the University of Wisconsin - Milwaukee with a double major in mathematical statistics and economics. ▼

Law Committee Case Summaries

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

As of the beginning of June 2007, there were 21 published case summaries and one regulation summary on the website. The committee encourages members to review the existing summaries and to routinely peruse this section for new additions

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

National Union Fire Ins. Co. of Pittsburgh v. American Re-Ins. Co. ., —- F.Supp.2d —-, 2006 WL 2089578, No. 03 Civ. 6999

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

Date Decided: July 28, 2006

Issue Addressed: Reinsurer required to follow-the-fortunes of cedent's settlement of underlying lawsuit.

Submitted by: Vincent J. Vitkowsky, Michael P. Thompson and Scott H. Casher*

In *National Union Fire Ins. Co. of Pittsburgh, PA v. American Re-Ins. Co.*, the U.S. District Court for the Southern District of New York granted summary judgment to cedent National Union as against its reinsurer, American Re. It held that American Re failed to prove National Union's settlement of several underlying claims against its insured was manifestly outside the scope of the policy reinsured by American Re, and further held that American Re failed to otherwise prove that National Union's decision to pay the claims was fraudulent, collusive, or in bad faith.

National Union insured a machine-manufacturing company under consecutive annual liability policies for each year from 1988 to 1995. American Re reinsured the 1994-95 policy. Claims were brought against the insured for alleged personal injuries caused by metalworking fluids manufactured by the insured and used by the plaintiffs. The insured asserted that manifestation was the applicable trigger of coverage under Ohio law, and it divided and assigned the plaintiffs evenly to two policy years, 1993-94 and 1994-95, based on medical evidence that showed the injuries manifested during that period. National Union initially objected to the insured's use of a manifestation trigger, but subsequently accepted its insured's position on trigger of coverage and allocation of claims.

The court held that American Re failed to prove that National Union's payment of the underlying settlement was clearly or manifestly outside the scope of the insurance coverage that was reinsured, and failed to prove that the settlement was fraudulent, collusive or in bad faith. Although the court agreed with American Re that there was conflicting evidence regarding the exact date that the underlying plaintiffs' injuries manifested, it held that the underlying claims were "at least arguably within the scope of the insurance coverage that was reinsured." The Court stated, "American Re, as a reinsurer bound to follow the fortunes of the reinsured, is not entitled to a 'de novo review of [National Union]'s decision-making process.' (*quoting N. River Ins. Co. v. Ace Am. Reinsurance Co.*, 361 F.3d 134, 140 (2d Cir. 2004). There is thus no issue of material fact to be tried with respect to whether the underlying claims fell outside of the reinsured policy."

The court rejected American Re's next argument that National Union acted unreasonably in accepting its insured's allocation, and held that the follow-the-fortunes doctrine prohibits judicial inquiry into the propriety of a reinsured's post-settlement allocation if the settlement itself was in good faith, reasonable, and within the terms of the policies. The Court stated that "this argument must fail because it is exactly the type of inquiry that the follow-the-fortunes doctrine is intended to prevent." The Court added, "Follow-the-fortunes, then, prohibits judicial inquiry into the propriety of a reinsured's post-settlement allocation 'if the settlement itself was in good faith, reasonable, and within the terms of the policies.' (*quoting Travelers Casualty & Surety Co. v. Gerling Global Reinsurance Corp.*, 419 F.3d 181, 189 (2d Cir. 2005) There has been no suggestion here that the underlying settlement was not taken in good faith or was unreasonable; indeed, American Re explicitly states that it 'is not questioning the underlying settlement.' Furthermore, as explained above, the settlement covered claims that were at least arguably within the terms of the policy. An inquiry into the reasonableness of National Union's post-settlement allocation is therefore inappropriate in light of Travelers Casualty."

Finally, the court also rejected American Re's argument that summary judgment was inappropriate because there was evidence from which a reasonable fact-finder could conclude that National Union acted in bad faith with respect to American Re's interests by accepting its insured's allocation decision in an effort to maximize reinsurance recoverables. The court held that "even assuming that National Union was indifferent to the improper allocation of plaintiffs to the reinsured policy, it would not rise to the 'extraordinary' showing of bad faith required to avoid application of the follow the fortunes doctrine. The simple fact is that National Union had no duty to American Re to minimize its reinsurance recovery." The Court added that "[l]ike the reinsurer in *North*

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River, American Re argues that the apparent inconsistency between National Union's initial belief that [it insured's] allocation decision was incorrect and its ultimate acceptance of that allocation in seeking reinsurance coverage is evidence of unreasonableness and/or bad faith. To the contrary, the most it evidences is that National Union took various legitimate factors and risks into account when deciding whether to settle the claims made against it, an examination of which is not an appropriate undertaking under the follow-the-fortunes doctrine."

** Mr. Vitkowsky and Mr. Thompson are partners and Mr. Casher is an associate in Edwards Angell Palmer & Dodge LLP.*

Borst v. Allstate Insurance Company, 717 N.W.2d 42 (2006)

Court: Wisconsin Supreme Court

Date Decided: June 13, 2006

Issues Addressed: Evident partiality of party-appointed arbitrator; disclosure of arbitrator's relationship with a party; pre-award challenges to an arbitrator's impartiality; extent of discovery in arbitration.

Submitted by: Paul Janaskie and Steven McNutt*

The Wisconsin Supreme Court has vacated an arbitration award in a dispute between Allstate Insurance Company ("Allstate") and a policyholder because the arbitrator selected by Allstate also regularly serves as an attorney for Allstate. *Borst v. Allstate Ins. Co.*, 2006 Wisc. LEXIS 364 (Wis. June 13, 2006). The court held that the arbitrator's "substantial, ongoing attorney/client relationship with Allstate" demonstrated "evident partiality" prohibited by Wisconsin law and that the arbitrator's "full disclosure" of his relationship with Allstate did not eliminate his evident partiality.

The court also held that, under Wisconsin law, all arbitrators, including party-appointed arbitrators, are presumed to be impartial unless the arbitration agreement or the arbitration rules specified by the parties allow for non-neutral arbitrators. The court further determined that pre-award challenges to an arbitrator's impartiality are permissible.

In addition, the court ruled that, under Wisconsin law, the parties are restricted to statutorily-authorized depositions in arbitration, and cannot propound written interrogatories or requests for production of documents unless the parties expressly agree to such discovery.

Background

A policyholder sought vacatur of an arbitration award that was rendered in an arbitration with his insurer, Allstate Insurance Company, regarding uninsured motorist coverage. The insurance contract required arbitration of coverage disputes. The insurance contract provided that each party would select an arbitrator, and the two arbitrators would select a third arbitrator. The insurance contract did not mention anything regarding the neutrality of any of the arbitrators.

For its selection of an arbitrator, Allstate selected a lawyer whose law firm represented Allstate on a continuing basis. The policyholder objected to the arbitrator selected by Allstate. The arbitrator, however, insisted that he could act impartially, and he and the other arbitrator selected the third arbitrator and proceeded with the arbitration. After the arbitration panel rendered its award, the policyholder moved to vacate the award in Wisconsin state court.

Presumption of Neutrality

As an initial matter, the Supreme Court ruled that Wisconsin law requires an arbitrator to be impartial, including party-appointed arbitrators, unless the parties' contractual agreement or the arbitration rules provide otherwise.

The court distinguished this present case from an earlier case precedent that seemed to suggest that a party-appointed arbitrator is presumed partial to the party that appointed him. Unlike the present case, though, the earlier case had an arbitration provision that called for "a third, independent arbitrator" whose decision would be final and binding if the three arbitrators could not reach a decision. Given this contract language in the earlier case, the court determined that the earlier precedent was not contrary to its present decision "that all arbitrators are presumed impartial."

The court stated that the presumption of neutrality for all arbitrators, including party-appointed arbitrators, "puts Wisconsin in line with 'the recent trend away from non-neutral party-appointed arbitrators and the heightened expectations of independence and neutrality of commercial arbitrators.'"

Evident Partiality

The court then examined whether the arbitration award had to be vacated because of "evident partiality" of Allstate's appointed arbitrator. The court concluded that "the fact that [Allstate's appointed arbitrator] had a substantial, ongoing attorney/client relationship with Allstate leads us to conclude, as a matter of law, that [Allstate's appointed arbitrator] demonstrated evident partiality such that the arbitration award must be vacated."

Reviewing its own precedent as well as Justice White's concurrence in the United States Supreme Court case Commonwealth Coatings Corp. v. Continental Cas. Co., 393 U.S. 145 (1968), the Wisconsin Supreme Court stated that the standard for "evident impartiality" as follows: an arbitration award must be vacated "if based on evidence that is clear, plain, and apparent, a reasonable person would have serious doubts about the impartiality of the arbitrator."

Full Disclosure of Arbitrator's Relationship with Party

The Wisconsin Supreme Court rejected Allstate's argument that its appointed arbitrator satisfied the neutrality requirement because he had disclosed his attorney-client relationship prior to the arbitration. According to the court, "[u]nder Allstate's view then, Allstate's corporate counsel could serve as an arbitrator, as long as this relationship was disclosed. This example demonstrates the fallacy of Allstate's position."

Pre-Arbitration Award Challenge to Arbitrator's Impartiality

The court also considered the "more difficult issue" of whether a party must await the arbitration award before it challenges the appointment of an arbitrator. The court concluded that pre-award challenges are permissible because the present case "provides an example of a situation where a pre-arbitration challenge is necessary and efficient."

No Discovery Permitted Beyond Statutorily Authorized Deposition

The Wisconsin Supreme Court addressed the extent of discovery permitted in arbitration; i.e., whether the parties were limited to depositions authorized by the Wisconsin Arbitration Act, or whether the parties could propound written interrogatories and document production requests in addition to taking depositions. The court concluded that under Wisconsin law arbitrators have "no inherent authority to dictate the scope of discovery, and absent an express agreement to the contrary, the parties are limited to [statutorily authorized] depositions."

** Mr. Janaskie is a partner and Mr. McNutt is an associate in the Insurance and Reinsurance Practice Group of Hunton & Williams LLP. They represent cedents and reinsurers in a wide range of reinsurance and insurance coverage matters.*

Patten v. Signator Insurance Agency Inc., 441 F. 3d 230 (2006)

Court: 4th Circuit U.S. Court of Appeals

Date Decided: March 13, 2006

Issue Addressed: Vacating an Arbitration Award on Grounds of Manifest Disregard of the Law.

Submitted by: John R. Cashin*

In *Patten v. Signator Insurance Agency* the Fourth Circuit held that where an arbitrator disregarded the plain and unambiguous language of the governing arbitration agreement, the arbitrator failed to draw his award from the essence of the agreement and acted in manifest disregard of the law.

In 1972 Ralph F. Patten, began working as a sales agent for John Hancock Mutual Life Insurance Company in Washington D.C. In 1992 Patten signed a "Mutual Agreement" that included an arbitration clause and a one year statute of limitations on all employment claims. In 1998 Patten became a branch manager and signed a "Management Agreement" with the Hancock affiliate, Signator. This agreement superceded the previous agreement. It also contained an arbitration clause, but a filing period for claims was not included. The Management Agreement mandated that it was to be governed by and construed in accordance with the laws of the Commonwealth of Massachusetts. In 2001 Signator terminated Patten's employment and alleged grounds of poor performance. Patten waited fourteen months before seeking arbitration of his claim for age discrimination.

Signator proceeded to arbitration and the parties participated in discovery and an exchange of potential witnesses. Signator then filed a motion for summary judgment on grounds that Patten's claim was time-barred as more than one year had passed since his termination. The sole arbitrator dismissed the arbitration proceedings as time-barred and entered summary judgment for Signator without conducting a hearing on the merits. As a preliminary matter, he determined that the arbitration proceedings were governed by both the Mutual Agreement and the Management Agreement. While the arbitrator observed that the Management Agreement contained no notice requirement, he determined that it contained an implied term limit. The arbitrator referenced the Mutual Agreement for guidance and adopted its one year limitation.

Patten filed a motion in district court to vacate the arbitration award contending manifest disregard of the law. The district court characterized the arbitration decision as a mere misinterpretation of the agreement which did not constitute grounds to vacate the award. Patten appealed the decision to the Fourth Circuit.

In a 2-1 decision, the Fourth Circuit vacated the district court's refusal to vacate the arbitration award and remanded the case for further proceedings. The court relied principally on the common law grounds for vacatur where the award fails to draw its essence from the contract, or the award evidences a manifest disregard of the law (*Apex Plumbing Supply, Inc., v. U.S. Supply Co.*, 142 F. 3D 188, (4TH Cir. 1998).

Citing a series of Fourth Circuit opinions, the Court stated: "Under our precedents, a manifest disregard of the law is established only where the arbitrator understands and correctly states the law but proceeds to disregard the same. Moreover, an arbitration award does not fail to draw its essence from the agreement merely because a court concludes that an arbitrator misread the contract. An arbitration award fails to draw its essence from the agreement when the result is not rationally inferable from the contract." (internal quotation marks omitted). *(See Remmey v. Paine Webber, Inc., 32 F. 3d 143 (4th in 1994); Upshur Coal Corp., v. United Mine Workers, Dist. 31, 933 F2d 225 (4TH Cir. 1991); Int'l*

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Union, United Mine Workers of Am v. Marrowbone Dev. Co., 232 F3d 383 (4th Cir. 2000)

The Fourth Circuit found that the arbitrator disregarded the plain and unambiguous language of the agreement when he concluded it contained an implied one-year limitations period. The arbitrator also failed to recognize that Massachusetts law was to govern the contract and that Massachusetts law should have provided guidance on the issue. Under Massachusetts law, claims of wrongful termination are subject to a three year statute of limitations.

**John R. Cashin is General Counsel - Group Reinsurance at Zurich Financial Services, Zurich, Switzerland. He is an ARIAS•U.S. Certified Arbitrator.*

Positive Software, Inc. v. New Century Mortgage Corp. 436 F.3d 495, 77 U.S.P.Q.2d 1658 (5th Cir. 2006)

Court: 5th Circuit U.S. Court of Appeals

Date Decided: January 11, 2006

Issue Addressed: Arbitrator bias

Submitted by: Rick Rosenblum*

In *Positive Software, Inc. v. New Century Mortgage Corp*., the Fifth Circuit U.S. Court of Appeals affirmed the decision of a federal district court that vacated an arbitration award because the arbitrator displayed "evident partiality," one of the grounds specified under Section 10 of the U.S. Arbitration Act on which a court may vacate an arbitrator's award. Positive Software, a software development company, licensed "LoanForce," a software product used in the mortgage lending business, to New Century Mortgage. Positive alleged that New Century had copied and used the licensed software in violation of the terms of the parties' license agreement. Positive sued New Century seeking damages and injunctive relief for breach of contract, theft of trade secrets, and copyright infringement. The district court compelled arbitration pursuant to the terms of the License Agreement.

The parties conducted the arbitration under AAA procedures using a single arbitrator to preside. During the arbitrator selection process, all of the arbitrator candidates received information about the case, including the names of the lawyers and law firms representing the parties to the dispute. In addition, the arbitrator candidates received "important reminder" notices several times advising them of their "obligation to disclose any circumstance likely to affect impartiality or create an appearance of partiality" and to "disclose any past or present relationship with the parties, their counsel, or potential witnesses, direct or indirect, whether financial, professional, social or any other kind."

The selection process resulted in the installation of Peter Shurn as arbitrator. Mr. Shurn's disclosures revealed no prior relationships with anyone in the *Positive* case. After a seven day hearing, Shurn concluded Positive should take nothing against New Century.

Promptly after the issuance of the award by Mr. Shurn, Positive conducted a detailed investigation into Shurn's background. This investigation uncovered that Shurn and his former law firm had previously served as co-counsel with the law firm and one of the primary lawyers wh represented New Century in the recently concluded arbitration over which Shurn presided. The district court found that the prior relationship between Shurn and the New Century lawyers involved protracted and significant litigation that lasted over a period of years. Based upon this information, Positive moved to set aside the take-nothing award. The district court agreed that Shurn's failure to disclose this prior relationship created a reasonable impression of possible partiality warranting vacating the award.

The Fifth Circuit affirmed the trial court's vacatur of the arbitration award. The court of appeals relied heavily upon the U.S. Supreme Court's decision in *Commonwealth Coatings Corp. v. Continental Cas. Co*., 393 U.S. 145, 89 S.Ct. 337, 21 L.Ed.2d 301 (1968), which held that an arbitrator's failure to disclose significant business relationships amounted to evident partiality under the U.S. Arbitration Act, 9 U.S.C. Sec. 10. The Supreme Court found that while no evidence existed of actual bias, and arbitrators are not expected to sever ties with the business world, the law mandates the "simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias."

The Fifth Circuit first noted some disagreement among circuit courts of appeal as to the controlling effect of *Commonwealth* due to the existence of a concurring opinion in *Commonwealth* that arguably narrows the scope of the majority opinion. Compare *Morelite Constr. Corp. v. NY City Dist. Council Carpenters Ben. Funds*, 748 F.2d 79 (2d Cir. 1984) (finding Commonwealth to be a plurality opinion, and, thus, not controlling, and requiring more than an "appearance of bias" to disqualify an arbitrator) with *Schmitz v. Zilveti*, 20 F.3d 1043 (9th Cir. 1994) (reasonable impression of partiality best expression of applicable standard in non-disclosure case). Ultimately the Fifth Circuit found *Commonwealth* better reasoned and controlling. The Fifth Circuit concluded that in a nondisclosure case, a showing of "reasonable impression of partiality" suffices to establish evident partiality and, thus, vacate an arbitration award. The court found this standard conformed with Canon II of the AAA's Code of Ethics for Arbitrators. Finally, the court noted it was not creating an "inflexible *per se*" rule for nondisclosure cases, but was encouraging arbitrators to "always err in favor of disclosure."

** Rick Rosenblum is a partner at Akin Gump Strauss Hauer & Feld. Mr. Rosenblum has represented U.S. and European insurers and reinsurers in state and federal courts and before arbitration panels across the U.S. for 18 years.*

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