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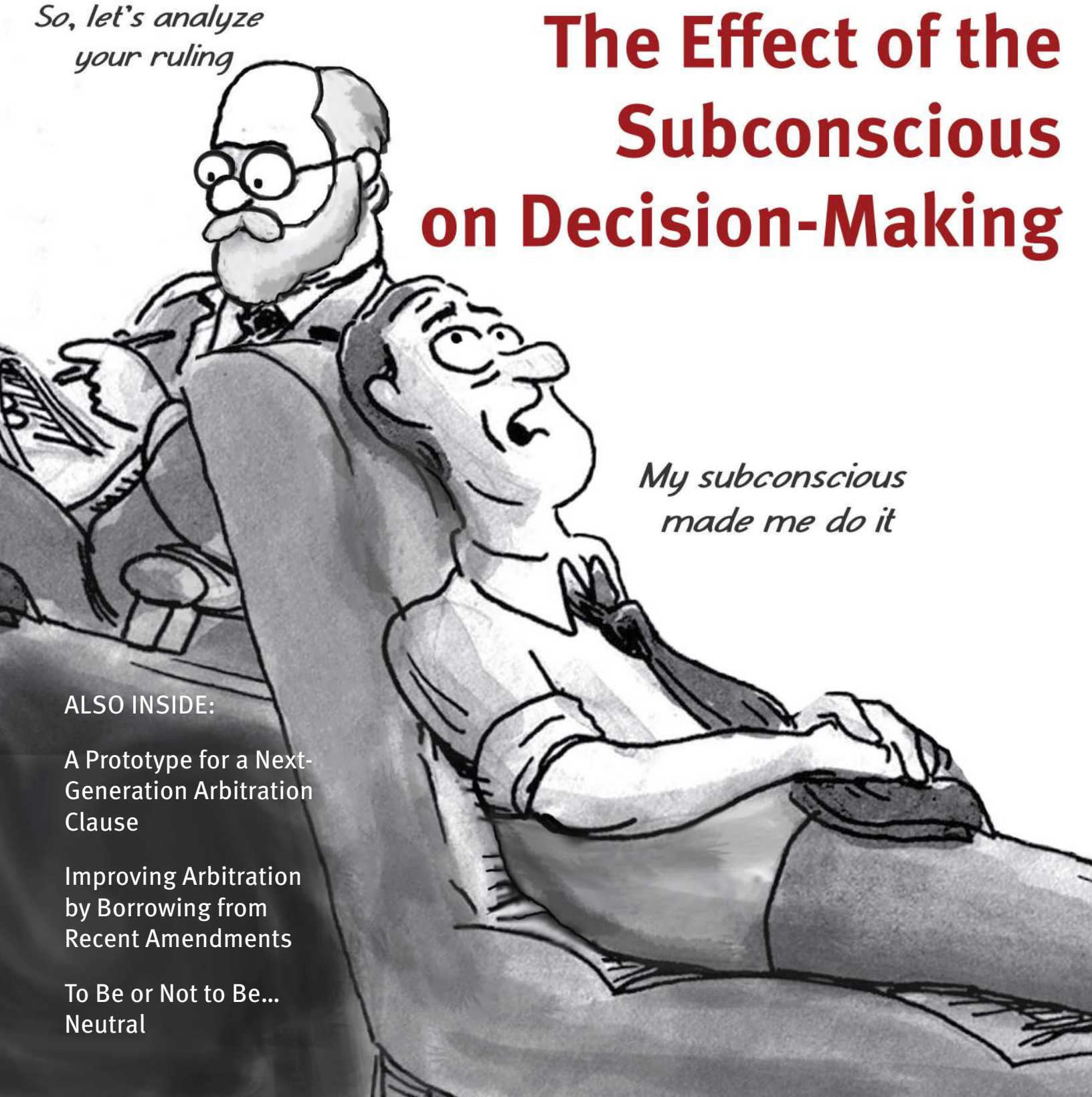
The Effect of the Subconscious on Decision-Making



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Thomas P. Stillman

editor's comments

Shakespeare wrote of it. So did Freud. Time and time again, it's been the subject of scholars in many disciplines. What's more, everyone has one, including arbitrators. I'm talking about *the subconscious*.

In this edition of the ARIAS *Quarterly*, we begin by exploring the role of the subconscious in decision making with two articles which have definite implications for arbitrators and arbitrations. The first, by Richard Waterman, suggests a broad framework for making decisions free of unconscious biases. The second, by Chuck Ehrlich, drills down to examine some of the behavioral research showing how the subconscious affects decision making in specific situations. He also offers recommendations for taming what he calls "The Ungoverned Brain."

Especially since the dawn of the digital age, litigation has become more slow, inefficient and costly. So has arbitration. Many of the problems have been driven by discovery, particularly burgeoning e-discovery. Recent amendments to the Federal Rules of Civil Procedure have attempted to address them. While there are distinct differences between the federal judicial system and the arbitrations in which we participate as members of ARIAS, according to Dan FitzMaurice and Dan Shiroma, who have authored an article on the subject, the suggestion that recent amendments to the Federal Rules might hold useful ideas for arbitration should not be as surprising as it might otherwise seem. A condensed version of the article appears in the hardcopy edition of the *Quarterly* while the complete version can be accessed on line by going to http://arias-us.org/index.cfm?a=486.

Did you know that the word "bellefonte" in Italian means "beautiful stream"? To those in reinsurance, it means something else entirely. In this edition of the *Quarterly*, Mark Sheridan analyzes post-*Bellefonte* opinions and concludes that instead of viewing *Bellefonte* as releasing a "beautiful stream," ceding companies have experienced the results of that decision more as a brackish pool of misplaced legal reasoning. Pretty strong language, indeed. It wouldn't be surprising to see other viewpoints expressed in future editions of these very pages.

Some work for love but I've never come across anyone in the reinsurance industry who doesn't work for money. We now turn to a subject in which arbitrators are very much interested — getting paid. It's rare, although not unheard of, that a party is unable or unwilling to pay what's due, be it the bills of its party arbitrator or the customary shared hearing costs of the umpire, court reporter and others. When a party defaults, what's to be done short of calling on hulking men with baseball bats to encourage payment? There's not much law on the subject nor is there much of a body of anecdotal experience on which to draw, which actually a good thing testifying to how seldom defaults occur. To the rescue come Bob and Deb Hall who explore several approaches which might bear fruit. Lawyers getting paid is beyond the scope of their article. Parties getting paid, of course, is what arbitrations are all about.

ARIAS recently promulgated rules for neutral arbitrators. A handful of arbitrators have taken the neutral plunge but many are wondering whether becoming a neutral makes sense. With the aid of interviews with several arbitrators who have chosen neutrality, Larry Ruzzo lays out pros and cons to guide the decision making.

Parties, arbitrators and counsel have often expressed dissatisfaction with contract language governing arbitration procedure. Is there a better approach? According to Elaine Caprio there is. She has written a model clause that she believes is far superior. All may not agree with her draft, but if it fosters discussion on better approaches, it will at least get the issue on the table.

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Editorial Policy

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

All contributions must be double-spaced electronic files in Microsoft Word or rich text format, with all references and footnotes numbered consecutively. The text supplied must contain all editorial revisions. Please include also a brief biographical statement and a portrait-style photograph in electronic form. The page limit for submissions is 5 single-spaced or 10 double-spaced pages. In the case of authors wishing to submit more lengthy articles, the *Quarterly* may require either a summary or an abridged version, which will be published in our hardcopy edition, with the entire article available online. Alternatively, the *Quarterly* may elect to publish as much of the article as can be contained in 5 printed pages, in which case the entire article will also be available on line.

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article

Thinking Open-Mindedly to Promote Good Decision-Making

By Richard G. Waterman

Richard G. Waterman

It is a high honor to be recognized by your peers to serve on an arbitration panel. It is also a gratifying and humbling experience to be considered as someone worthy of serving in a judicial capacity to resolve an industry dispute. I enjoy working with knowledgeable colleagues on arbitration panels who demonstrate their skills to navigate complex arbitration proceedings with a heightened appreciation of their vital responsibility to balance fairness with utmost integrity and professionalism.

Integrity and professionalism are high-minded words that few of us can define fully. If you have not recently read the *ARIAS·U.S. Code of Conduct*, I suggest you get a copy, read it again and re-read it every time you consider accepting an arbitration appointment. The Code of Conduct serves as a reminder of how important it is for each of us to uphold the integrity of the arbitration process by acting honestly, diligently and in good faith in rendering fair and just decisions without being influenced by outside pressure, fear of criticism or self-interest. It's a daunting reality that we really need each arbitrator to be an exceptional, unbiased kind of person. Quite a job description. Obviously, we cannot expect perfection when coping with intractable arguments and making judgments in an environment of practical uncertainties.

Rendering Just Decisions

All of us believe that we are capable of rendering fair and just decisions when serving on arbitration panels. Under ideal conditions, that is probably true. ARIAS·U.S. members are known to be smart and thoughtful, and they usually base their decisions on facts and experiential reasoning. Nonetheless, predispositions, outside pressures, influences and the demands of fairness are probably far more powerful than we can imagine. Arbitrators are not professional judges, we are not subject to the constraints of judicial ethics, review of our decisions, and our panel appointments are short-term, unlike some judges appointed to life terms. Consequently, extraneous pressure, criticism and second guessing are commonplace.

Furthermore, since we are business people with business experience deciding a business controversy, our judgment and reasoning have a tendency toward our expectations, preconceptions, and prior beliefs that influence our interpretation of new information. When examining evidence relevant to a given belief, people are inclined to see what they expect to see and conclude what they expect to conclude. Information that is consistent with their preexisting beliefs is often accepted at face value, whereas evidence that contradicts them is critically scrutinized and often discounted. Our beliefs may thus be less responsive than they should to the implications of new information.

More generally, the early stages of arbitration decision analysis, before all the possibilities and evidence are available, can be useful to understand what the disagreement is about and measure the probability of different outcomes. The evaluation of facts and search for possibilities can also be used as a way of understanding what sort of evidence is needed to support a particular hypothesis. Since we have a natural tendency to look for evidence that confirms our vision of the facts, early stages of thinking analysis should take into account facts that disagree with our initial hypothesis. Even in testing a hypothesis, however, decision makers tend to look for instances where the hypothesis proved true. We take pieces of information that corroborate our hypothesis and treat them as evidence. Of course we can easily find confirmation for just about anything if we just look.

The confirmation problem pervades our decision making since most conflicts usually involve a mental bias that is not receptive to alternate perspectives. When people say they sincerely believe a particular view, that is what they sincerely believe. Each of us has unique experiences and convictions. Democrats and Republicans, for instance,

Richard G. Waterman

Mr. Waterman is a charter member and certified arbitrator/umpire of ARIAS·U.S. Mr. Waterman is an industry consultant and former reinsurance executive. He has served on many industry arbitration panels and has mediated many other reinsurance disputes. Mr. Waterman has had an academic interest in behavioral decision making for many years and he has written several published essays pertaining to small group decision making similar to arbitration panel deliberations. This commentary is adapted from his "Decision Dilemma Series," a compendium of essays he has written concerning decision making strategies and the influence of heuristic principles that arbitrators may use in judging and deciding.

look at different parts of the same data and rarely converge to the same opinions. Global climate change and immigration policy are two highly contested real world issues that define political identity and produce strong feelings that affect decision making. Once our minds have developed a certain view of the world, we tend to only consider instances proving us to be right. Paradoxically, the more information we have, the more justified we feel in our opinions.

Open-Minded Thinking

Open-minded thinking to increase the probability of good decision making is something we all want to do. Acquiring the ability to think open-mindedly allows us to consider alternate possibilities and evidence against possibilities that we have already determined seem strong. Good open-minded thinking and decision making consist of an active search for relevant information in proportion to the problem to be decided, effective use of the available information to develop confidence that an appropriate amount and quality of thinking has been done, and fairness to other possibilities than the one we initially favor.

Poor thinking tends to be characterized by too little search for facts. We often ignore evidence that goes against a possibility we like. The favoritism for a particular possibility may cause us to prematurely cut off our search for alternative possibilities or for reasons against the one we have in mind. This favoritism therefore leads to insufficient thinking and overconfidence in hasty conclusions that are generally biased in simply reaffirming beliefs that were previously found to be appealing.

To a large extent, open-minded thinking and rational judgment are contextual. Some people have better judgment in some contexts than do others. A person may have astute judgment in practicing a certain trade or profession and quite poor judgment in another such as politics or teaching. To understand how people process and reflect about reasons underlying their judgment, it is important to emphasize the distinction between technical and practical knowledge. Technical knowledge can be abstractly acquired from books and lectures and employed in a step-by-step fashion. Technical knowledge is composed of factual and theoretical knowledge that enables us to understand a particular field of endeavor. Practical knowledge, by contrast, is acquired through experience practicing it. Practical knowledge cannot be taught in classrooms or books and cannot be fully acquired by attending a series of lectures. We learn important things about complex and unpredictable problems that emerge in real life situations by gaining experience doing the activity and absorbing practical knowledge from mentors who know what they doing practicing the skills of a particular kind of activity.

Open minded thinking challenges us to use both technical knowledge and experiential knowledge that we have already acquired when addressing decision analysis. Experience, coupled with a sufficiently thorough search for facts and possibilities, deepens our ability to decide rationally. It allows us to search memories for possibilities centered on knowledge that is already there. To illustrate, the popular notion of a superior chess player is someone who has a logical mind and makes deductions on the basis of each move, planning many moves ahead. It is well established now, however, that is not how a chess player's mind works. An expert player usually thinks only a few moves ahead. What makes the expert so formidable is the immense number of specific patterns of pieces on the board that are stored in memory. An expert beats a novice because the expert can recognize a pattern of pieces on the board, matching it to a similar pattern stored in memory, to which is attached a memory of a suitable move. Nonetheless, if an arrangement of pieces is randomly placed on the board not part of an actual game, the chess expert's powers of recognition and memory drop to the level of a novice.

It has been commonly observed that no board game can replicate the complexity and unpredictable conditions of an arbitration. Since all pieces of a chess match are visible on the board, the game eliminates any hidden strategic placement of pieces or opportunity for deception by opponents. In an arbitration setting, omissions of relevant evidence are frequently prevalent, satisfactory answers to pertinent questions are unavailing and underlying argument strategy is concealed. Card games are better models of an arbitration. Contract bridge, for example, is a popular card game that entails a mixture of memory, tactics, probability and the exchange of communications. Most of the time a bridge player sees only one-quarter of the cards in play and some of the observable information might be false or misleading. The difficulty of weighing truth and deception is one reason computers do not win at bridge whereas at the highest level of chess, computers do very well. Experienced people simply have an enormous store of technical knowledge, practical conceptual knowledge and problem solving reasoning methods to draw on that no machine can imitate.

Open minded thinking challenges us to use both technical knowledge and experiential knowledge that we have already acquired when addressing decision analysis.

Accuracy in Decision-Making

We should not expect that more and more technical knowledge will obviate the need for informed, reflective judgment during arbitration deliberations. Each piece of evidence presented in an arbitration proceeding has weight with respect to a given possibility. The weight of a given piece of evidence determines how much it should strengthen or weaken the possibility. Obviously, all pieces of information are not equal in importance. Sometimes a lot of data can be meaningless. At other times one single piece of information can be very meaningful. Critical reasoning that is overly focused on details may not always be beneficial for the quality of judgments. A deliberation style focused on too much detail may overlook aspects of the global picture that affect accurate judgment. In the view of many, being able to use just the right amount

Once formal knowledge and expertise in a domain have been established, intuition can be highly reliable for judgments and decisions.

and type of information is essential for good decision making. With the knowledge that business disputes entail ambiguities, interpretations of facts along with a range of contingencies and possibilities, the human judgment of experienced arbitrators will be needed to think open-mindedly and draw on their networks of knowledge to make better decisions to achieve fairness.

Although the best judgments and decisions are made after careful deliberation and a thorough analysis of the pertinent facts, we also engage an intuitive system during our decision making. Intuition is assumed to yield better judgments in certain situations. For instance, recent research has revealed the importance of intuition in making decisions when faced with uncertainty created by incomplete information. Intuition is a process of thinking. It refers to concepts ranging from gut feelings to snap judgments to premonitions. Intuition has been generally defined as a process of thinking and judgment in the absence of complete information. Decision making influenced by intuition is most accurate when experience has been acquired in a similar environment.

In our consideration of intuition as a reliable and valid assessment component in arbitration deliberations, we need to distinguish between general knowledge and expertise in the role of judgment and decision making. Expertise depends on a person's experience with and knowledge about a particular subject matter. People with general technical business knowledge but insufficient practical experience are often unsure of why they feel the way they do and are more likely to rely on intuition to generate reasons that are only marginally related to their expressed judgment. In contrast, knowledgeable people who possess both technical and practical business experience have a better understanding of why they feel the way they do based on actual experiences and are more likely to come up with high quality reasons to support their opinions during deliberations. This type of expert judgment is characterized by the ability to make accurate judgments when complete relevant evidence is unavailable or when unqualified assertions are not supported with evidence. Once formal knowledge and expertise in a domain have been established, intuition can be highly reliable for judgments and decisions. This makes sense because the knowledge necessary to perform competently is often the same knowledge required to guide open-minded decision making.

An important difference between arbitration and litigation to resolve industry disputes is recognition of the different levels of knowledge and experience that are available for analytic judgment. A judge in court is an expert on the law. Because judges lack practical knowledge and experience in a large variety of contexts in which they are called upon to make judgments, judges have learned to rely on legal argument and explicit legal rules on which to base their reasons for their judgment. A distinctive characteristic of arbitration is the knowledge and experience arbitrators have gained through training and years of practical experience that qualifies them to put their knowledge into practice during their deliberations and decisions. Experienced arbitrators are likely to make accurate judgments when they rely on factual determinations and analytical reasoning as well as the use of their experience-based intuition. As the quality of evidence improves, the role of intuition diminishes.

Summation

Opened-minded thinking and good decision making require the active search for information and use of knowledge that has already been acquired and is stored in memory. Of course, knowledge is used in all thinking, not just problem solving. In the context of arbitration deliberations, debate and differences are a necessary part of the process. Deliberation calls for a high degree of respect in listening to opposing views and the ability to acknowledge the good faith and strong arguments of those with other opinions. We are not in a position to disagree with sincere beliefs. What we can do if we disagree with opposing views is encourage open-minded thinking based on an examination of hard evidence and stimulate an awareness of biases, obsolete opinions or inaccuracies of knowledge in memory to counter thinking that might be the basis for errors in judgment. In some instances, a clear-cut solution cannot be found. To decide rationally in situations where a winner-take-all outcome cannot be reached, a third position or synthesis that combines the strongest features of the contending party positions may be a sensible outcome as well as more integrity preserving than either of the polar alternatives.

It is not clear how one acquires the disposition and capacity to think open-mindedly, to see matters from another's point of view, engage in various forms of give-and-take discussion and reflectively review and revise previously held positions. Psychological investigations into practical knowledge indicate that it is reasonable to suppose that such a disposition and capacity are often fostered by example, encouragement and criticism. Technical knowledge and practical experience deepen an ability to decide. Persons who serve on arbitration panels want to make decisions that are just or equitable. Because of this desire, we learn to make good judgments in various contexts by emulating others who know what they are doing and are regarded as having sound judgment. We also acknowledge that each other's viewpoints have some claim to equal respect and consideration. Thus, we need to cultivate in ourselves and in others the capacity and willingness to investigate and assess previously held positions in response to new information, insights, arguments, or understanding. ▼

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The Ungoverned Brain: A Wild Card in Arbitral Decision-Making

article

By Charles D. Ehrlich

Charles D. Ehrlich

If asked how she makes decisions, a reinsurance arbitrator might reply: "Through careful deliberation I apply my experience and concepts of fairness to the evidence presented, pertinent law, industry custom and practice, and the arguments of counsel."

Sounds great. Makes sense. But not totally accurate.

In reality, our brains take capricious detours. Arbitrators, counsel, and parties need to understand those detours and their possible effect on decision-making. This article identifies some of those detours, and suggests ways to keep them from leading us astray. We'll discuss the effects of inadmissible evidence, confirmation bias, hindsight, anchoring, framing, and, most captivating, self-serving bias.[1] We'll follow with a brief diversion into food's influence on decision-making. Then we'll look at some ways to avoid these thought detours.

Inadmissible Evidence

Inadmissible evidence is the classic challenge to a decision-maker; how to un-ring the bell? In fact, it's impossible – as demonstrated by several experiments with judges.[2]

Consider first a privileged document that is bad for the plaintiff. Seventy-one percent of the judges who saw the document ruled against the plaintiff. Of the judges who didn't see the document, only 45 percent ruled against the plaintiff. In other words, even though the document should have played no role in decision-making, it did.

Remedial measures taken after an accident are also generally inadmissible – the rationale being that eliminating dangerous conditions should be encouraged. So, what happened in an experiment where one group of judges learnt of remedial actions and the other group did not? All of the judges who didn't know about the subsequent fix ruled for the defendant. Only 75 percent of those who knew about it ruled for the defendant.

Lastly, let's look at a prior criminal conviction. Half of our judges were told that a personal injury plaintiff had been convicted of a swindle more than a decade before his accident; 80 percent of them ruled the conviction should be excluded. Yet, those judges awarded the plaintiff a median of $400,000; judges who didn't know about the conviction awarded 25 percent more.

We would likely all agree that offering clearly inadmissible material in order to ring the bell that cannot be un-rung is unethical. But admissibility is often fairly debatable. Thus, one might argue that counsel are well-advised to advance even evidence with a low probability of being admissible. One can certainly say that arbitrators need to be cautious how information admitted "for whatever it's worth" affects their decision-making.[3]

Confirmation Bias

Moving next to confirmation bias, this phenomenon was often a key plot point in the wonderful British detective series, *Inspector Morse*. Morse would rather quickly lock in on a likely suspect and then doggedly accumulate evidence confirming the unlucky person's guilt. The dramatic twist to the story was often that Morse's initial conclusion was wrong; he had been led astray by confirmation bias.

Confirmation bias occurs in legal decision-making. A variety of studies show that jurors often make an initial call on the case, and then listen carefully to evidence supporting that inclination while discounting contrary evidence.[4] In an experiment with judges, all were asked to evaluate evidence bearing on whether suspect #1 had committed a murder. Half of the participants were later told of a possible second suspect; the other half were not. Nevertheless, all evaluated the evidence, and the likely guilt of suspect #1, similarly. Suspect #2 was disregarded.[5]

Confirmation bias isn't a new concept. In 1620 the English philosopher Francis Bacon

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The judges who knew the outcome saw it as predictable at roughly double the rate of those who predicted without knowledge.

observed, "The first conclusion colors and brings into conformity with itself all that comes after."[6]

A variant of confirmation bias has the mysterious label "Implicit Egotism." In plain English, it means that we gravitate to people who resemble ourselves.[7] Thus, many reinsurance arbitrators may give additional credence to evidence coming from middle-aged, well-spoken, conservatively dressed, Caucasians of the professional class, i.e., their clones, while discounting witnesses who differ significantly from that prototype.

Hindsight Bias

Turning to hindsight bias, I think this phenomenon derives from our unconscious yearning to see the world as proceeding from cause to effect in a logical and predictable fashion.

Judges in an experiment were given information about an area that might experience a flood, including costs of flood protection.[8] They were told that if there was a greater than 10 percent likelihood of a flood, negligence liability would attach if a flood occurred. All were told that no protective measures were taken; half were told there had been a subsequent flood. Twenty-four percent of those who didn't know about the flood found negligence. More than twice as many, 57 percent, of those who knew about the flood found negligence. In other words, with the "benefit" of hindsight the judgment as to what was reasonable behavior *before the flood* changed 100 percent.

In another experiment, judges were given a hypothetical trial court sanctions ruling. They were asked to predict the most likely outcome on appeal: affirmance or vacation or a lesser sanction. Some of the judges were told of the "outcome;" the others were not. The judges who knew the outcome saw it as predictable at roughly double the rate of those who predicted without knowledge.

In a reinsurance arbitration, might "hindsight bias" incline a panel to find coverage for an event "post facto," even though the parties would have given a different answer when the contract was being agreed? Might a policy buy-out look far more reasonable if the policyholder later experienced an asbestos disaster than if measured at the time of the deal? Since reinsurance disputes almost always arise "post facto," arbitrators need to be especially wary of hindsight bias.

Anchoring

Moving to "anchoring," I'll observe that many of us grew up thinking that taking reasonable positions leads to the best outcomes, that rationality is rewarded. Anchoring experiments appear to rebut that concept. Instead, anchoring suggests that counsel (or party-appointed arbitrators) consider taking the most aggressive positions possible that don't careen into absurdity.[9]

In one anchoring experiment, judges were given the facts of a serious personal injury case in which liability was conceded.[10] Half of the judges were told that the plaintiff's lawyer had demanded $10,000,000 at a settlement conference; the other half were told only that "a lot of money" had been demanded.

The judges were then asked what damages they would award. Judges who hadn't been given the $10,000,000 number awarded an average of $808,000, with a median of $700,000. Those who knew the number averaged an award of $2,210,000, with a median of $1,000,000. Thus, a settlement demand several multiples of what either group of judges was willing to give nevertheless served as an anchor leading to much higher awards than if no specific demand had been made.

A second experiment presented another personal injury case in which only damages were at issue.[11] One group of judges was initially asked to rule on a motion to dismiss, made on the ground that damages couldn't exceed a hypothetical $75,000 jurisdictional threshold; the other group was not given that motion. Virtually every judge who had the motion denied it – in other words, it didn't have much merit. Nevertheless, the motion served as a very effective anchor. The "motion group" awarded damages that averaged $882,000, with a similar median. The "non-motion group" awarded an average of $1,249,000, with a median of $1,000,000. Thus, a motion of minimal merit, one that a conservative counsel might well not even present, was such an effective anchor that it reduced the damage awards by almost one-third.

How might anchoring affect a reinsurance arbitration? Consider allocation of continuing losses; there are often several approaches, each resulting in a significantly different outcome for the parties. A party strongly arguing for a return-maximizing approach that is isn't the most supportable one may nevertheless anchor the Panel to high-return alternative outcomes rather than low return alternative outcomes.[12] A similar approach might affect the result in a life insurance premium dispute, for example.

Framing

Our next concept, framing, teaches that that the verbal presentation of an event can have significant subconscious influence on the listener's assessment of what happened. In one experiment, the subjects were shown film of a car accident. Then, divided in subgroups, they were asked to estimate how fast the cars had been going when the accident occurred. The question was asked using a different descriptor for each subgroup, starting with "contacted," and then moving up through "hit," "bumped," "collided" and "smashed." The result? The more that the descriptor connoted a violent event, the higher the speed estimated by the test group.[13] Then, a week later, the groups were asked if they saw broken glass after the accident –although there was no broken glass in the film. The "smashed" group was more likely than any other to "remember" the non-existent broken glass.[14]

Interestingly, my experience in arbitration suggests that framing is used ineffectively because it's overly exaggerated. Thus, when counsel portrays a failure to

produce documents as the most egregious wrong since the Spanish Inquisition, the Panel is more dubious than terribly upset. That said, is it possible that more effective framing has influenced me without my knowing?

Self-Serving Bias

This brings us to self-serving bias, which might prompt the reader to ask "what on earth is that?" Self-serving bias is simply the conviction that we're right (because we're smarter) and those who disagree with us aren't either right or as smart. Thus, in a classic 1977 study, 94 percent of professors rated themselves above average relative to their peers.[15] In another study, 32 percent of the employees of a software company said they performed better than 19 out of 20 of their colleagues.[16]

In another study, judges were asked to estimate how their rate of reversal on appeal compared to their fellow jurists. The top quartile represented those who were reversed the most, the bottom quartile those who suffered the least reversals.[17] Surprise! Fifty-six percent put themselves in the bottom quartile – more than twice the number that could mathematically fit there. With another 31 percent putting themselves in the second lowest quartile, 87 percent of the judges thought that they had better records than 50 percent of their peers.[18] While arbitrators rarely face reversal, is there any reason to believe that our confidence in our judgment may not be similarly a bit overconfident?

And, what if it all actually comes down to our tummies?

An Israeli study looked at the decisions of judges ruling on prisoners' parole applications.[19] Judges who had recently eaten were more likely to rule favorably on an application. The longer a court session went on without a meal, the more negative the judges' decisions became. The authors attribute this phenomenon to "decision fatigue." In other words, the more decisions the judges made the more depleted their energy, and when their energy was depleted they were more likely to rule in favor of the status quo, i.e., continued incarceration.

Applying this learning to arbitrations, perhaps the party seeking relief should ensure that the panel is well supplied with energy bars, while the party opposing should try to extend proceedings well into the lunch hour.

So, what are we in the reinsurance arbitration community to make of all this? Of course, we can shrug it off as sociological mumbo-jumbo, having little relevance given our specialist qualifications and particular niche in the decision-making world. But, why would our analytical processes be significantly "better" those of other professional decision makers? Are we simply indulging in self-serving bias if we think we're immune from the subconscious?

So, let's experiment. Let's consider some processes that may sharpen our decision-making, including the following:

- Before coming to a final conclusion on an issue, run your tentative view though a mental checklist of the potentially skewing factors: inadmissible evidence, confirmation bias, hindsight, anchoring, framing, and self-serving bias. Consider whether any of them have affected your conclusion.
- Think about whether any other factor external to the merits is playing a part in your conclusion, e.g., reputation of counsel, (un)likeability of a witness, coherence of presentation, past experience with a party, etc. If it might be, try to re-examine your conclusion with that factor eliminated.
- When you've arrived at a tentative conclusion, take pen to paper (fingers to keyboard) and write up your reasoning. That helps clarify thinking and sometimes reveals that the tentative conclusion doesn't hold up.
- List the key points supporting each party's position and informally score them, say from 1 to 10. Then add up the scores; if there are significantly more points on the position you aren't inclined to support, you may want to deliberate further.
- Experiment by agreeing with your co-panelists to discuss the evidence at the end of each hearing day rather than withholding comment until deliberations. This approach can foster consideration of differing views before they've all solidified into cement.

Justice Scalia, in his treatise on advocacy, cautioned, "[w]hile computers function solely on logic, human beings do not. All sorts of extraneous factors – emotions, biases, preferences – can intervene, most of which you can do absolutely nothing about (except play upon them, if you happen to know what they are)."[20]

While advocates face the hurdles Scalia noted, those of us who are arbitrators can conscientiously work to recognize them and eliminate them. ▼

ENDNOTES

1. This article owes a considerable debt of gratitude to the work of Edna Sussman (www.SussmanADR.com), who has analyzed decision-making in depth and gathered much source material.
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7. Brett W. Pelham, Mauricio Carvallo and John T. Jones, *Implicit Egotism*, Current Directions in Psychological Science, April 2005 vol. 14 no. 2 106.
8. Chris Guthrie, *Misjudging*, 7 NEV. L. J. 420, 433 (2007).
9. While I haven't encountered anything in the literature dealing with absurd or unreasonable positions advanced as anchors, experience suggests that such positions do not anchor, reduce credibility, and are generally unwise.
10. *Id*. at 431.
11. *Ibid*.
12. I reiterate my belief that an effective anchor needs to be within some ambit of reason; that an absurd position backfires.
13. Elizabeth F. Loftus and John C. Palmer, *Reconstruction of Automobile Destruction: an Example of the Interaction Between Language and Memory,* Journal of Verbal Learning and Verbal Behavior 13, 585-589 (1974).
14. *Ibid*.
15. *Everyone Thinks They Are Above Average*, Lifescience.com, February 7, 2013, 12:25 PM.
16. *Ibid*.
17. Chris Guthrie, *Misjudging*, 7 NEV. L. J. 420, 436-37 (2007).
18. *Ibid*.
19. Shai Danziger, Jonathan Levav, and Liora Avnaim-Pesso, *Extraneous Factors in Judicial Decisions*, PNAS, April 26, 2011 v. 108 no. 17 6889–6892.
20. Sussman, supra note 6, at 490.

article

Improving Arbitration by Borrowing from Recent Amendments to Rules of Litigation

Dan FitzMaurice

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by Dan FitzMaurice and Matt Shiroma

To disparage arbitration, equate it with litigation. Lawsuits have become synonymous with excessive discovery, cost, contentiousness, and delay. Arbitration is supposed to be a different and, indeed, better process. Although the parties pay arbitrators for their services while the government heavily subsidizes the judicial system, certain efficiencies should enable arbitration to cost less overall.

Civil litigation operates under formal rules of evidence and procedure, including opportunities for various forms of discovery and an array of motions, culminating in a trial on the merits and an appeal. In arbitration, rules and procedures need to exist only when, where, and how they are useful, allowing the parties and arbitrators to tailor a streamlined process that fits the particular dispute, all subject to minimal, judicial review.

Significant disparities in the decision-makers' caseloads, methods of compensation, and qualifications in relation to the controversy also favor arbitration. The number of pending cases that a single U.S. District Court judge manages at any point in time often exceeds 400. Only one ARIAS·U.S.-certified arbitrator has self-reported being involved as an adjudicator in that many proceedings, and he did so over the course of more than 30 years. Ethical rules prohibit judges from accepting payments directly from litigants to devote time and efforts to their particular case, but that is precisely how most arbitrators are paid. Consequently, judges do not have the same capacity and incentives to focus on one case and to make themselves immediately available simply because one or both parties seek attention. Moreover, apart from certain specialized dockets, courts generally make no effort to ensure that the presiding judge, much less any jury, will have expertise or experience in the subject matter at issue.

In arbitration, by contrast, the parties can stipulate that the adjudicators must have specified levels of experience or hold certain credentials relevant to the area in controversy. Notwithstanding these many differences and potential advantages, arbitration can benefit from several ideas contained in recent amendments to the Federal Rules of Civil Procedure.

If the two processes are so different, why should the arbitral community pay any attention to Federal Rules of Civil Procedure?

Despite important differences, commercial arbitration and civil litigation do share much in common. Both processes exist to resolve disputes. Arbitration is the form of alternative dispute resolution that most closely resembles civil litigation. In the United States and the United Kingdom, arbitration – like litigation – typically employs an adversarial rather than inquisitorial model for gathering evidence, presenting competing claims, and reaching outcomes. Modern arbitrations, especially when significant issues and/or large sums of money are at stake, tend to be far less informal than anecdotal accounts of arbitrations of the past. Commercial arbitrations typically employ the same building blocks and sequence of events as civil litigation, including: (a) devices to identify and frame the issues, claims in dispute, and relief requested; (b) the exchange of some form or forms of pretrial discovery; (c) the opportunity to file motions and briefs, including dispositive motions; and (d) the presentation of evidence and arguments at a culminating hearing. Thus, arbitration faces many of the same challenges and criticisms as litigation, and the dedicated efforts of ARIAS·U.S. and other organizations to improve arbitration often parallel reforms aimed at solving similar problems with civil litigation. Accordingly, the suggestion that recent amendments to the Federal Rules might hold useful ideas for arbitration should not be as surprising as it might otherwise seem.

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What ideas underlie the recent Amendments to the Federal Rules of Civil Procedure?

One aim of the amendments is increased speed. The amendments reduce by 25% the time for serving a complaint and the time for the judge to issue a scheduling order. Moreover, the new rules also allow parties to commence discovery sooner by serving requests for production 21 days after service of process – even if that date precedes the initial scheduling conference under Rule 26(f). The amendments encourage active case management and cooperation, by requiring that the initial scheduling conference occur through "direct simultaneous communication," and making clear that not just the court but also the parties must construe, administer, and employ the rules "to secure the just, speedy, and inexpensive determination of every action and proceeding."

Discovery reform is another objective of the amendments. New Rule 26(b)(1) re-defines the scope of discovery, expressly requiring that the information requested must not only be relevant but also "proportional to the needs of the case...". As discussed below, the new rule identifies six considerations to assess proportionality. Another change to this same rule makes clear that information "need not be admissible in evidence to be discoverable." In furtherance of active case management, an amendment to Rule 16 allows the court to require a preliminary conference before any party files a discovery motion. An amendment to Rule 34 requires a responding party that objects to a document request to state whether it is withholding any responsive documents based on the objection. Collectively, these changes aim at a pretrial process that is more efficient.

Amendments to Rules 16, 26, 34, and 37 clarify parties' obligations with respect to electronically-stored information (ESI) and privileged materials. By explicitly referencing "preservation," the amendments highlight the importance of not only disclosing and discovering ESI but also of properly retaining it. Likewise, changes to Rule 37(e) provide for uniform rules governing sanctions for destroying ESI. Finally, a change to Rule 26(f)(3)(D) – which concerns the parties' proposed discovery plan – now permits the parties to ask the court to enter an order memorializing any agreements reached regarding privilege.

How can Amendments to the Federal Rules of Procedure improve arbitration?

Unless the parties stipulate otherwise, the Federal Rules of Civil Procedure have no direct bearing on how arbitrations proceed. Indeed, many arbitrations are conducted without reference to any set of pre-existing rules and proceed outside of the auspices of any organization. Although the original by-laws provided for ARIAS·U.S. to promulgate arbitral rules, it took nearly 20 years for the society to fulfill that objective. ARIAS·U.S. now offers three sets of rules: standard, streamlined, and neutral. Several issues that the new amendments to the Federal Rules address – increasing the speed of the process, reforming discovery, and managing ESI and privileged materials – also exist in arbitration and the ARIAS·U.S. rules. Accordingly, as discussed below, the amendments offer ideas about these issues that can improve arbitration.

Increased Speed

One of arbitration's calling cards is being faster than litigation. Nevertheless, some ideas to accelerate the pace of litigation can also work in arbitration. For example, just like the amendment to Rule 1 of the Federal Rules, the ARIAS·U.S. Rules can be changed to make it clear that the parties, not just the arbitrators, are responsible to construe, administer, and employ the rules "to secure the just, speedy, and inexpensive determination" of the proceeding. For those arbitrations that do not employ the ARIAS·U.S. Rules, the panel or the umpire can exhort the parties to act in this manner.

Another speed-enhancer in the amended Federal Rules – allowing parties to serve document requests early in the process – might aid arbitration, but there is a wrinkle. Unlike the Federal Rules, the ARIAS·U.S. Rules do not assume that the parties can conduct any form of discovery as a matter of right. Rather, the ARIAS·U.S. Rules allow for discovery only if the parties agree or the arbitrators order it. ARIAS·U.S. Rule 11.1 requires

By explicitly referencing "preservation," the amendments highlight the importance of not only disclosing and discovering ESI but also of properly retaining it.

the parties to confer in advance of the organizational meeting regarding exchanging relevant documents, and Rule 11.2, provides that the "Panel shall have the power to order the disclosure of such documents or class of documents relevant to the dispute as it considers necessary for the proper resolution of the dispute." Similarly, ARIAS·U.S. Rule 10.7(e) identifies the extent of permissible discovery as a topic for the organizational meeting. Thus, in order to allow for early document requests, the ARIAS·U.S. Rules would need to adopt, as a default, the notion that parties are able to request documents from each other.

Although a default rule favoring discovery might seem inconsistent with expediting arbitration, this change would likely benefit most proceedings for several reasons. First, document requests are common in arbitral practice. Second, the proposed default would permit, not require, discovery requests; where the parties agree document requests are unnecessary or inappropriate, they would simply abstain. Third, whenever the parties disagree about the propriety of document requests, the panel must resolve that dispute – regardless of whether the initial assumption favors or disfavors discovery. Indeed, the rules can specify that the party opposing discovery bears no extra burden merely because the default allows document requests. Fourth, if the ARIAS·U.S. Rules were modeled on the new Federal Rule, then no responses to any discovery requests would be due until *after* the organizational meeting, at which time the panel could resolve any discovery dispute. Thus, the ARIAS·U.S. Rules can be amended to: (a) establish, as a default, the opportunity to serve document requests, subject to the panel's authority to issue an order

barring requests in any particular case; and (b) allow the parties to serve requests in advance of the organizational meeting.

Discovery Reform

Under the new Federal Rule 26(b)(1), the relevance of requested discovery is not the only consideration, the discovery must also be "proportional to the needs of the case." Although the concept of proportionality appears in the ARIAS • U.S. Rules, there is room for clarification and refinement. ARIAS • U.S. Rule 11.2, which addresses document requests, says nothing about the concept of proportionality, whereas Rule 11.3 expressly authorizes the panel to permit depositions and other forms of discovery "reasonably necessary in light of the issues in dispute as well as the nature and size of the dispute."Thus, arguably, the ARIAS·U.S. Rules do not require proportionality for document requests. Accordingly, the ARIAS·U.S. Rules should be amended to clarify that proportionality applies to all forms of discovery.

Furthermore, Federal Rule 26(b) identifies six factors to consider in addressing proportionality: (1) the importance of the issues at stake; (2) amount in controversy; (3) parties' relative access to relevant information; (4) parties' resources; (5) importance of the discovery in resolving the issues; and (6) whether the burden or expense outweighs the benefit. It makes sense to apply these factors to arbitration as well as litigation. Indeed, arbitrators frequently perform individualized balancing of these kinds of considerations to tailor the process to the needs of the particular dispute. Moreover, including these factors in the ARIAS·U.S. Rules would provide a standard framework for determining the scope of discovery, making the arbitrators' job easier without affecting their discretion to weigh the factors as they see fit. Accordingly, the ARIAS·U.S. Rules can be improved by following the amendment to Federal Rule 26 to: (a) make clear that the notion of proportionality applies to all forms of discovery, including document requests; and (b) identify the considerations that affect proportionality.

Another discovery reform in the Federal Rules can aid arbitration – namely, the change to Rule 34 that requires a party to identify when it is withholding documents based on an objection to the document request. In litigation or arbitration, the same uncertainly arises when a party objects to discovery and produces some, but perhaps not all, of its responsive documents. Indeed, this ambiguity lies at the heart of recent litigation over a reinsurance arbitration completed in 2013. In *Arrowood v. Equitas,*[1] the reinsurer contended that the cedent committed fraud by intentionally withholding a critical piece of correspondence from its document production. For its part, the cedent maintained that it was justified in withholding the letter, because it fell within certain objections to discovery and the reinsurer had not protected itself by moving to compel. In denying the reinsurer's motion for relief, the District Court relied on procedural grounds and never reached the substance of the allegations of fraud. Subsequently, the reinsurer demanded a second arbitration, which the Court enjoined. The reinsurer has appealed. In hindsight, both parties could have saved significant time and money in their post-award disputes if the cedent had initially disclosed it was withholding responsive documents. Accordingly, arbitral practice would benefit from requiring the type of disclosure contemplated in the amendment to Federal Rule 34(b)(2)(C).

ESI and Privileged Documents

Discovery of ESI in arbitration, particularly certain insurance and reinsurance disputes, poses different issues and realities than courts confront in attempting to fashion overarching rules applicable to all civil litigation. Many of the leading cases regarding ESI involved claims by individuals with little or no ESI against corporations with extensive ESI. By contrast, commercial arbitrations usually involve two companies that may have comparable amounts of ESI. Thus, when companies engage in commercial arbitration, they often favor less exacting requirements for producing and preserving ESI in order to reduce costs and avoid mutually-assured destruction.

Moreover, information stored on paper still exists in many insurance and reinsurance disputes, particularly those involving long-tail claims, because the underlying transactions took place decades ago. Accordingly, many insurance and reinsurance arbitrations warrant an approach to ESI that differs from that applicable in federal court. Nevertheless, some of the rationale behind the recent amendments to the Federal Rules applies to insurance and reinsurance arbitration.

Recent amendments regarding the preservation of ESI contain ideas that may apply – though, perhaps, to a different degree – to insurance and reinsurance arbitrations. As time goes on and more companies digitize their paper files, the importance of ESI to insurance and reinsurance arbitrations will grow. Insurers and reinsurers would be well-served to use the recent amendments as an opportunity to re-evaluate their document/information retention policies to stay ahead of the ESI curve.

Although the ARIAS·U.S. Rules do not require or provide for a "discovery plan" in the Rule 26(f) report sense, Rule 10.7 calls for the panel and parties to address at the organizational meeting the extent to which discovery will be allowed and the schedule for discovery-related deadlines. ARIAS·U.S. Rules 10 and 11 can be amended to include the preservation and production of ESI as components of the discussions regarding discovery and scheduling. Indeed, given that certain ESI, e.g., back-up tapes, can be particularly expensive and time-intensive to retrieve and review, raising ESI issues early, and even before an organizational meeting, is prudent. Moreover, amending ARIAS·U.S. Rule 11.1 to include ESI in early discussions of documents would enable arbitration panels to hear and decide ESI issues (e.g., which custodians should be searched, what search terms are appropriate, what time period ESI will be examined, etc.) much earlier in the proceeding. It would

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news & updates

UPCOMING EVENTS

ARIAS•U.S. 2016 Spring Conference – Registration is Open!

ARIAS presents two conferences each year designed to advance the professional development and expertise of those in the arbitration profession and the reinsurance community. The Spring Conference provides a unique opportunity to combine work with fun in the sun. ***Staying Relevant in a Changing World*** will be held in Palm Beach, FL from May 11th to May 13th. More information and registration details are available at www.arias-us.org.

Unique opportunities offered to be a visible sponsor at the upcoming ARIAS•U.S. conference

Act quickly – opportunities will be on a first come, first serve basis. For more information, go to the ARIAS website or the direct link http://www.arias-us.org/mp_files/img_ftp/2016-Conference-Sponsorship-Prospectus.pdf or contact Sara Meier.

April 19th webinar is just around the corner

The ARIAS·U.S. online webinar program offers arbitrators, attorneys, and other experts within the reinsurance field, an opportunity to sharpen their knowledge and skills. These online educational opportunities are offered live and on-demand, and a great option to conveniently access a wealth of information in a short amount of time. Online webinars also provide an option for ARIAS·U.S. Certified Arbitrators to meet requirements towards recertification or prospective arbitrators to earn towards certification. Join us on April 19th for ***Surety and Financial Guaranty-An Overview*** or review any of the on-demand webinars available on the ARIAS website.

NEW! ARIAS·U.S. Networks in Action

As part of the organization's efforts to create new avenues for member interactions, ARIAS·U.S. is planning several networking events for the 2016 calendar. They will provide a space for discussion of issues of interest to the industry, allowing for greater interaction among arbitrators, company representatives and firm attorneys.

East Coast Location – June 9, 2016
New York Office of Crowell & Moring
590 Madison Ave, New York, NY 10022

West Coast Location & Date – TBD
Stay tuned for more details as they are confirmed!

REMINDERS

ARIAS•U.S. Quarterly – Call for Article Submissions

ARIAS welcomes articles written by its members addressing issues in the field of insurance and reinsurance arbitration and dispute resolution. The page limit for submissions is 5 single-spaced or 10 double-spaced pages. If you're interested in penning an article or have suggestions for topics for articles you'd like to see, please contact Tom Stillman at tomstillman@aol.com.

Interested in Advertising in the *ARIAS•U.S. Quarterly*?

The ARIAS·U.S. Media Kit is now available. Go to the ARIAS website or the direct link for more details: www.arias-us.org/mp_files/img_ftp/ARIAS-Media-Kit-2016.pdf or contact Sara Meier at smeier@arias-us.org.

UPDATED RESOURCES

ARIAS•U.S. Board of Directors Updates Code of Conduct

In an effort to ensure that the Code of Conduct stays current with the development of and updating to the various ARIAS Rules, the Board of Directors has made edits to Canons I, II and IV. Please review the Code of Conduct here: http://www.arias-us.org/index.cfm?a=26 on the ARIAS website.

ARIAS•U.S. Neutral Panel Rules Update

The ARIAS·U.S. Neutral Panel Rules and Application have been updated. In particular, Sections 6.3 (a) – (d) relating to the Neutral Criteria (as that term is defined in Section 6.3) have been revised. The updated rules can be found on the ARIAS Rules page here: http://arias-us.org/index.cfm?a=462 on the website.

article

Establishing "Custom and Practice" on the *Bellefonte* Issue: More Difficult Than Cedents May Assume

By Mark G. Sheridan

"Bellefonte" in Italian means "beautiful stream" or "good source." For reinsurers, the decision in *Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co.*, 903 F.3d 910 (2d Cir. 1990), has indeed produced a beneficial stream of decisions confirming that the limits on their contracts cap their overall exposure, even if their ceding companies paid well beyond the limits of the ceding companies' direct policies of insurance.

Because courts have generally rejected cedents' arguments that contract language requires reinsurers to pay beyond their limits, cedents often argue that "custom and practice" requires reinsurers to do so. A handful of courts have permitted cedents to attempt to prove their "custom and practice" arguments. When attempting to establish the existence of a "custom and practice" in the reinsurance industry that reinsurers regularly paid amounts in excess of the limits on reinsurance contracts, however, it is important to understand just how difficult this may be.

Current State of the Law on the *Bellefonte* Issue

Since the *Bellefonte* decision was rendered,[1] the issue of whether reinsurers must pay in excess of the amounts set forth in facultative certificates has been addressed by a dozen courts. *None* of those courts held that the reinsurer was obligated to do so.

Eight of those 12 courts granted the reinsurers' motions for summary judgment or for judgment on the pleadings, holding as a matter of law that the amount set forth in the certificates was the maximum amount of the reinsurers' liability. These cases are as follows:

Unigard Sec. Ins. Co. v. North River Ins. Co., 4 F.3d 1049, 1071 (2d Cir. 1993) (fact that insurer was compelled to pay amounts in addition to the limits on its direct policy of insurance "does not alter the terms of the bargained-for agreement" in the reinsurance contract; judgment granted to reinsurer that its liability is capped by amount stated in reinsurance contract);

- *Aetna Cas. & Sur. Co. v. Philadelphia Reins. Corp.*, No. 94-2683, 1995 WL 217361 (E.D. Pa. April 13, 1995) (enforcing amount stated in contract as a cap on the reinsurer's liability, including expenses);
- *Allendale Mut. Ins. Co. v. Excess Ins. Co., Ltd.*, 970 F. Supp. 265, 270 (S.D.N.Y. 1997), *vacated on other grounds*, 62 F. Supp. 2d 1116 (S.D.N.Y 1999) (amount stated in reinsurance contract "imposes an absolute cap" on reinsurers' liability);
- *Excess Ins. Co. Ltd. v. Factory Mutual Ins. Co.*, 3 N.Y.3d 577, 583, 822 N.E.2d 768, 771 (2004) ("[o]nce the reinsurers have paid the maximum amount stated in the [reinsurance] policy, they have no further obligation");
- *Pacific Employers Ins. Co. v. Global Reins. Corp. of Am.*, 2010 WL 1659760 at *4 (E.D. Pa. Apr. 23, 2010) (cedent's arguments that it could avoid the "Reinsurance Accepted" amounts were "without merit"), *reconsideration denied*, 2010 WL 2376131 (E.D. Pa. June 9, 2010), *reversed on late notice grounds in favor of reinsurer*, 693 F.3d 417 (3d Cir. 2012) (*Bellefonte* issue not addressed on appeal);
- *Continental Cas. Co. v. MidStates Reins. Corp.*, 2014 Ill. App. (1st) 133090, 24 N.E.3d 122 (2014) (expenses fall within reinsurance limit);
- *Utica Mut. Ins. Co. v. Clearwater Ins. Co.*, No. 6:13-cv-1178 (GLS/TWD), 2014 WL 6610915 (N.D.N.Y. Nov. 20, 2014) (rejecting argument that certificate is ambiguous, court found reinsurer's liability capped by the amount stated on face of certificate), *reconsideration denied*, 2015 WL 4496374 (N.D.N.Y. July 23, 2015);
- *Global Reins. Corp. of Am. v. Century Indem. Co.*, No. 13 Civ. 6577 (LGS), 2014 WL 4054260 at *7 (S.D.N.Y. Aug. 15, 2014) (the "dollar amount indicated in each of the Certificate Limits is the maximum amount that [the reinsurer] can be obligated to pay for loss and expenses, combined"), *reconsideration denied*, 2015 WL 1782206

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(S.D.N.Y. April 15, 2015), *appeal filed*., 2015 WL 1782205 (2d Cir. 0215).[2]

Four other courts, including in some recent cases, have found that certain certificate language is ambiguous, thus precluding the entry of judgment for either party as a matter of law, as follows:

- *TIG Premier Ins. Co. v. Hartford Acc. & Indem. Co.*, 35 F. Supp. 2d 348 (S.D.N.Y. 1999) (contract language ambiguous; case settled thereafter without a definitive interpretation of the contract);
- *Utica Mut. Ins. Co. v. Munich Reins. Am. Inc.*, 594 Fed. Appx. 700 (2d Cir. 2013) (non-precedential Rule 23 Order finding neither party entitled to judgment as a matter of law);
- *Century Indem. Co. v. OneBeacon Ins. Co.*, No. 2928 (Pa. Comm. Pl. March 27, 2015) (certificate ambiguous);
- *Utica Mut. Ins. Co. v. R&Q Reins. Co.*, No. 6:13-cv-1332 (BKS/ATB), 2015 WL 4254074 (N.D.N.Y. June 4, 2015) (same).

These courts have stated that extrinsic evidence was necessary to interpret the specific facultative certificate language at issue in those cases. Thus, it is likely that cedents will redouble their as-yet unsuccessful efforts to establish a "custom and practice" that reinsurers routinely paid beyond the limits of their contracts.

What Is "Custom and Practice"?

Cedents will often assert, as though it is a given, that a "custom and practice" has always existed in the reinsurance industry whereby cedents would bill, and reinsurers would pay, amounts in excess of the limits on facultative certificates. This breezy assertion, however, overlooks just how difficult it is to establish a true "custom and practice."

"Custom and practice" is not something that a few companies in a particular industry do most of the time. Nor is it something that most companies do occasionally. Graydon S. Staring, *Unsettling Loss Settlements Doctrine: A Comment on Some Deviant Decisions*, Mealey's Lit. Rptr., 16, 19 (1995) ("custom and practice" is "not a practice followed by some people, or by all people sometimes").

To the contrary, "custom and practice" is something that is "so well settled, so uniformly acted upon, and so long continued as to raise a fair presumption that it was known to both contracting parties and that they contracted in reference thereto." *Reuters Ltd. v. Dow Jones Telerate, Inc.*, 662 N.Y.S.2d 450, 454-55 (N.Y. App. Div. 1997). *See also Black's Law Dictionary* 193 (4th pocket ed. 2011) (custom is a "practice that by its common adoption and long, unwavering habit has come to have the force of law"). The party asserting the existence of a "custom and practice" bears the burden of proof, and the proof must be that the action in question is "fixed and invariable" in the relevant industry. *British Int'l Ins. Co. Ltd. v. Seguros La Republic*, 342 F.3d 78, 84 (2d Cir. 2003).

Thus, a "custom and practice" is a near-universally followed and unwavering practice that virtually all companies in a particular industry follow almost all of the time. Indeed, one prominent court has held that an affidavit stating that reinsurers often paid a certain type of billing was insufficient evidence of an alleged "custom and practice" in the reinsurance industry because the affidavit failed to state that reinsurers "always and invariably" paid that type of billing. *See British Int'l Ins. Co. Ltd. v. Seguros La Republic*, 342 F.3d at 84.

On the *Bellefonte* issue, therefore, cedents seeking to establish a "custom and practice" will need to show an unvarying, long-standing, well-settled, and uniformly followed practice whereby reinsurers regularly paid expenses in addition to the limits on their reinsurance contracts. As set forth below, this may be a difficult standard to meet.

To Date, Courts Have Not Recognized a "Custom and Practice" on the Limits Issue

Cedents have offered a wide range of evidence that supposedly establishes a "custom and practice" on the *Bellefonte* issue. However, no court has ever found that a "custom and practice" existed in the reinsurance industry whereby reinsurers would pay in excess of the amounts stated on their contracts.

Cedents sometimes cite to a few arbitration awards that have become public in which the panel (or at least a two-person panel majority) ordered a reinsurer to pay beyond the certificate limits. Unreasoned arbitration awards, however, typically do not cite the certificate language or underlying facts of the confidential arbitrations. It is also unknown whether these awards were compromise decisions in which panel majorities ruled in favor of the cedent on the *Bellefonte* issue but in favor of the reinsurer on another issue. The lack of a complete record makes it difficult to draw broad conclusions from any particular arbitration award. *See generally* John M. Nonna, Larry P. Schiffer & Lisa A. Joedecke, *Res Judicata and Collateral Estoppel*, ARIAS·U.S. *Quarterly*, Third Quarter 2003, at 6 (discussing "seemingly insurmountable" problems of drawing definitive conclusions about substance of confidential arbitrations).

Cedents have also cited to a few articles criticizing the *Bellefonte* decision. The articles largely critique the legal reasoning of *Bellefonte* and its progeny, without offering any evidence (as opposed to raw assertions) that reinsurers routinely paid excess-of-limits billings. Moreover, these articles were usually written by counsel who represent (or who would like to represent) ceding companies. These types of advocacy pieces are meaningless for purposes of proving the existence of a "custom and practice."

Additionally, some cedents have hired opinion witnesses to testify that they do not recall the specific reinsurers with whom they worked objecting to excess-of-limits billings. Such testimony is necessarily anecdotal, reflecting only the limited number of reinsurers with whom the witness worked and only during a specific time period. Moreover, the fact that the witness does not recall objections by reinsurers does not necessary mean that the reinsurers paid excess-of-limits billings; as discussed more fully below, it may mean only that the issue never arose on the particular billings that the witness recalls.

Finally, some cedents have pointed out that a particular reinsurer paid an excess-of-limits billing in the past. Obviously, evidence that one (or even a few

reinsurers) paid *Bellefonte* amounts should be insufficient to establish a "custom and practice." The near-universal nature of a "custom and practice" requires a showing that virtually every reinsurer did so. Likewise, establishing that a reinsurer paid excess-of-limits amounts once or sporadically should be similarly insufficient. Identifying past payments in a few instances does not show an unvarying practice.

Moreover, a reinsurer may have paid *Bellefonte* amounts in the past for a variety of reasons unrelated to its understanding of its obligations under its contract. A reinsurer may have paid amounts in excess of its limits as a business accommodation or to secure a renewal. A reinsurer may have paid because the excess-of-limits amount was relatively modest and not worth fighting. If the cedent did not flag the excess-of-limits nature of its billing and/or the cedent submitted such a billing on a bordereaux basis, the reinsurer may have processed the billing without knowing that it exceeded the limit on the contract. Payments of these kinds could not be construed as an acknowledgment that the reinsurer understood that its contract required such a payment. As such, evidence of these kinds of payments would appear to be insufficient to establish a near-universal understanding among reinsurers that they were *obligated* to pay excess-of-limits billings.

Prior to *Bellefonte*, the "Custom and Practice" Is Unclear and Probably Non-Existent

A little history goes a long way toward determining whether a "custom and practice" always existed that reinsurers would pay amounts beyond the limits on their contracts. This history suggests that there was no "custom and practice" *one way or the other* prior to the *Bellefonte* decision.[3]

Prior to the 1980s, mass tort claims were rare. The claim activity that did occur in those years often did not exhaust the full limit of the policy. Defense costs were relatively modest, and cedents rarely incurred significant declaratory judgment expenses. The asbestos and environmental tsunamis that would overwhelm dozens of companies in the years to come had not yet materialized.

In other words, the situation that creates the *Bellefonte* issue hardly ever arose. Cedents and reinsurers simply did not regularly experience a full policy limits loss with huge amounts of defense costs or declaratory judgment expenses paid out in addition to the limits.

All of that began to change in the early 1980s. In 1982, Johns-Manville declared bankruptcy because it had run through all of its product liability limits across its entire insurance program. This was one of the first instances where a major industrial corporation had exhausted all of its insurance policies, requiring its insurers to pay significant defense costs over and above the limits on those policies. Around that same time, other significant product liability losses hit various drug manufacturers and other industrial insureds. Asbestos claims and environmental losses also began to increase substantially.

Additionally, coverage disputes between insurers and their policyholders -- which were relatively rare prior to the 1980s -- began to multiply. Court decisions started to turn against the insurance industry on key issues. Specifically, some courts started to impose joint and several ("all sums") liability upon insurers for claims that triggered policies in multiple years. One of the first such decisions, *Keene Corp. v. Insurance Co. of North America,* 667 F.2d 1034 (D.C. Cir. 1981), was rendered in 1981. The landmark consolidated asbestos proceedings before California Superior Court Judge Ira Brown that would result in an influential continuous trigger ruling was filed in 1985. *Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co.*, 45 Cal. App. 1 (Cal. App. Ct. 1996)**.** These decisions and others like them greatly increased the likelihood that mass tort and/or environmental claims could exhaust the limits of liability on substantially all policies across a policyholder's entire insurance program and require the insurers to pay significant additional defense and/or declaratory judgment expenses in excess of those limits.

All of these events occurred in the early or mid-1980s. Thus, beginning at that time, ceding companies first began to confront on a more regular basis the situation in which they could pay out their full limits of liability on policies in addition to incurring significant defense costs or declaratory judgment expenses over those limits.

A few years would pass before these losses worked through to the reinsurance level. When those losses were first presented to reinsurers on a more regular basis in the mid- to late 1980s, the available evidence suggests that reinsures objected. The group of six reinsurers in the *Bellefonte* case,[4] for example, filed that lawsuit in 1985, *i.e.*, almost immediately upon the first emergence of this issue. *See Bellefonte*, 903 F.2d at 911 (the "reinsurers commenced the instant action in 1985"). Before that time, neither reinsurers nor ceding companies regularly dealt with the issue. Accordingly, it is exceedingly difficult to find evidence that cedents and reinsurers had a firmly-established, widely-followed, near-universal practice to reinsure amounts in excess of the limits on reinsurance contracts, and for a very simple reason: the issue rarely arose.

After *Bellefonte*, "Custom and Practice" is that Cedents Try to Collect Excess-Of-Limits Amounts, and Reinsurers (Including Some Surprising Examples) Object

Although evidence of "custom and practice" on the "cap" issue prior to the 1980s is sparse, the "custom and practice" in the industry post-*Bellefonte* is clear: cedents attempt to collect excess-of-limits amounts and reinsurers resist. This more recent "custom and practice" appears to be widespread. Considering only the reported decisions in which the "cap" issue arose, almost 40 different reinsurers have taken the position that their potential liability was capped at the amount of "Reinsurance Accepted" stated in their certificates, are noted in the chart below.

And these are just the reinsurers whose reliance on their limit of liability has become public. It is unknown how many other reinsurers have taken this position in confidential arbitrations.

Interestingly, prominent net ceding companies have adopted the *Bellefonte* principle when they act as a reinsurer. As stated above, AIG, through its affiliate Insurance Company of the State of Pennsylvania, was one of the original plaintiff-reinsurers in the *Bellefonte* decision.

In *Century Indemnity Co. v. OneBeacon Insurance Co.*, No. 2928 (Pa. Comm. Pl. March 27, 2013), OneBeacon Insurance Company's predecessor (General Accident) facultatively reinsured certain direct policies of insurance. When the cedent submitted bills for amounts in excess of the "Reinsurance Accepted" amounts on the certificates, OneBeacon objected, expressly invoked *Bellefonte*, and argued that the "Reinsurance Accepted" amount served as an overall cap on its liability, including liability for expense payments.

Similarly, Century Indemnity Company filed pleadings in federal court urging the application of *Bellefonte*. In *Appalachian Insurance Co. v. Insurance Co. of North America*, No. 2:10-cv-7614, U.S. District Court for the Eastern District of Pennsylvania. Century's predecessor, Insurance Company of North America ("INA"), had issued a facultative certificate reinsuring a policy issued to Union Carbide. When the cedent billed amounts in excess of the "Reinsurance Accepted" amount on the certificate, Century rejected the excess-of-limits portion of billing, invoking the *Bellefonte* principle. In its counterclaim, Century asked the court to declare that the "Reinsurance Accepted" amount on the certificate is "the maximum amount Appalachian could possibly recover under the Certificate in connection with Appalachian's settlement payments to Union Carbide." *Id.*, Dkt. # 4 at 7.[5]

Admittedly, the widespread adoption of *Bellefonte*, even by notable net cedents, does not establish the "custom and practice" prior to that decision. It does suggest, however, the *Bellefonte* principle is not nearly as beyond the pale as some would suggest today.

Future of *Bellefonte* Litigation

Instead of viewing *Bellefonte* as releasing a "beautiful stream," ceding companies have experienced the results of that decision more as a brackish pool of misplaced legal reasoning. For that reason, cedents will undoubtedly continue their efforts to dam up any further flowing of the *Bellefonte* principle. Because their arguments based on contract language have largely failed, they are likely to focus future efforts on establishing a "custom and practice." The combination of the high legal standard for establishing a "custom and practice" and the lack of anything other than anecdotal evidence on this issue prior the 1980s, however, may present challenges in this regard. ▼

ENDNOTES

1. Prior to *Bellefonte*, one district court in North Carolina found that a reinsurer's liability was not capped by the amount stated in the reinsurance contract. *Penn Re Inc. v. Aetna Cas. & Sur. Co.*, 1987 WL 909519 (E.D.N.C. June 20, 1987). In the 28 years since that outlier decision was rendered, no court in any jurisdiction has ever followed it.
2. In many of these cases, the cedents argued that it is illogical to conclude that they would have purchased facultative reinsurance that left substantial expense payments unreinsured. Outside of the *Bellefonte* context, however, standard certificate language can easily lead to this result. Most facultative certificates providing reinsurance on an excess of loss basis specify that the reinsurer will reimburse the cedent for expenses "in the ratio that the Reinsurer's loss payment bears to the Company's loss payment." Thus, the reinsurer shares in expenses only if the loss payment is sufficient to implicate the excess of loss reinsurance. If the cedent incurs substantial defense costs on behalf of its policyholder and succeeds in having the underlying third-party lawsuit dismissed without any indemnity payment (or if the cedent pays only a token settlement payment that does not reach the attachment point of the reinsurance), all of the defense costs would remain with the cedent. Thus, depending on the facts of the underlying claim, this familiar certificate language exposes cedents to potentially significant amounts of unreinsured expenses.
3. It can be convincingly argued that any facultative certificate issued after *Bellefonte* was decided in 1990 cannot reasonably be construed to cover excess-of-limits amounts unless the certificate specifically extends reinsurance to those amounts. Contracting parties are assumed to contract with knowledge of the law. See, e.g., *Ramah Navajo Chapter v. Salazar,* 644 F.3d 1054, 1076 (10th Cir. 2011). Given that the Bellefonte decision was widely known in the reinsurance industry, cedents looking for facultative reinsurance extending to defense costs or other amounts beyond the limit expressed on the certificate could have negotiated wording to that effect. If a cedent did not do so, particularly after it knew that courts interpreted standard certificate wording as an absolute cap on the reinsurer's liability, it is reasonable to assume that the cedent was content with the *Bellefonte* interpretation or, at a minimum, that the issue was not important to the cedent.
4. Bellefonte Reinsurance Company, Mission Insurance Company, Insurance Company of the State of Pennsylvania, North American Company for Property & Casualty Insurance, Constitution Reinsurance Corporation, and Gerling Global Reinsurance Corporation, U.S. Branch.
5. Century subsequently withdrew this pleading and settled the case.

Reinsurers that have argued their limit of liability is capped in reported decisions

Bellefonte Reinsurance Co.
Constitution Reinsurance Corp.
Gerling Global Reinsurance Corp., U.S. Branch
Insurance Co. of the State of Pennsylvania
Mission Insurance Co.
North Am. Co. for Prop. & Casualty Ins.
Unigard Security Ins. Co.
CIGNA Reinsurance Co., individually and as successor to INA Reinsurance Co.
Philadelphia Reinsurance Corp.
Allianz International Ins. Co. Ltd.
Cornhill Ins. Co. PLC
English and American Ins. Co. Ltd.
English and American Underwriting Agency
Excess Ins. Co. Ltd.
Fuji International Ins. Co. Ltd.
London and Hull Maritime Ins. Co. Ltd.
Marine Ins. Co. Ltd.
Minster Ins. Co., Ltd.
Nippon Ins. Co. of Europe Ltd.
Ocean Marine Ins. Co. Ltd.
Prudential Assurance Co., Ltd.
Sovereign Marine and General Ins. Co. Ltd.
Switzerland Ins. Co. UK, Ltd.
Threadneedle Ins. Co., Ltd.
Tokio Marine and Fire Ins. Co. (U.K.) Ltd.
Willis Faber Ltd.
Yorkshire Ins. Co., Ltd.
Various Lloyd's Underwriter Syndicates
Ace American Reinsurance Co.
Global Reinsurance Corp. of America
MidStates Reinsurance Corp.
Munich Reinsurance America, Inc.
Clearwater Ins. Co.
R&Q Reinsurance Co.

article

What Does an Arbitration Panel Do When a Party Does Not Pay Its Share of Arbitration Costs?

By Robert M. Hall and Debra J. Hall


Robert M. Hall


Debra J. Hall

Robert M. Hall

Mr. Hall is an attorney, a former law firm partner, a former insurance and reinsurance executive and acts as an insurance consultant as well as an arbitrator and mediator of insurance and reinsurance disputes and as an expert witness. He is a veteran of over 170 arbitration panels and is certified as an arbitrator and umpire by ARIAS·U.S. Mr. Hall has authored over 100 articles that may be viewed at his website: www.robertmhall.com.

Debra J. Hall

Ms. Hall is an attorney, the former Senior Vice President & General Counsel of the Reinsurance Association of America and a former reinsurance company executive. She is an ARIAS·U.S. certified arbitrator, accepting only umpire appointments and arbitrator appointments for neutral panels. Ms. Hall also serves as a consultant and expert witness. She has authored and supervised the creation of multi-volume compilations of reinsurance law and practice and was the initiator and facilitator of the original Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes, now largely incorporated into the ARIAS·U.S. Rules with the same name. Articles and other information can be obtained from her website at: www.hallarbitrations.com.

Introduction

On rare occasions, a party to a dispute subject to arbitration does not pay arbitration costs *i.e.* the fees of its party arbitrator, half the costs of the umpire, and court reporter fees. This may be tactical as a means of preventing the arbitration from going forward or it may be due to a lack of assets. Whatever the cause, it presents a dilemma for the arbitration panel.

Some arbitration forums, such as the AAA, have procedural rules that allow panels significant discretion in fashioning remedies for such situations.[1] Reinsurance arbitrations, which have been *ad hoc,* traditionally, lack such formalized procedures. The recently adopted ARIAS·U.S. Rules for the Resolution of U.S. Insurance and Reinsurance Disputes do not address this issue.

The purpose of this article is to explore the case law and practice around several options available to reinsurance arbitration panels when dealing with a party that does not pay its share of arbitration costs.

Breach and Waiver

It appears that the most common result of a party's failure to pay arbitration costs is that such party is in breach of the contract containing the agreement to arbitrate and waives its arbitration rights. For instance, *Pre-Paid Legal Services v. Cahill*, 786 F.3d 1287 (10th Cir. 2015) involved a dispute over an employment contract containing an arbitration clause. The employer alleged breach of the contract and sued in court. The employee obtained a stay and an order to arbitrate but did not pay AAA arbitration fees. When the AAA terminated the arbitration, the employer went back to court. The employee then asked the court to defer to arbitration again since the employee had obtained sufficient funds to pay the AAA arbitration fees. The court declined to do so ruling: "[A] party's failure to pay its share of arbitration fees breaches the arbitration agreement and precludes any subsequent attempt by that party to enforce that agreement."[2]

A very similar fact situation but with the employer not paying arbitration fees is presented by *Sink v. Aden Enterprises, Inc.,* 352 F.3d 1197 (9th Cir. 2003). The court ruled similarly that the employer had breached the contract containing the arbitration clause and had waived arbitration:

> Accepting [the employer's] reading of the [Federal Arbitration Act] would . . .
>
> Allow a party refusing to cooperate with arbitration to indefinitely postpone litigation. Under [the employer's] interpretation, the sole remedy available to a party prejudiced by default [in paying arbitration fees] would be a court order compelling a return to arbitration. The same offending party could then default a second time, and the prejudiced party's sole remedy, again, would be another order compelling arbitration. The cycle could continue, resulting in frustration of the aggrieved party's attempt to resolve its claims. . . . [The employer's failure] to pay required costs of arbitration was a material breach of its obligations in connection with the arbitration.[3]

A dispute over a purchase agreement with an arbitration clause provided the backdrop to *Norgren, Inc. v. Ningbo Prance Long, Inc.*, 2015 U.S. Dist. Lexis 126716 (D. CO). NPL, a Chinese manufacturer, initiated arbitration proceedings for non-payment against Norgen, a Colorado corporation that intended to incorporate the parts manufactured by NPL into larger products. Norgen counterclaimed for breach of contract by NPL. After long and involved negotiations, the arbitrator dismissed the arbitration without prejudice for failure to pay arbitration fees. Later, NPL initiated a second arbitration on the same dispute and paid the appropriate arbitration fees. Norgen objected arguing that NPL had waived its arbitration rights by not paying the appropriate arbitration fees in the first

arbitration. The court agreed: "[T]his court finds that by virtue of its actions in the First Arbitration, NPL defaulted on or waived its arbitration rights under the parties' Purchase Agreement and is thereby barred from asserting those rights anew in the Second Arbitration."[4]

See also *Sanderson Farms, Inc. v. Gatlin*, 848 So. 2nd 828 (Miss. 2003), which involved a dispute between a chicken distributer, Sanderson Farms, and a chicken grower. When the chicken grower's contract was cancelled, he initiated arbitration pursuant to the arbitration clause in the contract. Sanderson Farms declined to pay certain arbitration fees and the chicken grower filed suit in court. Sanderson Farms filed a motion to dismiss but the court refused finding that Sanderson Farms had waived its right to arbitrate:

Sanderson Farms waived its right to arbitrate by refusing to pay its one-half of the costs associated with filing and administrative fees and/or the additional charges presented for payment one month before the scheduled hearing. This refusal amounts to an act inconsistent with the right to arbitrate. By waiving its right to arbitrate, Sanderson Farms has relinquished the right to seek the protections of the arbitration provision in the boiler contract.

Furthermore, the [Federal Arbitration Act] provides that a party in default essentially waives its right or is precluded from invoking the arbitration agreement. Section 3 of the FAA provides that a party may compel arbitration and stay the trial court proceedings if it is not in default in proceeding with such arbitration.'[5]

Alternatives to Litigation When One Party Defaults on Arbitration Fees

If the non-defaulting party prefers litigation to arbitration as a dispute resolution method, then that party is free to pursue litigation. But what if the non-defaulting party prefers to enforce their contractual right to arbitration? Declaring a breach of contract can simply feed into the strategy of a defaulting party who wants out of arbitration. It is unlikely that courts would find fairness in allowing a party that contractually agreed to arbitration the ability to avoid the arbitration process simply by not paying its share of the costs of the arbitration. The authors, and other ARIAS·U.S. arbitrators have confronted these situations and worked with their respective panel members and the parties to craft a variety of satisfactory solutions. The strategies are nuanced and are a function of the factual contexts.

One Party Is Required to Pay all Costs

One such solution *requires* the non-defaulting party to pay all fees to arbitrators and to pay fully the other costs of the arbitration such as court reporter fees. The payment of such fees and costs is conditioned on the agreement by the panel to incorporate them into the panel's ultimate award. This is not a perfect solution as there are no guarantees that the non-defaulting party: (a) will win the arbitration, or even if it does win; (b) that there will be sufficient available funds to pay the award of the panel. However, in the appropriate situation, it can enable the arbitration process to go forward to a ruling on the merits.

Order to Show Cause/Default

Another approach is to issue an order to show cause why a default judgment should not be entered against the party who has failed to comply with the arbitration payment terms of its contract. The award can include the unpaid fees and costs, state that the award will not be final until the fees are paid, and that the award will carry the statutory rate of interest until paid by the loser to the winner. A hearing can be convened with a court reporter to make sure the record reflects why the bills are not being paid. As with any default judgment, the panel should address procedural safeguards needed to address the merits of the underlying dispute, a topic beyond the scope of this article.

Dispositive Motions and Non-Final Order

In the event that the parties have filed dispositive motions, and the panel is in agreement with respect to those motions, the panel can issue a non-final order that sets forth preliminary findings of fact and conclusions of law but specifically states that the order is not to be considered a final award until the panel's fees and costs are paid by some party (not designating which party). The award can state that upon payment of fees and costs, the final award shall be issued within a prescribed time period, consistent with the preliminary findings and conclusions expressed in the non-final order, and will include any fees and costs advanced on behalf of a defaulting party. In this situation the parties know which way the panel intends to rule, and if the winning party is the non-defaulting party, it may well be worthwhile to advance the fees and costs of the defaulting party in order to obtain the issuance of the final award in its favor which it also knows will include reimbursement of its fees and costs. This alternative may result in the panel expending time that might not be fully reimbursed, but depending on the factual context, it might result in recovering panel fees and costs that would otherwise never be paid.

Attorneys' Fees and Costs

To the extent that the non-defaulting party may have incurred excess fees and costs due to the defaulting party's failure to pay as required by the contract, the panel may also consider imposition of attorneys' fees and costs against the defaulting party. In doing so the panel must be cognizant of providing the defaulting party the opportunity to review and object to the imposition as well as the amount of fees and costs. Details of awarding attorneys' fees and costs are beyond the scope of this article.

Judicial Support

There is some judicial support for such approaches. The procedural rules of the AAA give arbitrators broad authority over payment and apportionment of arbitration fees. The methodology of allowing the non-defaulting party to pay arbitration costs and recoup them from the award on the merits is cited with approval in a AAA context in *Dealer Computer Servs. v. Old Colony Motors, Inc.* 588 F.3d 884, 888 (5th Cir. 2009) and *Lifescan, Inc. v. Premier Diabetic Servs.*, 363 F.3d 1010 (9th Cir. 2004).

Conclusion

One remedy for the problem of non-paying parties is for the ARIAS·U.S. Rules for

the Resolution of U.S. Insurance and Reinsurance Disputes to be amended to include remedies and sanctions similar to those contained in the AAA's Commercial Arbitration Rules and Mediation Procedures.[6] However, such an amendment would only be applicable to arbitrations utilizing the ARIAS rules.

In an environment where parties do not favor retainers or other advanced funds to allow arbitrators to protect themselves in the event of non-payment from a defaulting party, arbitration panels can and should be creative in delivering on their obligation while using incentives to ensure that appropriate payment is made for their services. While a party's payment or non-payment of fees and costs should never affect the outcome of the arbitron on the merits, the panel has broad authority and discretion to time or condition the issuance of a final award on the proper and contractually bargained for payment of the panel. ▼

ENDNOTES

1. *See* sections R-57 and R-58 of the AAA's Commercial Arbitration Rules and Mediation Procedures that allow a panel to suspend a proceeding or limit the non-paying party's participation therein.
2. 786 F.3d 1287 at 1294.
3. 352 F.3d 1197 at 1201.
4. 2015 U.S. Dist. Lexis at *38-9.
5. 848 So. 2d 828 at 838.
6. *See* fn. 1 and accompanying text.

Recently Certified Arbitrators

Andrew Amer

In order to serve as a neutral arbitrator on a full-time basis, Andrew Amer has recently retired as a senior partner from Simpson Thacher & Bartlett LLP, where he spent his 30-year career specializing in insurance and reinsurance coverage disputes. Mr. Amer's litigation practice focused mainly on coverage disputes involving mass tort exposures, including those arising from asbestos, radiation, medical devices, prescription drugs and environmental contamination. In addition, Mr. Amer acted as national coordinating counsel for insurance and reinsurance clients with respect to significant claims asserted nationwide involving various lines of business, including property/casualty, worker's compensation and D&O.

As a litigator, Mr. Amer handled numerous bench and jury trials, appeals and ad hoc reinsurance arbitrations, including for the latter more than 30 matters that went to an evidentiary hearing and award, typically involving multi-million dollar losses. In addition to his law firm experience, Mr. Amer also serves as president and chairman of a licensed insurer domiciled in Vermont, qualifying him to serve under arbitration clauses requiring arbitrators to be active or retired insurance executives.

Mr. Amer received his law degree from the University of Pennsylvania School of Law, where he was an editor of the Law Review, and received his BS degree in engineering from Cornell University.

Richard McCarty

Rich McCarty is an experienced insurance and reinsurance executive with more than thirty years of experience managing complex disputes, litigation, arbitrations and mediations. He recently served for eleven years as XL's Senior Vice President and General Counsel for North America, providing innovative leadership to the insurance and reinsurance businesses. He worked closely with XL's companies globally including the "Bermuda form". Mr. McCarty has spearheaded strategies for management of complex insurance and reinsurance disputes, civil litigation, and numerous successful settlements, arbitrations and mediations involving claims, industry products, compensation practices, and challenges to hiring practices in support of growth initiatives. He designed the strategy for civil and criminal investigations by federal and state agencies, appearing before the SEC, DOJ, attorneys general and regulators.

Prior to joining XL Mr. McCarty was a member of legal teams at General Reinsurance Corporation, Crum and Forster and Chubb with experience including all property/casualty lines, captives, fronting relationships, environmental and professional businesses and claims involving environmental liabilities and bad faith claim-handling. He directed knotty regulatory matters including complex restructurings and insolvencies. At Crum he effected the restructuring of subsidiary corporations enabling Xerox' exit strategy with de-pooling of group companies and novation of multi-million dollars of exposure. He has appeared in numerous arbitration proceedings for reinsurers and ceding companies.

Mr. McCarty received his undergraduate degree from Princeton University and his Juris Doctor degree from New York Law School. He resides in Wilton, Connecticut with his wife, Ann and has three grown children.

article

A Prototype for a Next-Generation Arbitration Clause

By Elaine A. Caprio

In recent years, ARIAS·U.S. promulgated state-of-the-art arbitration rules that govern the resolution of U.S. insurance and reinsurance disputes, as well as streamlined arbitration rules for small claim disputes.[1]

In order to promote the use of these rules, and to further the objectives of ARIAS·U.S.,[2] this article provides suggested language[3] for a prototype of a next-generation arbitration clause ("Prototype Arbitration Clause") for insurance and reinsurance contracts. [4]

Why Advance This Prototype?

In addition to incorporating ARIAS·U.S. Regular, Neutral and Streamlined Rules for the resolution of U.S. insurance and reinsurance disputes, this Prototype Arbitration Clause wording is designed to help streamline the arbitration process and efficiently resolve disputes by:

- Setting variable time limits from the organizational meeting to hearing, based on the amount of dollars in dispute;
- Applying parameters for E-Discovery between the parties;
- Utilizing mediation during the arbitration process; and
- Examining the potential application of the English Rule for panel and attorney fees, as well as costs.

A version of the Prototype Arbitration Clause can be incorporated into future insurance or reinsurance contracts, as well as existing or new Master Trading Agreements between reinsurers and ceding companies.[5] Prior to an insurance or reinsurance dispute, the parties could contractually agree to utilize a version of the Prototype Arbitration Clause in lieu of the arbitration clause contained within the subject reinsurance contract(s).[6]

Prototype Arbitration Clause

The parties agree to the following regarding any and all disputes between the Company and the Reinsurer arising out of, relating to, or concerning this Contract, including its formation and validity, whether sounding in contract or tort and whether arising during or after termination of this Contract.

A. Application of Streamlined Rules: For all disputes involving amounts at issue less than USD $1,000,000, the arbitration shall be conducted in accordance with then applicable ARIAS·U.S. Streamlined Rules for the Resolution of U.S. Insurance and Reinsurance Disputes (The Streamlined Rules).

B. Application of Neutral or Regular Rules: For all disputes involving amounts at issue of USD $1,000,000 or greater, the arbitration shall be conducted in accordance with the then applicable [ARIAS·U.S. Neutral Panel Rules for the Resolution of U.S. Insurance and Reinsurance Disputes (The Neutral Rules)], OR [ARIAS·U.S. Rules for the Resolution of U.S. Insurance and Reinsurance Disputes (The Rules)], subject to the following amendments:

1. Honorable Engagement: Section [I3.3 of the Neutral Rules] OR [14.3 of the Rules] for the Resolution of U.S. Insurance and Reinsurance Disputes shall provide: The Panel shall interpret this contract as an honorable engagement, and shall not be obligated to follow the strict rules of law or evidence. In making their decision, the Panel shall apply the custom and practice of the insurance and reinsurance industry, with a view to effecting the general purpose of this Contract.

2. Time Limits for Disputes Less Than a Certain Dollar Amount: For disputes involving amounts at issue from USD $1,000,000 to USD $__,000,000, the date for the hearing shall be set no later than three hundred and sixty (360) days from the date of the Organizational Meeting.

3. Consolidation: If the Company and more than one Reinsurer are involved in the same dispute(s) or difference(s) arising out of this Contract, and the Company requests consolidated arbitration with those Reinsurers in an initial Notice of Arbitration or Response, then those Reinsurers shall constitute and act as one Party for

Elaine A. Caprio

Elaine A. Caprio

Elaine Caprio is an ARIAS·U.S. Certified Arbitrator and Qualified Mediator. She is President of Caprio Consulting, LLC, providing insurance and reinsurance services, operational advising, and alternative dispute resolution services. Before forming Caprio Consulting, Ms. Caprio worked at Liberty Mutual Insurance for over 20 years as a reinsurance executive and lawyer.

purposes of the arbitration. For purposes of this paragraph, any instance in which two or more Reinsurers have not paid their proportional shares of the same balance claimed due by the Company shall be deemed to involve the "same dispute(s) or difference(s) arising out of this Contract." Communications shall be made by the Company to each of the Reinsurers constituting one Party. Nothing in this paragraph shall impair the rights of Reinsurers to assert several rather than joint defenses or claims, change their liability under this Contract from several to joint, or impair their rights to retain separate counsel in connection with the arbitration.

4. E-Discovery: Discovery of electronically stored information ("ESI") is limited to sources used in the ordinary course of business, and shall not extend to restoration of back-up tapes, erased data, or data deleted in the ordinary course of business. The panel has discretion to limit ESI discovery, as well as order reasonable costs be paid from the requesting party to the producing party if the burden and cost of producing ESI outweigh the likely importance of the discovery requested.

C. Place of Arbitration: Any arbitration conducted under Sections A or B of this Article shall take place in [insert City and State].

D. Mediation During Arbitration: [Section 12 of the Rules shall provide:] During the course of an arbitration conducted under Sections A or B of this Article, the parties agree to submit to a mediation session of at least eight (8) hours, to attempt to resolve certain or all of the disputes at issue in the arbitration. Mediation submissions are limited to ten (10) pages in length. Notwithstanding the foregoing, the Panel has the discretion to order the parties to submit to additional mediation at any time during the course of an arbitration conducted under Sections A or B of this Article.

E. Jurisdiction: Unless prohibited by law, the [Insert Court] shall have exclusive jurisdiction over any and all court proceedings that either party may initiate in connection with this Article, including proceedings to compel, stay, or enjoin arbitration or to confirm, vacate, modify, or correct an Arbitration Award under Sections A or B. In addition, the Company and the Reinsurer shall have the right to seek and obtain in such court provisional relief prior to the Panel being fully formed pursuant to this Article, including prior to the commencement of the arbitration proceeding.

F. Application of English Rule: The Prevailing Party in a dispute resolved in accordance with sections A or B or this Article shall be entitled to recovery of costs as well as reasonable arbitrator and attorney fees (hereinafter collectively referred to as "Fees."). Fees awarded shall be the lesser of 1) actual Fees, or 2) thirty (30) percent of the difference between the final award and the non-prevailing party's last written offer of settlement. The "Prevailing Party" means the party identified by the arbitrator(s) in the award as the party to have most nearly prevailed in the dispute, even if such party did not prevail on all matters.

OR

F. Application of American Rule: Each party shall bear the costs of the arbitrator it selected and shall bear, equally and jointly with the other party, the costs of the third arbitrator. Each party shall also bear the costs and attorney fees of the attorneys it selected. Notwithstanding the foregoing, the panel may, at its discretion, award attorney fees, costs and the panel's fees and costs, as it considers appropriate.

G. Resolution of Conflicts between Rules and this Article: In the event of any conflict between the Streamlined Rules and this Article, or the [Neutral Rules] OR [Rules] and this Article, this Article will control.

H. Survival: The provisions of this Article shall survive the termination or expiration of this Contract.

Provided below is a summary of the progressive wording contained in the foregoing Prototype Arbitration Clause that could assist with streamlining the arbitration process.

Application of Streamlined, Neutral or Regular Rules

Unlike those arbitration clauses that contain a set of arbitration rules within the body of the clause, the Prototype Arbitration Clause applies the state-of-the-art ARIAS·U.S. Rules. For claims seeking monetary relief where the amount in dispute is less than USD $1,000,000, the ARIAS·U.S. Streamlined Rules would apply.[7] Such arbitration would be conducted by a single Umpire, with streamlined pre-hearing procedures and discovery.[8] A hearing on the merits would be set no later than one hundred and eighty (180) days after the Organizational Meeting. [9] For claims seeking monetary relief where the amount in dispute is USD $1,000,000 or more, either the ARIAS·U.S. Neutral Panel or Regular Panel rules would apply.

Features of the ARIAS·U.S. Neutral Panel Rules include:

- The panel will consist of three ARIAS·U.S. Certified Arbitrators who qualify under the ARIAS·U.S. Neutral Arbitration Panel Criteria, or are ARIAS·U.S. Certified Neutral Arbitrators;
- Ex parte communications between a party or its representatives and any potential arbitrator are not permitted; and
- The arbitration panel shall issue a written reasoned decision.[10]

Features of the ARIAS·U.S. Regular Panel Rules include:

- One arbitrator is appointed by the Petitioner, and one by the Respondent. The third arbitrator shall serve as the umpire, who shall be neutral;
- Ex parte communications are permitted between the Party Appointed arbitrator and the party who appointed such arbitrator; and
- If both parties request a written rationale for the final award, the Panel shall provide one. If one party requests a written rationale but the other party objects, the decision whether to issue one is at the Panel's discretion.[11]

Time Limits for Disputes Less Than A Certain Dollar Amount

In addition to the time limitation within the Streamlined Rules, the Prototype Arbitration Clause provides an additional time limitation, up to three hundred sixty (360) days from the Organizational Meeting to the Hearing, where the amount in dispute is between USD $1,000,000 and USD $_,000,000 (an amount agreed by the parties). Utilizing contractual time limitations can prevent runaway arbitrations from occurring and accentuate the parties' intention that time is of the essence during the arbitration process.

E-Discovery Parameters

In this section of the Prototype Arbitration Clause, limitations are placed upon the scope of electronically stored information ("ESI") discovery to be provided by the parties. The panel is granted discretion to deny requests or award reasonable costs to the producing party if the panel believes the burden and cost of producing the ESI outweigh the importance of the discovery requested.[12] Using a variation of this wording could assist with controlling electronic discovery costs in arbitrations.

Mediation During Arbitration Process

The Prototype Arbitration Clause mandates that the parties agree to submit to at least eight (8) hours of mediation at any time during the arbitration process. In addition, an arbitration panel is provided discretion to order the parties to submit to additional mediation. Including this language would, at key junctures during arbitration proceeding, provide the parties an opportunity to attempt to resolve all or a portion of the dispute through the mediation process, or to tailor the issues to be presented at the hearing. It would also contractually provide an arbitration panel with the same powers that judges have in the court system to order parties to submit to mediation.

Application of the English Rule or the American Rule

Using the Prototype Arbitration Clause, the parties can consider whether to retain the American Rule, or adopt a form of the English Rule, which is not only in place in the United Kingdom, but across Western Europe as well as Canada and Australia. [13] Adoption of such a rule could increase the viability of smaller, highly meritorious claims that are not being arbitrated in the current system.[14] This rule could also lead to both parties re-examining which matters should end up in arbitration, and the amount of legal costs to be incurred.[15] The suggested wording for the application of the English Rule encourages the parties to make settlement offers, and creates incentives for the parties to control litigation costs.[16]

The parties may choose to adopt all or a portion of the Prototype Arbitration Clause, and to modify the suggested language. ▼

ENDNOTES

1. *See* ARIAS•U.S. Rules for the Resolution of Insurance and Reinsurance Disputes; ARIAS-U.S. Neutral Panel Rules for the Resolution of Insurance and Reinsurance Disputes; ARIAS-U.S. Streamlined Rules for Small Claims Disputes.
2. *See ARIAS•U.S. By-Laws*, § 1 (e): The objectives of the Society shall be... to propose model arbitration clauses; "*Objectives of ARIAS•U.S.*," #5: To propose ...model arbitration clauses. *"About ARIAS•U.S." under the header "Policy:"* The ARIAS•U.S. Board of Directors and members act as an insurance think-tank for procedural issues involving the insurance/reinsurance arbitration arena- developing alternative contract language designed to streamline the arbitration process.
3. This language is being proposed in lieu of, or in addition to the arbitration clause wording suggested in the ARIAS•U.S. Rules for the Resolution of Insurance and Reinsurance Disputes. ARIAS•U.S. Neutral Panel Rules for the Resolution of Insurance and Reinsurance Disputes, and/or ARIAS•U.S. Streamlined Rules for Small Claims Disputes.
4. The author does not make any representation as to whether such prototype wording complies with all applicable laws or regulations, or as to its legal sufficiency. While this language is being provided for practitioners to consider for use within insurance or reinsurance contracts, it does not represent an exhaustive survey of arbitration clauses or source material.
5. *See* BRMA Master Trading Agreement- A Practical Guide, 2011.
6. *See* Beneficial National Bank, U.S.A. v. Payton, 214 F. Supp. 679, 685 (S.D. Miss. 2001) ("If [an] arbitration clause contains retroactive time-specific language, e.g. a phrase reading 'this agreement applies to all transactions occurring before or after this agreement,' then [the court] may apply the arbitration provision to events relating to past events.").
7. *See* ARIAS•U.S. Streamlined Rules for Small Claims Disputes.
8. *Id*.
9. *Id*.
10. *See* ARIAS•U.S. Neutral Panel Rules for the Resolution of Insurance and Reinsurance Disputes.
11. *See* ARIAS•U.S. Rules for the Resolution of Insurance and Reinsurance Disputes.
12. *See* Emilia A. Quesada, *E-Discovery In Arbitration Proceedings*, 2013, at 2 (available at http://www.americanbar.org/content/dam/aba/publications/litigation_committees/womanadvocate/aba-annual-2013-preventing-a-runaway.authcheckdam.pdf).
13. See Marie Gryphon, *Greater Justice, Lower Cost: How a "Loser Pays" Rule Would Improve the American Legal System*, Civil Justice Report No. 11, December 2008 at Forward.
14. *Id*. at 8.
15. *Id*. at 8 and 11.
16. *Id*. at 20.

	Summary of Prototype Arbitration Clause
Composition of Panel	• ARIAS·U.S. Neutral Panel; or • ARIAS·U.S. Traditional Panel; or • ARIAS·U.S. Single Arbitrator Panel
Rules and Tools	• ARIAS·U.S. Regular, Neutral or Streamlined Rules • Time Limits for Disputes with Certain Dollar Amounts • E-Discovery parameters
Attorney's Fees	• English Rule; or • American Rule
Mediation	• Mandatory during arbitration process; further use at Panel's discretion

STAYING RELEVANT IN A CHANGING WORLD

2016 ARIAS·U.S. Spring Conference
The Breakers, Palm Beach, Florida

MAY 11-13, 2016

2016 ARIAS-U.S. SPRING CONFERENCE

THE BREAKERS, PALM BEACH, FLORIDA | MAY 11-12, 2016

As the world continues to change at a rapid pace, there are significant impacts to the insurance industry and staying relevant becomes even more crucial to our business success. Judge Kaye's empowering keynote speech at the ARIAS·U.S. Fall 2015 Conference addressed this very issue and in planning the 2016 ARIAS·U.S. Spring Conference, we have designed a program that will look at how we can stay current and pro-actively remain ahead of these rapid changes. The Spring Conference will also continue to explore neutrality and the new rules in action. We will hear from a panel that followed the ARIAS·U.S. newly adopted neutral panel rules and learn from their experience.

When discussing neutrality, we will go beyond the procedural aspect and focus on important underlying issues such as unconscious bias and the role it should not play in the arbitrator's decision making process. Developing issues and products will be discussed by experts in the industry and we will hear from executive officers within insurance and reinsurance companies on emerging risks to better understand how these companies stay relevant and ahead of the changes that will continue to transpire.

HOTEL ACCOMMODATIONS & RESERVATIONS

ARIAS·U.S. has secured a block of rooms at a reduced rate at The Breakers. The room block rate ends on April 10, 2016. To make your room reservation, visit https://resweb.passkey.com/go/ARIAS16 to be taken to the reservation site or call 1-888-273-2537. Be sure to mention you are attending the 2016 ARIAS·U.S. Spring Conference to receive the reduced rate. All accommodations are available on a first-come, first-served basis. Local taxes are not included. To hold your reservation, a one-night deposit is required. Check-in time is 4:00 p.m.

ARIAS U.S.

article

To Be (Neutral) or Not to Be (Neutral)? Considerations in Seeking Certification to the ARIAS·U.S. Neutral Arbitrator List

Loreto J. "Larry" Ruzzo, Esq.

By Loreto J. ("Larry") Ruzzo, Esq.

Among the major initiatives promoted by ARIAS in recent years has been the development of Neutral Panels as an alternative to the traditional model of cedents and reinsurers resolving disputes by selecting a party-appointed arbitrator and then agreeing on a neutral umpire. The ARIAS·U.S. website describes the Neutral Panel process[1] and suggests the new Neutral Rules[2] may be adopted at the time of contract formation or at any time prior to commencing a dispute resolution. The Rules provide that all three arbitrators ultimately selected to resolve a dispute must be certified arbitrators who either meet the Neutral Criteria of Rule 6.3 or have been previously designated on the "ARIAS·U.S. Certified Neutral Arbitrator List." Rule 6.4 requires each party to nominate six such individuals, following which the ARIAS will circulate its Neutral Arbitrator Questionnaire to determine whether the nominees actually qualify under the Neutral Criteria and wish to serve in a neutral capacity. The Neutral Panel process presupposes that there will be at least twelve certified arbitrators willing to serve as neutrals from which the parties may make their nominations.[3]

This article addresses the factors an arbitrator may consider in deciding whether to apply for certification to the Neutral Arbitrator List or accept an appointment under the Neutral Rules. The criteria for appointment prohibit an arbitrator from serving on a Neutral Panel if, during the past five (5) years, the arbitrator has served as a party-appointed arbitrator for one of the parties in more than 10% of the candidate's total party appointments or for the law firm (or in-house legal department) representing one of the parties in more than 10% of the candidate's total party appointments.[4] Prior service as a consultant, expert witness or employee of a party as set forth in Rule 6.3(b)-(d) may also preclude service on the Neutral Panel. But perhaps the biggest hurdle to overcome in accepting appointment on a Neutral Panel is the agreement required by Rule 6.3(e) that a candidate chosen to serve will "refuse to accept appointments or engagements as an expert, consultant, counsel or non-neutral arbitrator for either of the Parties or their counsel prior to the final disposition of the arbitration." For arbitrators applying to the Certified Neutral Arbitrator List, the pledge to refrain from party appointments and other disqualifying engagements must be made in writing at the time certification is sought. "In other words, if a person wants to be listed as a Certified Neutral Arbitrator, he or she must agree to only serve as an arbitrator in arbitrations governed by a truly neutral process."[5]

What would prompt an arbitrator to make such a pledge? And what does it mean for a practicing arbitrator to take himself or herself out of the traditional role of providing expert advice and consultation to a party that may subsequently appoint the person to an arbitral panel (let alone give feedback to their appointing party in a dispute prior to the termination of *ex parte* communications)? At first glance, agreeing to refrain from future party appointments might seem like a huge leap of faith for an arbitrator to make without securing a commensurate benefit in exchange (*i.e.*, no guarantee of appointment to any panel). Understanding the basis for an arbitrator to take such a step requires considering the rationale behind the Neutral Rules and exploring the issue with those arbitrators who have already joined the Certified Neutral List.

"[T]he Neutral Rules came from perceived concerns with the current arbitration process in which party-appointed arbitrators do not have to remain strictly neutral, but can be, as one court described it, 'an amalgam of judge and advocate'."[6] The Neutral Rules resulted from extensive deliberations among the ARIAS·U.S. Arbitration Task Force and the

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Can we really have Neutral Panels before we have a critical mass of certified arbitrators willing to serve on them?

ARIAS Board of Directors. Not everyone agrees with the premise that the existing arbitration system is biased or unfair. However, consistent with the ARIAS mandate to promote the improvement of insurance and reinsurance arbitration, the ARIAS·U.S. Neutral Panel Rules offer a choice to those industry participants who would prefer an arbitral system similar to ones already in use in other advanced economies.[7] The new Neutral Rules effectively set up a test of market-place acceptance: will the cedents and reinsurers who "own" the arbitration process in the United States prefer the Neutral Panels to the system they have had in place for many years?

This initiative creates an essential "chicken and egg" dilemma for arbitrators considering taking the pledge of neutrality. Should an arbitrator sign up for service on the Neutral Panel before there are active Neutral Panels on which to serve? Alternatively, can we really have Neutral Panels before we have a critical mass of certified arbitrators willing to serve on them?

To those who supported the development of Neutral Panels, there are obvious benefits to industry participants from the perception that truly neutral arbitrators will render better decisions. But promoters of the Neutral Rules also see advantages to the arbitrators themselves, who will no longer feel the stress – perhaps on a subconscious level – that may come from fear of the financial consequences for voting against the party that appointed them. Even a seasoned arbitrator who chose not to sign up for the Neutral Panel understands the concerns placed on a newly-certified arbitrator in the current party-appointed system. He or she must always worry about getting a second appointment from a party if they ultimately determine that the facts and the law do not support their appointing party's position.

Removing fear of retribution isn't the only reason an arbitrator might agree to forego the party-appointed system. I interviewed several arbitrators who decided to do so. I've noted some of their views in this article. John Chaplin, who has been certified for 12 years, believes the decision to join the Certified Neutral List presents an improvement in the odds of being selected for assignments in the years ahead. Being one of the earliest early adopters of the Neutral Panel process might distinguish an arbitrator as among the few who offer the new alternative most effectively. Parties can feel free to nominate such arbitrators without fear of their declining to serve under the Neutral Rules.

But this advantage does not address the perennial question of how an arbitrator may ethically and effectively market himself or herself to industry participants and become selected for appointments to the Neutral Panels. The Neutral Rules require not only that the parties designate arbitrators from the Certified Neutral List (or those agreeing to serve under the Neutral Criteria), but also that the parties rank the 12 designated candidates in order of preference, with the three arbitrators receiving the highest ranking being selected to serve.[8] The process presupposes some familiarity with the arbitrator candidates as a basis to nominate and rank them in the first place. As one seasoned arbitrator advises, simply being on the Neutral List will not be sufficient to attract appointments. Newer arbitrators must still make themselves known to the in-house and outside attorneys who do most of the vetting and recommend arbitrators to sit on their panels.

Whether counsel will recommend that their clients pursue Neutral Panels or continue to use the party-appointed system remains, perhaps, the most significant open issue affecting success of the Neutral Panel process. After all, attorneys want to win their cases. And surrendering a perceived advantage from having one appointed arbitrator who they believe truly understands their position may be too much for counsel to give up in recommending a Neutral Panel format.

However, certified neutral arbitrator Dick White signed up for the Neutral

Newer arbitrators must still make themselves known to the in-house and outside attorneys who do most of the vetting and recommend arbitrators to sit on their panels.

Panel List precisely because he believes they will succeed as an alternative to the party-appointed system (*i.e.,* because company representatives are insisting upon them). He's seen the initiative evolve over the past several years of ARIAS·U.S. conferences and takes the company representatives at their word when they announce a preference for Neutral Panels. Mr. White also believes the Neutral Panels present an opportunity for newer arbitrators who have yet to break into the party-appointed system to obtain more chances to serve.

Ron Wobbeking agrees that the Neutral Panels will solve perceived abuses in the party-appointed system and will therefore come to be accepted as the way forward. Though he had some concerns about being "shut out" from party appointments, Mr. Wobbeking undertook the neutral designation because he believes it is the right thing to do. He is less optimistic on whether Neutral Panels will automatically open doors for arbitrators without a track record of party appointments. He would advise recently-certified arbitrators to weigh the potential costs of taking the neutrality pledge thoroughly to be certain it is the right thing for them.

Jens Juul, on the other hand, has no doubt that the significant number of arbitrators who've never had a party appointment should sign up for the Neutral Panels. An experienced international arbitrator who doesn't rely on party-appointed ARIAS·U.S. arbitrations, Mr. Juul signed up for the Neutral Panel because he prefers always to serve as a neutral. With respect to the large number of ARIAS·U.S.-certified arbitrators who have yet to receive any party appointments, he argues "they have nothing to lose" by agreeing to serve on the Neutral Panels.

The most expeditious way to find a panel of qualified neutral arbitrators would be to designate those who have already accepted appointment to the Certified Neutral List.

With only a small number of arbitrators currently on the Certified Neutral List, there exists a potential shortfall in the number of arbitrators contemplated for the nomination and selection process. The Rules allow the parties to nominate any six certified arbitrators, at which point ARIAS will undertake to determine whether the candidates meet the Neutral Criteria and agree to serve under the Rules. The time delay in assembling a sufficient number of arbitrators qualified and willing to serve may impact the request made by ARIAS directors at the conclusion of the fall conference – a request that company representatives attempt to convene a dispute resolution process using the Neutral Rules at or before the spring conference in Florida.

If a cedent and reinsurer take up the challenge and the parties each nominate six certified arbitrators who are not currently on the Neutral List, they must hope that the candidates will respond to the Neutral Questionnaire and affirmatively agree to serve under the Neutral Rules (*i.e.*, to forego party appointments from either party until the resolution of the dispute at issue). Securing the arbitrators' agreement before nominations and turning the process over to ARIAS would prove problematic, since the Rules presume the arbitrators do not know which party nominated them.

Thus, the most expeditious way to find a panel of qualified neutral arbitrators would be to designate those who have already accepted appointment to the Certified Neutral List. With the first group of certified arbitrators currently on the list (and several more applications in the pipeline), it should soon be possible to convene a Neutral Panel entirely from the Certified Neutral List. The test case can then move forward by selecting these early adopters and rewarding them for already taking the pledge.

No doubt a large group of ARIAS members from different constituencies are awaiting the outcome of the first successful Neutral Panel arbitration. Satisfactory conclusion of the initial Neutral Panel arbitrations might encourage more certified arbitrators to apply for the Neutral List. Having a larger number of certified arbitrators to choose from might also make the alternative more attractive to cedents and reinsurers, expanding the use of Neutral Panels over time.

Whether the Neutral Panels ultimately come to supplant the current system of party-appointed arbitrations will likely take longer to determine. The final market-place acceptance test depends as much on the parties' subjective satisfaction with the proceedings themselves and their sense that disputes have been resolved fairly and efficiently within industry norms. And this objective, after all, is the service that all arbitrators strive to deliver – Certified Neutral or not. Why else did we qualify to become arbitrators in the first place? ▼

ENDNOTES

1. http://www.arias-us.org/index.cfm?a=462
2. ARIAS-U.S. Neutral Panel Rules for the Resolution of U.S. Insurance and Reinsurance Disputes (hereinafter "Rules").
3. Rule 6.7.
4. Rule 6.3(a).
5. R. Bernie, *et al*., "The New ARIAS•U.S. Neutral Rules for the Resolution of U.S. Insurance and Reinsurance Disputes," *ARIAS Quarterly* Journal, Vol. 22, No. 1 (2015), p. 10.
6. *Ibid*., citing C*ia De Navegacion Omsil, S.A. v. Hugo Neu Corp.*, 359 F. Supp. 898 (S.D.N.Y. 1973).
7. The differences between the Neutral Rules as promulgated by ARIAS·U.S. and the neutrality procedures for arbitrators appointed by parties in other systems is beyond the scope of this article. Suffice to say, a number of certified arbitrators believe that it is possible to be both "party appointed" and "neutral" when acting under rules prevailing in Bermuda or London.
8. Rules 6.7 through 6.9 describe the ranking process in detail, with the selections based, in part, on the arbitrators' responses to the ARIAS·U.S. Neutral Arbitrator Questionnaire, and establish procedures for resolving ties among the top-ranked candidates. The essence of neutrality requires that none of the candidates should learn which party nominated or highly ranked them in the selection process.

editor's comments, cont.

Finally, Ron Gass, once again, brings us his Case Notes Corner. In past issues of the *Quarterly*, we've published articles concerning the preclusive effect of arbitration awards. It's not usual that arbitration agreements themselves address the issue, but in the recent case of *Fox v. Geico General Insurance Co.,* that's precisely what occurred. Ron's column reports on the opinion.

From behavior to Bellefonte in this edition of the *Quarterly*, and in prior ones as well, it's been our custom to present articles on a variety of topics. However, in the future, on occasion we may devote an entire issue to a single topic.

One that has been oft-suggested is privilege, particularly concerning coverage counsel opinions. The mechanics of dealing with privilege controversies such as maximizing cooperation between the parties, the definition and identification of privileged documents and the choice of a mechanism for reviewing and deciding questions of privilege are some of subtopics which have also been suggested. With that in mind, we're soliciting authors who are interested in writing articles on these topics and soliciting suggestions from everyone for topics sufficiently significant for us to devote an entire edition of the *Quarterly*.

We need your support, so please send comments, questions, articles or anything else on your mind concerning the *Quarterly* to me at tomstillman@aol.com. ▼

Enforcement of Arbitration Clause's Collateral Estoppel Limitation Recommended by Federal Court Magistrate Judge

case notes corner

By Ronald S. Gass


Ronald S. Gass

Occasionally, a party in arbitration may raise the threshold question of whether a disputed issue should be precluded from the proceeding based on either res judicata or collateral estoppel grounds because the identical matter was necessarily decided in a prior litigation or arbitration. Ruling on such motions can be tricky for a variety of reasons when, for example, the prior arbitration was subject to a confidentiality agreement or the record of what was previously decided and the underlying rationale was not well documented.[1]

Due to the high frequency of arbitrated disputes, their relatively nominal value, or both, some parties may prefer to avoid future issue preclusion arguments altogether by including in their arbitration agreements a clause expressly stating that any decision by the arbitrator(s) shall not be res judicata or collateral estoppel to any other claim or suit arising out of the same accident, occurrence, or event. The application of just such a provision in the context of an automobile insurance dispute was the focus of a 2015 New York federal court magistrate judge's report and recommendation, which offers valuable insights into how a federal court might be inclined to analyze and rule on the enforcement of similar clauses in arbitration agreements.

In 2012, a Geico General Insurance Company ("Geico") policyholder from New York, Henry J. Fox ("Fox"), was involved in an automobile accident and sustained serious personal injuries. Because apportionment of property damage liability between the policyholder and the other driver could not be resolved, Geico and the other driver's insurers[2] submitted the issue to inter-company arbitration pursuant to a pre-existing property subrogation arbitration agreement. The insurers, not the policyholders, were reportedly the signatories to that agreement, and the policyholders did not participate in that arbitration.

The insurers' property subrogation arbitration agreement provided:

[The arbitrator's decision] is neither **res judicata** nor **collateral estoppel** to any other claim or suit arising out of the same accident, occurrence, or event except where an applicant seeks recovery of supplemental damages[3] as allowed under the Awards section of the rules. The decision is conclusive only of the issues in the matter submitted to the panel and only as to the parties to the arbitration. The admissibility of the decision in any other proceeding is not intended, nor should be inferred from this Agreement. [Emphasis in original.]

The arbitrator ruled that fault for the property damage arising from the accident should be apportioned equally to both drivers. Fox subsequently settled his claim for the personal injuries he sustained from the accident for the full coverage amount available under the other driver's insurance policies, which totaled $125,000. Because this amount did not fully compensate him for those injuries, Fox filed a claim for an additional $375,000 against Geico under his policy's supplemental uninsured/underinsured motorist ("SUM") provision, which had a $500,000 per accident limit (the prior $125,000 recovery from the other driver's insurer was deducted from the coverage limit).

When Geico denied his claim, Fox filed a civil action in New York federal district court seeking the additional $375,000 under his policy's SUM coverage. In a summary judgment motion, he invoked the collateral estoppel doctrine arguing that Geico's liability for these damages was previously established in the inter-company property subrogation arbitration. Geico objected on two

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grounds: (1) the formal requirements for collateral estoppel were not met, and (2) the inter-company arbitration agreement expressly precluded application of that doctrine. In recommending that Fox's summary judgment motion be denied, the magistrate judge analyzed the applicability collateral estoppel in arbitrations. Although he found that this doctrine could be applied to issues previously decided by an arbitrator, he acknowledged that the law was equally "settled" that parties may choose to limit an arbitration award's preclusive effect in subsequent litigation.

Reviewing the inter-company arbitration agreement provision quoted above, the magistrate judge found a "clear intention" by the parties (i.e., the automobile insurers) *not* to be bound by the arbitrator's decision in any other proceeding regardless of whether all the elements supporting a finding of collateral estoppel were met. Noting that the insurers' arbitration agreement was intended to resolve disputes over a policyholder's *property* liability only and finding the language limiting any arbitration decision's preclusive effect both express and unequivocal, the magistrate judge concluded that "[t]he language of the agreement does not leave open any other interpretation" – the insurers' clear intent was to make the outcome of the inter-company arbitration inadmissible in any other proceeding.

Both parties argued that public policy favored their respective positions. Fox claimed that identical parties should not be forced to incur the time and expense of relitigating the exact same issues in another forum. Geico countered that disregarding the parties' clear intention to limit the preclusive effect of the arbitrator's decision would "cause insurance companies to forego arbitration altogether." Considering collateral estoppel an "elastic doctrine" intended as a framework, rather than a substitute, for analysis, the magistrate judge concluded that invoking this doctrine when the property subrogation arbitration provision so clearly dictated a contrary result would "offend the critical concern of 'fairness to the parties,'" modify the arbitration agreement after the fact, and discourage parties from engaging in arbitration, which would be at odds with the clear public policy favoring arbitration.

The magistrate judge's recommendation to deny Fox's summary judgment motion seeking issue preclusion seems reasonable given the language of the insurers' inter-company property subrogation arbitration agreement, which so plainly barred the invocation of both res judicata and collateral estoppel in any other forums.[4] Issue preclusion limitation clauses in reinsurance arbitration agreements are certainly not the norm. However, this magistrate judge's analysis and recommendation[5] clearly favors the view that the parties' unambiguously expressed intent to bar issue preclusion in arbitration will be paid due judicial regard notwithstanding the conventional countervailing public policy arguments. ▼

Fox v. Geico Gen'l Ins. Co., No. 13-CV-6436 (MKB) (VVP), 2015 U.S. Dist. LEXIS 122275 (E.D.N.Y. Aug. 21, 2015) (federal magistrate judge report and recommendation to federal district court).

ENDNOTES

1. Collateral estoppel motions can also be fraught with controversy when one of the party-arbitrators on a tripartite panel actually participated in the prior arbitration, heard the evidence, and decided the identical disputed issue. Query whether that carryover arbitrator is able to fairly and impartially evaluate and decide the issue preclusion question in the subsequent proceeding especially when one element of the analysis is an assessment of whether the party against whom preclusion is asserted had a full and fair opportunity to litigate that issue in the prior proceeding.
2. The other driver in this case was insured by two separate automobile insurance companies, one of whom also happened to be Geico. The inter-company property subrogation arbitration agreement evidently applied notwithstanding Geico's appearance as a party on both sides of the dispute.
3. As the magistrate judge noted in a footnote to his report, the import of this seemingly relevant exception was not addressed by the parties in the litigation before him.
4. The one catch here may be the salient unaddressed exception to the application of the insurers' issue preclusion clause when an "applicant seeks recovery of supplemental damages," which, if explored further, might have added some new interpretive twists.
5. The magistrate judge's report and recommendations may not serve as precedent until it is subsequently reviewed and adopted by the referring federal court.

Improving Arbitration by Borrowing from Recent Amendments to Rules of Litigation, *continued from pg. 12...*

also be worthwhile to consider whether the ARIAS·U.S. Rules should be amended, like Federal Rule 37, to identify the level of misconduct with respect to ESI that warrants sanctions.

Finally, the ARIAS·U.S. Rules might be amended to provide, like new Federal Rule 25(f)(3)(D), for panels to address any agreements between the parties with respect to privileged documents and inadvertent production.

Conclusion

The recent amendments to the Federal Rules of Civil Discovery offer potential ways to improve arbitration. In particular, arbitration can benefit from several changes that expedite the process, reform discovery, address privileged information, and better manage the preservation of and access to electronically-stored information. ARIAS•U.S. should consider amending its arbitral rules to incorporate these useful ideas. ▼

ENDNOTES

1. Arrowood Indem. Co. v. Equitas Ins. Ltd., No. 13cv7680, 2015 U.S. Dist. LEXIS 63643 (S.D.N.Y. May 14, 2015) (denying relief from judgment affirming arbitral award) and 2015 U.S. Dist. LEXIS 99787 (S.D.N.Y. July 30, 2015) (enjoining second arbitration).

To view this article in its entirety, please visit http://arias-us.org/index.cfm?a=486.

A Response to the Arbitrators' Panel on the Code of Conduct

article

By Thomas F. Bush

Thomas F. Bush

At the recent Fall Conference of ARIAS·U.S., panels of arbitrators had the opportunity to express their views on a variety of topics. Few views were more provocative than those offered by a panel on the ARIAS·U.S. Code of Conduct. In a nutshell, these arbitrators do not like the comments to the Code. They view these comments as reflecting an unnecessarily strict set of rules. Better to relegate these comments to the status of "guidelines," they said, and leave to each arbitrator the responsibility to interpret and apply the more broadly phrased canons in accordance with his or her own best judgment. They also regard the imposition of specific ethical rules as a gratuitous insult. "Ethics are morality," said one of the panel members, and specific rules should not be imposed on ARIAS-certified arbitrators, who can be relied upon to conduct themselves properly.

I am acquainted with no arbitrator certified by ARIAS whose ethical judgment I would question, but I hold a different view of the Code of Conduct. Ethics for professionals like arbitrators are not morality. They are not rules for distinguishing good from bad behavior. Rules of ethics serve to give people assurance that they can place trust and confidence in professionals whose conduct they cannot always observe and whom they might not know well enough to have confidence that they will act properly.

Consider an ethical situation that lawyers commonly face. I might be asked to represent a client on a matter adverse to an existing client of the firm. I have not been involved, and will not be involved, in the representation of that existing client. It will be represented by lawyers in another office. I am confident that neither my representation of the proposed new client nor the other lawyers' representation of the existing client will be compromised in any way, and I am certain that the confidences of both clients will be maintained. In this situation, my representation of the new client is not inherently bad behavior.

Nonetheless, under the ethical rules governing the legal profession, I cannot take on the representation unless both the new and the existing client give their consent, following a full disclosure of relevant facts. If one of them declines to consent, the representation is barred, even if it poses no threat of real harm. The point of the ethical rule is that without informed prior consent, clients have no effective means to ensure that I will make a sound judgment on whether the representation poses a threat of real harm or that I will conduct the representation in a manner that will avoid such harm. The judgment of the legal profession is that clients should not be required to put complete faith in lawyers acting properly outside of their view.

The same considerations arise with arbitrators. The deliberations and decision-making of arbitrators take place outside of the presence of parties and their lawyers, and their decisions essentially are unreviewable, save for the very narrow grounds available under the Federal Arbitration Act. Parties to arbitration must place a high degree of trust in arbitrators to resolve disputes fairly. Frequently, the parties' lawyers know the members of a panel well enough to assure their clients that these individuals deserve their trust. However, the number of ARIAS certified arbitrators now exceeds 240. No lawyer knows all of them, or even most of them, well enough to be able to vouch for the arbitrators' impartiality and fairness in every case.

Furthermore, a party or lawyer might know an individual arbitrator well enough to question his or her ability to act fairly, but it can do very little to prevent the arbitrator from serving on its panel. Presumably each party will select, as its own party-appointed arbitrator, an individual in whom it has sufficient confidence to act fairly, but it has no role in selecting the other party's arbitrator. Although each party does participate in selecting the umpire, neither can be assured that the individual ultimately selected will

Tom Bush

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

be someone that it knows to be deserving its trust, especially when the final selection is made by a coin toss. And once the panel is assembled, the parties have very little means to challenge its makeup. The Federal Arbitration Act allows a party to challenge an award on the grounds of "evident partiality" of one or more arbitrators, but that is a very high standard, and a challenge under it is available only after the completion of the arbitration.

Hence the problem: the arbitration process requires a company to entrust the resolution of its dispute to the unobservable and unreviewable decision-making of three individuals, two of whom the company did not select and in whom the company might not have full confidence. This problem can lead to a temptation to treat an unfavorable decision of the panel as the product of bias rather than a fair and reasoned resolution of the dispute. The problem can also discourage companies from submitting their disputes to arbitration.

Ethical rules spelling out how arbitrators should respond to specific situations, such as those found in the comments to the Code of Conduct, can help address this problem. Companies and their lawyers can review these rules. If they are satisfied that the rules are adequate, then a commitment by arbitrators to follow the rules can give them greater assurance in the integrity of the arbitration process. Moreover, if arbitrators address ethical issues openly with reference to the Code's comments, parties can have greater confidence that ethical issues have been addressed properly.

From this perspective, the rules expressed in the comments to the Code of Conduct are not subject to criticism on the ground that they prohibit conduct that is not necessarily bad or that they restrict the discretion of arbitrators on ethical issues. The primary question for any particular rule is whether it serves to enhance the confidence of parties in the arbitration process and does so without imposing an unreasonable burden on the arbitrators or the parties. Where the answer to that question is yes, the rule should be accepted. ▼

Remember to Vote!

The Board of Directors requests your vote on the initiative to expand the Board of Directors from nine to eleven members. The two additional members would represent the Arbitrator community. As you are aware, to make this type of change to the Board composition, an affirmative vote is required of two thirds of the members of the society. Members must be in good standing to be eligible to vote (i.e., annual dues must be current). The voting period is now open and will close on Friday, April 15, 2016. All members in good standing (those who have paid their dues) will be sent a link to the online voting page. All members in good standing have been sent a link to the online voting page. If you have not received the link and have paid your dues, please contact Anna Haber at ahaber@arias-us.org for assistance.

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Members on the Move

Mary Kay Vyskocil, a senior litigation partner at Simpson Thacher & Bartlett and longtime ARIAS member, has been chosen as the newest bankruptcy judge in the Southern District of New York. Ms. Vyskocil is a past Chair of ARIAS • U.S. and chaired the Strategic Planning and 20th Anniversary Celebration Committees. Her practice at Simpson Thacher & Bartlett is concentrated in insurance and reinsurance coverage litigation and cases involving the financial services industry. Ms. Vyskocil is co-author of the leading treatise, Modern Reinsurance Law & Practice, (Thompson Reuters 2014), the third edition of which is about to be published.

Save the Date

ARIAS U.S.

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ARIAS U.S.

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

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

An Invitation…

The rapid growth of ARIAS•U.S. (AIDA Reinsurance & Insurance Arbitration Society) since its incorporation in May of 1994 testifies to the increasing importance of the Society in the field of reinsurance arbitration. Training and certification of arbitrators through educational seminars, conferences, and publications has assisted ARIAS•U.S. in achieving its goals of increasing the pool of qualified arbitrators and improving the arbitration process.

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

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

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

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

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

If you are not already a member, we invite you to enjoy all ARIAS•U.S. benefits by joining. Complete information is in the Membership area of the website; an application form and an online application system are also available there. If you have any questions regarding membership, please contact Sara Meier, Executive Director, at director@arias-us.org or 703-506-3260.

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

Sincerely,

Elizabeth A. Mullins
Chairwoman

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

703-506-3260

Fax: 703-506-3266

Email: info@arias-us.org

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Note: Corporate memberships include up to five designated representatives. Additional representatives may be designated for an additional $425 per individual, per year. Names of designated corporate representatives must be submitted on corporation/ organization letterhead or by email from the corporate key contact and include the following information for each: name, address, phone, cell, fax and e-mail.

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