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INTRUSION

Private and Data Breach Risks

INSIDE...

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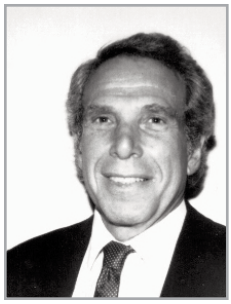

Eugene Wollan

editor's comments

We hope you had a pleasant and restful Summer (LOL)

Security breaches . . . . data breaches . . . . invasion of privacy . . . . these all permeate the headlines and the editorial pages these days. They concern our membership too. We are unable to offer any contributions on the subject from Wikileaks or any former NSA contractors, but we can provide a learned and comprehensive discussion of the subject from Edwards Wildman, a firm that has made an intensive study of it.

The Brazilian reinsurance market is opening up, and the article by Ilan Goldberg tells us all about it. Marc Abrams is heard from again, this time on the subject of interest in reinsurance awards. Ron Gass's case analysis is, as usual, superlative. My contribution, also as usual, is another discourse on language.

It has always been our policy not to publish articles that have already appeared in print elsewhere. That remains the case. Some pieces, however, fall into a shadowy gray area. Here are the general guidelines we follow, always subject to arbitrary exceptions or modifications:

1. If the place where it was published is a limited-distribution publication like an in-house journal, we could consider it.

2. If it has been so substantially changed or modified or updated that important portions can fairly be described as new, we could consider it.

3. If it offers a unique contribution on a subject of special interest to our membership, we might consider it.

We would be very interested in any comments on this policy.

We had a situation recently in which an article we planned to publish was substantially revised by the author after it had been submitted to us. We had already proofread it and edited it, meticulously, carefully, word by word, punctuation mark by punctuation mark. It was a fairly lengthy piece, and the prospect of doing that all over again seemed rather daunting. The author was kind enough to provide a track version (I think that's the technical term) highlighting the changes, so theoretically we were able to limit any additional editing to the new material only, without disturbing the editorial changes to the retained portions of the original version. The problem was that the changes were fairly substantial and the original edits were not in the new version, so we were looking at three separate versions: the edited original, the largely rewritten new version with tracking, and the clean new version. Some new editing was done on the revision, and Bill Yankus volunteered to integrate the three, being particularly careful not to lose the edits of those portions of the original that remained unchanged. Now, this may sound like child's play to those of you who are true computer geeks, but to me it sounded no easier than deciphering Linear B on Cleopatra's Needle. But Bill came through! My point: Bill has always, as in this instance, been responsive and efficient, and that goes for his terrific staff at CINN too. They are too often taken for granted.

Personal note: I have been receiving innumerable invitations from ARIAS members to join them in Facebook, Linked-In, Twitter, or other manifestations of contemporary technology that I don't begin to understand, and therefore simply don't participate in. If you have been inviting me in but have only received a cold shoulder, please don't take it personally.

Solecism of the Quarter: "Before starting on Enbrel, your doctor should test you for tuberculosis." Someone please explain to the author of this TV commercial voice-over that it's the patient, not the doctor, who's starting on Enbrel.

Most irritating TV commercial of the Quarter: anything involving talking or singing animals or insects. Close runner-up: anything featuring Jennifer Hudson.

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Editorial Policy

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

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

Manuscripts should be submitted as email attachments to ewollan@moundcotton.com .

Manuscripts are submitted at the sender's risk, and no responsibility is assumed for the return of the material. Material accepted for publication becomes the property of ARIAS•U.S. No compensation is paid for published articles.

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feature

Privacy and Data Breach Risks

This article is based on a paper presented at the 2013 ARIAS•U.S. Spring Conference.

Laurie Kamaiko

Insurance industry companies have the same vulnerabilities to data breach as other institutions. Some may even have an elevated risk because of their heavy dependence on computer systems and the nature of the information stored on their systems.

Laurie Kamaiko is a partner in the Insurance and Reinsurance Department of Edwards Wildman and Palmer LLP in its New York office. She advises insurers and reinsurers on cyber risk exposures, coverage issues, and contract wordings. This paper is an excerpt from the May 2013 edition of Edwards Wildman's white paper, "Everyone's Nightmare: Privacy and Data Breach Risks."

Laurie Kamaiko

Insurance Company Exposures

A. Exposure of Companies in the Insurance Industry as Entities Subject to Data Breaches

While insurers generally focus on the exposures of their insureds, they are themselves in an industry in which companies have potential exposure to data breaches. Insurance industry companies have the same vulnerabilities to data breach as other institutions. Some may even have an elevated risk because of their heavy dependence on computer systems and the nature of the information stored on their systems.

First, at risk is their own employee information. As large-scale employers, often of employees residing in many different states (including Massachusetts with its rigorous data security requirements), insurers, reinsurers, brokers, and companies servicing the insurance industry are subject to breach of their own employees' Personal Information, including payroll, personnel, pension, workers' compensation, and disability claim information.

Second, at risk is the Personal Information insurers have of policy applicants, insureds, claimants, and beneficiaries.[1] Liability insurers often have claimant information, ranging from medical records and financial documents to claimants identified by name and Social Security number which, if lost or improperly accessed, would be a data breach of Personal Information. Personal lines and life and health insurers may maintain Personal Information of policyholders and of beneficiaries, which are also subject to data breaches. Such Personal Information may remain stored by insurers, reinsurers, brokers, and third-party administrators as well as vendors of such entities, either in paper or electronic form, for decades.

Insurers are also subject to extensive state and federal regulations that include requirements for safeguarding Personal Information and reporting data breaches, as well as common law standards for protecting confidential information.[2]

The Departments of Insurance of several states have issued bulletins and regulations requiring insurers and certain other of their licensees doing business in their states to send them data breach notifications. For example, Ohio Insurance Bulletin 2009-12 requires insurers to provide notice to the Ohio Department of Insurance of loss of control of policyholder information within fifteen calendar days after discovery if the loss involves more than 250 Ohio residents.[3] Pursuant to Chapter 11 of Rhode Island Insurance Regulation 107, licensees of the Rhode Island Department of Business Regulation, which includes insurance companies, must notify the Department of a data breach in the most expedient time possible and without unreasonable delay.[4] Similarly, the Wisconsin Office of the Commissioner of Insurance, under a bulletin dated December 4, 2006, requires that insurers notify the Office no later than ten days after they become aware of unauthorized access to the Personal Information of insureds.[5] The Connecticut Department of Insurance issued Bulletin IC-25 on August 18, 2010 to require all entities doing business in Connecticut that are licensed by or registered with the Department to notify the Department of any information security incident. Notice must be provided as soon as the incident is identified, but no later than five calendar days afterward. The Connecticut Bulletin lists numerous facts, as they are known at the time, that must be disclosed in the notification to the Department of Insurance, including details about the incident and remedial actions taken. The notice must contain a draft of the notice the licensee or registrant intends to send to Connecticut residents. The Bulletin also imposes a

requirement on the licensee or registrant to report incidents involving a vendor or business associate.[6]

Insurers are also subject to federal and state regulations of Personal Information that are not specifically directed at the insurance industry, but apply to all companies that obtain and maintain Personal Information (such as state data breach notification laws).[7] Thus, for example, the broad-ranging Massachusetts Regulation discussed above affects any entity that has Personal Information of a Massachusetts resident, and thus is likely to affect a significant number of insurers. It technically applies to liability insurers with Personal Information of Massachusetts claimants and to life insurers that have Personal Information of non-policyholder beneficiaries, as well as to those with employees or insureds who are Massachusetts residents.

Accordingly, in addition to the exposures insurers face as the issuers of policies that may cover the costs of data breach incurred by their insureds and claims asserted against insureds arising from data breaches, insurers and other entities in the insurance industry have their own risk of data breaches.

B. Potential Insurance Coverages

The increasing range of costs incurred by entities that sustain a breach and the third-party claims against them have given rise to efforts by such entities to seek coverage for those costs and claims. Specialty insurance products have been developed to specifically address data breach risks, although not all address the full scope of costs and claims. Moreover, entities that sustain a breach that have not purchased policies directed at providing data breach coverage often look with varying success and failure to the more traditional types of policies they have in place for coverage of at least some of the costs, defense expenses, and indemnity payments they incur.

A number of different types of insurance policies have the potential to be implicated in the event of a data breach – or at least to be subject to a request for defense and/or indemnity – depending on factors such as the type of breach, the relationship of the parties, the nature of the information in issue (Personal Information, Intellectual Property), the type of policy in issue and, if for third-party liability, the allegations asserted and the type of damages in issue. As in all requests for coverage, the determination of coverage turns on policy terms, including both grants of coverage and exclusions, as well as on the specifics of the claim.

As the risk of data breaches and statutory privacy violations becomes increasingly recognized, policy definitions and exclusions are being added and tightened to reduce the exposure of policies not intended to apply to those risks, and sublimits for some types of costs are often included even in those policies expressly directed at insuring the risks of data breach, network security failures, and the claims arising from collection and usage of information about individuals. Many insurers impose application procedures directed at identifying the risks and the security procedures of the applicant entities, and some impose risk management conditions before agreeing to issue a policy that provides coverage for these types of claims.

As the field of privacy develops, so do the types of claims made, the effect of data breaches and privacy violations on individuals and companies, and the information available as to the nature and source of the cyber attacks and alleged privacy violations. These, in turn, raise new issues and exposures for insurers and their insureds. Thus, questions are increasingly arising as to, *e.g.*, whether cyber attacks from foreign sources are government-sponsored and potentially subject to terrorism exclusions, whether attacks result in physical damage or loss of use of tangible property, whether information collection practices constitute knowing and deliberate conduct, and whether resultant business losses can be accurately measured and insured, among other issues.

Some of the issues that may be presented by a claim for coverage are identified below, although of course the issues can vary depending on the claim and the policy wording.

(i) Cyber Risk/Data Breach/Privacy/Network Security Policies

A growing number of insurers are offering policies specially tailored to provide coverage for a variety of cyber risks, ranging from breaches of Personal Information to cyber extortion, to business interruption and reputational damage arising from cyber attacks, to claims of wrongful collection, usage or disclosure of information about individuals. Coverage has also been developed for liability associated with social media, such as posting of a defamatory comment on a blog. Some of these policies are industry-specific, such as cyber risk insurance designed for technology companies, restaurants, healthcare entities, or financial institutions. In the current market, coverages are often expanded and new coverages developed, including express coverage for the Payment Card Industry (PCI) contractual assessments that are often associated with breaches of Personal Information involving credit card numbers. As data protection regulations and statutes, with concomitant response requirements, continue to be enacted and expanded in the U.S., E.U., and elsewhere, the market for such specialty products is expanding and new products are likely to be developed.[8]

Policies designed to provide data breach coverage do not necessarily restrict themselves to electronic breaches of statutorily defined Personal Information. These policies may also broadly encompass coverage for breach of privacy costs and claims arising from other types of data breach, including loss or theft of Personal Information contained in paper records and other types of confidential information that, while not itself Personal Information, can be used to obtain Personal Information or interfere with the business operations of a breached company or its clients. In addition to providing insurance coverage in the event of a breach, some insurers offer breach prevention services to their clients.

Some of these policies have both first and third-party coverages. First-party coverages in such policies are generally

designed to pay or reimburse an insured that has sustained a breach for its own costs incurred in addressing a breach, such as notification costs, although some such policies limit coverage of notification costs to situations in which the insured is legally obligated to provide notice of data breach under state or federal statutes or to a maximum number of individuals. Policies directed at providing coverage for data breaches may also provide some coverage for costs directed at mitigating loss or reducing the likelihood of third-party claims, such as legal advice as to the company's notice obligations, credit monitoring offered to those whose Personal Information is compromised, and forensic investigation as to the cause of the breach. Some policies offer first-party coverage for business interruption losses related to data breaches, even in the absence of physical damage to tangible property. Liability coverages for defense costs and losses arising from a claim by a third party for damages arising from a data breach are also generally the subject of express coverages under such policies. Some cyber risk policies now also integrate coverage for online media liability.

However, even policies directed at providing coverage for data breaches of Personal Information and other privacy exposures vary in the scope of coverages provided and often have sublimits for certain types of costs or damages, and exclusions for others. Issues can arise as to whether there is coverage of costs incurred by an insured that are not legally required but are undertaken to preserve an insured company's reputation or reduce the likelihood of a third-party claim; of contractual indemnity obligations; of contractual fines and penalties as well as fines and penalties imposed by regulatory authorities; of breaches due to insured/employee dishonesty; of business interruption loss; of losses due to reputational harm; and of other types of claims or costs. The terms of these policies are largely untested by the courts, and their terms, conditions, and exclusions are still in flux.

Moreover, the focus of such specialty policies is no longer just on data breaches and traditional out-of-pocket costs. There is increasing recognition of the exposures presented to companies by regulatory and legal proceedings asserting wrongful collection, usage and disclosure of information about individuals. Such information is often one of the most valued assets of companies, and a key component of targeted marketing, but recent increasing regulatory scrutiny from states and countries around the globe on company practices and disclosures of their collection and usage of such information have made both insurers and insureds consider the insurability of the exposures generated by such practices.

(ii) Property Policies – First-Party

First-party property policies, which usually cover physical damage to real and personal property and may (depending on their terms) also provide coverage for resulting business interruption, may be scrutinized by insureds looking for potential insurance coverage, particularly those who sustain not only a data breach but also business interruption losses, or costs for replacement of a computer system or data storage unit as a result of a breach.

However, such claims generally fail in the absence of some indication of physical damage to the computer system involved, or an express provision for coverage of replacement costs for loss of electronic data (which at times is offered, although usually on a sublimited basis). Such policies generally cover "direct physical loss or damage" to insured property caused by a covered cause of loss. "Physical" is generally construed to mean "tangible."[9] Case law generally maintains that electronic data is not tangible property.[10]

Further, policy exclusions often specifically exclude or limit coverage of electronic data and other "valuable papers and records." Business interruption coverage is generally required to result from damage to or destruction of property caused by a loss otherwise covered under the policy, and thus if there is no physical loss or damage to tangible property in a data breach, the resultant business interruption losses are also generally not covered under a traditional property policy.

Non-coverage of a claim under a policy, though, cannot always be assumed. If a computer becomes unusable by virtue of the installation of malware, a policyholder may be able to seek recovery under a coverage for loss of use of tangible property that is not physically injured.[11] There can also be claims involving destruction or corruption of electronic data on the system of the insured because of viruses that may be covered under the limited electronic data additional coverage provided by some property policy forms.[12] Further, there can be endorsements and other manuscript provisions added to more traditional business property forms that expressly provide some additional limited coverage for impairment of data systems and papers and other losses implicated in a data breach claim. Should there be potential coverage of any portion of a loss under a property policy, loss mitigation provisions may also be targeted by policyholders as a basis for requests for coverage of loss mitigation costs.

(iii) Fidelity / Commercial Crime Insurance

In the 1990 film *Ghost*, one of the characters, who works at a financial institution, sets up a dummy account to facilitate a money-laundering scheme. In the event of a hypothetical real-world scenario where an insider steals customer account data in order to siphon money out of customers' accounts – and in the absence of a Patrick Swayze to change the password and thwart the crime – the financial institution might be able to bring a claim under its Fidelity and Crime insurance policy. Such policies generally protect organizations from the loss of money, securities, or inventory resulting from employee crime. "Common Fidelity/Crime insurance claims allege employee dishonesty, embezzlement, forgery, robbery, safe burglary, computer fraud, wire transfer fraud, counterfeiting, and other criminal acts."[13]

Many data breaches involve theft and other criminal conduct by employees, e.g., theft of laptops or other computer

equipment containing Personal Information or other confidential data. Thus, depending on its terms and exclusions, the company's fidelity insurance may be triggered. Moreover, some fidelity or crime insurance policies may expressly provide for computer crime coverage in the form of a computer fraud endorsement, while others may contain exclusions that limit or preclude such coverage. Whether such an endorsement would provide coverage to the insured company for its losses and claim expenses arising from a data breach will depend on the policy terms, including if there is a loss of electronic data exclusion, and the jurisdiction considering the issue of coverage.[14]

(iv) CGL – Third-Party Claims

An insured entity subjected to a lawsuit in connection with a data breach it suffers may tender the defense of that suit under its commercial general liability policy. While privacy and data security are developing areas of the law, there are a few judicial decisions indicating the likely issues on which a coverage dispute will focus when a claim for coverage is made under a CGL policy.

(1) Coverage A

Coverage A of a CGL policy typically provides that "we will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies." "Property damage" is typically defined as "physical injury to tangible property, including all resulting loss of use of that property," and "loss of use of tangible property that is not physically injured."[15]

Generally in data breach cases, the focus of analysis as to whether there is coverage, or at least sufficient allegations to trigger a duty to defend, under Coverage A is on its "property damage" prong. Because of the required component of "tangible property," it is usually considered unlikely that lawsuits related to a typical breach of electronic data security would be covered under Coverage A.[16] As in the first-party property policy context, case law generally maintains that electronic data is not tangible property.[17] Additionally, ISO's 2004 form and other CGL forms include in the definition of "property damage" the provision that "for the purpose of this insurance, electronic data is not tangible property."[18]

In addition, the 2004 ISO form (and many other CGL forms) include an Electronic Data Exclusion, according to which "this insurance does not apply to ... damages arising out of the loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data." Under policies containing such an exclusion, for there to be any coverage there would need to be damages caused by physical injury to, or the loss of use of, "tangible property," which must be something other than electronic data. However, there may be data breaches involving damage other than to electronic data for which insureds may be able to satisfy the "tangible property" requirement as well as the "occurrence" requirement, and demonstrate either physical injury to that property or loss of use of the property containing the data, such as malware attacks that cause damage to computer hardware.

Further, while analyses of whether Coverage A applies have focused on the property damage aspect of that Coverage Part, Coverage A also applies to "bodily injury." The recent spate of consumer third-party claims has often included an emotional distress component. Thus, if a policy or governing law defines "bodily injury" as including emotional distress even when there is no physical injury, there potentially could be a claim for coverage for that aspect of the alleged damages. However, while the "tangible property" barrier would not apply to such a claim, the insured would still have to demonstrate that the "bodily injury" was caused by an "occurrence," and that the Electronic Data Exclusion did not apply,[19] and circumvent any other provisions that may be added by an insurer to its policy to preclude coverage of data breach claims. The potential for coverage may be more likely for data breaches directly causing demonstrable bodily injury, such as those involving computer-controlled medical equipment that affect medical care of individuals, rather than for the typical electronic data breach involving Personal Information.

(2) Coverage B

Attempts at seeking coverage, or at least obtaining a defense, under CGL policies have been asserted under Coverage B, Personal and Advertising Injury. Results have varied depending on jurisdiction and claim.

Personal and Advertising Injury coverage under Coverage B is limited to injuries arising out of certain enumerated offenses.[20] Standard Coverage B coverage provides: "we will pay those sums that the insured becomes legally obligated to pay as damages because of '*personal and advertising injury*' to which this insurance applies," and the policy's definition of personal and advertising injury generally lists the enumerated offenses for which coverage is provided. Although "personal injury" and "advertising injury" used to be separately defined as two different sets of enumerated offenses within Coverage B, the industry began merging the terms into one consolidated set of enumerated offenses in 1998.[21] Among those enumerated offenses is typically "injury ... arising out of ... oral or written publication, in any manner, of material that violates a person's right of privacy." This is the offense that is often alleged to apply when a claim for coverage for a data breach is made.[22]

To tender a data breach claim successfully under Coverage B, then, an insured would have to demonstrate, among other things, at least a potential that the data breach in issue constituted a "publication" that violated the data owner's "right of privacy." The standard ISO insurance form does not define the terms "publication" or "right of privacy." Courts ruling on the applicability of Coverage B to privacy claims have found some types of personal data, but not others, to be within the data owner's "right of privacy," and the result can vary depending on the information and the jurisdiction's law that applies, as well as the specific policy's provisions and exclusions. Thus, some courts have found privacy rights implicated for

purposes of Coverage B where the issue was an insured's improper access and use of certain types of information that are statutorily protected, such as access and use of credit reports in violation of the Fair Credit Reporting Act (FCRA expressly states that it is intended to protect consumers' right to privacy).[23] Similarly, the personal data at issue in data breach scenarios is sometimes also protected by statutes designed to keep that data private. However, to the extent that the right to privacy is based on a statute, there are often exclusions that serve to preclude coverage.[24] Moreover, to the extent that a claim is based on a common law or constitutional right to privacy, under some states' laws, only information that is of an embarrassing nature and published under egregious circumstances is considered to be in violation of a right to privacy.[25]

Even apart from the content of the information involved, the application of the "publication" requirement of Coverage B presents a significant hurdle in data breach cases, particularly those involving theft of information from the breached entity. Decisions in some jurisdictions have held there to be sufficient issue of publication under some fact situations that involve violations of privacy rights to at least trigger a duty to defend in situations that, among other things, have involved insured's alleged distribution of the Personal Information in issue; others have, however, held there to be no coverage as a matter of law. Thus, for example, in Fair Credit Reporting Act cases, several courts took a broad view of "publication," and held that publication can occur when information is revealed by the insured to others, including the owner of the information.[26] One court, relying on a dictionary, found "publication" to mean "to produce or release for distribution."[27] In contrast, courts in other jurisdictions analyzing the application of Coverage B to a violation of FACTA reached a different conclusion with regard to "publication" on the ground that it is not publication where credit card information is improperly printed in full, but is provided only to the cardholder and thus not "in any way made generally known, announced publicly, disseminated to the public, or released for distribution."[28] However, in a case construing "publication" in the context of an employer subjecting his employee to audio surveillance without informing the employee in violation of the Wiretapping and Electronic Surveillance Act, that surveillance was found to constitute "publication."[29]

Overall, the limited case law and legal authorities on the issue indicate that "publication" within the context of Coverage B requires that the insured have affirmatively disseminated the information in issue to others, rather than have that information stolen from it, for there to be any potential for the "publication" prong of Coverage B to apply. Thus, while the term "publication" has been found satisfied in the Coverage B context in instances involving affirmative acts by the insured, so far there is a dearth of authority indicating that the term "publication" may be satisfied on the basis of passive, non-affirmative conduct by the insured in the data breach context.[30] As a result, an entity seeking coverage under Coverage B for a typical data breach involving third party theft of information is likely have an uphill battle triggering coverage obligations under Coverage B, as a data breach does not generally involve any affirmative acts of dissemination on the part of the insured, although that is an issue being litigated.[31]

Additional issues include whether there are any covered "damages" to which the insurance applies and whether, if only statutory fines or penalties are involved, those qualify.

Thus, in the event of a request for coverage under Coverage B of a third-party claim based upon improper access to Personal Information because of a data breach, the focus is likely to be whether there was a violation of the data owner's "right of privacy," whether there was "publication" by the insured, whether covered "damages" are sought, and which jurisdiction's law applies.

Variations in Coverage B policy wording can also affect whether a court is likely to find coverage for a data breach under Coverage B. In a case involving claims brought under the Electronic Communications Privacy Act and Computer Fraud and Abuse Act in connection with the collection of information regarding the underlying plaintiffs' online activity for eventual dissemination to third-party advertisers, one court construed a policy that had Coverage B wording different from the wording found in the ISO form. That policy defined "personal injury offense" to include "Making known to any person or organization written or spoken material that violates a person's right to privacy." This took the place of the phrase "oral or written publication, in any manner" found in the ISO form.[32] Under that non-ISO definition, the court held the defendant's passage of information to its parent company and the defendant's employees sharing of the information among themselves to constitute "making known to any person or organization." (The holding was reversed on appeal but not on this point.)[33]

Further hurdles faced by insureds seeking coverage under a CGL policy for claims arising from a data breach, even if they overcome the significant thresholds to coverage contained in the Coverage B insuring provisions, include that there are typically a number of policy exclusions applicable to Coverage B that can operate to exclude coverage. For example, the standard ISO form contains an exclusion for "personal injury and advertising injury" arising out of violation of any "statute, ordinance or regulation . . . that addresses, prohibits or limits the . . . sending, transmitting, communicating or distribution of material or information."[34] Further, even if a Coverage B statutory violation exclusion does not include in its provisions that "alleged" violations are also precluded from coverage, at least two district courts in the TCPA context have found that allegations alone in the underlying complaint of such violations may be sufficient for coverage to be excluded (as opposed to requiring an adjudication or admission of such violation for the exclusion to trigger).[35] Other Coverage B exclusions that can potentially come into play upon a data breach include ones for "personal and advertising injury" arising out of the criminal act of the insured (which could

Intensive Workshop and Umpire Master Class

September 18, 2013

Two New Simultaneous ARIAS•U.S. Training Events:

1. A newly recreated Intensive Arbitrator Training Workshop

The Education Committee is reorganizing the workshop to provide a more intense arbitration experience for attendees. This workshop is for anyone planning to apply for initial certification and for all arbitrators who would like to hone their skills. It is an all-day training program. It is not considered an "educational seminar" for renewal purposes.

2. Announcing the first Umpire Master Class!

The first in a series of new seminars designed to provide additional education programs geared to the more experienced certified arbitrators who would like to improve their umpire skills. A full morning of instruction, with "educational seminar" credit toward certification renewal.

Reception and dinner on the evening before the classes!

A unique networking experience…faculty and student participants from both courses will attend a reception and dinner on the evening of September 17.

Crowne Plaza Hotel in White Plains, New York.

Registration is open only until August 30, 2013

Go to www.arias-us.org
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As policyholders attempt to find loopholes in CGL policies to trigger at least a duty to defend data breach claims in situations not contemplated by insurers or intended to be covered by such policies, any success by policyholders will likely result in insurers responding by drafting and including in policies additional exclusions and limitations on coverage directed to preventing any unintended coverage from being found.

come into play when employee theft is in issue); arising out of intellectual property rights; committed by insureds in media and Internet type businesses; arising out of an electronic chat room or bulletin board the insured hosts, owns or controls; arising out of breach of contract; and other exclusions that may be more general in nature but apply to the specific claim in issue, or that may be specifically manuscripted for the insured in issue.

(3) Additional Coverage A and B Hurdles

Yet another hurdle for attempts to obtain coverage of a third-party data breach claim under a CGL Policy is the requirement under both Coverage A and Coverage B that the claim be for "sums that the insured is legally obligated to pay as damages." As discussed, often consumers have not sustained out-of-pocket losses, or the payments in issue are the type of fines, penalties, or other types of costs that do not fall within the scope of covered damages.

While CGL coverage issues have recently become a battleground,[36] the field is not likely to be a static one. As policyholders attempt to find loopholes in CGL policies to trigger at least a duty to defend data breach claims in situations not contemplated by insurers or intended to be covered by such policies, any success by policyholders will likely result in insurers responding by drafting and including in policies additional exclusions and limitations on coverage directed to preventing any unintended coverage from being found.

(v) Professional Liability/E&O

Most professionals and entities engaged in providing services to others have errors and omissions (E&O) liability policies in place that they look to for a defense and indemnity when a claim is asserted against them by their clients. When a data breach at least arguably occurs within the scope of covered services, particularly when it involves data of its client, such an insured may look to its professional liability/E&O insurer to at least provide a defense to any third-party claims arising from the data breach. Thus, for example, a law firm, engineering firm, or technology services firm that improperly disposes of or loses client files or is otherwise subject to a data breach – or a firm that is involved in issues relating to planning, designing or implementing a client's software program that is involved in a breach – and is thus subject to client claims, may try to seek coverage under its professional liability/E&O policies.

Professional liability and other E&O policies, however, may contain electronic data or software design exclusions, although some may have exceptions for such services that are incidental to the "professional services" covered and thus trigger a duty to defend some data breach claims that arguably fall within the exception.

On the other hand, some E&O policies are expressly designed to provide coverage for such claims. For example, many E&O policies issued to technology companies recognize that such insureds are engaged in activities likely to make them more prone than companies in other industries to involvement in electronic data breaches, either as direct targets or as vendors to others. Thus, policies available to such technology companies may also include coverages directly encompassing data breach claims. Cyber risks are also increasing professional liability and other errors and omissions exposures in another way, particularly for insurance brokers and entities involved in providing network security or other network services: there will likely be an increasing number of claims to be addressed that professionals failed to adequately advise their clients about cyber risks. As cyber risks become increasingly known as a significant risk to businesses that can result in substantial costs and claims, entities sustaining a costly cyber attack or privacy-related claim will be looking for others to share those costs with it. If insurance for the types of costs and losses was available in the market, but not discussed with an entity as a potential part of its insurance program, that may make the entity's broker a target. When a vendor is involved, that entity and its indemnity agreements and insurance will also be scrutinized as a source of recovery. Thus, regardless of the applicability of policy limitations and exclusions of coverage, companies in the insurance industry will have the increased cost of dealing with a growing frequency of claims to address.

Often the coverage issues include whether the claim is within the scope of covered services, whether the insured's error that caused the alleged damage or financial injury in question falls under the policy's definition of "wrongful act," whether there

are alleged to be "damages" covered by the policy, whether contractual liability exclusions apply to indemnity claims, and whether there is an exclusion directed at data breach or other electronic claims.[37]

(vi) D&O

As large publicized data breaches and other cyber incidents involving publicly traded companies often result in drops in companies' stock prices, companies and their directors and officers who are faced with such a data breach or other type of cyber attack or incident may well also face the securities/D&O claims that frequently accompany a significant and unexpected fall in stock prices and allegations of failure to disclose a material risk. For example, following the Heartland data breach, the company's stock price fell, and shareholders pursued securities fraud litigation against Heartland on the basis that it had misrepresented the state of its computer security. While the suit was ultimately dismissed, it shows the potential for shareholder litigation against companies that are victims of data breaches.[38]

Further, with the increasing issuance by state and federal agencies of data security regulations requiring the institution of data security protocols by companies, some of which expressly require board review of data protection plans and procedures, there is likely to be a concomitant increase in D&O claims. For example, in addition to the accountability placed on boards by the Sarbanes-Oxley Act of 2002, the federal Red Flags Rule discussed above specifically requires that the board of directors, a board committee, or a designated employee at the level of senior management be involved in the oversight, development and administration of the required identity theft prevention program. In addition, as discussed above, in October 2011, the SEC Division of Corporation Finance released a Disclosure Guidance stating that public companies may need to disclose their exposure to cyber security risks and incidents as potential material information subject to securities law disclosure requirements and accounting standards.[39] This also potentially provides grounds for claims against directors and officers as well as public entities alleging inadequate disclosure.

If a data breach leads to a suit by the owners of the compromised data – or by shareholders if the breach leads to a large loss to the insured company – against the allegedly responsible directors or officers, those directors and officers may look to their D&O policies to see if there is coverage (mindful, of course, of any exclusions that may apply).[40] Similarly, in the event of a securities action, the targeted company will likely look to any entity coverage provided by such policies.

(vii) Kidnap and Ransom/Cyber Extortion

Corporations and individuals operating in high-risk areas around the world often carry kidnap and ransom coverage. The policies typically provide indemnity in connection with ransom payments and personal accident losses caused by kidnapping incidents. Such policies may also cover extortion, including extortion related to a threatened introduction or activation of a computer virus to the insured's computer system unless a ransom is paid. Depending on the policy's scope of coverage, including how the policy defines "virus," such coverage may extend to a hacker's threatened use of software to capture private data.

With the increase in threats of cyber extortion in recent years, policies specifically directed at cyber extortion are now available and often offered in conjunction with specialty policy products directed at providing coverage for network security and related risks.▼

1 For example, in February 2013, a putative class action was filed against an insurance company following an October 2012 data breach. The proposed class was alleged to include approximately 1.1 million people, and defined as follows in the complaint:

> All persons who sought an insurance quote from Nationwide Mutual Insurance Company or Allied Insurance Company, and whose names, and some combination of their Social Security numbers, driver's license numbers, dates of birth, marital statuses, genders, occupations, and their employers' names and addresses, were compromised by the October 3, 2012 data breach of the computer network used by Nationwide Mutual Insurance Company and Allied Insurance Company agents ....

The action is currently pending in Ohio federal court. *See Galaria et. al. v. Nationwide Mutual Insurance Company*, No. 2:13-cv-118 (S.D. Ohio, filed Feb. 8, 2013). On Apr. 19, 2013, the defendant insurance company filed a 12(b)(6) motion to dismiss the action, in part, on the basis that the plaintiffs failed to allege any cognizable harm from the intrusion or that any third party used any of their personal information.

2 In *Daly v. Metropolitan Life Ins. Co.*, 4 Misc. 3d 887, 782 N.Y.S. 2d 530 (2004), a New York state court denied a motion to dismiss claims brought by a life insurance applicant against a life insurer arising from the purported theft of her personal information by a janitor who cleaned the insurer's premises and which resulted in fraudulent use of her personal information to create credit accounts. The court noted that after completing her application, the applicant had received a Privacy Notice from the insurer detailing the company's privacy policy and stating that confidential information would be safeguarded. The court held that the gravamen of the plaintiff's claim was that in order to obtain a life insurance policy the plaintiff had to provide sensitive personal information and the insurer represented that information would be protected and remain confidential. Thus, the court held that the insurer had a common law duty to protect the confidential personal information provided by the applicant and, in light of questions of fact concerning precautions taken by the insurer to safeguard that information, it denied summary judgment of claims at that juncture.

3 The Ohio Bulletin is available at http://www.insurance.ohio.gov/Legal/Bulletins/Documents/2009-12.pdf.

4 The Rhode Island Regulation is available at http://www.dbr.state.ri.us/documents/rules/insurance/InsuranceRegulation107.pdf.

5 The Wisconsin Bulletin is available at http://oci.wi.gov/bulletin/1206security.htm.

6 The Connecticut Bulletin is available at http://www.ct.gov/cid/lib/cid/Bulletin_IC_25_Data_Breach_Notification.pdf.

7 For instance, in July 2011, Wellpoint Inc. (an Indiana-based insurer) reportedly agreed to pay the State of Indiana $100,000 for failure to promptly notify consumers and the Indiana Attorney General after the Personal Information of thousands of Wellpoint customers was potentially accessible through an unsecured website. This settlement followed a 2010 lawsuit brought by the Indiana Attorney General against Wellpoint under Indiana's data breach notification statute. *See* Press Release, Attorney General reaches settlement with Wellpoint in consumer data breach, July 5, 2011, http://www.in.gov/portal/news_events/71252.htm.

8 *See The Betterley Report – Cyber/Privacy Insurance Market Survey 2012: Surprisingly Competitive, as Carriers Seek Market Share*, June 2012; *Data protection measures could increase demand for cyber risk products*, Post Magazine, Dec. 16, 2011; *Cyber risks and data privacy market set for strong 2012 growth*, Insurance Insider, Dec. 12, 2011.

9 *See, e.g., Florists' Mut. Insurance. Co. v. Ludy Greenhouse Mfg. Corp.*, 521 F. Supp.2d 661, 680 (S.D. Ohio 2007); *Philadelphia Parking Authority v. Federal Insurance Co.*, 385 F. Supp.2d 280, 288 (S.D.N.Y. 2005).

10 *See, e.g., Ward General Services, Inc. v. Employers Fire Ins. Co.*, 114 Cal.App.4th 548, 556-57 (Cal.App. 4 Dist. 2003); *Southeast Mental Healthcare Center, Inc. v. Pacific Insurance Company, LTD,* 439 F.Supp.2d 831, 838-839 (W.D. Tenn. 2006); *America Online, Inc. v. St. Paul Mercury Ins. Co.*, 347 F.3d 89, 93-98 (4th Cir.2003); *State Auto Property & Cas. Ins. Co. v. Midwest Computers &*

Corporations and individuals operating in high-risk areas around the world often carry kidnap and ransom coverage.... Such policies may also cover extortion, including extortion related to a threatened introduction or activation of a computer virus to the insured's computer system unless a ransom is paid.

More, 147 F.Supp.2d 1113 (W.D.Okla. 2001). Courts reaching a different conclusion have done so where the data is permanently lost to its owner, not merely improperly accessed. *See Computer Corner, Inc. v. Fireman's Fund Ins. Co.*, 46 P.3d 1264 (N.M. 2002) (holding that loss of the pre-existing electronic data was tangible property damage covered by CGL policy where computer store repairing customer's computer permanently lost all the data); *American Guar. & Liab. Ins. Co. v. Ingram Micro, Inc.*, 2000 WL 726789, 2000 U.S. Dist. LEXIS 7299 (D. Ariz. Apr. 18, 2000) (holding that computer data permanently lost during a power outage constituted "direct physical loss or damage from any cause" covered by first-party insurance policy); *NMS Services Inc. v. Hartford*, 62 Fed.Appx. 511 (4th Cir. 2003) (characterizing the erasure of vital computer files and databases as direct physical loss or damage to property for purposes of business income coverage).

11 *See, e.g., Eyeblaster, Inc. v. Federal Ins. Co.*, 613 F.3d 797 (8th Cir. 2010).

12 *See, e.g., Lambrecht & Assocs. Ins. v. State Farm Lloyds*, 119 S.W.3d 16 (Tex. App. 2003) (holding that a property policy covered loss of business income due to damage to software and electronic data by a virus, where the section of the policy defining coverage for loss of income included "electronic media and records," defined to include electronically stored data); *see also Southeast Mental Health Center, Inc. v. Pacific Ins. Co.*, Ltd., 439 F.Supp.2d 831,837-39 (W.D. Tenn. 2006) (finding corruption of a commercial insured's pharmacy computer after a storm and power outage constituted "direct physical loss of or damage to property" under business interruption policy).

13 Hossein Bidgoli, Handbook of Information Security, 820 (John Wiley and Sons, 2006).

14 For example, in *Retail Ventures, Inc. v. National Union Fire Ins. Co. of Pittsburgh, PA*, No. 2:06-CV-00443 (S.D. Ohio, Mar. 30, 2009), *aff'd*, 2012 WL 3608432, at *9 (6th Cir. Aug. 23, 2012), decided under Ohio law, coverage was held to be available for a data breach under a "Computer & Funds Transfer Fraud" endorsement of a commercial crime policy. There, a hacker fraudulently accessed a national retail company's computer system and stole data for approximately 1.4 million customers, including credit card and checking account information. As a result of the breach, among other costs, the U.S. Secret Service initiated an investigation; the company paid the cost of reissuance of credit cards for customers whose account information was fraudulently used; the Ohio Attorney General brought suit; and four class action lawsuits were brought by customers. The insurer argued, in part, that (1) the theft of the customers' data did not result in a "direct loss" to the store under the endorsement language, which only covered "loss . . . resulting directly from" theft of insured property, and (2) the following exclusion was applicable: "Coverage does not apply to any loss of proprietary information, Trade Secrets, Confidential Processing Methods, or other confidential information of any kind." The district court, however, disagreed with both points. It determined that the "direct loss" language of the endorsement required only application of the traditional *proximate cause* standard, and found that there was a "sufficient link between the computer hacker's infiltration of [the company's] computer system and [the company's] financial loss to require coverage . . . ." Second, the district court held the exclusion inapplicable, in part, because the information obtained in the hacking theft did not constitute "proprietary information" or even "other confidential information of any kind" within the meaning of the exclusion. On appeal, the Court of Appeals for the Sixth Circuit recently affirmed. *See Retail Ventures, Inc.*, Nos. 10-4576, 10-4608, 2012 WL 3608432, at *9 (6th Cir. Aug. 23, 2012) (holding that the district court correctly applied the proximate cause standard, and that "stored data consisting of customer credit card and checking account information would not come within the plain and ordinary meaning of 'proprietary information'"). However, the policy in issue apparently did not include an electronic data exclusion or other terms that, if present, might well have led to a different result.

15 This is standard policy language in recent ISO form policies (see CG 00 01 12 04). While there is variance in language among different insurers' CGL policies, the ISO language is in widespread use and there are judicial decisions dealing directly with ISO wordings.

16 If tangible property is actually stolen, however, such as a CD containing personal information, it is possible that a court may find the "property damage" requirement satisfied (depending upon the precise definition of "property damage" in the policy at issue), at least for purposes of a duty to defend, although exclusions may nonetheless operate to preclude coverage. *See, e.g., Nationwide Ins. Co. v. Central Laborers' Pension Fund*, No. 11-cv-618, 2012 WL 734193 (S.D. Il. Mar. 6, 2012) (employee of an accounting firm left a laptop with a CD in her automobile containing personal information of approximately 30,000 participants and beneficiaries of several pension funds that the accounting firm was performing audit work for; following theft of the CD, and claims by the pension funds against the employee to recover costs incurred as a result of the theft such as credit monitoring, the employee submitted a claim for coverage under her homeowner's policy, which provided coverage "[i]f a . . . suit is brought against an 'insured' for damages because of . . . 'property damage' caused by an 'occurrence' to which this coverage applies," and defined "property damage" as "physical injury to, destruction of, or loss of use of tangible property"; the district court held, under Illinois law, and for purposes of a duty to defend, that the property damage requirement was satisfied because the employee suffered a "loss of use of tangible property," but nonetheless held coverage excluded because the policy did not cover "property damage to property rented to, occupied or used by or in the care of the insured"), *aff'd*, 704 F.3d 522 (8th Cir. 2013) (finding that the exclusion for "in care of" the insured applied, as well as alternatively an exclusion for "property damage arising out of or in connection with a business engaged in by an insured").

17 *But see, e.g., Eyeblaster, Inc. v. Federal Ins. Co.*, 613 F.3d 797, 801-02 (8th Cir. 2010) (underlying allegations of loss of use of a computer – *e.g.*, that the computer "froze," was "taken over and could not operate," and was otherwise "no longer usable" due to software installed by the insured – held sufficient to satisfy the "loss of use of tangible property that is not physically injured" prong of the definition of "property damage").

18 The ISO definition of "property damage" also defines "electronic data" for purposes of applying the policy: "As used in this definition, electronic data means information, facts or programs stored as or on, created or used on, transmitted to or from computer software, including systems and applications software, hard or floppy disks, CD-ROMS, tapes, drives, cells, data processing devices or any other media which are used with electronically controlled equipment."

19 ISO has announced that its 2013 CGL policy form includes a revision of the electronic data that would make the exclusion expressly *inapplicable* to bodily injury claims. *See, e.g., Changes to the CGL Coverage Form*, International Risk Management Institute, Inc., Feb. 2013 ("The exclusion is being revised to make it inapplicable to bodily injury claims, meaning that only consequential property damage resulting from an electronic data loss is excluded. So, for example, loss of production on a computerized manufacturing assembly line caused by damage to the software that runs it would be excluded from CGL coverage. Injury to a patient in a hospital caused by the accidental corruption of electronic medical records would not be

excluded.").

20 This is in contrast to Coverage A, which is typically triggered by an *accidental* occurrence. *Accord, e.g., Stonelight Tile, Inc. v. Cal. Ins. Guarantee Ass'n*, 58 Cal. Rptr. 3d 74, 89 (Cal. Ct. App. 2007) ("Personal injury liability is a term of art that covers certain enumerated offenses. Unlike liability coverage for property damage or bodily injury, personal injury coverage is not based on an accidental occurrence.").

21 *See* CGL Policy Handbook, § 9.01 (2d ed. 2011).

22 The ISO revisions to its 2013 CGL form include the option of an endorsement that deletes the prong of "oral or written publication, in any manner, of material that violates a person's right of privacy" from the list of covered offenses in Coverage B. See ISO form CG 24 13 04 13, Amendment of Personal and Advertising Injury Definition; *see also*, Chris Boggs, *ISO's CGL Changes for 2013 – Part III*, Claims Journal, Apr. 9, 2013, www.claimsjournal.com/new/national/2013/04/09/226615.htm. If such an endorsement were included in a policy, that would be a potentially significant change in the coverage afforded under the policy and remove the basis for many of the arguments that have been presented in coverage disputes for coverage of data breach claims under CGL policies. *See, e.g., Changes to the CGL Coverage Form*, IRMI, Feb. 2013, *supra*; Ted A. Kinney, *2013 Change in the Commercial General Liability Program*.

23 *See Pietras v. Sentry Ins. Co.*, 2007 WL 715759, 2007 U.S. Dist. LEXIS 67013 (N.D. Ill. 2007) (holding under Illinois law that the insurer had a duty to provide a defense); *American Family Mutual Ins. Co. v. C.M.A. Mortgage, Inc.*, 2008 WL 906230 (S.D. Ind. 2008) (holding under Indiana law that a claim involving improper use of credit reports in violation of FCRA states a potentially covered claim and thus triggers the insurer's duty to defend) (order rescinded in part due to docketing error, 2008 WL 5069825); *Zurich American Ins. Co. v. Fieldstone Mortgage Co.*, 2007 WL 3268460 (Md. Dist. Ct. 2007) (holding under Maryland law that a FCRA claim based upon improper access and use of others' credit information triggered a duty to defend).

24 To the extent statutes create a "right of privacy" in the type of Personal Information in issue, CGL policies typically also include an exclusion applicable to Coverage B for Violation of Information Law that may preclude coverage for claims based on violations of such statutes.

25 *See, e.g., Allstate Ins. Co. v. Ginsberg*, 863 So.2d 156 (Fl. 2003) (finding absence of personal injury coverage because underlying claims did not allege common law violation of privacy); *Lextron, Inc. v. Travelers Cas. and Sur. Co. of America*, 267 F.Supp.2d 1041, 1047 (D. Colo. 2003) (looking to the Restatement (Second) of Torts for guidance); *A & B Ingredients, Inc. v. Hartford Fire Ins. Co.*, No. 08-6264, 2010 WL 5094419 (D. N.J. Dec. 8, 2010) (holding absence of personal and advertising injury coverage on the basis of a broad statutory exclusion and a finding that the jurisdiction in which the underlying claims arose apparently did not recognize common law privacy violations in that context); *Ananda Church of Self Realization v. Everest Nat. Ins. Co.*, No. C038570, 2003 WL 205144, 2003 Ca. App. Unpub. LEXIS 1095 (Cal. Ct. App. Jan. 31, 2003) (unpublished) (holding absence of Coverage B coverage, in part, on the basis that the type of information at issue, while confidential, were not facts that "the average person would find offensive or objectionable"); *Ruiz v. Gap, Inc.*, 540 F.Supp.2d 1121 (N.D. Cal. 2008), *aff'd*, 380 Fed.Appx. 689 (9th Cir. 2010) (holding that the employer's possible negligence (i.e., in allowing the computers containing unencrypted personal information of job applicants to be stolen) did not rise to the level of egregiousness required). *See also State Farm Fire and Cas. Co. v. National Research Center for College and University Admissions*, 445 F.3d 1100, 1103 (8th Cir. 2006) (deciding under Missouri law and defining "privacy" as "isolation, seclusion, or freedom from unauthorized oversight or observation.")

26 *See Zurich v. Fieldstone, supra*, 2007 WL 3268460 at *5; *see also, e.g. Park Univ. Enterprises, Inc. v. American Cas. Co. of Reading*, 442 F.3d 1239, 1248-49, 1250 (10th Cir. 2006) (applying Kansas law and holding that violation of a law prohibiting unsolicited fax advertisements violated "a species of privacy interest"; that it is reasonable to define publication as "making something generally known" and faxing advertisements is to effectively "publish;" and that there was therefore a duty to defend).

27 *Id. See also LensCrafters, Inc. v. Liberty Mut. Fire Ins. Co.*, No. C-04-1001, 2005 WL 146896 (N.D. Cal. Jan. 20, 2005) (involving alleged disclosure of private medical information); *Moore v. Hudson Ins. Co.*, No. B189810, 2007 WL 172119, at *6 (Cal. Ct. App. Jan. 24, 2007) (unpublished) (discussing scope of dissemination required).

28 *Whole Enchilada, Inc. v. Travelers*, 581 F. Supp. 2d 677, 698 (W. Dist. Pa. 2008); *see also Creative Hospitality Ventures, Inc. v. U.S. Liability Ins. Co.*, No. 08-cv-22302 (S.D. Fla. Mar. 23, 2011) (restaurant printed more than five digits of customers' credit card numbers on printed receipts, along with expiration dates, in alleged violation of FACTA; court found no "publication" for purposes of Coverage B had occurred because the underlying complaint lacked allegations of any "dissemination of information to the public," or even any "allegation that any FACTA-violation receipt was provided to anyone other than the cardholder"), *aff'd*, No. 11-11781, 2011 WL 4509919, at *5 (9th Cir. Sept. 30, 2011) ("In sum, providing a customer a contemporaneous record of a retail transaction involves no dissemination of information to the general public and does not constitute publication within the meaning of Essex's Policy").

29 *Bowyer v. Hi-Lad Inc.*, 609 S.E.2d 895, 912 (W.Va. 2004) (insured argued that the term "publication" was ambiguous and should be construed against the insurer to cover an employee's underlying claim that the insured "used the surveillance system to capture his oral communications, and then publish that audio material through speakers to the officers and employees" of the insured's business; the court held that there was "nothing in the policy indicating that the word publication necessarily means transmitting the intercepted communications to a third party, as is required of material in the defamation context. And, even were we to assume publication does require communicating to a third-party, the surveillance monitoring system apparently functioned in such a way that anyone in the manager's office or in [the hotel owner's] home had the ability to listen in on employee conversations").

30 *See, e.g., Recall Total Info. Mgmt. Inc. v. Fed. Ins. Co.*, No. X07CV095031734S, 2012 WL 469988, at *6-7 (Conn. Super. Ct. 2012) (130 computer data tapes, containing personal information for more than 500,000 IBM employees, fell from the back of a transport truck and were then removed by an unknown person and never recovered; court found "publication" for purposes of Coverage B did not occur because there was "no evidence of *communication* to a third party," finding "the loss and the subsequent theft of the tapes . . . is not the offense, publication . . . that the policy contemplates to trigger personal injury coverage.") (emphasis added); *Butts v. Royal Vendors, Inc.*, 202 W.Va. 448, 504 S.E.2d 911 (W. Va. 1998) (per curiam) (employee filed civil action against his employer for wrongful inducement after the employee's physician made certain statements in alleged breach of the patient's privacy; employer then sought coverage under its CGL policy that provided coverage for "oral or written publication of material that violates a person's right of privacy"; court found that no coverage existed under this section of the policy because there was no allegation that the insured affirmatively disseminated any statements in violation of the employee's privacy; rather, the complaint alleged that the employer "induced" a third party – *i.e.*, the employee's treating physician – to do so; the court specifically stated that the Coverage B publication offense was "not written to cover publication by a third party"); *see also Harrow Products, Inc. v. Liberty Mut. Ins. Co.*, 64 F.3d 1015, 1025 (6th Cir. 1995) (stating that "each enumerated tort in the personal injury clause requires an intentional act" under a policy that included coverage for "publication . . . in violation of an individual's right of privacy"); *Gregory v. Tennessee Gas Pipeline Co.*, 948 F.2d 203, 209 (5th Cir. 1991) (stating that "each of the enumerated risks specifically assumed requires active, intentional conduct by the insured" in relation to a policy that included coverage for "oral or written publication of material that violates a person's right of privacy"); *Buell Industries, Inc. v. Greater New York Mut. Ins. Co.*, 259 Conn. 527, 562, 791 A.2d 489, 510-11 (Conn. 2002) (stating that a policy's "personal injury provisions were intended to reach only intentional acts by the insured" in relation to a policy that included coverage for "a publication . . . in violation of an individual's right of privacy"); *County of Columbia v. Cont'l Ins. Co.*, N.Y.2d 618, 634 N.E.2d 946 (N.Y. 1994) (stating that "the coverage under the personal injury endorsement provision in question was intended to reach only purposeful acts undertaken by the insured or its agents" under a personal injury endorsement that provided coverage for "publication" that constituted an invasion of an individual's right of privacy").

31 Currently pending are several lawsuits concerning requests by policyholders for coverage, or at least a defense, under Coverage B for claims arising from breach-related events. *See, e.g., Nationwide Mutual Fire Insurance Company v. First Citizens Bank and Trust Co., Inc.*, No. 4:13-cv-00598 (filed Mar. 6, 2013 in Illinois federal court); *see also Zurich v. Sony et. al.*, No. 651982/2011 (currently pending in New York state court). *See also* case discussions in the section below about Privacy Litigation.

32 Some courts have distinguished between the terms "publication" and "making known" for purposes of Coverage B coverage. *Compare Motorists Mut. Ins. Co. v. Dandy-Jim, Inc.*, 182 Ohio App.3d 311, 319, 912 N.E.2d 659, 655 (Ohio App. Ct. 2009) (*distinguishing* "publication" from "making known" for Coverage B purposes), *and Zurich American Ins. Co. v. Fieldstone Mortg. Co.*, No. CCB-06-2055, 2007 WL 3268460, *5 (D. Md. Oct. 26, 2007) (same), *with State Farm General Ins. Co. v. JT's Frames, Inc.*, 181 Cal.App.4th 429, 104 Cal.Rptr.3d 573 (Cal. Ct. App. 2010) (equating the term "publication" to "making known to any person or organization" for Coverage B purposes).

As large publicized data breaches and other cyber incidents involving publicly traded companies often result in drops in companies' stock prices, companies and their directors and officers who are faced with such a data breach or other type of cyber attack or incident may well also face the securities/D&O claims that frequently accompany a significant and unexpected fall in stock prices and allegations of failure to disclose a material risk.

33 *Netscape Communications Corp. v. Federal Ins. Co.*, 2007 WL 2972924 (N.D.Cal.), *reversed, Netscape Communications Corp. v. Federal Ins. Co.*, 2009 WL 2634945 (9th Cir., Aug. 27, 2009). The Ninth Circuit found the policy's language regarding "any person or organization" to be dispositive. However, the Ninth Circuit disagreed with the lower court regarding the applicability of an exclusion to Coverage B. The policy excluded coverage for personal injury offenses relating to defined "online activities," including the provision of Internet access. While the lower court held that the exclusion barred coverage because the claims involved the use of software to assist with downloading files, the Ninth Circuit, reading the exclusion narrowly, reasoned that the software itself does not provide Internet access, and thus the exclusion did not apply.

34 This exclusion was slightly modified and expanded in ISO's latest 2013 filing, and now, among other things, lists not only the TCPA, CAN-SPAN Act of 2003, but also the Fair Credit Reporting Act. A variation of this exclusion was construed in *Creative Hospitality Ventures, Inc. v. U.S. Liability Ins. Co.*, 655 F.Supp.2d 1316 (S.D. Fla. 2009) (Rosenbaum, U.S.M.J.), *adopted in part, ruling reserved in part*, 655 F.Supp.2d 1316 (S.D. Fla. 2009). There certain underlying claims alleging FACTA credit card violations against a restaurant were excluded from personal and advertising injury coverage under the policy's "Distribution Of Material In Violation of Statutes" exclusion (that exclusion excluded coverage for personal and advertising injury "arising directly or indirectly out of any action or omission that violates or is alleged to violate . . .[a]ny statute, ordinance or regulation . . . that prohibits or limits the sending, transmitting, communicating or distribution of material or information"). It was held that because FACTA is a "statute that limits the information that . . . an electronically printed receipt . . . may include . . . FACTA qualifies as a statute that 'prohibits and limits the ... communicating or distribution of material or information,' within the ordinary meaning of the terms of this exclusion." It should be noted that the Court of Appeals for the Eleventh Circuit issued a related decision (as to another restaurant), and held that a restaurant's issuance of a credit card receipt to a customer does not constitute "publication" within the meaning of the clause "publication . . . of material that violates a person's right of privacy." *See Creative Hospitality Ventures, Inc. v. U.S. Liability Ins. Co.*, No. 11-11781, 2011 WL 4509919 (11th Cir. Sept. 30, 2011). The court reasoned that such a transaction involves "no dissemination of information to the general public." *Id.* at *5. As a result, the Ninth Circuit did not need to reach whether any exclusion was applicable because coverage was not triggered due to the absence of any "publication" by the insured.

35 *See Collective Brands, Inc. v. National Union Fire Ins. Co. of Pittsburgh, P.A.*, No. 11-4097-JTM, 2013 WL 66071 (D. Kan. Jan. 4, 2013) (finding that nothing in the exclusion required a formal adjudication and that it was sufficient if the liability arose from excluded statutory violations for the exclusion to apply); *see also Interline Brands, Inc. v. Chartis Specialty Ins. Company*, No. 3:11-cv-731-J-25JRK (M.D. Fla. Nov. 21, 2012) ("The Court cannot find legal precedence to rewrite the insurance contract to necessitate there being an 'adjudged violation' for the exclusion to apply"). *Interline Brands, Inc.* is currently on appeal in the Court of Appeals for the Eleventh Circuit.

36 See cases identified in footnotes in this section, and in the section below about Privacy Litigation.

37 For example, the "wrongful act" coverage requirement has been found (under some states' law) to include "intentional, non-negligent acts but to exclude *intentionally wrongful* conduct." (Emphasis added). See *Eyeblaster, Inc. v. Federal Ins. Co.*, 613 F.3d 797, 804 (8th Cir. 2010) (under Minnesota law). In *Eyeblaster, Inc.*, a computer user sued Eyeblaster, Inc., alleging that Eyeblaster injured his computer, software, and data after he visited an Eyeblaster website. The E&O policy at issue obligated Eyeblaster's insurer "to pay loss for financial injury caused by a *wrongful act* that results in the failure of Eyeblaster's product to perform its intended function or to serve its intended purposes." The insurer conceded that the underlying claim sufficiently alleged "financial injury." Nonetheless, the insurer argued (and the district court agreed) that coverage was non-existent because Eyeblaster had acted intentionally, and thus no "wrongful act" within the meaning of the policy had occurred ("wrongful act" was defined under the policy as "an error, an unintentional omission, or a negligent act"). On appeal, the Court of Appeals for the Eight Circuit reversed, finding that although Eyeblaster had acted intentionally in placing its software in the underlying complainant's computer, there was "no evidence that the allegations . . . spoke of intentional acts that were either negligent or wrongful." Thus, the court held that the underlying complaint had sufficiently alleged a "wrongful act" on the part of Eyeblaster within the meaning of the policy, and consequently that a duty to defend had been triggered.

38 *In re Heartland Payment Systems, Inc. Securities Litigation*, Civ. No. 09-1043 (D.N.J., Dec, 7, 2009). The court found that the securities fraud claims failed to meet the heightened pleading standards provided by the Private Securities Litigation Reform Act of 1995 (PSLRA). The court explained that the PSLRA requires fraud to be pleaded with particularity, and also requires plaintiffs to state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind. Citing the Supreme Court's decision in *Tellabs, Inc. v. Makor Issues & Rights Ltd.*, 551 U.S. 308 (2007), the court explained that a complaint will adequately allege state of mind only if a reasonable person would deem the inference of scienter to be at least as strong as any inference of non-fraudulent intent. The court held that the plaintiffs had failed to meet this heightened pleading requirement. In particular, the court held that the defendant's statements regarding its computer security, when examined in context, were not misleading. The court also held that the plaintiffs had failed to allege that the defendant knew or should have known that its statements were false. Having found that the complaint failed to adequately allege two of the elements of its fraud claims, the court dismissed the complaint with prejudice.

39 For more information regarding the recently released Disclosure Guidance, *see Edwards Wildman Palmer LLP Client Advisory*, "*Public Companies May Need to Disclose their Exposure to Material Cyber Security Risks According to New Guidance Issued by SEC Division of Corporation Finance*," Oct. 2011, http://www.edwardswildman.com/newsstand/detail.aspx?news=2634.

40 As to exclusions, it is possible, for instance, that the D&O policy at issue may exclude claims arising from violations of privacy rights, thus potentially limiting the scope of available coverage in the event of a data breach. *See, e.g., Resource Bank v. Progressive Cas. Ins. Co.*, 503 F.Supp.2d 789, 795-97 (E.D. Va. 2007) (insured sought coverage under its D&O policy for two class action lawsuits alleging that the insured violated the Telephone Consumer Protection Act by sending unsolicited facsimile advertisements; court held coverage was excluded, in part, on the basis of the policy's Bodily Injury and Property Damage Exclusion that excluded coverage for claims of "invasion of privacy").

news and notices

ARIAS Announces New Intensive Arbitrator Training Workshop

ARIAS•U.S. will be conducting the next Arbitrator Training Workshop on Wednesday, September 18, 2012 at the newly renovated Crowne Plaza Hotel in White Plains, New York.

This full-day training program will focus on the effective engagement of party arbitrators. Presentations by industry veterans and involvement in mock sessions will emphasize the role of the party-appointed arbitrator in the arbitration process.

The format of this workshop is different from previous programs in that arbitrators will have more time on the mock panels and feedback will be integrated into the sessions. Also, the faculty will present a new sequence of topics during the instruction periods.

This will be the only Intensive Arbitrator Training Workshop conducted during 2013. It is required for anyone who intends to apply for arbitrator certification under Options B or C of the Arbitration Experience / Knowledge Component of the ARIAS•U.S. Certification Requirements. It is not considered an "educational seminar" for purposes of arbitrator certification renewal or initial certification.

The program will begin with a dinner on the previous evening with the Umpire Master Class attendees. **Registration and hotel reservations will close on August 30.**

Complete details are available on the website Calendar.▼

ARIAS Announces Umpire Master Class

The first in a series of new educational classes has been created by the Education Committee focused on training for the role of umpire in a reinsurance arbitration. It is set for September 18, as well.

This half-day course will take place that morning also at the Crowne Plaza Hotel. It will begin with a dinner on the previous evening with the Intensive Arbitrator Training Workshop attendees. **Registration and hotel reservations will close on August 30**. This class provides "Educational Seminar" credit for certification renewal and qualifies for initial arbitrator certification as a seminar under Option C. It was open to all ARIAS-U.S. members.

Complete details are available on the website Calendar.▼

James Sherman is Approved as Certified Arbitrator

At its meeting on June 4, the ARIAS•U.S. Board of Directors approved **James E. Sherman** as a Certified Arbitrator, bringing the number of arbitrators to 226. His sponsors were Denis Loring, Susan Mack, and Joseph McCullough. His biography is on page xx of this issue. His profile is on the website.▼

Donald DeCarlo Approved as Qualified Mediator

On July 30, the ARIAS•U.S. Board of Directors approved the application of **Donald T. DeCarlo** to be an ARIAS•U.S. Qualified Mediator, bringing the total number to 34.▼

DID YOU KNOW...?

THAT DURING THE MONTHS LEADING UP TO AN ARIAS•U.S. CONFERENCE, THERE IS A PRELIMINARY ATTENDEE LIST ON THE HOME PAGE THAT IS UPDATED ONCE OR TWICE A WEEK.

Fall Conference to Support Career Gear and Dress for Success

For the second year, ARIAS will ask attendees at the Fall Conference to bring along some extra clothing when they come to the Hilton.

ARIAS will be collecting men's and women's suits and accessories that are in good condition for distribution to Career Gear (men) and Dress for Success (women). These are national non-profit organizations that promote the economic independence of disadvantaged men and women by providing not only a suit, but also a network of support and the necessary career development tools to help them become successful, self-sufficient members of their communities.

Complete details will be sent to all ARIAS members in September.▼

Fall Educational Seminars Will Feature Simultaneous Tracks

The Education Committee has begun development of the October seminars. As in the previous three years, this October 30 event will consist of two simultaneous tracks, one covering key aspects of the arbitration process, the other tackling some of its most difficult issues. The latter seminar is for very experienced arbitrators only.

Each "Educational Seminar" qualifies as one of the three requirements for renewal of ARIAS arbitrator certification. Details will be announced in late August, with registration beginning in mid-September.▼

feature

Regulation and Arbitration in the Brazilian Insurance/Reinsurance Market

Ilan Goldberg

Ilan Goldberg

The repercussion in the market was negative and touched off a good deal of lobbying to reestablish the rules as originally drawn. The restriction on intra-group transactions was particularly criticized, mainly by foreign reinsurers.

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I. Regulatory Environment:

The opening of the Brazilian reinsurance market dates to 2007, with enactment of Complementary Law[1] 126, resulting from Bill of Law 249, introduced in Congress in 2005. The bill was sent by the executive branch for consideration by lawmakers under a regime of urgency after the government concluded that the monopoly held for over seventy years by the state-controlled IRB - Brasil Resseguros S.A. was not efficient to serve the needs of the country's economic and social development.

The market received the new legislation positively and looked forward with great expectations to the follow-on regulations to put the changes into practice, to be issued by the National Council for Private Insurance (*Conselho Nacional de Seguros Privados* - CNSP), the policy-making body, and the Superintendent Office of Private Insurance (*Superintêndencia de Seguros Privados* - SUSEP), the industry supervisor.

Complementary Law 126/2007 contained some reservations, such as in its Art. 11[2], which established mechanisms to preserve the economic viability of IRB, by assuring local reinsurers 60% of all cessions in the first three years after the law took effect, and 40% thereafter. These measures were not well received, since the general feeling in the market was that free competition should not suffer restrictions, particularly in light of the absence of a constitutional provision for this.

During 2007 and 2008, the CNSP and SUSEP issued resolutions and other rules to regulate the provisions sketched out by Complementary Law 126/2007, to specify the way the market would function in practice.

CNSP Resolution 168/2007 defined, among other points: (i) the three types of reinsurers that would obtain authorization to operate (local, admitted and occasional); (ii) the requirements necessary for operation; (iii) rules for the exercise of the preferential right of local reinsurers; (iv) some mandatory contractual clauses; and (v) the prerogative afforded the parties to choose arbitration as an alternative method to resolve disputes[3].

On the matter of the mentioned market reserve to local reinsurers, CNSP Resolution 168/2007 conformed to the text of Complementary Law 126/2007, that is, reservation of 60% of cessions in the first three years and 40% thereafter[4]. Everything went smoothly until in 2010 the CNSP issued a set of new resolutions, substantially altering the rules established until then regarding the market reserve. The first was Resolution 224, which forbade intra-group transactions in the following terms:

> "§ 4. The responsibilities assumed under insurance, reinsurance or retrocession in the Country may not be transferred to companies connected to or belonging to the same financial conglomerate headquartered abroad."

Soon afterward, Resolution 225 was issued, imposing the 40% quota of reinsurance cessions to local reinsurers, without any ending date, as previously established in Complementary Law 126.

The repercussion in the market was negative and touched off a good deal of lobbying to reestablish the rules as originally drawn. The restriction on intra-group transactions was particularly criticized, mainly by foreign reinsurers. This in effect meant that companies established for decades, with financial solidity recognized by the leading rating agencies, could not maintain their subsidiaries in Brazil because these would be prohibited from laying off their risks with another company of the group abroad. Besides the financial aspects, CNSP

Resolution 224 was the target of strong criticism from the standpoint of legality, in light of the fact that Law 126 did not determine this restriction and an administrative rule can only regulate laws, not innovate on them.

In reaction to the criticism, and in a certain form recognizing the errors committed, in 2011 the CNSP issued Resolution 232, relaxing the rule against intra-group transactions. The new Resolution replaced the mentioned fourth paragraph of Article 14 of CNSP Resolution 168 and added others, the most relevant being paragraphs 7 and 8:

> "§ 4. Local insurers or reinsurers may not transfer to connected companies or companies belonging to the same financial conglomerate headquartered abroad more than 20% (twenty percent) of the premium corresponding to each coverage contracted.
>
> F. The maximum limit set forth in § 4 does not apply to the guarantee, export credit, rural, internal credit and nuclear risks lines, for which the reinsurance cession and retrocession are permitted to connected companies or companies belonging to the same financial conglomerate headquartered abroad, with observance of the other legal and regulatory requirements.
>
> § 8. The automatic contracts already signed shall be considered for the effect of the limit set forth in § 4, upon their renewal or as of March 31, 2012, whichever occurs first."

In summary, the CNSP eased the rule established by Resolution 224, which had imposed a total prohibition on intra-group transactions. The new Resolution 232 permitted these up to 20% with companies of the same group located abroad, and also allowed exceptions for certain lines and established a limited grandfather right for existing automatic contracts.

Finally, regarding the preference for local reinsurers, the regulations specify the procedure for the exercise of this right. In short, if the insurer obtains better quotations from admitted or occasional reinsurers, it must submit these to local reinsurers to give them a chance to match the offer. If insufficient local reinsurers accept the risk to reach the minimum guaranteed market reserve, then the cedent may lay off the risk to admitted and occasional reinsurers. The order or priority is detailed in Article 15 of Normative Resolution 168/ 2007[5].

Further regarding the preference enjoyed by local reinsurers, irrespective of the criticisms leveled at Resolutions 224, 225 and 232, it must be borne in mind that the purpose of regulators was to bring international players to the Brazilian market as securely as possible[6]. In this respect, it is better for there to be more local than admitted or occasional reinsurers because of the more stringent requirements for local reinsurers, especially the amount of capital that must be deposited with SUSEP.

Therefore, the rules regarding the division of risks among reinsurers depending on their type and origin of capital have a certain coherence, with the overall aim being to guarantee the solvency of the market, for the benefit of insureds and the insurance companies ceding risks.

This is a brief summary of the regulatory setting of the Brazilian reinsurance market at present. In numbers, there are now over 100 reinsurers authorized to accept Brazilian risks by SUSEP, of which 11 are local reinsurers[7].

II. Insurance, Reinsurance and Arbitration in Brazil:

Arbitration in Brazil is governed by Law 9,307 of 1996 (Arbitration Law). This law, inspired largely by the UNCITRAL Model Law and the Spanish Arbitration Law of 1988, has provided the legal framework for a significant advance in the use of arbitration in Brazil. The previous framework was specified in the Civil Procedure Code and discouraged arbitration by, among other provisions, requiring all arbitral awards to be ratified by a judicial court, subject to higher appeals.

The Arbitration Law was initially challenged on constitutional grounds, because the 1988 Federal Constitution provides that no law may deny parties the right to apply to the judiciary to resolve disputes[8]. The obstacle was finally overcome in December 2001, when the Court ruled that while a law may not preclude parties from seeking judicial relief, they can waive this right as an expression of contractual will regarding disposable pecuniary rights[9].

Since then, the use of arbitration has been increasing strongly. The table below shows this growing trend to use arbitration in Brazil in relation to other countries.

Ano	Quantidade arbitragens:	Posicao de (internacional)
2000	10	20ª
2001	28	12ª
2002	18	17ª
2003	22	14ª
2004	30	13ª
2005	35	11ª
2006	67	4ª
2007	35	11ª
2008	27	9ª

II.1 The Main Administrative Rules:

With respect to the rules that enable the use of arbitration in insurance and reinsurance, in the latter case arbitration enjoys blanket authorization, while in the former case there are separate rules on insurance for damages, persons and general civil liability.

On the matter of reinsurance, besides Art. 38 of CNSP Resolution 168/2007, Art. 41 of the resolution determines that both lawsuits and arbitral proceedings must be reported to SUSEP:

> Art. 41. Cedents and local reinsurers must maintain effective control over the contracts involving their portfolios of ceded and/or accepted risks, as the case may

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> be, with indication of the intermediaries, estimated and actual premiums, recovery of loss payouts as well as other relevant information, keeping such information at the disposal of SUSEP.
>
> Sole paragraph. The lawsuits or arbitral proceedings related to payment of claims refused by the reinsurer must be communicated to SUSEP within 30 (thirty) days counted from the date of their commencement. (emphasis added).

Regarding insurance of damages, arbitration is expressly mentioned in SUSEP Circular 256 of 2004, whose Art. 44 establishes specific rules for the validity of arbitration clauses:

> Art. 44. The Arbitration Commitment Clause, when inserted in an insurance contract, must obey the following provisions:
>
> I - be **written in boldface** and contain the **signature of the insured, under the clause itself** or in a **specific document, establishing express consent** to its application;
>
> II - contain the following information:
>
> a) that **adherence by the insured is facultative**;
>
> b) that in agreeing to the application of this clause, the **insured** will be **undertaking** to **resolve** all **disputes** with the insurance company by means of an **Arbitration Court**, whose decisions have the same effect as those rendered by the Judiciary Power;
>
> c) that it is governed by Law 9,307 of September 23, 1996." (emphasis added).

For insurance covering persons (life and personal accident), SUSEP Circular 302 of 2005 basically reproduces the above provision, in its Art. 85.

Regarding the rules for general civil liability insurance, the "standard general conditions" established by the regulator, through Circular 437 of 2012, also refer to the possibility of arbitration:

> "By agreement between the parties, without charging any additional premium, a specific arbitration clause may be included in the insurance contract."

As can be seen, from a general legal standpoint, arbitration is definitely present as a means of resolving disputes in question of both reinsurance and insurance, independent of the line.

On the matter of the minimum conditions that must be contemplated by the arbitration clause, it is necessary first to present some brief considerations on the rules established in the Consumer Defense Code, especially its Art. 51, VII[11]. According to this provision, any contractual clause in contracts with consumers that compels the use of arbitration is null.

This provision is relevant because most insurance contracts are subject to the rule, in particular mass policies with individuals, in all lines of coverage. Accordingly, the choice of whether or not to resolve a dispute must rest with the insured, who can never be forced to use arbitration.

For contracts covering large risks, the insured is almost always a large company, making it virtually impossible to apply consumer law, which is based on the idea that the consumer is the weaker party and is thus is deserving of special protection. The same goes for reinsurance contracts, where neither party can be considered a consumer. In general, even though companies can be considered consumers in some situations, this is not usually the case in insurance matters, based on the position that insurance acts as an input to the productive process, not a product that is consumed by the company[12].

11.2 Arbitration in Practice:

Although the legal and regulatory environment is fully in place, there have as yet not been many cases involving arbitration of insurance and reinsurance disputes in Brazil, for several reasons.

The first reason involves the monopoly enjoyed by IRB for over 70 years, which wound up creating a culture of aversion to litigation, particularly in matters involving large risks. During the monopoly, the needs for relevant reinsurance protection invariably reached the only reinsurer. No matter how solid the insurers were, they were obliged to cede their excess risks to the IRB, which in turn laid off its excess through retrocession,

mainly in the international market.

While the monopoly was in force, there were virtually no lawsuits or arbitrations between insurers and IRB for a very simple reason: they needed it to reinsure future risks, making them reluctant to take a confrontational stance. While this has no longer been the case since 2007, the monopoly has left a culture of avoiding litigation that still exists.

The few disputes that have occurred involving large risks have been resolved by the courts, including a case where interesting questions were addressed related to the use of arbitration. This case, decided by the São Paulo State Court of Appeal, involved a pool of insurers that intended to use arbitration, under the argument that there was an arbitration clause regularly accepted in the body of an insurance contract, stipulating resolution according to the rules of ARIAS UK, while the insureds, all large construction and energy companies, refused, claiming they had not specifically signed this clause, so they could not be forced to accept arbitration[13].

In fact, the insurance contract contained two clauses, one determining resolution of disputes exclusively through the judicial courts and the other stipulating arbitration. The question addressed by the court in face of this impossible situation was whether it should be resolved by the judiciary or arbitration, in other words where kompetenz-kompetenz rested.

A deeper examination of the question revealed that in fact the general conditions that contained the two clauses had been sent to the insureds after the negotiation and issuance of the policy, and the document had not been signed by them expressly agreeing to the choice of arbitration.

The appellate chamber ruled, by majority vote, to recognize the absence of the insureds' signature, so they could not be compelled to use arbitration to resolve disputes, as reflected in the leading opinion of the reporting judge assigned to the case:

> "However, careful analysis and evaluation of the question shows that Clause 12, unlike everything that was stated by the appellees, cannot prevail for a very simple reason: it does not have the express consent of all the parties, as required by Art. 4, § 2, of Law 9,307/96. SUSEP Circular 256/2004 contains the same requirements, establishing that the clause must "*be written in boldface and contain the signature of the insured, under the clause itself or in a specific document, establishing express consent to its application*" (numeral I) and must contain the information that " adherence by the insured is facultative" (numeral II, letter "a").
>
> In the presence of situations of this nature, Carlos Alberto Carmona teaches: ' *The most sensible way to* ***resolve this type of impasse will be to suspend the arbitral proceeding until the decision of the judge at law on the preliminary question submitted to him****, because in the final analysis, it will be a court of law that will have to face the question of the validity of the arbitration clause because the resistant party will file a lawsuit based on Art. 32 of the Law. Although this is not the hypothesis aimed at by Art. 25 of the Arbitration Law, the suspension of the proceeding appears, in casu, the* ***least traumatic*** *solution.'* (Arbitragem e Processo, Um Comentário à Lei. n°. 9.307/96, 2nd ed., Atlas, pp. 161 et seq.).
>
> The author continues, recalling that the doctrine ' *does not have a firm position in the sense of exactly identifying the limits of the investigation powers of the judge regarding the invalidity of arbitration clauses. Emmanuel Gaillard suggests that the judge may only declare an arbitration clause invalid when the defect is recognizable prima facie, that is, immediately, without the need for greater examination. It appears the illustrious Parisian professor is correct, since the limitation of cognizance only to aspects that can be immediately detected, without greater probing (hence summary cognizance),* ***is in harmony with the principle of kompetenz-Kompetenz adopted by the Law.'***
>
> In the final analysis, the defects in the contractual provisions, as indicated above, generate more than

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SAVE THE DATE

MAY 7 - 9 2014

In 2014, for the first time, ARIAS•U.S. will meet on Key Biscayne, a beautiful island just south of the Miami Beach barrier island. It is accessed by a causeway from Miami and is convenient to Miami International Airport.

While The Breakers is the member favorite, a change of venue keeps our conferences fresh. The Ritz-Carlton is one of the finest hotels in Florida, overlooking Biscayne Bay and the Atlantic Ocean. Hotel information is at http://www.ritzcarlton.com /keybiscayne .

Information about the 2014 Spring Conference will be posted on the website calendar and sent to all members as the date approaches.

This conference applies toward the conference component of the ARIAS certification and renewal requirements.

Ritz-Carlton Key Biscayne

ARIAS U.S.
2014 SPRING CONFERENCE

a reasonable doubt (...). (emphasis in the original)."

The second judge to vote diverged from the reporting judge's opinion, mainly under the argument that the insureds, all of them large companies accustomed to contracting insurance coverage of large risks, always knew that possible disputes would be resolved by arbitration. Here are some passages from his dissenting opinion:

> "(...) It is not credible that companies the size of the appellants are naive about the question of contracting insurance, particularly because they are companies accustomed to tenders, for the contracting and execution of large national and international projects, in various countries.
>
> It is not reasonable to argue they were ignorant of the procedures to contract insurance for huge works in the most varied places in the world. (...)
>
> For these reasons, there is no way to accept the allegation of lack of knowledge or acceptance of the arbitration clause in the policies in question, at least not at this procedural phase. It is up to the appellants to bring proof that in contracts such as these it is not common to have this type of clause."

This case had considerable repercussions in the legal community and elicited some interesting comments, such as that of Arnoldo Wald[14]:

> "First of all, the builders never accepted the arbitration clause, so the arbitration in London could never be conducted, because it resulted from a unilateral decision of the insurers.
>
> There is no doubt, as even recognized in the English decisions, that Brazilian law does not permit coercive arbitration and provides that the arbitration clause is only effective when accepted by both parties. (...) even assuming the presumption of acceptance of the fact that this is common in international deals, the thesis does not apply in relation to contracting by adhesion, which has a special regime.
>
> (...) In the present arbitration, there is no doubt that the insurance contract is an adhesion contract. Based on the proof that the arbitration clause was not accepted, the arbitration cannot be conducted and the English judiciary is evidently incompetent, so that jurisdiction rests in this case with the Brazilian courts."

In summary, the São Paulo State Court of Appeal held that arbitration could not be imposed on the insureds because they did not consent to this choice of dispute resolution.

The São Paulo State Court of Appeal[15] also rendered a decision in another interesting case, regarding the extension of an arbitration clause to companies belonging to the same business group. In this decision the appellate panel ruled that the parent company outside Brazil, because of its active participation along with its Brazilian subsidiary and all the elements presented in the case, had unequivocal knowledge of the choice of arbitration.

In an interesting article on the case, Selma Lemes[16] provides details-

> "(...) This is the Trelleborg case. The São Paulo judiciary extended the clause on compulsory arbitration to corporate groups. It involved an arbitration clause inserted in an agreement for sale of an equity interest in a Brazilian company to the Brazilian subsidiary of a Swedish company, in which the parent company in Sweden participated in all the negotiations. There was an arbitration clause in the agreement, but the parent company did not sign the contract. Nevertheless, when a dispute arose over the agreement to sell the equity stake of the Brazilian company, the parent company was included as a respondent along with Trelleborg in Brazil. The Swedish parent company alleged it had not signed the arbitration clause, so it could not be a party to the arbitration. The arbitration clause was not considered complete (did not have all the elements to commence arbitration)17 and a lawsuit was filed as set forth in Articles 6 and 7 of Law 9,307/1996. The lower court judge held that, from the evidence submitted, the Swedish parent company participated in all the negotiations and was directly involved in the transaction, and thus ordered the arbitration to go forward with that company maintained as a respondent. This decision was upheld by the SP Appellate Court, thus extending the arbitration clause to a party that did not sign it."

Under the same prism that arbitration is in essence a voluntary proceeding, the Rio de Janeiro State Court of Appeal struck down the extension of an arbitration clause contained in an agreement to lease a port terminal to an insurance contract[18] guaranteeing performance of the lease agreement. This case is well summarized in an article by Rodrigo Garcia da Fonseca examining associated contracts, guarantees and arbitration:

> "In the case in question, there was an agreement to lease a port terminal containing an arbitration clause. In parallel, guarantee insurance was contracted to assure compliance with the lessee's obligations. The policy did not have any stipulation on the means of resolving disputes. Because of the alleged default of the lessee, the lessor then sought to invoke the policy and filed a suit with the common

judiciary. In its defense, the insurer raised the preliminary argument that the case should be dismissed because of the existence of an arbitration clause contained in the guaranteed contract, the lease agreement. This preliminary argument was rejected by the lower court. The appellate decision upheld this ruling, on the grounds that the policy was silent regarding the obligation to arbitrate, and '*therefore, the effects of the clause stipulating arbitration in the lease agreement do not extend to the guarantee insurance contract*'."[19]

In another decision, issued in 2002, the Rio de Janeiro State Court of Appeal[20] held in favor of private autonomy regarding choice of arbitration, by declaring the legality of an arbitration clause freely agreed between the parties. One of the parties later regretted this arrangement and filed a suit to prevent the commencement of arbitration. The appellate panel held that the voluntary choice of arbitration by the parties was in harmony with the Federal Constitution, with no offense to the right of action (Art. 5, XXXV). Below are some passages from the headnote of this decision:

"Appeal. Ordinary suit filed by a national company against a foreign company seeking reparation for damages resulting from the termination of long-term contracts for transfer of technology. **Lower court decision accepting the preliminary argument of the existence of an arbitration clause, attributing competence to the commercial arbitral body in Tokyo, dismissing the suit without prejudice**, pursuant to Art. 267, VII, of the Civil Procedure Code. Constitutional law. **Arbitration. Validity of the arbitration clause. The Constitution prohibits the law from excluding consideration by the judiciary of injury or threat to rights (Art. 5, XXXV, of the 1988 Constitution). It does not prohibit the parties from stipulating extrajudicial means of resolving their conflicts, current or future. There is no constitutional prohibition against parties that are adults and capable from agreeing** to submit the conflicts that may arise under a specific contract to the **system of arbitration**. This does not entail abstract waiver of state jurisdiction. Rather, it involves a covenant to arbitrate possible future disputes specific to the contractual relationship, rigorously determinable. This is relative waiver of jurisdiction. The waiver is circumscribed to disputes resulting from the particular contract, within the limits set by the clause. It is not possible to read the constitutional rule (Art. 5, XXXV, of the 1988 Constitution), aimed at lawmakers, to prohibit the parties from waiving the right to sue regarding determinable disputes under a specific contract. One does not find that prohibition there. On the contrary, the text forbids lawmakers, not citizens. **This involves recognition of individual liberty. This is the ambit of validity of Law 9,307/96.** International Law. Geneva Protocol on Arbitration Clauses of 1923, Art. 4: '*The tribunals of the Contracting Parties, on being seized of a dispute regarding a contract made between persons to whom Article 1 applies and including an arbitration agreement, whether referring to present or future differences which is valid in virtue of the said article and capable of being carried into effect, shall refer the parties on the application of either of them to the decision of the arbitrators'. (...)*". *(emphasis added).*

Despite the small number of cases involving insurance/reinsurance submitted to arbitration, the Brazilian judiciary is generally supportive of this choice of dispute resolution by the parties, as long as the formal requirements set forth in the Arbitration Law are satisfied.

III. The Main Arbitral Chambers with Expertise in Insurance/Reinsurance:

The main arbitral chambers with expertise in insurance/reinsurance matters are the Chamber for Conciliation, Mediation and Arbitration (*Câmara de Conciliação, Mediação e Arbitragem*) of the São Paulo State Center for Industries/São Paulo State Federation of Industries (CIESP/FIESP[21]) and the Brazilian Center for Mediation and Arbitration (*Centro Brasileiro de Mediação e Arbitragem* - CBMA)[22], created through a joint initiative of the Rio de Janeiro State Commercial Association (ACRJ), the Rio de Janeiro State Federation of Industries (FIRJAN) and the National Confederation of General Insurance, Private Pension Plan, Life Insurance, Supplementary Health Plan and Capitalization[23] Companies (CNseg).

IV. Conclusions:

Despite the growing number of players and volume of transactions in the Brazilian insurance market, and the opening of the reinsurance market to international companies, there are not that many disputes involving large risks, and most of these have been presented to judicial courts for resolution rather than to arbitration, as is now permitted under the Arbitration Law of 1996 and the regulations issued by the CNSP and SUSEP. While the figures on arbitration in general show Brazil is currently in fourth place in the ranking of countries where arbitration is most used, this trend has not yet reached the insurance/reinsurance sector.

However, the perspective is for this situation to change, as the legacy of avoiding suits regarding reinsurance generated by the former monopoly market gradually fades. This trend will also likely be driven by the large number of cross-border deals that are under way and will be formed for construction of large infrastructure projects in Brazil, particularly for the 2014 World Cup and

2016 Olympic Games. Whatever the future holds, the legal and regulatory framework is in place assuring that parties can securely choose arbitration as the means of resolving their disputes, and Brazilian courts are generally supportive of arbitration.▼

1 A complementary law (*lei complementar*) is an enabling law of constitutional provisions.

2 Art. 11. With observance of the rules of the insurance regulatory entity, cedents shall contract or offer preferentially to local reinsurers, at least:
I - 60% (sixty percent) of their reinsurance cessions, in the first 3 (three) years after this Complementary Law takes effect; and
II - 40% (forty percent) of their reinsurance cessions, after the elapse of 3 (three) years from the entry into effect of this Complementary Law.

3 Art. 38. The reinsurance contracts aiming to protect risks located in national territory must include a clause determining the submission of possible disputes to Brazilian legislation and jurisdiction, **reservation made for cases of an arbitration clause, which shall observe the legislation in force**. (emphasis added).

4 CNSP Resolution 168/2007, Art. 15. Insurance companies must assure one or more local reinsurers the preferential offer of each reinsurance cession in a minimum amount of 60% (sixty percent) of the premiums ceded until January 16, 2010, and 40% (forty percent) after January 16, 2010.

5 Normative Resolution 168 of 2007.
"Art. 15. Insurance companies must assure one or more local reinsurers the preferential offer of each reinsurance cession in a minimum amount of 60% (sixty percent) of the premiums ceded until January 16, 2010, and 40% (forty percent) after January 16, 2010.
§ 1. For purposes of compliance with the limit referred to in the main section of this article, insurance companies must send a formal consultation to one or more local reinsurers of their free choice.
§ 2. The local reinsurers shall have 5 (five) business days, in the case of facultative contracts, or 10 (ten) business days in the case of automatic contracts, to formalize the total or partial acceptance of the offer mentioned in the main section of this article, after which their silence shall be considered as refusal.
§ 3. The consultation referred to in the first paragraph of this article must contain the terms, conditions and information necessary to analyze the risk, with guarantee of equal treatment to all the local reinsurers consulted.
§ 4. The insurance companies may include in the consultation the quotations of admitted or occasional reinsurers that are committed to accept, individually or jointly the same conditions offered, with indication of the respective percentages of acceptance, whose sum may not be less than 60% (sixty percent) of the reinsurance cession.
§ 5. In the case of refusal, either total or partial, the insurance company must offer the excess to other local reinsurers, so as to satisfy the provision of the main section of this article.
§ **6. The requirement defined in the main section of this article shall be considered satisfied when**:
I - the minimum amount of the preferential offer referred to in the main section of this article has been accepted by local reinsurers; or
II - after consultation of all the local reinsurers, they have, as a set, totally or partially refused the minimum amount of the preferential offer referred to in the main section of this article; or
III - there has been acceptance by admitted and/or occasional reinsurers, under more favorable price conditions, as long as the same conditions and prices have been submitted to the local reinsurers consulted in the form of the preceding numerals.
§ 7. Insurance companies must maintain on file, for each cession or acceptance, as the case may be, all the documents involving proof of the requirements of this article for a period of 5 (five) years, counted from the end of the period determined for the preferential offer". (emphasis added).

6 The success of this effort to wean the Brazilian reinsurance market from the monopoly can be measured in IRB's market share, which in 2001 had fallen to 23%, although it recovered to 40% at the end of 2012, and the company intends to raise this to 45% in the near future. Source: *Revista do IRB*, year 71, no. 310, October 2012, p. 26.

7 The local reinsurers are: ACE, Alterra, Austral, Chartis, IRB, J. Malucelli, Mapfre, Munich Re, Swiss Re, Terra Brasis and XL Resseguros. Information available at http://www.aberesseguros.org.br/article.php3?id_article=255, consulted on February 26, 2013.

8 Art. 5, XXXV: "The Law shall not exclude from consideration by the Judiciary Power any damage or threat to a right."

9 In analyzing the choice of the parties as a way to resolve disputes versus the right of recourse to the courts, as set forth in Art. 5, XXXV, of the Constitution, the Federal Supreme Court (STF) recognized the absence of any constitutional prohibition, as follows: "(...) 3. **Arbitration Law**. Constitutionality, in theory, of the arbitration court; incidental discussion of the constitutionality of various topics of the new law, especially regarding whether or not there is compatibility of specific enforcement for resolution of future conflicts with the arbitration clause and the constitutional guarantee of universal jurisdiction of the judiciary. (Constitution, Art. 5,)(XXXV). **Constitutionality declared by the Court sitting en banc**, holding, by majority of vote, holding **that the manifestation of will of the parties to the arbitration clause, at the time of executing the contract, and the legal permission given to the judge to substitute the will of a recalcitrant party in forming the commitment to arbitrate do not offend Article 5, XXXV**, of the Constitution. (...)". (STF, Motion for En Banc Reconsideration in Extraordinary Appeal SE 5.206-7. emphasis added).

10 Information available in Fichtner, Jose Antonio and Monteiro, Andre Luis. *Temas de Arbitragem: primeira sêrie*. Rio de Janeiro: Renovar, 2010. Presentation.

11 Consumer Defense Code (Law 8,078/90.) "Art. 51. Among others, contractual clauses relative to the supply of products and services are null by operations of law that: (...) VII - determine the compulsory use of arbitration;"

12 "When the risk subject to the coverage is an insured input, this obviously has a business nature, so the Consumer Defense Code does not apply to the contract. This is the case, for example, of credit insurance, insurance against property damage related to the business establishment, civil liability coverage for work-related accidents in favor of employees and others. The insurance that is subject to consumer protection legislation, as in the example of all other contracts, is characterized by a consumer relationship, that is, the insured can be considered the final receiver of the insurance service. This is the case of life and health insurance, coverage against damage to property in residences, etc. In other words, insurance contracts are subject to the codified consumer legislation only if the insured can be legally characterized as a consumer. This means that if the risk subject to the coverage is not a business element or activity, the coverage in reality applies to an *input*. In this case, the CDC does not apply." (Coelho, Fabio Ulhoa. "A aplicação do Código de Defesa do Consumidor nos contratos de seguro". *I Forum de Direito do Seguro "Jose Sollero Filho"* (annals). São Paulo: Max Limonad, 2001. p. 278).

13 São Paulo State Court of Appeal, Interlocutory Appeal no. 0304979-49.2011.8.26.0000, 6th Private Law Chamber, Reporting Judge Paulo Alcides, judged by majority vote, judged on April 19, 2012. The original suit was filed by Sul América Cia. Nacional de Seguros, Mapfre Seguros, Allianz Seguros, Aliança do Brasil, Itaú Unibanco Seguros and Zurich Brasil Seguros against Energia Sustentável do Brasil S/A, Construções e Comércio Camargo Corrêa and Enesa Engenharia.

14 Wald, Arnoldo. "Cláusula Compromissória Inválida por ser Unilateral e não ter sido Aceita pela Outra Parte. Prevalência da Decisão do Poder Judiciário Competente. Comentarios". In *Revista de Arbitragem e Mediação* I, v. 34, p. 407, July 2012.

15 São Paulo State Court of Appeal, Civil Appeal no. 2674504/6-00, 7th Civil Chamber, Reporting Judge Constança Gonzaga.

16 Lemes, Selma Regina Ferreira. "Arbitragem e Seguro". *Revista de Arbitragem e Mediação*. vol. 27, p. 56. October 2010.

17 For an arbitration clause to be considered complete (cheia, or literally "full"), it must cover all the mandatory elements specified in the Arbitration Law, namely: (i) identification of the parties; (ii) names or method of appointing the arbitrators; (iii) scope of the arbitration; and (iv) place where the arbitral award will be issued.

18 Rio de Janeiro State Court of Appeal, Motion for En Banc Reconsideration no. 2005.002.28435, 11th Civil Chamber, Reporting Judge Cláudio de Mello Tavares, judged on March 29, 2006.

19 Fonseca, Rodrigo Garcia. "Os contratos conexos, as garantias e a arbitragem na indústria do petróleo e do gás natural", in *Revista de Arbitragern e Mediação*, year 8, vol. 29 (April-June 2011), Coord. by Arnoldo Wald, pp. 168-170.

20 Rio de Janeiro State Court of Appeal, Civil Appeal no. 28808/2001, 6th Civil Chamber, Reporting Judge Gilberto Rêgo, judged on April 30, 2002.

21 For more information, see http://www.camaradearbitragemsp.com.br, consulted on February 27, 2013.

22 For more information, see http://cbma.com.br/hp/, consulted on February 27, 2013.

23 "Capitalization" (*capitalização*) is an incentivized savings product with lottery-based prize drawings. It is considered to be an insurance product in Brazil.

members on the move

In each issue of the Quarterly, this column lists employment changes, re-locations, and address changes, both postal and email that have come in during the last quarter, so that members can adjust their address directories.

Although we will continue to highlight changes and moves, remember that the ARIAS•U.S. Membership Directory on the website is updated frequently; you can always find there the most current information that we have on file. If you see any errors in that directory, please notify us at director@arias-us.org.

Do not forget to notify us when *your* address changes. Also, **if we missed your change below, please let us know**, so that it can be included in the next Quarterly.▼

Recent Moves and Announcements

Susan E. Mack was recently appointed as Secretary and General Counsel of life insurer Royal Neighbors of America. Founded in 1895 and with offices in Rock Island, Illinois and Mesa, Arizona, Royal Neighbors of America is the largest fraternal benefit society in America dedicated to marketing to women. Susan will continue to accept assignments as an arbitrator, umpire and mediator as an "active" executive. Her business address is Royal Neighbors of America, 230 16th Street, Rock Island, Illinois 61201, phone 309-732-8282, email susanmack@portiacs.com.

Daniel E. Schmidt's new email address is dan@des4adr.com.

Mark Chudleigh can now be contacted at Sedgwick Chudleigh, E W Pearman Building, 20 Brunswick St., Hamilton, Bermuda HM-10. His email is mark.chudleigh@sedgwicklaw.com.

Peter Clemente's new email address is peteclemente1@gmail.com. He is no longer a member, but some members may still wish to contact him at his new address.

Irwin Giles's contact information is now 19 West 34th Street, Penthouse, New York, NY 10001, phone 845-480-2661, email ifgiles@yahoo.com.▼

On July 31, **Bracken O'Neill** retired from General Reinsurance Company and from ARIAS•U.S. Anyone wishing to contact him can connect by email at bracken.oneill@gmail.com and by cell phone at 203-610-7209. ARIAS•U.S. wishes him fair winds and following seas as he heads into retirement.▼

BRING AN EXTRA SUIT TO THE 2013 FALL CONFERENCE!

Again, this year, take a look in your closet before the Fall Conference. See if there isn't a suit or two in there that are in fine condition, but that you haven't worn for a year because you have moved on to newer ones. There are people who could use those suits, and any accessories that you aren't using, to help them land jobs and change their lives.

At the Fall Conference, ARIAS•U.S. will be collecting men's and women's suits and accessories that are in very good condition for distribution to Career Gear (men) and Dress for Success (women). These are national non-profit organizations that promote the economic independence of disadvantaged men and women by providing not only a suit, but also a network of support and the necessary career development tools to help them become successful, self-sufficient members of their communities.

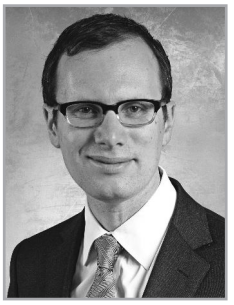
Full details will be sent to members in late September.

feature

A Star is Born? The Role of Interest in a Reinsurance Arbitration

Marc L. Abrams
Michael C. Ledley[1]

Marc L. Abrams



Michael C. Ledley

The purpose of this article is to provide practitioners and arbitrators with the basic legal landscape on the role of interest and to offer some observations on how interest disputes may play out.

Marc Abrams is a partner in the New York office of Nelson Levine DeLuca & Hamilton LLC; Michael Ledley is a partner with the New York firm of Wollmuth Maher & Deutsch LLP. The authors thank Michael C. Ward for assisting in the preparation of this article.

In the standard reinsurance dispute, a cedent's claim for an award of interest typically takes a secondary role in the arbitration, almost an afterthought that the parties spend limited resources addressing after presenting their respective positions on the underlying merits of the case. More recently, and possibly in conjunction with developments in the "run-off" market, a small segment of reinsurance arbitrations are turning the tables on the role of interest. In these arbitrations, the remedy of interest casts off its supporting role and becomes the star of the show. Indeed, the interest sought may even exceed the disputed balances in the arbitration. This is particularly the case in disputes involving a large collection of smaller (and sometimes older) balances, in which the ceding company contends that the reinsurer has engaged in a comprehensive pattern of delaying payment on a wide spectrum of claims, necessitating an interest award on all outstanding and even recently paid claims in order to make the ceding company whole. In return, the reinsurer will typically contend that the ceding company is not adhering to its contractual obligations to support its losses with sufficient information and is refusing to respond timely to the reinsurer's good faith queries, which are designed to better understand the claim presentation. In some situations, the reinsurer may contend that the claims are stale or can no longer be presented because of the passage of time.

The reason that both reinsurers and cedents may find themselves disputing interest as vigorously as the claims themselves is partly a historical curiosity. Many reinsurance contracts require application of a state's law or mandate an award of interest based on a particular state's statutory interest rate. Whether known to the drafters of these contracts or not, applicable state interest rates on a damages award often range between nine and twelve percent (with one state even requiring an award of fifteen percent), as a result of having been imposed by these states during time periods of double digit interest rates.[2] These interest rates typically have not been readjusted, perhaps because they are viewed as an incentive toward settlement.

While today's low interest rate environment is a long way away from the era of stagflation and disco music, questions remain as to how arbitration panels should treat applications for interest, especially in situations where interest is at the forefront of the arbitration. The purpose of this article is to provide practitioners and arbitrators with the basic legal landscape on the role of interest and to offer some observations on how interest disputes may play out.

We start with the law.

First, courts typically distinguish between two forms of interest: prejudgment interest which, as it sounds, constitutes any interest due prior to the judgment in favor of the claimant, and post-judgment interest, which accrues following the award. Prejudgment interest typically runs from the date the cause of action accrues up to the date the judgment is entered. Post-judgment interest may accrue on both the principal amount of the judgment and the pre-judgment interest that the court awards.

Second, the starting point for any consideration of interest should be the actual contractual provision relating to interest, if any. In particular, the reinsurance agreement may indicate whether an interest award is mandatory or permissive, and also may provide guidance as to whether a statutory rate should be applied or if the amount is at the arbitration panel's discretion.

Third, barring any contrary directions regarding interest in the reinsurance agreement itself, an arbitration panel typically has the authority to award pre-judgment and post-judgment interest.[3]

Fourth, a ceding company attempting to collect interest will typically make the argument that pre-judgment interest must be awarded in accordance with state law as a matter of right.[4] Typically, statutory provisions impose interest on a mandatory basis.

See e.g., N.Y. C.P.L.R. 5001 (McKinney) ("Interest shall be recovered upon a sum awarded because of a breach of performance of a contract . . .") (emphasis supplied.) Under this "legal" approach, an award of interest is not intended to be punitive, but instead is designed to ensure that the claimant is made whole for the loss of use of the funds that were in dispute.[5] This argument may be supported by the contention that if interest were not awarded, a reinsurer would have no incentive to make payments on a timely basis.

Fifth, in response, a reinsurer seeking to thwart an award of interest may refer to the disengagement clause in an arbitration agreement to argue that an award of interest should be considered as a matter of equity. In particular, the reinsurer may argue that if the ceding company is not furnishing basic claims information enabling the reinsurer to properly assess the claim, or if the ceding company has substantially delayed the claim presentation, the panel should not penalize the reinsurer for any delays in payment. This argument may be supported by the contention that the reinsurance agreement typically requires presentation of loss information to support a claim.

Sixth, there is a notable line of cases discussing the role of interest relating to partial payments — in other words, whether a cedent may claim interest on a settled part of a claim despite having already received a partial payment. New York courts considering this issue have refused to award prejudgment interest on partial payments made by a reinsurer prior to an award unless the insurer receiving the partial payment expressly reserved its right to receive prejudgment interest on the particular payment at the time it was made. These courts have ruled that they can only provide interest on the sum that they award — not the balance previously paid by the reinsurer.[6] In this regard, the North River v. ACE case is particularly instructive, ruling that the ceding company was only entitled to prejudgment interest on the amount owed at the time of the judgment and not the portion of the bill that the reinsurer had already paid before either party moved for summary judgment because (i) the latter amount was not "awarded" by the court and (ii) North River failed to reserve its right to the prejudgment interest upon receiving the payment.

From these legal principles, we offer our observations.

Initially, the debate about interest may center on speed. In other words, how long does the ceding company take to present the claim, how quickly does the ceding company respond to its reinsurers' queries, and how quickly does the reinsurer pay the particular claim after it has been appropriately presented? In this regard, the ceding company may enhance its prospects to the extent it has a rigorous tracking system that records the date of a reinsurer's query, and where it can demonstrate that an expeditious follow-up has been performed to secure a response to that query. On the other hand, the reinsurer may enhance its argument to the extent it can demonstrate that the cedent's systems suffer from procedural problems as well as a corresponding track record of paying claims promptly after appropriate presentation.

A second critical factor may be the size of the claim. To the extent a reinsurer is asking numerous difficult questions and/or making substantial requests for information on a very small claim presentation it may be exposing itself to the argument that its inquiries are not being posed in good faith. Conversely, the reinsurer may find itself on more comfortable ground to the extent it seeks basic materials or details on a larger loss, particularly in instances where the cedent is unwilling to permit broad audit rights. Obviously, these sorts of judgments will be colored by the circumstances of the individual claim and the parties' respective reactions to it. The fact that parties oftentimes disagree on the level of information necessary to support a claim presentation may add further complexity to the mix.

Further complications may also exist when the interest dispute involves claims that have been presented through a reinsurance intermediary. For one thing, if the Panel does decide to award interest it can become technically difficult to determine exactly

Initially, the debate about interest may center on speed. In other words, how long does the ceding company take to present the claim, how quickly does the ceding company respond to its reinsurers' queries, and how quickly does the reinsurer pay the particular claim after it has been appropriately presented?

when interest accrues, especially in situations when the claim presentation, the query or even the ultimate payment rests with the intermediary for some time before being circulated to either the reinsurer or the cedent. In these situations, there may even be a dispute on the issue of whether the intermediary represents reinsurer or reinsured. The authorities considering this issue usually side with the reinsurer.[7] In addition, a leading commentator has suggested that the burden is ultimately on the cedent to ensure that notices and billings are properly disseminated to its reinsurers, even when the cedent employs a network of brokers to assist it for these purposes.[8] It remains to be seen whether the development of technology — particularly counterparties communicating directly on claims via email — will ultimately ease or resolve these complications.

Finally, disputes relating to an award of interest may often be accompanied by a demand for the imposition of "protocols" — in other words, detailed rules for the presentation and payment of claims, including requirements governing: (i) the presentation of claims; (ii) supporting information required; (iii) time limits for review and payment; (iv) potential discounts for particular losses and/or failure to provide supporting information; (v) audit rights and (vi) dispute resolution procedures to the extent the parties disagree on these issues. In considering application of protocols, the arbitration panel would be well advised to give the parties an opportunity to provide input on the protocols themselves. By bringing the parties into the "protocol" process, the Panel may protect itself from the claim by one of the parties that it does not have the authority to order protocols insofar as doing so may alter the terms of the reinsurance contract.[9]▼

1 The views expressed in this article do not necessarily reflect the views of the firms, their attorneys, or their respective clients.

2 For instance, in New York an award generally accrues at a nine percent rate of interest per annum, as a result of a 1981 amendment (it was previously six percent), see N.Y. C.P.L.R. 5004 (McKinney), while in Rhode Island, a damage award accrues at the rate of twelve percent per annum. See R.I. Gen. Laws Ann. §6-26-1 (West). Like New York, an award in Illinois accrues at the rate of nine percent per annum, see IL ST CH 735 § 5/2-1303, whereas the statutory interest rate in California is ten percent per annum on the principal amount of a money judgment remaining unsatisfied, see Cal. Civ. Proc. Code § 685.010 (West). Apparent outliers on the statutory interest scale include Nebraska, which provides for interest accrual at the rate equal to two percentage points above the bond investment yield of twenty-six week U.S. Treasury bills, see Neb. Rev. Stat. § 45-103, and New Mexico, which provides for a rate of interest of not more than fifteen percent annually, in the absence of a written contract fixing a different rate. See N.M. Stat. Ann. § 56-8-3 (West).

3 See, e.g., W. Side Lofts, Ltd. v. Sentry Contracting, Inc., 300 A.D.2d 130 (1st Dep't 2002) (holding award of prejudgment interest could not be challenged as beyond the arbitrator's power); Merrins v. Honeoye Teachers Ass'n, 107 A.D.2d 184, 185 (4th Dep't 1985) ("[a]n arbitrator has very broad powers to fashion a remedy and do justice as he see it.") (internal quotations omitted); Metro. Prop. & Cas. Co. v. Barry, 892 A.2d 915, 919 (R.I. 2006) (stating ". .. that arbitrators are vested with broad discretion to award prejudgment interest to an award .... .").

4 Turner Constr. Co. v. Am. Manufacturers Mut. Ins. Co., 485 F. Supp. 2d 480, 490 (S.D.N.Y. 2007) ("... the awarding of interest on breach of contract claims, including breach of . . . insurance policies, is non-discretionary."); Stanford Square, L.L.C. v. Nomura Asset Capital Corp., 232 F. Supp. 2d 289, 292 (S.D.N.Y. 2002) ("[p]rejudgment interest is awarded under New York law as a matter of right for contract damages . . ."); Mann v. Gulf Ins. Co., 300 A.D.2d 452, 454 (2d Dep't 2002) ("[i]n an action to recover the proceeds of an insurance policy, prejudgment interest must be awarded on amounts due pursuant to the terms of the insurance policy on the ground that the delay in payment constituted a breach of the terms of the insurance policy.") (citation omitted); Cardi Corp. v. State, 561 A.2d 384, 387 (R.I. 1989) ("[o]nce the claim for damages has been 'duly reduced to judgment the addition of [statutory] interest is peremptory' .. and automatically awarded . .") (citations omitted) (emphasis supplied).

5 See Calgon Carbon Corp. v. WDF, Inc., 700 F. Supp. 2d 408, 416 (S.D.N.Y. 2010) ("Interest is designed, not to be a penalty, but rather to require a person who owes money to pay compensation for the advantage received from the use of that money over a period of time.") (internal quotation omitted) (emphasis in original); Lifespan Corp. v. New England Med. Ctr., Inc., 2011 U.S. Dist. LEXIS 97480, at *6 (D. R.I. Aug. 26, 2011) ("The dual purpose of prejudgment interest . . . is to encourage early settlement of claims and to compensate an injured plaintiff for delay in receiving compensation to which he or she may be entitled.") (internal quotation and citation omitted)

6 See N. River Ins. Co. v. ACE Am. Reinsurance Co., 361 F.3d 134, 145 (2d Cir. 2004) (". [section] 5001 only gives the court authority to award prejudgment interest on the 'sum awarded,' and, of course, a party can also reserve the right to receive prejudgment interest on a payment at the time it is made.") (internal citation omitted); In re Hoffman, 275 A.D.2d 372, 372-73, 712 N.Y.S.2d 165, 166 (2d Dep't 2000) (for a claimant to preserve its statutory right to prejudgment interest on a partial payment, it must "accept[] the tender without prejudice to [the plaintiff s] claim for interest"); Employers Ins. of Wausau v. Am. Centennial Ins. Co., 1989 U.S. Dist. LEXIS 563, at *6-7 (S.D.N.Y. Jan. 24, 1989) (granted prejudgment interest on the claims still unpaid at the time of the trial, but with respect to the claim that the reinsurer had paid as of the trial date, no prejudgment interest was awarded because the cedent accepted tender of those amounts and made no demand for interest before or at the time of tender, and because there was testimony at trial that is not the cedent's custom and practice to receive or to pay interest on balances due); see also R.B. Williams Holding Corp. v. Ameron Int'l Corp., 2001 U.S. Dist. LEXIS 2812, at *56-57 (W.D.N.Y. Mar. 12, 2001) (deducting payment already made before calculating prejudgment interest).

7 See Graydon Staring, The Law of Reinsurance, §7:3[3] ("The broker is, of course, also the agent of the [cedent] in presenting a claim against the reinsurer..."); Robert Strain, Reinsurance, 1981 at pp. 334 ("The custom of the market has been to view the broker as the ceding company's agent in all respects"); Travelers Indemnity Co. v. Booker, 657 F.Supp.280, 282 (D.D.C. 1987)("It is recognized custom and usage of the London insurance market that the broker is the agent of the insured"); Edinburgh Assurance Co. v. Burns, 479 F.Supp. 138, 145-146 (Cent. Dist. Cal. 1979) *rev'd on other grounds*, 669 F.2d 1259 (9th Cir. 1982) ("The recognized custom and usage of the London insurance market is that the broker is the agent of the potential assured for most purposes, including the placement of insurance)".

8 Larry P. Schiffer, How to Make Friends With Your Reinsurer, 2006 (emphasis added) ("While most-professional reinsurance brokers do their jobs and quickly pass on to reinsurers all communications from the ceding company, it remains the job of the ceding company to ensure that the information is being passed along in a timely and accurate manner. Disputes arise when the broker is not passing on information from the ceding company to the reinsurer. It is important for the ceding company to let the reinsurance broker know that it should pass on to the reinsurers all relevant information and communications from the ceding company without diminishing or significantly altering the flow of information.").

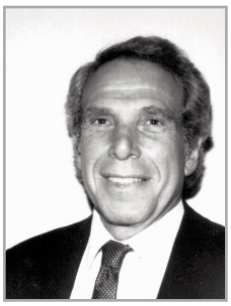
9 This article takes no position on that issue.

It remains to be seen whether the development of technology — particularly counterparties communicating directly on claims via email — will ultimately ease or resolve these complications.

This column appears periodically in the Quarterly. It offers thoughts and observations about reinsurance and arbitration that are outside the normal run of professional articles, often looking at the unconventional side of the business.

off the cuff

Another Language Class



Eugene Wollan

In our last issue, I pontificated enthusiastically on what I consider to be the basic principles that must be observed in order to achieve some modicum of good writing style. Now we move on to consider some examples of words that even moderately good writers often misuse, or use interchangeably when they really have very different meanings.

In my CLE class on writing, this part of the discussion is headed:

"Educated, Literate Writers Know the Difference Between"

1. Due to/Because of. Due is generally used as an adjective, and therefore should modify a noun. "The plane is due to arrive at noon" is fine. "The game was cancelled due to rain" is not.

2. Further/farther. "Farther" is generally limited to a measureable number, mostly relating to physical distance. "Further" has a broader scope, and can mean "beyond" or "moreover."

3. Fewer/less. Use "fewer" for something quantifiable, such as the number of people in a group. "Less" is used for things not specifically measureable, such as the amount of pressure on a young associate. The supermarket sign identifying a checkout lane as being for "10 items or less" is wrong.

4. Between/among. Technically, "between" applies only to two people, "among" to any larger group. Too often nowadays "between" is applied randomly, regardless of the number.

5. May/can. "May" implies permission to do something, whereas "can" refers to the right or ability to do it. "May" is NOT just a more elegant way of saying "can."

6. Uninterested/disinterested. You are uninterested in something if it bores you or you just don't care about it. You are disinterested if you have no stake in it.

7. Infer/imply. You infer when you draw a logical conclusion from the facts before you. You imply when you suggest or hint at something.

8. Verbal/oral. Too many folks think that communications are either written or verbal. What they don't realize is that "verbal" means "using words," and both speech and writing are forms of verbal communication. The proper distinction is between and oral and written communication.

9. Will/shall. I was taught to use "shall" for the first person ("I/we shall be there tomorrow.") and "will" for the second and third persons ("you/he/they will be there tomorrow.") This is reversed to convey extra emphasis or determination. This, "We Shall Overcome" is a prediction rather than a battle-cry. These distinctions have pretty much been obscured by contemporary sloppy usage.

10. Affect/effect. "Affect" means influence or change. "Effect" as a verb means carry out, and as a noun means consequence. The detestable current fad of using "impact" as a verb synonymous with "affect" drives me nuts. It's one thing to coin a new word or usage in order to fill a perceived need, but in this instance "affect" does the job very well and there's no need to replace it with a new "in" word.

11. Principle/principal. "Principle" means doctrine or tenet. "Principal" means main or major.

12. Eager/anxious. You are "eager" when you are looking forward to something. You are "anxious" when you are apprehensive. They are not synonymous despite the all-too-common use of "anxious" when what is really meant is "eager."

13. Constant/continuous. This too is a distinction that has largely disappeared, and they are now generally considered synonymous. Originally, "constant" meant faithful; the title of John Le Carre's book The Constant Gardener described a

Verbal/oral. Too many folks think that communications are either written or verbal. What they don't realize is that "verbal" means "using words," and both speech and writing are forms of verbal communication. The proper distinction is between and oral and written communication.

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protagonist who was devoted to his wife, not one who spent 24/7 in the backyard with a pruning shears.

14. Curious/inquisitive. Another vanishing distinction. Theoretically, you are inquisitive if you ask a lot of questions, but you are curious if you are simply odd. In a Sherlock Holmes story entitled "The curious case of the ___" Conan Doyle got it right. The author of the children's series of Curious George books probably got it wrong.

15. Flout/flaunt. You flaunt something when you display it ostentatiously. You flout it when you deliberately ignore it. If I won Wimbledon, I would flout the convention calling for modesty and flaunt my trophy.

16. I.e./ e.g. Back to my favorite subject, Latin. I.e. stands for id est, meaning "that is"; use it when you are redefining or clarifying what you just said. E.g. stands for exampli gratia; use it when you are giving an example of what you just said. Thinking of these as synonymous would send Cicero spinning madly in his mausoleum.

17. Each other/one another. "Each other" refers to two people; "one another" refers to any larger group. Too many writers use "one another" incorrectly because they think "each other" sounds plebian and "one another" is a more elegant way of saying the same thing.

18. Discrete/discreet. How many of you out there think "discrete" is a fancier way of spelling "discreet"? "Discreet" means tactful; "discrete" means separate. Never the twain shall meet.

19. Allusion/illusion. An "allusion" is a reference to something. An "illusion" is a deceptive or imaginary image.

20. Prescribe/proscribe. "Prescribe" means dictate or make a rule. "Proscribe" means prohibit. You are probably more likely to take the medicine your doctor prescribes than to follow faithfully his attempt to proscribe red meat in your dish.

End of today's lecture. If even a few of my constant (see #13) readers have benefitted from this discourse, it will have been worth the effort.▼

case notes corner

New York Court Decides Whether Party-Arbitrators Must First Disagree Before Appointing the Umpire

Ronald S. Gass

Ronald S. Gass

Fortunately, most modern reinsurance arbitration clauses provide for the timely and orderly designation of the umpire by the two party-arbitrators prior to the organizational meeting and certainly long before any evidentiary hearing is held. However, a rare form of industry contract wording persists that provides for party designation of the two arbitrators and only if they disagree on the award is the umpire to be selected or "called in" to resolve their dispute. This awkward choreography is more often than not ignored by parties, and umpire selection typically proceeds apace *before* any dispute arises between the party-arbitrators. Then again, there are parties who perceive some tactical advantage in strict enforcement of such outmoded clauses and insist that the umpire cannot be appointed by the two arbitrators unless and until a disagreement arises between them, which may not occur until *after* the evidentiary hearing. This was the interesting issue recently presented to the Supreme Court of New York, which relied, in part, on arbitration precedents dating back to the 19th century to reject this impractical approach to umpire selection and its obvious arbitral inefficiencies.

In this case, the parties were embroiled in multiple New York-based arbitrations arising under three separate reinsurance treaties. The first treaty's arbitration clause provided in pertinent part:

> All disputes or differences arising out of this Agreement shall be submitted to the decision of two arbitrators, one to be chosen by each party and *in the event of the arbitrators failing to agree, to the decision of an umpire to be chosen by the arbitrators*. [Emphasis added.]

If either party failed to appoint an umpire within one month of a written request by either of them to do so, or if the arbitrators failed to appoint an umpire within one month of being requested by either of them to do so, the umpire was to be appointed by the New York Supreme Court at the request of either party. The other two treaties had more typical arbitration clause wording. They provided that the parties' dispute was to be referred to three arbitrators, "one to be chosen by each party and the third by the two so chosen." If either party refused or neglected to appoint an arbitrator within thirty days after receipt of written notice from the other party, the contract provided that "the requesting party may nominate two arbitrators, who shall choose the third."

Pursuant to these three treaties, the parties appointed the same two party-arbitrators in each of the three arbitrations; however, owing to an apparent stalemate over umpire (or third arbitrator) selection, the umpires had not yet been appointed.[1] Resorting to the New York Supreme Court to break this deadlock, the insurer argued that New York CPLR § 7504 of the state arbitration law was applicable. This statute authorizes the court to appoint an arbitrator "if the agreed method fails or for any reason is not followed, or if an arbitrator fails to act and his successor has not been appointed." Rejecting the reinsurer's argument that this statute was inapplicable because it was not specifically mentioned in the reinsurance treaties, the Supreme Court ruled that the mechanism for court appointment of an arbitrator existed well before the formation of these mid-1970s treaties and that a contract generally incorporates the state of the law in existence at the time of its formation. It also did not matter that the reinsurer blamed the insurer for the dispute over umpire selection because the statute provided for court appointment of an arbitrator if the agreed method failed or "*for any reason*" was not followed.

Of course, each party offered different

However, a rare form of industry contract wording persists that provides for party designation of the two arbitrators and only if they disagree on the award is the umpire to be selected or "called in" to resolve their dispute.

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approaches to umpire appointment for the court's consideration. The insurer proposed that the umpire or third arbitrator be appointed from the slate of three candidates its arbitrator had proposed to the reinsurer's arbitrator, or alternatively that the ARIAS•U.S. ranking method be applied.[2] The reinsurer recommended a strike and random draw (by a coin toss) methodology, arguing that this was the usual and customary procedure in reinsurance arbitrations or, alternatively, that the court appoint any one of the three candidates on its arbitrator's slate but not necessarily the same person for each of the three arbitrations (i.e., it was *not* seeking to consolidate these arbitrations).

With regard to the treaty that arguably required that there be a dispute between the party-arbitrators before an umpire could be selected, the reinsurer contended that the full arbitration had to be held before the two arbitrators *before* an umpire was selected because the two arbitrators had not yet failed to agree on the resolution of the parties' dispute. As framed by the court, the issue was twofold: (1) whether the umpire can be appointed *before* a disagreement among the party-arbitrators arose, and (2) whether the umpire can be appointed and be present at the hearing held before the two arbitrators.

There was a split in New York authority on the issue, with one trial court concluding that the umpire should be appointed before, and be present at, any arbitral hearing, and another holding that, in the absence of any disagreements between the two arbitrators, the arbitration clause cannot be invoked to appoint the umpire prematurely, overlooking the obvious procedural inefficiency argument, i.e., that the entire matter would have to be reheard so that the umpire would have a sufficient evidentiary basis to resolve the two arbitrators' disagreements. In this case, the Supreme Court opted for the much more efficient approach of appointing the umpire to hear all of the evidence presented by the parties *prior* to any disagreement arising between the arbitrators, thereby avoiding the wasted time and expense of having to conduct more than one evidentiary proceeding in the event that the party-arbitrators subsequently disagreed. Delving into the 19th century roots of New York and other states' commercial arbitration case law, the court found ample precedent to support the pre-hearing and pre-disagreement appointment of umpires notwithstanding conflicting contract wordings.

Regarding the two other treaties incorporating more typical umpire selection clauses, the court addressed how the parties' umpire selection impasse should be resolved. Noting that CPLR § 7504 does not set forth any specific substantive criteria for the court to follow in the appointment of umpires and that the treaties also did not do so, the Supreme Court looked to other judicial precedents for guidance. Citing *Lexington Insurance Co. v. Clearwater Insurance Co.*, Index No. 651280/2011 (N.Y. Sup. Ct. Jan. 6, 2012), in which a combined ranking and random draw method was used, the Supreme Court opted to modify the judge's methodology slightly. While the *Lexington Insurance* court chose to break any umpire ranking ties with a coin toss, which under the ARIAS-U.S. method would normally result in the winning candidate being appointed the umpire, the judge in that case apparently ruled that the winner of the toss was *the party*, not that party's umpire candidate, thereby entitling that side to choose the umpire unilaterally (it is unclear from the context if the winning party's choice was necessarily limited to its top ranked umpire candidate). The Supreme Court rejected this element of the *Lexington Insurance* court's approach and instead adhered to the ARIAS•U.S. method, i.e., in case of a rankings tie, the candidate selected by the party winning the random draw would be appointed the umpire. The court extended this protocol to all three treaties at issue with the caveat that it was not ordering any of them to be consolidated notwithstanding the parties' appointment of the same party-arbitrators in each.

Arbitration clauses employing "call in the umpire" or "if failing to agree, the arbitrators shall chose an umpire" language are unequivocally antiquated and should be eliminated from every contract drafter's sourcebook. As the New York Supreme court rightly concluded, it is simply impractical to delay umpire appointment until after a dispute arises between the two party-arbitrators, and it is certainly neither cost- nor time-effective for all concerned to rehear the evidence initially presented to the arbitrators so that the newly appointed umpire can resolve the dispute. It also ignores the reality that there are plenty of pre-hearing matters about which the party-arbitrators might disagree such as motions regarding consolidation (as could have been presented in this case), prehearing security, discovery, and summary disposition, which frequently arise long before any evidentiary hearing on the merits and more often than not are made subsequent to arbitration panel formation either during or shortly after the organizational meeting.

National Union Fire Insurance Co. v. Clearwater Insurance Co., 39 Misc. 3d 184, 958 N.Y.S.2d 870 (N.Y. Sup. Ct. Jan. 15, 2013).▼

1 Resolution of umpire selection stalemates is a frequent subject of judicial applications seeking relief pursuant to the Federal Arbitration Act, 9 U.S.C. § 5, and similar state arbitration statutes. E.g., National Casualty Co. v. OneBeacon American Insurance Co., Civ. Action No. 12-11874-DJC, 2013 U.S. Dist. LEXIS 92840 (D. Mass. July 1, 2013); Ronald S. Gass, Federal Court Breaks Umpire Selection Deadlock, 13 ARIAS-U.S. Quarterly 34 (2006).

2 See ARIAS-U.S. Umpire Selection Procedure (eff. 1/1/00), Section C – "Candidate Ranking and Umpire Selection" at http://www.arias-us.org/index.cfm?a=318. Briefly, the parties start with a pool of ten umpire candidates who have all completed umpire questionnaires. Each side selects five names and then simultaneously exchanges its candidate roster with the opposing side. Next, the parties simultaneously strike two candidates from the other's roster leaving a slate of three names per side. If there is a single match, that person is appointed the umpire. If there is more than one match, the parties draw lots or use some other agreed method to break the tie. If there are no matches, the parties rank the six names in order of preference from "1" through "6," with "1" being the most preferred candidate. The name with the lowest combined numerical ranking is appointed as the umpire. In the event of a numerical tie, the parties will draw lots or use some other agreed method.

Recently Certified Arbitrators

James E. Sherman


James E. Sherman

James Sherman is the managing member of Sherman Law LLC, which specializes in reinsurance and insurance law, corporate law, real estate law, and compliance risk management. He has over 27 years of experience in the insurance and reinsurance business.

Previously, Mr. Sherman was the Executive Vice President, General Counsel, and Secretary of Reinsurance Group of America, Incorporated ("RGA"), a Fortune 500, NYSE-listed, reinsurance company with operations in 23 countries. Through its various subsidiaries, RGA reinsured annuities, individual and group life, and living benefits (critical illness, longevity, health and long-term care insurance). In addition, RGA provided financial reinsurance and was well known for its facultative underwriting. Mr. Sherman was the RGA General Counsel for over 11 years.

While at RGA, Mr. Sherman managed teams of internal and outside attorneys, paralegals and other staff responsible for securities law, corporate law, corporate governance, reinsurance transactions, compliance risk management, intellectual property, claims, reinsurance law and regulations (domestic and international), governmental relations (state and federal), employment law, mergers and acquisitions, and litigation and arbitrations, among other things. In addition, he served as Secretary to the RGA Holding Company Board and its Committees.

Prior to becoming the General Counsel of RGA, Mr. Sherman was General Counsel of RGA's principal US operating company, RGA Reinsurance Company, for about eight years, while he was an employee of General American Life Insurance Company (General American). Mr. Sherman joined the General American Law Department in 1983 and held various titles and responsibilities of increasing importance, involving insurance law, investment law, governmental relations, legislative drafting, real estate transactions, and leasing of mineral interests, among other things.

Prior to joining General American, Mr. Sherman was a Research Analyst for the Missouri Senate assigned to the Banking and Insurance Committees.

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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.

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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* and *Guidelines for Arbitrator Conduct*. These 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.

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