

**ARIAS•U.S. 2016 FALL CONFERENCE
COMPARATIVE ETHICS: LESSONS TO BE LEARNED
FROM OTHER ARBITRATION REGIMES**

Fact Pattern

I. Background

Insure Em All, Inc. (“Insure”) issued two excess policies to Asbestos Is Us (“Asbestos”). The first policy was a first excess layer of \$100 million xs \$10 million. The second was a \$100 million xs \$110 million layer. The Primary Policy (which Insure did not write) was an \$8 million dollar policy which sat on top of a \$2 million Self Insured Retention. Asbestos was named as a defendant in hundreds of thousands of complaints by asbestos plaintiffs, alleging bodily injury or death due to asbestos exposure. Asbestos estimated its total liability to exceed \$200 million. Asbestos commenced a declaratory judgment action against Insure, seeking insurance coverage under the two excess policies (the “Asbestos Litigation”).

Insure’s liability to Asbestos hinged on whether there was one or multiple occurrences. If the court found multiple occurrences, Insure would have no coverage obligation. With one occurrence, its policies would be exhausted. Insure’s lawyers and consultants conducted an analysis into the likelihood of success of its multiple occurrences defense. Insure’s advisors concluded that there was a 50/50 chance that it would succeed. Based on that advice, Insure offered to settle with asbestos for a 50% discount. Asbestos accepted and the parties settled. Insure then allocated its \$100 million settlement payment to its policies using the “rising bathtub” method. As a result, it allocated the full \$100 million payment to the first excess layer.

No Pay Reinsurance (“No Pay”) facultatively reinsured Insure’s first layer. Based on Insure’s rising bathtub allocation, the policy that No Pay reinsured was exhausted. Insure therefore billed No Pay for the full limit of its facultative certificate. No Pay did not pay,

arguing that it should have benefited from the same 50% discount that Insure received. Insure demanded arbitration.

II. **Appointment of No Pay's Arbitrator:**

Following receipt of the arbitration demand, No Pay engaged counsel and began the process of securing a party-appointed arbitrator. No Pay's in-house and outside counsel called ARIAS•U.S. certified arbitrator, Hired Gun, to discuss the matter and his potential appointment. After clearing conflicts, No Pay's counsel described the facts and explained their belief that No Pay should benefit from the same discount that Insure secured through its settlement with Asbestos. After finishing his description of the facts, No Pay's counsel asked Hired: "Will you rule in our favor?" Hired responded, "based on what you have told me, I will certainly rule in your favor."

- **Applicable Canons:**

1. ARIAS•U.S. Code of Conduct ("ARIAS•U.S. Code") Canon II, Comment 2.
2. American Arbitration Association Code of Ethics for Arbitrators in Commercial Disputes ("AAA Code of Ethics") Canon I (D), and Canon X (A)(2).

III. **Appointment of Insure's Arbitrator:**

Insure's counsel also called a potential party-appointed arbitrator, Joe Paladin. In addition to describing the facts, he sent certain documents to Paladin, including a Settlement Memo from Insure's claims department to management. The Settlement Memo explained that Insure's settlement with Asbestos was based on the legal advice that Insure had a 50/50 chance of success on its number of occurrences defense. The memo also advises management that, "as

always, we will allocate the loss using the rising bathtub method.” In discovery, however, Insure withholds the document as privileged.

At the hearing, Insure’s arbitrator, Paladin, references the Settlement Memo and suggests that there is no basis for No Pay’s bad faith argument because Insure always uses the rising bathtub method. No Pay calls for Paladin’s resignation. Paladin declines to voluntarily resign and No Pay asks the Panel to remove him.

- **Applicable Canons:**

1. ARIAS•U.S. Code Canon V, comment 3.
2. AAA Code of Ethics CANON I, comment H.
3. AAA Code of Ethics Canon X, Comment (B)(2).

IV. **Appointment of the Umpire:**

Once the two party-appointeds are in place, they schedule a call to discuss possible umpire candidates.

Ultimately, they narrow it down to two candidates. Umpire candidate #1 has been ARIAS•U.S. certified for 2 years. During those two years, she has been appointed as an arbitrator 5 times. Although she has never been appointed by either party, she has been appointed by Insure’s law firm 3 times.

Umpire candidate #2 has worked in the industry for 40 years, both in-house and for law firms. He has never worked for either party. He is currently Of Counsel in a law firm that regularly represents insurers and reinsurers. One of the firm’s partners currently represents No Pay. Candidate #2 works in different office from this partner, has never worked on the No Pay cases, and has no knowledge of them. However, a formal ethical wall is not currently in place.

After a coin toss, the Panel is formed with Umpire Candidate #2. Insure suggests the appointment is improper because, although he is on a salary, some of Candidate #2's compensation is necessarily derived from the firm's work for No Pay. Insure also objects because there is no formal ethical wall in place between him and the firm's work for No Pay. Insure reserves the right to challenge the award based on umpire bias. Upon appointment, the Umpire immediately puts an ethical wall in place at his firm.

- **Applicable Canons:**

1. ARIAS•U.S. Code Canon I, Comment 4 (h) and (j).
2. ARIAS•U.S. Code Canon I, Comment 3(c).

V. Organizational Meeting/Motion to compel

At the organizational meeting, the Panel orders that: (1) ex parte communications as to any interim issue will terminate when the issue is submitted to the Panel for decision; and (2) the final cut off of ex parte communications will occur following the submission of the Pre-Hearing Reply Briefs.

No Pay indicates that it will seek vast discovery into all of Insure's litigation files relating to the Asbestos Litigation, including the file of Insure's coverage counsel, as well as any documents related to Insure's pre-settlement analysis and/or the basis for its settlement.

The parties and the panel agree to a briefing schedule for the motion to compel. Both parties communicate with their party-appointeds regarding the motion prior to submitting their briefs to the panel. The Panel orders production of the litigation record, but upholds the privilege of communications between Insure and its attorneys regarding the underlying litigation and the settlement. It also allows Insure to withhold the Settlement Memo that was sent to management describing the basis for the settlement.

Insure reaches out to its party-appointed, Paladin, to understand the rationale of the Panel's decision and also to understand how it affects the Panel's thinking on the merits. Paladin explains that the Panel felt that the facts of the underlying litigation were relevant to the basis for Insure's settlement and that No Pay was entitled to investigate whether that settlement was reasonable. However, he also explains that the Panel believed that the communications between Insure and its attorneys were privileged. No Pay learns of this discussion and reserves its right to move to vacate the award based on the conversation.

- **Applicable Canons:**
 1. ARIAS•U.S. Code Canon V, Comments 4 and 6.
 2. ARIAS•U.S. Code Canon VI, Comment 3.
 3. AAA Code of Ethics Canon X, (C)(4)(b).

VI. Pre-hearing Briefs

Two weeks prior to the due date of the opening pre-hearing briefs, Insure's attorney sends a draft of Insure's pre-hearing brief to Paladin and asks him to comment on whether it should keep or abandon its second argument.

A few days later, Paladin sends back a heavily red-lined mark- up of the brief, providing comments on the entire brief and recommending that Insure retain its second argument, but also adding a third argument that was not in the original draft.

- **Applicable Canons:**
 1. ARIAS•U.S. Code Canon V, Comment 6.
 2. ARIAS•U.S. Code Canon II, Comment 2.

VII. Hearing

At the hearing, several witnesses are called to testify. Most witnesses are presented on direct and are cross examined. Each are also asked a few questions by each party appointed arbitrator and by the umpire. However, Hired Gun (No Pay's arbitrator) interrupts the questioning of the Insure witness who was responsible for billing the reinsurers. He proceeds with an aggressive cross examination which lasts 20 minutes. Insure objects and reserves its right to move to vacate the award based on arbitrator misconduct.

Before the hearing, the umpire reviews the brief, but assigns an associate to read and summarize the cases for him and to prepare a draft final award based on the associate's evaluation of which party should win. The umpire does not read the cases himself and relies entirely on his associate's summary of them. At the conclusion of the hearing and following Panel deliberations, the umpire removes the word "draft" from the award drafted by his associate and publishes it as the final award in the matter.

- **Applicable Canons:**
 1. ARIAS•U.S. Code Canon VII, comments 4, 5.
 2. AAA Code of Ethics Canon X, A(1).
 3. ARIAS•U.S. Code Canon VIII, Comment 3.