



**ARIAS-U.S.  
INTENSIVE ARBITRATOR TRAINING WORKSHOP  
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**MOCK ARBITRATION SCENARIO**

## **FACTS REGARDING THE CASUALTY**

### **The Subway Attack**

While the September 2014 National Tea-Party Conference was taking place in Metropolis, Pennsylvania, a group identifying itself as the New Citizens for a Democratic Society (NCDS) conspired to create a disturbance on the night of the keynote address in order to distract media attention from the event. The NCDS planted a fake bomb in the City's underground transit system. An NCDS member then anonymously informed a local TV station that the group had planted a bomb at Center Station, the City's busiest commuter station, and that the bomb would detonate during the peak of the rush-hour commute. The TV station immediately contacted the proper authorities.

Many of the City's leaders, including the mayor, the chief of police and the head of the Southeast PA Rapid Transit Authority (SPARTA), were attending a cocktail party hosted by state Tea Party leaders. They were quickly notified of the situation and convened in a hotel conference room to determine an appropriate course of action. After some initial delay, the City's emergency personnel were dispatched.

After bomb squad, police and fire officials arrived at Center Station the situation quickly deteriorated into mass confusion. There was a lack of coordination and no one took control of the scene. Consequently, efforts to initiate an evacuation of the station were delayed. Eventually, commuters were told they had to evacuate but they were not told why. When a fire official was overheard telling one of his colleagues that the bomb might be in a duffel bag, word quickly spread and the crowd broke into a panic. Hundreds of commuters rushed to exit the station. In the wake of the stampede, forty-two people were injured.

At the same time that panic broke out at Center Station, a City police officer told the engineer of a train stopped in the station that there was a bomb threat. He instructed the engineer to take the train to the next station and unload all passengers with an announcement that the train was being taken out of service due to mechanical problems. When the train arrived at Union Station, the engineer ignored the instruction of the police officer; he announced over the intercom that all passengers were to exit the train and evacuate the station because of a bomb threat. Again, scores of commuters broke into a panic as they attempted to flee the station. Another twenty-two persons were injured at Union Station.

During the year following the incident, fifty-eight lawsuits were filed against Metropolis, SPARTA and others (the "Personal Injury Litigation").

## THE CONTRACTS

### The Reinsured Policy

Mega Insurance Company, a Pennsylvania corporation, issued Comprehensive General Liability Policy #GL 2525 to SPARTA effective 1/1/14 – 1/1/15 (the “Policy”). The Policy provides limits of \$1 million per occurrence. “Occurrence” is not defined. The Policy provides for a defense obligation “in addition to” indemnity limits. The Policy also names the City of Metropolis as an additional insured “but only with respect to liability arising out of operations of the Named Insured [SPARTA] on the Leased Premises identified in Schedule A.” Center and Union Stations are identified in Schedule A as premises leased by Metropolis to SPARTA.

### Reinsurance

Mega reinsures its liabilities under the Policy through SPARTA’s captive reinsurer, Mass Transit Insurance Ltd. (MTIL), a Bermuda corporation. The board of directors of MTIL is comprised of SPARTA’s VP of Finance (Katherine Selene), SPARTA’s General Counsel (Frank Homer), SPARTA’s Risk Manager (Samuel Rhodes), and a partner in a Bermuda law firm used by MTIL. SPARTA capitalized MTIL in accordance with Bermuda law. The reinsurance contract provides in pertinent part as follows:

#### ARTICLE I – DEFINITIONS

“Allocated Loss Adjustment Expenses” – Expenses incurred in connection with the settlement of a claim or suit including expenses of litigation. Salaries of Company employees and normal overhead charges shall not be considered allocated loss adjustment expenses.

“Incurred Loss” – Sum total of the Company’s Paid Losses, ALAE, and Outstanding Loss and ALAE Reserves with respect to claims under Policy #GL 2525 (the Policy).

“Loss Occurrence” – any one accident, disaster, casualty or occurrence or series of accidents, disasters, casualties or occurrences arising from one originating cause.

#### ARTICLE II – REINSURING CLAUSE

Reinsurer shall be liable to the Company for (1) losses paid under the Policy up to \$1 million for each Loss Occurrence and (2) all Allocated Loss Adjustment Expenses.

All loss settlements by the Company shall be binding on the Reinsurer.

## ARTICLE VIII – CEDING COMMISSION

The consideration for the reinsurance provided hereunder shall be a reinsurance premium which shall be the entire earned premium received by the Company under the Policy, minus a Ceding Commission of 23% of the said earned premium

## ARTICLE X – ARBITRATION

As a condition precedent to any right of action hereunder, any dispute arising out of this agreement shall be submitted to the decision of a board of arbitrators meeting in Metropolis, PA. The arbitration shall be conducted before a three-person Arbitration Panel appointed as follows. Each party shall appoint one arbitrator, and the two arbitrators so appointed shall then appoint an impartial Umpire before proceeding. The arbitrators and Umpire shall interpret this Agreement as an honorable engagement, and shall not be obliged to follow the strict rules of law or evidence. In making their award, they shall apply the custom and practice of the insurance and reinsurance industry, with a view to effecting the general purpose of the Agreement. The decision of a majority of the Arbitration Panel shall be final and binding, except to the extent otherwise provided in the Federal Arbitration Act. The Arbitration Panel shall render its award in writing. Judgment upon the award may be entered in any court having jurisdiction, pursuant to the Federal Arbitration Act. Unless the Arbitration Panel orders otherwise, each party shall pay: (1) the fees and expenses of its own arbitrator; and (2) an equal share of the fees and expenses of the Umpire and of the other expenses of the arbitration.

### **THE PERSONAL INJURY LITIGATION AND UNDERLYING COVERAGE DISPUTE**

Fifty-eight personal injury lawsuits arising out of the September 2014 events were consolidated in state court in Pennsylvania. SPARTA and Metropolis were named as defendants. Mega undertook to defend SPARTA in the litigation. Metropolis also tendered its defense to Mega as an additional insured under the Policy. Mega retained coverage counsel to advise whether Metropolis was entitled to coverage.

In the meantime, Mega's senior claims manager (Karen Hamilton) met with SPARTA's Risk Manager (Samuel Rhodes) to discuss the litigation. Mr. Rhodes also served on MTIL's Board of Directors and as Vice President of Claims for MTIL. In the course of the meeting, Mr. Rhodes suggested that Mega should deny the City's "additional insured" claim. Ms. Hamilton stated that she had already referred the matter to outside counsel. Mr. Rhodes told Ms. Hamilton, "Look, it's your job to handle the claims, but ultimately it's SPARTA's money. I am expecting you to make the right decision." Ms. Hamilton was unsure exactly what SPARTA's Risk Manager meant by his comments. Ms.

Hamilton, however, prepared notes from the meeting. Her notes include the following entry:

If we do not deny coverage to City, SPARTA captive may refuse to reimburse – net \$\$ to Mega??

Mega's outside coverage counsel advised that while the issue of coverage to the City was by no means clear, there was a good faith basis to deny coverage. Counsel recommended that Mega deny coverage based upon the "arising out of" language in the additional insured provision of the Policy. Mega notified Metropolis of its denial of coverage. The City immediately commenced a DJ action.

After his meeting with Mega's claim manager (Hamilton), Mr. Rhodes retained the firm of Alexander, Solon & Pindar to represent the interests of MTIL and SPARTA.

The personal injury litigation proceeded to trial in the summer of 2015 and resulted in a \$4 million jury verdict in favor of the plaintiffs. The plaintiffs argued that both Metropolis and SPARTA contributed to the mayhem that led to their injuries. SPARTA argued that the panic was caused by the slow response of City officials and the failure of the Metropolis police to manage the situation properly. The jury found Metropolis 100% liable and placed no liability on SPARTA. Metropolis appealed the jury verdict but settled the plaintiffs' claims soon thereafter for \$3.5 million.

Approximately a year after the settlement, Metropolis and Mega filed cross-motions for summary judgment in the DJ action. The judge, who was up for election in November 2016, issued his decision in early October 2016. He granted the City's motion on the "additional insured" issue holding that the City was entitled to coverage as an additional insured under the Policy. The opinion stated that the motions presented a close question, but in the absence of clear guidance in the policy language "socio-economic reasons" counseled that Mega, rather than the citizens of Metropolis, should bear the burden of the settlement. Denying Mega's motion, the judge further ruled that Metropolis had produced sufficient evidence to submit its bad faith claim to a jury. The judge cited the Claims Manager's notes from his meeting with SPARTA's Risk Manager as "particularly compelling evidence of bad faith."

The court further held that the personal injury claims arose out of two separate occurrences – one occurrence at Center Station and one occurrence at Union Station. Judgment was entered in favor of Metropolis in the amount of \$2 million. The court's opinion suggested that, if the jury were to find that Mega acted in bad faith, Mega could be held liable for the entire \$3.5 million settlement paid by Metropolis. The decision was heralded by the City's political leaders, but questioned by its legal community.

In light of the judge's ruling, Mega asked its coverage counsel to reevaluate the case. Mega's coverage counsel wrote:

I expect it may be possible (60% chance of prevailing and 40% chance of losing) in an eventual appeal to overturn the additional insured ruling and/or the two occurrence ruling. Overturning the two occurrence ruling would limit the available policy limits to \$1 million, while prevailing on the additional insured ruling would result in no liability.

Certainly there was no bad faith in Mega's original denial of coverage to Metropolis but, because of the Hamilton memo, there is a risk (50%) that a jury will find bad faith and will hold Mega liable for the remainder (\$1.5 million) of Metropolis' \$3.5 million settlement of the personal injury litigation, plus an estimated \$1 million of punitive damages and/or Metropolis' counsel fees.

Mathematically, the value of the case could be expressed as:

<u>Coverage:</u>	.40 x \$2.0 million	= \$0.8 million
<u>Bad faith:</u>	.50 x \$2.5 million	= \$1.25 million
<u>Total</u>		\$2.05 million

Of course, a settlement at this point would save you at least \$100,000 in counsel fees, and possibly more.

After several weeks of negotiations, Mega and Metropolis settled the DJ action for \$2 million.

### **THE REINSURANCE BILLING AND ENSUING ARBITRATION AND LITIGATION**

Upon payment of the \$2 million settlement, Mega submitted a reinsurance billing to MTIL. The billing totaled \$2,450,000 and consisted of the following:

\$215,000 defense costs from defense of SPARTA in the personal injury litigation

\$2 million settlement with Metropolis

\$235,000 expenses from coverage litigation with Metropolis

MTIL promptly paid the \$450,000 in defense and litigation costs on a without prejudice basis but rejected the remainder of the reinsurance billing. MTIL took the position that the \$2 million settlement payment related substantially to the City's bad faith claim against Mega. Further, MTIL argued that even if the City had a claim under the Policy,

that claim arose out of a single occurrence as defined by the reinsurance contract. Mega demanded arbitration.

Immediately upon receipt of the arbitration demand, SPARTA and MTIL commenced a bad faith action against Mega in state court in Pennsylvania. The complaint alleges that Mega settled the DJ action with Metropolis out of concern for its own bad faith, and then improperly manipulated its reinsurance billings in order to pass on all liabilities to SPARTA's captive reinsurer, MTIL. MTIL also sought to enjoin the arbitration arguing that because the dispute involves SPARTA which is not a party to the reinsurance contract, the matter is not subject to arbitration.

Mega filed a motion to dismiss the suit in favor of the pending arbitration. The court dismissed the suit with respect to MTIL but held that SPARTA cannot be compelled to arbitrate its dispute because it is not a party to the reinsurance contract. The court refused to enjoin the arbitration. Consequently, the arbitration and the litigation are proceeding simultaneously.

Mega is represented in the arbitration by Merrill, Chase and Morgan. Alexander, Solon and Pindar represent MTIL in the arbitration and also represent SPARTA in the bad faith litigation.

## **THE ARBITRATION: ORGANIZATIONAL MEETING**

The parties and the arbitration panel meet in Metropolis, PA in September 2017 for the Organizational Meeting where the panel is asked to address the following issues:

### **Confidentiality**

Mega requests that the panel issue a confidentiality order to protect all testimony and information disclosed in the arbitration. Mega moves for the entry of an ARIAS form confidentiality order protecting all "arbitration information" generated in connection with this dispute from disclosure. Mega argues the unfairness of allowing confidential or privileged information to be acquired by SPARTA which is not a party but which has retained the same counsel.

MTIL refuses to agree to such an order, also citing the existence of SPARTA's parallel bad faith action. MTIL notes that the reinsurance agreement does not include any requirement of confidentiality and that the Panel cannot unilaterally impose confidentiality where the parties have not agreed to it. Furthermore, MTIL notes that there is significant public interest and public importance to the resolution of the dispute and that the court in the companion litigation has expressly denied the entry of a protective order for proceedings in that case.

### **Discovery**

The parties request that the panel rule on several discovery issues:

MTIL seeks to compel Mega to produce its claim and litigation files relating to its defense of the Metropolis claims. MTIL asserts that these files are material to the issues of Mega's position on number of occurrences and to the bad faith claims. Mega asserts that these files are privileged and that, in any event, the manner in which the claim was handled and defended is not relevant to issues of coverage under the reinsurance contract. Mega voluntarily produced the coverage analysis of its counsel, outlined at p. 6, above, because it relied on this analysis in determining to settle the claims. Mega asserts that production of this analysis does not waive the privilege that otherwise applies to the work product and communications of its counsel in the litigation.

MTIL also sought in discovery the identification of all claims in which Mega was involved in the 2013-2016 timeframe involving the issue of number of occurrences and sought production of Mega's files in respect of these claims. Mega objects to this discovery on grounds that it is overbroad, unduly burdensome, and unlikely to lead to the discovery of admissible evidence. MTIL asserts that this discovery is relevant to issues of Mega's duty of utmost good faith to MTIL insofar as Mega cannot permissibly take positions on the issue of occurrence merely because they maximize recoveries. MTIL asks this panel to order this discovery.



Mega seeks to depose four persons associated with MTIL who were involved with the Metropolis claims. Included in this group are the MTIL Vice-President of Claims, Samuel Rhodes, who also serves as SPARTA's risk manager, and the SPARTA General Counsel (Frank Homer) who serves on the MTIL board of directors. MTIL objects to the deposition of Frank Homer on grounds that the deposition of a member of MTIL's board who was not directly involved with claims handling is an abuse of the discovery process, designed only to oppress and harass MTIL. MTIL objects further to the extent that testimony will be sought from Homer, or Rhodes respecting their involvement with the management of SPARTA or SPARTA's role in the underlying claims against Metropolis and SPARTA. MTIL asserts that SPARTA activities in the underlying claims are irrelevant to the reinsurance claims at issue in this arbitration. Mega seeks to compel this discovery.

### **THE ARBITRATION: HEARING ON THE MERITS**

In discovery, Mega produced the opinion of its coverage counsel setting out the evaluation of issues for appeal and trial on the bad faith claim (see reference to opinion at page 6).

Mega also produced an email dated December 5, 2013 from Helen Tyche to Mega. Tyche was the broker who created MTIL for SPARTA. The email concerned the 1/1/14 renewal of the program, and stated:

Further, you will be pleased to note that in line with legal developments, we have altered the Loss Occurrence definition by deleting the phrase "any one event" and substituting the phrase "one originating cause."

Tyche testified in deposition that the reason for this change was SPARTA/MTIL's need to broaden their ability to group common exposures under their reinsurance program given the array of risks they believe they face in the current environment.

At the arbitration hearing, the panel will address the following two issues:

#### **Bad Faith**

MTIL asserts that the settlement relates substantially to Mega's bad faith exposure, which is not covered by the reinsurance contract. Mega responds that the reinsurance contract does not exclude coverage for bad faith but that, in any event, its billing only relates to the \$2 million trial judgment. Mega also argues that Sam Rhodes, acting both in the interests of SPARTA and MTIL, played a very significant role in the handling of the claim such that MTIL should be responsible for any bad faith exposure that might exist.

## **Occurrence**

Mega argues that MTIL is bound, under the “follow the fortunes doctrine”, by the court’s two occurrence ruling, which is also a reasonable reading of the reinsurance contract’s “Loss Occurrence” definition. MTIL’s position is that it is not bound by the judge’s clearly biased ruling and that, in any event, it is entitled to the panel’s separate interpretation of “originating cause” under the reinsurance contract.