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Altering the Structure of Reinsurance Arbitrations: Are Old Habits Too Hard to Break?

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I. Introduction

For over a century, reinsurance disputes, as rare as they may have been in the past, have been resolved through arbitration as opposed to litigation. Ceding companies and reinsurers alike felt so strongly about this method of dispute resolution that it became commonplace to include an arbitration clause in most reinsurance contracts, and this practice largely continues today. Given the important and ongoing business relationship between cedent and reinsurer, arbitration was seen as a better way to resolve disputes. Some of the advantages to arbitration, which continue to this day, include: (1) having a case decided by experienced and knowledgeable decision-makers rather than a judge or jury to whom reinsurance is foreign; (2) maintaining the confidentiality of the dispute; (3) providing a method of dispute resolution generally considered to be more economical and efficient; and (4) basing an award on custom and practice in the industry rather than simply on the literal meaning of the contract itself or on applicable state law.

Recently, however, with the proliferation of reinsurance arbitrations combined with increased contentiousness and expense, some in the industry have begun to question the efficacy of arbitration. Among the reasons for this disillusionment are: (1) the fact that interim procedural rulings are unpredictable; (2) a few select arbitrators are used over and over again by the same party; (3) there are insufficient ethical boundaries and restraints on arbitrators; (4) some arbitrators have an economic incentive to rule in favor of the party most likely to appoint them in the future; and (5) the willingness of certain panel members to issue a compromise award. These issues have caused some parties to contemplate eliminating arbitration clauses from new reinsurance contracts. But maybe this drastic measure can be avoided and the current concerns about arbitration can be resolved by altering the structural way in which arbitrations are conducted.

The purpose of this paper is to introduce some structural alternatives to what has become the typical arbitration process with two party appointed arbitrators and an umpire; a process largely controlled by the parties and not the arbitrators, as originally envisioned. Some or all of these structural changes can be achieved under old contracts by agreement of the parties and should be considered by companies when negotiating renewals or new reinsurance agreements.

II. The Origins of the Three-Member Panel with Two Party-Appointed Arbitrators and an Umpire and the Increased Frequency of Arbitrations

Since the early 1800s, particularly in English marine reinsurance disputes, the reinsurance industry has been using arbitration as a dispute resolution mechanism.[2] The utilization of a three-member panel is similarly historic. For example, a Munich Reinsurance Company contract from 1895 contained this provision:

> In the event of any difference hereafter arising between the contracting parties with reference to any transaction under this treaty the same shall be referred to two Arbitrators who are to be chosen amongst the Managers or Secretaries of Accident Insurance Companies, one to be chosen by each Company and to an Umpire chosen by the said two Arbitrators, who shall interpret the present contract rather as an honourable engagement than as a merely legal obligation, and their award shall be final and binding on both parties.[3]

Historically, the industry turned to arbitration, utilizing arbitrators experienced in the business, in part to maximize the

chances of resolving a dispute without jeopardizing a business relationship.[4] Before the 1990s, arbitrated disputes were the exception as cedent and reinsurer worked to amicably resolve any disputes in the interest of their ongoing business relationship.[5] It is not surprising, then, that the parties had a level of trust that the panel would be selected as envisioned when the treaty was underwritten and not in a way to "game the system," with each side vying for control and undue advantage. This historical approach changed dramatically with the increase in cessions involving environmental, asbestos and other long-tail claims, coupled with the fact that an increasing number of ceding companies and reinsurers were in runoff. With runoff, the goal of maintaining a future relationship was gone, the need for arbitrations increased, and contentiousness both in panel formation and in the arbitration process as a whole -rose.

As the stakes got higher, arbitration began to look more like litigation, starting with maneuvering for the "best" panel, just as some litigants engage in forum shopping. This maneuvering tactic became most prevalent in umpire selection as many parties began to feel that the case could be won or lost depending upon the umpire. Many contracts, including the quoted 1895 Munich Re treaty, require the two party-appointed arbitrators to choose the umpire. Notice that the umpire was to be elected by the arbitrators, not by the parties or -counsel. In many contracts that contain a similar provision, it is only if the two arbitrators cannot agree on an umpire that some alternative method, like drawing lots, is undertaken. In other words, drawing lots was designed to be a last resort. Now, however, drawing lots has become the norm, is done with the heavy influence of counsel or the parties, and is often viewed as a mechanism for parties to "game the system."[6] This method of panel selection may also provide an avenue for delay, minimizing one of the advantages of arbitration quick resolution.[7]

While there are alternatives to this usual arbitration structure, some of which are discussed here, the wheels of change move so slowly that it may be years (or even decades)before we see any real shift in the structure of reinsurance arbitrations. Of course, change can come in different shapes and sizes, including how a panel is selected, the number of arbitrators, the role of the arbitrators, and the general procedures followed throughout the course of the proceeding.

III. Arbitration Before a Single Arbitrator

One obvious alternative to the three-person panel is to have a single arbitrator. In the United Kingdom, for example, a single arbitrator is the default mechanism when there is no agreement between the parties or contract provision mandating the number of members on the panel. As the U.K. Arbitration Act of 1996, § 15(3) provides: "If there is no agreement as to the number of arbitrators, the tribunal shall consist of a sole arbitrator."[8] Of course, self evident benefit to a single arbitrator proceeding is economics; each party pays for half an arbitrator instead of one- and a half arbitrators (party-appointed plus half the umpire).

Where the rubber hits the road in the single arbitrator proceeding is the method of selection. There are some organizations like AAA that provide procedures for the selection of the arbitrator.[9] Pursuant to section R-1 5 of AAA's Procedures for the Resolution of Intra Industry U.S. Reinsurance and Insurance Disputes Supplementary Rules, "if the arbitration agreement does not specify the number of arbitrators, the dispute shall be heard and determined by one arbitrator, unless the AAA, in its discretion, directs that three arbitrators be appointed."[10] The appointment of a single arbitrator may be achieved in accordance with Rule R-l 1(a) and (b) of AAA's Commercial Arbitration Rules.[11] Under that provision:

> (a) If the parties have not appointed an arbitrator and have not provided any other method of appointment, the arbitrator shall be appointed in the following manner: The AAA shall send simultaneously to each party to the dispute an identical list of 10 (unless the AAA decides that a different number is appropriate) names of persons chosen from the National Roster. The parties are encouraged to agree to an arbitrator from the submitted list and to advise the AAA of their agreement.
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> (b) If the parties are unable to agree upon an arbitrator, each party to the dispute shall have 15 days from the transmittal date in which to strike names objected to, number the remaining names in order of preference, and return the list to the AAA. If a party does not return the list within the time specified, all persons named therein shall be deemed acceptable. From among the persons who have been approved on both lists, in accordance with the designated order of mutual preference, the AAA shall invite the acceptance of an arbitrator to serve. If the parties fail to agree on any of the persons named, or if acceptable arbitrators are unable to act, or if for any other reason the appointment cannot be made from the submitted lists, the AAA shall have the power to make the appointment from among other members of the National Roster without the submission of additional lists.[12]

While the parties and counsel have a role in this method of arbitrator selection, the fact that the original slate is chosen for them should reduce each party's ability to "game the system" and will decrease the "over-use" of certain arbitrators.

The recently enacted AIRROC Dispute Resolution Procedure similarly offers a mechanism for the selection of a single arbitrator)[13] Under that Procedure, AIRROC will select 15 names at random from its list of approved arbitrators, or from an alternative list as agreed by the parties, and submit a disclosure form for

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The basic premise of the mini-trial is to provide an opportunity to a senior executive from each party to assess the strengths and weaknesses of the case in a controlled environment that is not emotionally charged.[29] The senior executives who participate should not be involved in the underlying claim that is at the heart of the dispute.[30] This helps to remove the emotions that the day-to-day handlers have in the dispute.

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those candidates to complete.[14] Once those disclosure forms are returned, AIRROC will notify the parties about those candidates available to serve.[15] Each party will then select just over half of the candidates on the list (*e.g.* if 11 candidates remain on the list, each party will select 6) and exchange those names.[16] By selecting just over half, there will be at least one common name on each list.[17] If there is just one match, that person will be the arbitrator)[18] If there is more than one match, AIRROC will decide the arbitrator by lot among the matched candidates.[19]

The Insurance and Reinsurance Dispute Resolution Task Force provides another appointment method for a single neutral in the Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes ("Procedures"). Pursuant to the Alternative Streamlined Procedures contained in the Procedures, selection of the neutral is as follows: (1) each party submits a list of 8 candidates; (2) questionnaires are sent to each candidate; (3) each party strikes the other party's list down to three arbitrators; (4) if there is a common individual, that person is the arbitrator; (5) if there is more than 1 common individual, the parties draw lots to select the arbitrator; (6) if there are no common individuals, each party ranks the six candidates in order of preference (1 being the most preferred) and exchange rankings.[20] The individual with the lowest combined number is the arbitrator.[21] If there is a tie, the parties draw lots to select the arbitrator.[22]

Finally, the ARIAS•U.S. Newer Arbitrator Program contains an option for expedited proceedings with a single arbitrator selected from the newer arbitrator list.[23] The neutral is selected in accordance with the ARIAS Umpire Selection Procedure.[24] Briefly, the process for selecting the neutral consists of: (1) obtaining a random list of candidates from ARIAS; (2) sending a questionnaire to the first 10 candidates; (3) each party selecting five candidates from the list of 10; and (4) each party selecting 3 candidates from the other party's list of 5. If there is one name appearing on both lists, that person will be the neutral. If there is more than one common candidate, the neutral is selected by drawing lots. If there is no common candidate, each party will rank the candidates, with the person with the lowest number being named the neutral.[25]

In a single arbitrator proceeding, there may be some time savings. First, for the purposes of scheduling, there is only one calendar with which to contend (in addition to those of counsel and parties) instead of three. Second, during the course of the arbitration, there is no conferring necessary among decision-makers, so discovery or evidentiary rulings may be made more quickly. Third, following the hearing, there is no debate among decision-makers so deliberations may be shorter. Fourth, there may be less chance of a compromise award. There are many who believe that compromise awards are becoming all too frequent and are not serving the needs of the parties. One philosophy is that 3-person panels issue compromise awards as a way to achieve a unanimous result or as a consequence of one of the two party-appointed arbitrators exerting some influence on the umpire. With only one arbitrator, those reasons for compromise awards disappear.

IV. The Mini-Trial: A Chance for Resolution

The mini-trial was born in 1977 in an effort to resolve a complex patent dispute between TRW Inc. and Telecredit, Inc.[26] The *Telecredit* case had languished in court for years with no imminent trial date set.[27] The parties had each spent several hundred thousand dollars in legal fees and decided there must be another way to resolve the dispute.[28] Over several months, the parties negotiated a procedure for a mini-trial.[29] Once there was an agreement over the procedure, the mini-trial itself took place over a two- day period.[30] After the respective presentations, the parties were able to achieve a settlement within a half-hour.[31]

The basic premise of the mini-trial is to provide an opportunity to a senior executive from each party to assess the strengths and weaknesses of the case in a controlled environment that is not emotionally charged.[32] The senior executives who participate should not be involved in the underlying claim that is at the heart of the dispute.[33] This helps to remove the emotions that the day-to-day handlers have in the dispute.

In a mini-trial, a business executive from each party, as well as a neutral, jointly selected by the parties, sit on a panel to hear the dispute.[34] In *Telecredit*, each party nominated 2 people to act as a neutral and then came to an agreement as to whom should be appointed.[35]

Subsequently, the parties engaged in an expedited period of targeted discovery, including a limited exchange of documents and abbreviated depositions of key witnesses.[36]

Typically, counsel present each side's "best case;" however, on occasion, witnesses, fact and/or expert, may be used.[37] Questions may be asked by any of the panel members, including the neutral.[38] To make sure the case that is presented is the most comprehensive possible, it is best if the mini-trial takes place towards the end of discovery.[39] Following the presentations, the two business executives meet in an attempt to achieve some amicable resolution.[40] To the extent the executives cannot reach a compromise, they can request the neutral to provide a non-binding advisory opinion setting forth the strengths and weaknesses of each side's case.[41] Once that advisory opinion is reviewed, the parties may return for another round of negotiation.[42]

The mini-trial process is designed to be flexible rather than a one-size-fits-all.[43] The parties are free to agree on the rules and procedures that will apply to the mini-trial.[44] Although. the selection of the umpire in an arbitration is often viewed as the "game changer," the nonbinding nature of the mini-trial puts the neutral in a different light. The neutral should have technical expertise with respect to the issues in dispute and should be someone whom both parties respect.[45] Generally, the parties agree that the mini-trial is confidential, that rules of evidence will not apply, and that the scope of evidence presented should not be limited, even if it may be precluded in litigation or arbitration.[46] This elimination of restrictions ensures that the business executives fully appreciate the strengths and weaknesses of both side's cases.

An important component of the mini-trial is that it is confidential.[47] This is of critical importance especially when the procedure is non-binding.[48] Each party needs assurance, for example, that the neutral's opinion about each side's strengths and weaknesses, and about a likely outcome, to the extent given, is not used in the later arbitration or litigation.[49]

While most mini-trials are non-binding in nature, there is nothing to prevent the parties from agreeing in advance to make it binding. The parties could agree that the business executives will first attempt to reach a resolution, but if that is not achievable, the neutral will issue a binding award. The downside to such an approach is that the selection of the neutral becomes all the more important, which can lead to more contentiousness in the neutral selection process. The prospect of an amicable resolution, however, may outweigh this risk.

Even if there is no final resolution of the dispute following the mini-trial, it can help to narrow the issues that need to be litigated or arbitrated. While some have argued that an unsuccessful mini-trial just adds to the cost of an already expensive litigation or arbitration,[50] others argue that the work done in preparation for the mini-trial needed to be done anyway, so any additional cost (i.e., the neutral) is minimal.[51]

V. "Baseball" Arbitration

As the name suggests, the *origin* of "baseball" arbitration is Major League Baseball. Certain players in Major League Baseball are eligible for salary arbitration.[52] Prior to the arbitration, the team and the player each submit a proposed salary figure to the panel of three arbitrators.[53] At the hearing, each side presents its case in support of the figure submitted and each side has an opportunity to rebut the other's case. Following the hearing, the Panel only has authority to order one salary or another, that's it. [54]

"Baseball" arbitration can be applicable to other fields, including reinsurance disputes. It could be particularly useful if a reinsurer acknowledges it owes an amount of money to its ceding company, albeit less than the amount claimed by the ceding company. In such a scenario the two sides can present their cases to a panel of arbitrators and the arbitrators can award either the amount the reinsurer submitted or the one submitted by the ceding company. This would, of course, eliminate any risk of a compromise award. However, this type of arbitration would be unworkable if, for example, the reinsurer claimed to owe nothing or was seeking declaratory relief or rescission. In other words, "baseball" arbitration would appear to be less appealing if the parties are at opposite extremes.

There are a couple of variations on the "Baseball' arbitration theme that parties may wish to consider. One alternative would be where two amounts are presented to the Panel but those amounts form a high and a low for the Panel, so that it can award either extreme or any number in between. Similarly, the parties can decide on a high and a low figure about which the Panel is unaware. In that case the parties decide on the highest amount the party seeking damages can recover and the lowest amount. If the Panel awards an amount higher or lower than the extremes, the high-low number will apply. If the Panel awards anything in between, that is the amount that will be awarded. Again, compromise awards under this scenario would be minimized and there would be less risk that the umpire (or party-appointed arbitrators) would rule out of a sense of loyalty to one party or the other.

VI. Mediator-to Arbitrator or Arbitrator-to-Mediator

In litigation a potential conflict may present itself if the judge who will act as the trial judge compels the parties to attend a settlement conference before him or her. In that situation, parties may be required to reveal weaknesses about their case before the very person who will preside over the case. While some judges recognize this dichotomy and send the parties to another judge for a settlement conference, some see nothing wrong with the practice, believing they can discount whatever was said during the course of settlement negotiations. Of course, the trial judge who serves as finder of fact in a bench trial may be more likely to ask another judge to conduct the settlement conference.

In an arbitration, which is consensual by nature, the parties could agree on almost anything, including having a mediator become the arbitrator if in fact mediation fails. The central problem with such an arrangement is that the

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parties may be disinclined to be forthright during the mediation, fearing that facts (that may otherwise be inadmissible) will be revealed that would hurt their case if arbitration is necessary. On the other hand, the mediator will be familiar with the case as he puts on his arbitrator hat, reducing the cost of getting someone else up to speed on the case.

The reverse situation, arbitrator turned mediator, may be less of a problem in terms of a conflict situation. This may be particularly so in a single arbitrator scenario. If, at the conclusion of the hearing but prior to the rendering of any award, the single arbitrator indicated to the parties that she thinks the parties could reach a compromise with her help in light of what she has heard, the parties may want to take advantage of that facilitation service. To protect the parties and encourage absolute candor, the arbitrator could issue an award and seal it. She can then offer her services to the parties in an effort to facilitate a compromise. In the event the case does not settle, the award will be unsealed. This arrangement guarantees that settlement discussions will not sway the decision-maker one way or the other. The disadvantage is that the parties have already expended considerable time and expense going through a full blown hearing. At that point, one or both parties may just prefer to get the award. On the other hand, given the uncertainties of arbitration, business minds may prevail in favor of an amicable compromised resolution.[55]

VII. Conclusion

While it is understandable that some members in the industry are disenchanted with the current structure of reinsurance arbitrations, there are alternatives to consider before parties begin to abandon reinsurance arbitrations altogether. The benefits of arbitration (having experienced decision-makers, maintaining confidentiality, realizing economical benefits, maintaining efficiencies, relying on custom and practice, etc.) still abound and should not be disregarded arbitrarily or casually. The intent of this paper was to provide a few alternative structures that parties in existing contracts should consider and possibly agree upon, and contract drafters should consider including in new contracts; it in no way is meant to be exhaustive. As an industry of experts, all we need is some creativity and we should be able to reduce some of the negative aspects of arbitration we currently face while holding on to the time- honored custom of arbitrating, rather than litigating, reinsurance disputes.▼

1. The views expressed in this paper do not necessarily reflect the views of White and Williams LLP, any of its attorneys, or those of its clients.
2 Bank & Winters, *Reinsurance Arbitration: A US. Perspective*, 7 Journal of Insurance Regulation 324 (1989).
3 Reinsurance Association of America, *Manual for the Resolution of Reinsurance Disputes*, *A Historical Perspective on the Growth of Arbitration in the US. and its Introduction to the Reinsurance Industry*, 8n.. 17(2008 ed).
4 *Id*. at 9.
5 Bank at 323.
6 Some contracts provide for the two arbitrators to decide the case with the umpire playing a role only if the two arbitrators are unable to agree on a final disposition. This practice is still followed in the United Kingdom but appears to have been abandoned in the U.S. even if a strict reading of the contact requires it.
7 One way to minimize this distraction is to select a panel in accordance with the literal language of the contract, that is let the two party appointed arbitrators select an umpire without the influence of the parties or counsel as is the case in the United Kingdom.
8 Arbitration Act, 1996, ch. 23.
9 AAA's Procedures for the Resolution of Intra Industry U.S. Reinsurance and Insurance Disputes Supplementary Rules can be found at www.adr.org.
10 American Arbitration Association, Resolution of Intra-Industry U.S. Reinsurance Disputes Supplementary Rules, R-I 5 (2005).
11 *Id*. at 4.
12 American Arbitration Association, *Commercial Arbitration Rules and Mediation*, R-1 1(2009).
13 Association of Insurance and Reinsurance Run-Off Companies, *The AIRROC Dispute Resolution Procedure*) § *III (2009).*
14 *Id*.
I5 *Id*. at IIIA.
16 *Id*. at IIIB.
17 *Id*.
18 *Id*.
19 *Id*.
20 [1] *Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes*, § 16 (2009)
21 *Id*.
22 *Id*.
23 ARIAS Newer Arbitrator Program, www.arias-us.org.
24 *Id*.
25 ARIAS Umpire Appointment Procedure, www.arias-us.org.
26 Davis & Omlie, *Mini-Trials: The Courtroom in the Boardroom*, 21 Willamette L Rev. 531,535(1985).
27 E. Green, The CPR Legal Program Mini-Trial Handbook, MH-22 (1982).
28 *Id*.
29 *Id*.
30 *Id*.
31 *Id*.
32 Davis at 541.
33 *Id*.
34 American Arbitration Association, *Mini-Trial: Involving Senior Management*, 2(2007).
35 Green at MII-I-23.
36 *Id*.
37 Green at MI-I-24.
38 Davis at 542.
39 *Id*. at 537.
40 *AAA Mini-Trial* at 3.
41 *Id*.; Davis at 532.
42 AAA Mini-Trial at 3.
43 Green at MI-I2 I.
44 *Id*.
45 Davis at 534.
46 *Id. at* 539, 543.
47 *Id. at* 543.
48 *Id*.
49 *Id*.
50 Civil Litigation: The Judicial Mini-Trial, Alberta Law Reform Institute 5(1993).
51 Davis at 532.
52 Ray, How Baseball Arbitration Works: MLB Rules Governing the Eligibility and Process of Arbitration, www.baseball.suite101.com (2008).
53 *Id*.
54 *Id*.
55 Pursuant to some arbitration clauses in newer reinsurance contracts, the parties agree to attend mediation in advance of any arbitration. Such a clause helps to ensure that parties, especially those in an ongoing business relationship, make an attempt to amicably resolve their disputes short of arbitration, Those responsible for contract drafting would be wise to consider this approach, as well as any other alternatives discussed herein.