For a complete Index, see page 4

ASSOCIATION OF INSURANCE AND REINSURANCE RUN-OFF COMPANIES

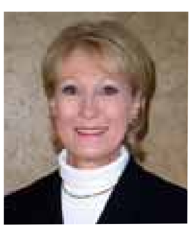
AIRROC Matters

A NEWSLETTER ABOUT RUN-OFF COMPANIES AND THEIR ISSUES

VOL. 4 NO. 1 www.airroc.org SPRING 2008

Message from CEO and Executive Director

AIRROC's Education Thrust



Trish Getty

By Trish Getty

AIRROC's 2008 board of directors reflects on the value of our membership, again reviewing our mission statement while considering the needs of participating members. We remind ourselves of these words from our mission statement:

"…improving professional and managerial standards and practices, and enhancing knowledge and communications within and outside of the run-off industry through educational activities."

In line with our value proposition, AIRROC's ongoing thrust will have a strong emphasis on education.

continued on page 22

Notes from the Special Editors

Improving the Run-Off Dispute Resolution Experience

Special Editors Marc Abrams(l),William Maher(r) and Matters Editor Peter Scarpato(c)

By William A. Maher and Marc L. Abrams

In this Special Edition of AIRROC Matters, we consider an issue that strikes at the heart of the run-off experience: dispute resolution. There can be little dispute that our contributors to this issue are special. In our roundtable discussion, for instance, we convene an expert panel consisting of Brian Snover, Mark Gurevitz and Jonathan Rosen, each of whom maintains an exceptional range of experience exploring the intersection between run-off and dispute resolution. Together, the three Panelists respond to our questions, and sound off on a variety of issues including whether run-off companies have any friends, how parties can streamline their run-off disputes, and whether an AIRROC sanctioned "small claims court" might create a market for resolution of smaller run-off claims.

The level of scholarship in this Special Edition is equally probing. In their article "Claims Protocols: Suggestions Concerning the Run-off of Long Tail Liability Claims," Michael Knoerzer and Stephen Kennedy provide a practical guide for repeat players in the industry to develop protocols for the handling

continued on page 3

Notes from the Special Editors

Improving the Run-Off Dispute Resolution Experience

continued from page 1

of asbestos and other long tail liability claims. By following these protocols, the authors explain, reinsurers and cedents may ultimately avoid litigation, and even if they do not, adherence to the protocols may lead to more structure, certainty and disclosure in the claims handling process.

Assuming that pre-litigation protocols are unable to stave off a dispute, a critical issue for parties is one of process: *i.e.*, which dispute resolution mechanism should the parties use for resolving their dispute. In "Resolution of Run-off Disputes: What Works Best?" James Shanman explores this exact issue, and provides insight into the benefits and burdens that mediation, arbitration and litigation each offer. Oftentimes though, the parties may not have a choice in the matter. For instance, when a party finds itself in a dispute with a receiver, certain jurisdictions may require the party to resolve the dispute in receivership court; other jurisdictions though may reach a seemingly contradictory result, and allow for arbitration of the dispute. Fortunately for our readers, Larry Schiffer is able to explore and explain these nuances in his article "Arbitration in Run-off—the Receivership Anomaly — Part I."

One way or another, many run-off disputes will result in arbitration. Two issues that the arbitrating parties may then confront are appointing a panel, and – once the panel is formed – seeking an award of security. In "Arbitration Practice and Procedure in U.S. and U.K. Reinsurance Disputes: Part I", Philip Loree and Costas Frangeskides provide a provocative study on arbitrator neutrality in both English and U.S. reinsurance arbitrations. And with comparable vim, Kevin Walsh discusses applications for security on both sides of the Atlantic in "Some Thoughts on the Pre-Hearing Security Freight Train in the Run-Off Context," while also providing suggestions for parties seeking or opposing applications for security in their run-off disputes.

Although this may surprise some, all run-off disputes ultimately reach a conclusion, and at this point, the parties might ask themselves whether it was really worth the fuss. In their joint articles, beginning with "The Future of Arbitration in Run-off: Is it (Mostly) the "Costs," Stupid?," Jim Veach, Mark Megaw and Janet Kloenhamer entertain this very question from three different perspectives, with Jim first providing a sense of the mood pervading the reinsurance dispute resolution community, Mark then invoking the tools of the "dismal science" (*i.e.*, economics – not finite reinsurance) to determine the true costs of a dispute upon the parties, and Janet discussing the benefits of mediating disputes as well as a possible industry trend toward mediation.

Besides their scholarship, the quality that the contributors to the Special Edition share is a desire to enhance the run-off dispute resolution experience. This quality is exemplified by both the Roundtable Panel's numerous ideas for streamlining run-off disputes as well as the suggestions offered by the article authors. It is a credit to AIRROC that it has provided a forum for such a lively and necessary discussion. ■

William A. Maher is a Founding Member of Wollmuth Maher & Deutsch LLP where he leads the firm's Insurance and Reinsurance Dispute Resolution practice. He can be reached at wmaher@wmd-law.com.

Marc L. Abrams is a Partner at the law firm of Wollmuth Maher & Deutsch LLP and practices in the areas of reinsurance, insurance and general commercial litigation and arbitration. He can be reached at mabrams@wmd-law.com.

AIRROC – In this Issue

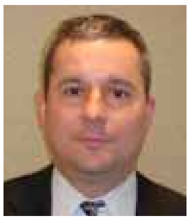
Vol. 4 No. 1 • Spring 2008

Copyright Notice

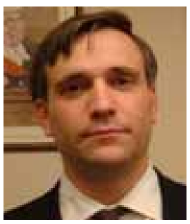
AIRROC Board of Directors

Feature Article

Claims Protocols: Suggestions Concerning the Run-off of Long Tail Liability Claims



Michael A. Knoerzer



Stephen M. Kennedy

By Michael A. Knoerzer and Stephen M. Kennedy

I. Introduction

With seemingly ever-growing frequency, reinsurance disputes involve not a substantive issue such as whether a claim is covered or whether an allocation is correct, but a procedural issue of whether certain claims information provided is sufficient to trigger the reinsurer's obligation to pay a claim. This procedural issue most frequently arises with mass tort claims such as asbestos that involve multiple insureds, reinsurance contracts and underwriting years.

The run-off of the enormous volume of asbestos and other long tail liability claims continues to challenge both insurers and reinsurers alike, requiring them to devote significant time and resources to handle claims on business often written long ago. High claim volume and a corresponding high demand on company resources can create a combustible environment in which ceding companies and their reinsurers may sharply disagree as to whether sufficient claims information has been provided to the reinsurers to adjust the claims.

With seemingly ever-growing frequency, reinsurance disputes involve...a procedural issue of whether certain claims information provided is sufficient to trigger the reinsurer's obligation to pay a claim.

As the parties attempt to sort through this issue on a multiple claim and reinsurance contract basis, the ceding company's impatience is bound to grow as its reinsurance recoverables remain uncollected and/or continue to increase. Likewise, a reinsurer's patience will be strained as the burden of adjusting claims significantly increases because it must continue to monitor, on a claim by clam basis, which of its queries have been answered and which remain outstanding.

When confronted with this situation, both the ceding company and reinsurer may believe that the other is not acting with the best of intentions. Ceding companies may, for example, complain that reinsurers' information demands are nothing more than a delay tactic to postpone paying claims for as long as possible. Reinsurers, on the other hand, may view the failure of a ceding company to provide requested claim information as an unjustified constraint upon their ability to evaluate coverage and their own exposure.

If a cedent and reinsurer cannot resolve their differences concerning the production of information to support a claim, then formal dispute proceedings likely results. In the arbitration or litigation, the ceding company will typically demand principal and interest and may also ask for a declaration that the reinsurer must promptly pay future billings under the reinsurance contract(s) at issue. It may also seek an award of attorneys' fees, costs and extra contractual damages based upon allegations that the reinsurer is refusing to pay in bad faith.

The reinsurer may respond by seeking relief of its own, such as an award: (1) denying the ceding company's billings until it provides the claims information requested by the reinsurer in the ordinary course of business; (2) directing the ceding company to provide timely and full notices of future losses under the reinsurance contract(s); and (3) awarding attorneys' fees, costs and extra contractual damages based upon allegations that the ceding company has forced the reinsurer in bad faith to incur the costs of adjusting claims in arbitration or litigation rather than in the ordinary course of business.

Arbitration and litigation of this sort is wasteful. Yet, because of the absence of a plan in advance for dealing with these issues before feelings and positions harden, arbitration of this sort may often be unavoidable.

continued on next page

Michael A. Knoerzer and Stephen M. Kennedy are Partners in the New York office of Clyde & Co US LLP where their practice focuses upon the litigation and arbitration of insurance and reinsurance disputes. Emails: Michael.Knoerzer@clydeco.us; Stephen.Kennedy@clydeco.us.

Ceding companies and reinsurers would do well to consider pragmatic, commercial options for resolving their differences. One such option is for the cedent and reinsurer to agree upon and implement a set of claims handling protocols for asbestos and other long tail liability claims.

II. Claims Handling Protocols

The amount of claims information that a reinsurer may reasonably expect to receive from a ceding company depends on the reinsurance contract language at issue, the parties' prior course of conduct under the reinsurance contract(s), and the nature of the parties' overall relationship.

As a practical matter, ceding companies usually try to provide as much information to a reinsurer that they believe is reasonable in order to receive payment of their billings as soon as possible.

As a practical matter, ceding companies usually try to provide as much information to a reinsurer that they believe is reasonable in order to receive payment of their billings as soon as possible.

Reinsurers, for their part, generally seek information that allows them to assess any coverage issues under the reinsured policies and/or reinsurance contracts. They also generally look to the ceding company for information explaining the reasons for its settlement and allocation decisions. That information may consist of pleadings, settlement and allocation analyses, litigation decision trees, and copies of relevant underlying policies or reinsurance contracts. Once a reinsurer receives this information, it may then assess whether there are substantive coverage or claims issues that need to be addressed with the ceding company, including, for example, what constitutes the occurrence, the number of occurrences, when the occurrence(s) took place, whether the claims are products/completed operations claims subject to aggregate limits, and whether there are Wellington signatory/non-signatory issues.

A set of claims handling protocols may be an effective and orderly way to get reinsurers sufficient information to assess claims within timeframes that are acceptable to ceding companies. Under these protocols, for example, a ceding company and reinsurer might agree that:

1. the ceding company will provide specific information to the reinsurer prior to or contemporaneous with its billings;
2. the reinsurer will ask any questions and/or request an audit within a certain period of time after receipt of the billings and information supporting the billings;
3. the ceding company will provide responses to any questions or audit request by the reinsurer within a certain period of time; and
4. the reinsurer will then either pay or deny a claim within a specified time upon receipt of the ceding company's responses to its queries and/or after the completion of an audit.

In addition to drafting the precise terms of the claims handling protocols, there are other issues the parties may need to consider and agree upon. For example, (a) what should the parties do if certain of the information required to be provided under the protocols does not exist; (b) whether the protocols should constitute a separate agreement or be made part of the reinsurance agreements; (c) how should the parties address claims that have already been notified and/or billed prior to the implementation of the protocols; (d) whether and how the protocols may be modified; and (e) whether the protocols should be admissible in any dispute resolution proceedings between the companies.

Working through these issues and drafting mutually agreeable protocols may take significant time and effort. The potential benefits in the claims handling process, however, should be worth the hard work.

III. Conclusion

To be sure, there will be instances when a ceding company and reinsurer cannot agree - for a variety of reasons - to a workable set of claims handling protocols. For other companies, however, protocols may provide a way to resolve the initial but critical issue of precisely what information should be provided to a reinsurer to adjust asbestos and other long tail liability claims.

With agreed upon procedures and timeframes, claims handling protocols have the potential to lend more structure and certainty to the claims handling process.

To the extent a reinsurer ultimately decides to deny a claim under a set of protocols, then the discussion between the parties regarding the claim should be more substantive and focused than it otherwise might be if they were disputing what information the reinsurer had already received and exactly how much more it is entitled to. Likewise, should the parties not resolve their differences regarding claims under a set of protocols, any subsequent dispute proceeding should be significantly more streamlined and cost effective. ■

Feature Article

Resolution of Run-off Disputes: What Works Best?

James A. Shanman

By James A. Shanman

Industry literature is replete with discussions and comparisons of the commonly used methods for resolving reinsurance disputes, namely, arbitration, litigation and mediation. What is frequently missing from those discussions, however, is any consideration of the special circumstances which frequently accompany disputes involving companies in run-off and the impact of those circumstances on efficient and effective resolution of disputes.

In theory, at least, run-off disputes should be relatively simple to resolve, because run-off is in essence a purely commercial endeavor. The objective is to collect assets and discharge liabilities as quickly, efficiently, and profitably as possible.

In theory, at least, run-off disputes should be relatively simple to resolve, because run-off is in essence a purely commercial endeavor. The objective is to collect assets and discharge liabilities as quickly, efficiently, and profitably as possible.

Thus, disputes should be relatively free from the influence of historical and ongoing corporate policies and relationships. To put it another way, such disputes should, ideally, involve only present economic considerations.

Unfortunately, this is not always the case. Moreover, there are often special circumstances which may complicate resolution, even in disputes which are purely economic. First, in a run-off situation, relevant documents and knowledgeable witnesses may be missing or not readily available, thus making it difficult to obtain an accurate picture of the facts. This may be compounded by the absence of any "institutional memory" of the background or of the practices in dispute. Further, if one of the parties to the dispute is not in run-off, it may not have the same incentive to resolve the matter quickly that the run-off company has.

Finally, although there is clearly no way to document this, it may well be that arbitrators and others involved may have somewhat less sympathy for companies in run-off than for ongoing concerns.

In the proper case, the best alternative is clearly mediation.

Given these circumstances, what method of dispute resolution works best?

In the proper case, the best alternative is clearly mediation. At its best, it is by far the fastest and most economical alternative.

In order for mediation to be successful, however, both parties must be genuinely open to settlement. Absent that prerequisite, attempts to mediate will almost certainly prolong by months, sometimes many months, disputes which are protracted already. This is not to say that the parties need enter into mediation with the intent to settle; rather, only that they have a genuine willingness to consider reasonable compromise. Further, each party should actively involve in the mediation an individual or individuals at a sufficiently high corporate level to be able to agree upon a settlement. Failing this, again it is unlikely that much will be accomplished. Moreover, as an empirical matter, cases involving extremely complex facts or principles or unusual practices, may be less susceptible to successful mediation.

Key to success in mediation is selecting an effective mediator. Obviously it is important to select a mediator with experience and substantial knowledge of the industry. However, more important in a mediator is the ability to bring the parties together on some common ground — as opposed to merely pointing out where one party is right or wrong. It is also important to select a mediator who has sufficient time and flexibility in his or her schedule to move the proceedings quickly.

Mediation may be conducted on an ad hoc basis or under the rules of an organization such as, for example, the American Arbitration Association or the International Institute for Conflict Prevention and Resolution. In any

continued on next page

James A. Shanman is a Partner in the Stamford, Connecticut office of Edward Angell Palmer & Dodge, LLP. James' practice is concentrated in the areas of insurance and reinsurance disputes, including litigation and arbitration, and complex commercial litigation. He can be reached at jshanman@eapdlaw.com.

event, the aim of any procedure selected should be to facilitate settlement and to do so expeditiously. The latter consideration is important not only for obvious reasons but, also, because even mediation can consume many months if the parties do no push it forward.

Turning to arbitration, this is, of course, the method of dispute resolution most widely used in the industry. Indeed, most reinsurance agreements include arbitration clauses. Traditionally, one of the major advantages of arbitration was that it was relatively fast and inexpensive. However, whatever advantage arbitration enjoys over litigation in terms of speed and cost is rapidly eroding. Turning first to speed, the actual working pool of reinsurance arbitrators is quite small (probably considerably less than 100 individuals) and many of them are simply very busy. Thus, it is not infrequent to contact a potential arbitrator and learn that he or she will not be available for a hearing for a year or more, especially if the hearing is to last more than a few days. Even putting that hurdle aside, it is very difficult to schedule arbitration hearings when the convenience and schedules of three arbitrators, two or more parties, and numerous witnesses are involved. As a practical matter, arbitration panels simply do not engage in the same sort of preemptive scheduling as courts; that is, arbitration panels are generally reluctant to set an arbitrary date and instruct the parties to conform to it no matter what. Since speed is often a primary consideration in run-off, this is clearly a disadvantage. With respect to costs, although arbitration is still in most cases less expensive than litigation, that gap, too, is closing, particularly as arbitrators are more and more inclined to allow extensive discovery and motion practice. For example, summary judgment motions in arbitrations used to be extremely rare; now they are becoming more frequent. This, of course, affects both cost and timing. A successful summary judgment motion may speed up the proceedings; but such motions do not often succeed and, when they don't, months are often wasted.

In smaller cases, it is sometimes feasible to use a simplified arbitration procedure. Usually, in such cases there is only one arbitrator and discovery is restricted or largely eliminated — for example, document discovery might be allowed but not depositions. Obviously, this procedure saves time and cost and can be very useful if the parties can agree on, and have confidence in, the single arbitrator.

While arbitrators have become more inclined to permit wider discovery, nonetheless the discovery permitted in arbitration is frequently much narrower than that accorded by the courts. This may be a disadvantage to companies in run-off which do not have easy internal access to relevant facts, documents and witnesses.

This lack of predictability may constitute a real problem for a company in run-off which may face a large number of potential disputes involving similar issues and needs to formulate an efficient and cost-effective way to deal with them.

Another issue with arbitration is predictability. Generally, arbitrators are not held to strict rules of law and, indeed, absent provisions providing specific standards for decision, which are extremely rare, cases are usually decided on the basis of the arbitrators' views of custom and practice, honorable conduct, or commercial fairness. The problem is that all of these factors are subjective and what is fair and honorable, or indeed what constitutes normal custom and practice, may vary in the views of different arbitrators. As a result, it is quite possible for two arbitration panels with the same facts and issues before them to reach opposite decisions. Moreover, there is effectively no appeal.

This lack of predictability may constitute a real problem for a company in run-off which may face a large number of potential disputes involving similar issues and needs to formulate an efficient and cost-effective way to deal with them.

Since most reinsurance agreements contain arbitration clauses, relatively few disputes go into litigation. Having said that, however, some reinsurance agreements do not contain arbitration clauses, especially older facultative certificates, and, in addition, it is always possible for parties to agree to waive arbitration and proceed in court. From the standpoint of a company in run-off, litigation may offer some advantage.

Although litigation may still be somewhat more costly than arbitration, it is probably no longer much more protracted. Moreover, for the company in run-off which no longer has complete access to records, witnesses, and institutional memory, the broader discovery permitted in litigation may be an important advantage. A second advantage may be the more definite standards employed by courts coupled with the right to appeal. This could be particularly useful for a company which has a large number of essentially similar claims and wants to obtain a legal ruling which would serve as a precedent for resolving all such claims.

In short, for companies in run-off it is useful to consider all of the alternative methods of dispute resolution and not merely focus on arbitration. ■

ATLANTA

AUSTIN

CHICAGO

DALLAS

HOUSTON

LONDON

LOS ANGELES

NEW ORLEANS

NEW YORK

SACRAMENTO

WASHINGTON

LOCKE LIDDELL & SAPP PLLC Attorneys & Counselors and LORD BISSELL BROOK LLP ATTORNEYS AT LAW

have combined to form

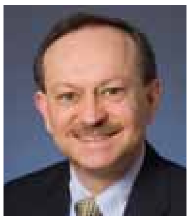
LOCKE LORD BISSELL & LIDDELL LLP

Locke Lord Bissell & Liddell LLP has 700 attorneys with offices in Atlanta, Austin, Chicago, Dallas, Houston, London, Los Angeles, New Orleans, New York, Sacramento and Washington, D.C.

Our combination represents the shared vision of both of our firms to support the long-term success of our lawyers and to better serve our cilents. With complementary strengths, experiences and similar cultures, we offer our clients a diverse and dynamic firm with the knowledge, resources and commitment to serve their needs effectively and efficiently.

Feature Article

Arbitration in Run-off – The Receivership Anomaly – *Part 1 (of a 2-part series)*


Larry P. Schiffer

By Larry P. Schiffer

Introduction

A dispute between a cedent and reinsurer, whether one party or the other is in run-off, generally has no affect on either party's right to arbitrate that dispute if the reinsurance contract has an arbitration clause.

This time-honored contractual tradition of arbitration as the mechanism for resolving disputes between parties to reinsurance contracts takes a back seat in some jurisdictions when one of the contracting parties is in receivership. Yet, in other jurisdictions, receivers must honor the contracts of the insolvents under their protection. When an arbitration clause is present in a reinsurance contract, receivers in those states must resolve contract disputes through the arbitration process just as the company would have had it not been placed into receivership.

A dispute between a cedent and reinsurer, whether one party or the other is in run-off, generally has no affect on either party's right to arbitrate that dispute if the reinsurance contract has an arbitration clause.

The arguments for and against compelling a receiver to arbitrate a reinsurance dispute are varied. They range from technical preemption arguments under the McCarran-Ferguson Act ("McCarran-Ferguson")[1] to equitable principles governing the role of a receiver standing in the shoes of an insolvent company in run-off. In those states where the receivership court takes a strong view against resolving an insolvent's contract disputes outside of its watchful eye, reinsurers, obviously, would prefer to arbitrate. Receivers, on the other hand, sometimes enjoy a favored status in the liquidation court and would much prefer to resolve reinsurance disputes before what is often perceived as a friendly face. These broad generalizations do not hold for every reinsurer and every receiver, as the particular facts and circumstances of a given receivership, dispute, and jurisdiction may alter the usual assumptions.

Interestingly, there are some receivers that have initiated arbitration proceedings, finding the arbitral process to be more appropriate for resolving reinsurance contract disputes than the receivership court. So the question is not solely whether a receiver can be compelled to arbitrate, but sometimes the question is whether the receiver has a right to arbitrate. A more complex question is whether the receiver has the right to pick and choose when to arbitrate.

What we have found in the case law is a wide divergence of opinion among those states that have addressed this issue. In some states, there is no controversy: once a company goes into run-off through a receivership, the arbitration clause is abrogated and all disputes must be resolved in the liquidation court. In other states, receivers are held to stand in the shoes of the insolvent company and may be compelled, or may choose, to arbitrate. Other states address this issue with less clarity and, of course, many states have never addressed the issue.

This article will review some of those cases and may attempt to make some sense of the divergence of opinion on whether receivers are bound to arbitrate reinsurance disputes when the company is running-off through receivership.

The New York Rule – Receivers Not Bound to Arbitrate

New York is one of the few jurisdictions that have resolved the issue of whether a receiver of a company in run-off is bound by the arbitration provisions of a reinsurance agreement. New York law, as it stands today, does not require a receiver to submit to arbitration and

Larry P. Schiffer is a Partner in the New York office of Dewey & LeBoeuf LLP, practicing commercial, insurance, and reinsurance litigation, arbitration, and mediation. He is active in legal and trade associations where he has held various leadership positions, and writes and speaks regularly on insurance and reinsurance issues. He can be reached at larry.schiffer@dl.com.

continued on next page

the receiver is free to resolve reinsurance disputes in the state court supervising the receivership.

The seminal case on this issue is *Knickerbocker Agency, Inc. v. Holtz.*[2]

…But another New York federal judge followed *Knickerbocker* in a dispute between a rehabilitator and the liquidator of a New York insolvent.

In *Knickerbocker*, the parties had entered into a contract containing an arbitration clause that provided "[a]ll controversies and disputes arising out of or relating to this agreement or the subject matter thereof shall be submitted to arbitration."[3] As liquidator of one of the parties to the contract, the New York Superintendent of Insurance commenced an action to recover a sum alleged to be owed to the insolvent insurer under the contract. The defendant took the position that the matter should be submitted to arbitration under the contract. The trial court directed the Superintendent to proceed to arbitration and stayed the action against the defendant pending the outcome of that arbitration. The Appellate Division reversed, citing the legislature's vesting of exclusive jurisdiction in the trial court of all claims involving an insolvent insurer.

On appeal, the defendant argued that the Superintendent "stepped into the shoes" of the insolvent insurer, and as such, was subject to the arbitration provision as would be the insurer outside of a liquidation proceeding. The Court of Appeals rejected this argument, noting that the comprehensive nature of the insurance insolvency statute (the predecessor to the current Article 74 of the New York Insurance Law[4]) vested exclusive jurisdiction of all claims involving the insolvent insurer in the New York Supreme Court. In affirming the Appellate Division, the Court stated that it was difficult to envision that the legislature "contemplated turning over liquidation proceedings, and incidental actions and proceedings, to private arbitrators to administer."[5]

The New York Court of Appeals' decision in *Knickerbocker* was followed in *Corcoran v. Ardra Insurance Co., Ltd.*[6] There, the Court held that even though the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("the New York Convention"),[7] as an international treaty, preempts conflicting state and federal law, the Superintendent, as liquidator, was exempted from its provisions as the Superintendent was not authorized under the statutory scheme to participate in arbitration proceedings.

The applicability of *Knickerbocker* was limited by one New York federal court to those cases that are within the exclusive jurisdiction of the receivership court. In *Bernstein v. Centaur Insurance Co.*,[8] the parties to the dispute included the rehabilitator of an insolvent Vermont insurer and a New York reinsurer. The case was brought by the rehabilitator in New York federal court with jurisdiction based on the diversity of the parties. Again, the underlying reinsurance agreement contained a contractual provision whereby matters of interpretation or performance under the agreement shall be submitted to arbitration.

The reinsurer moved to dismiss one of seven claims brought by the rehabilitator, but also moved to stay the proceedings pending arbitration, citing the Federal Arbitration Act ("FAA"),[9] and its statutory presumption in favor of arbitration. In finding that the rehabilitator could be compelled to arbitrate, the Court looked to the decision in *Knickerbocker* and noted that, the Court there did not find that the state insolvency statute expressly granted exclusive jurisdiction of insurance insolvency matters in the New York Supreme Court, but merely that "the overall scheme and plan of [the statute] require[d] such a result."[10] The Court found that this case was not under the exclusive jurisdiction of the state court (having been brought in federal court on diversity grounds), and was not brought under former Article XVI of the New York Insurance Law. Therefore, the Court was not governed by the holding in *Knickerbocker*. Further, the Court found the rehabilitator's McCarran-Ferguson argument to be unavailing because that act only exempts state practices from pre-emption (by federal laws such as the FAA) if a state's law would be invalidated, impaired, or superseded. The Court held this was not the case here and compelled the rehabilitator to arbitrate certain of the matters brought in its complaint.

But another New York federal judge followed *Knickerbocker* in a dispute between a rehabilitator and the liquidator of a New York insolvent. In *Washburn v. Corcoran*, the district court decided a matter that presented a conflict between the FAA and McCarran-Ferguson.[11] The rehabilitator of one company in financial distress brought an action in federal court against a company in liquidation seeking to compel the liquidator to arbitrate under to the reinsurance agreement between the two companies. The rehabilitator's action was in response to the liquidator's petition to the liquidation court to declare the insolvent's rights under the reinsurance agreement. The liquidator moved to dismiss the federal action arguing that McCarran-Ferguson barred application of the FAA to the dispute.

continued on next page

In granting the liquidator's motion, the Court relied heavily on *Knickerbocker*. The Court noted that Article 74 of the New York Insurance Law conferred exclusive jurisdiction of the liquidation of insurance companies on the state Supreme Court, which overrides and nullifies arbitration agreements. Finding that the enforcement of the FAA would unquestionably "impair or supersede" Article 74, the Court held that application of the FAA was barred by McCarran-Ferguson.

The *Washburn* decision can be distinguished from *Bernstein* in major part by the forum chosen. In Washburn, the liquidator commenced its action in the state receivership court, while in *Bernstein*, the rehabilitator brought the action in federal court based on diversity of citizenship. Because the liquidator commenced the action under Article 74 in the liquidation court, the federal court had very little choice but to follow *Knickerbocker*.

Some state insolvency laws contain express anti-arbitration provisions where receivers are concerned.

Some state insolvency laws contain express anti-arbitration provisions where receivers are concerned.

Unlike the judicially-created New York rule, the Second Circuit, interpreting Kentucky law, has held that, because the anti-arbitration provision of the Kentucky Insurers Rehabilitation and Liquidation Law is preserved by McCarran-Ferguson, the liquidator cannot be compelled to arbitrate disputes arising from a reinsurance agreement entered into by the pre-insolvency reinsurer.[13] In *Stephens v. American International Insurance Co.*, the liquidator argued that he should not be compelled to arbitrate because the Kentucky Act contained a provision prohibiting the liquidator from arbitrating.[13] In pertinent part, the statute provided:

> If there is a delinquency proceeding under this subtitle, the provisions of this subtitle shall govern those proceedings, and all conflicting contractual provisions contained in any contract between the insurer which is subject to the delinquency proceeding and any third party, including but not limited to, the choice of law or arbitration provisions, shall be deemed subordinated to the provisions of this subtitle.

Ky. Rev. Stat. Ann. § 304.33-010(6).[14]

Under McCarran-Ferguson, state statutes that are enacted "for the purpose of regulating the business of insurance" are preserved from preemption, and the regulation of the business of insurance is left to the states. The Court applied the three part test of *Union Labor Life Insurance Company v. Pireno*[15] and determined that the Kentucky Liquidation Act was a statute that was enacted for the purpose of regulating the business of insurance, and as such, was not preempted by the FAA.

In *Stephens*, the Court also considered the reinsurers' claim that because they were corporations based in foreign countries, the Kentucky Act was rendered ineffective by the later-dated New York Convention under the Supremacy Clause of the U.S. Constitution. Under the New York Convention, the Court has the power to compel arbitration. In resolving these two conflicting authorities, the Second Circuit held that the federal law (McCarran-Ferguson) controlled even though it predated the treaty (the New York Convention). In the Second Circuit's view, the New York Convention is not self-executing and has no legal force unless it is subsequently implemented by an Act passed by Congress.[16] Because the New York Convention was not supported by any legislative act, it could not overcome the conflicting state law supported by a congressional mandate.

A completely different result as to whether the New York Convention supersedes McCarran-Ferguson was reached by a Georgia federal court in 2008.

A completely different result as to whether the New York Convention supersedes McCarran-Ferguson was reached by a Georgia federal court in 2008.[17] In *Goshawk*, a British insurer sought an order compelling arbitration. The defendant, a United States company in receivership, argued that the state court supervising the receivership had exclusive jurisdiction under the state based anti-arbitration laws. Conceding that the state law was indeed preserved by McCarran-Ferguson, the British insurer nonetheless countered that McCarran-Ferguson mandate was superseded by the New York Convention because the dispute involved a foreign corporation. Finding the *Stephens* line of the cases unpersuasive, the District Court sided with the British insurer and held that the New York Convention must be enforced according to its terms over all prior inconsistent rules of law, including statutes passed by Congress. The Court's holding in *Goshawk* is in direct contrast with the Second Circuit's decision in *Stephens*, but consistent with the Eleventh Circuit's emphasis on the primacy of the Convention.[18] Thus, at least in the Eleventh Circuit, the

continued on next page

New York Convention supersedes McCarran-Ferguson insofar as it preempts state law defenses to enforcement of arbitration clauses in insurance contracts.

As the Second Circuit in *Stephens*, the Tenth Circuit reached the same conclusion interpreting Utah law, holding that the Utah statute consolidating all claims against a liquidating insurer was enacted for the purpose of regulating the business of insurance. Applying McCarran-Ferguson, the Court held that allowing a creditor "to pluck from the entire liquidation proceeding one discrete issue and force arbitration contrary to the blanket stay entered by the Utah state court would certainly impair the progress of an orderly resolution of all matters involving the insolvent company."[19] Interestingly, the Tenth Circuit indicated that the plaintiff could bring the dispute before the liquidation court and if arbitration was the best way to resolve the conflict, it could be ordered by that court.[20]

Ohio has also joined those states that will not compel a liquidator to arbitrate disputes arising from reinsurance agreements notwithstanding an otherwise valid arbitration provision contained in those agreements.

Ohio has also joined those states that will not compel a liquidator to arbitrate disputes arising from reinsurance agreements notwithstanding an otherwise valid arbitration provision contained in those agreements.

In *Womer v. Pipoly*,[21] an intermediate appellate court expressly overruled its earlier decision in *Fabe v. First General Insurance Co.*,[22] in which the liquidator was compelled to arbitrate under the arbitration provisions of a reinsurance agreement. As the *Pipoly* court spends much time examining its decision in *Fabe*, a brief overview of that case is warranted.

In *Fabe*, the liquidator appealed a judgment granting the defendants' motion to compel arbitration in a reinsurance dispute. In affirming, the appellate court noted the favorable history of arbitration in Ohio, including case law and statutory provisions encouraging arbitration as far back as the nineteenth century. The Court also engaged in statutory construction to determine if the liquidator should be compelled to arbitrate. First, the Court noted that an Ohio statute governing arbitration provisions provided that such provisions "shall be valid, irrevocable and enforceable." That same statute contained exceptions to this rule, none of which applied to liquidation proceedings.

Second, the Court noted that, where there was a conflict between a general and a special statute, the special statute will control, and if possible, both should be construed so that effect is given to both. Though the liquidation statute was special and the arbitration statute general, the Court stated that "only if compelling arbitration would somehow interfere with the liquidators powers . . . could such a contractual arbitration provision be held unenforceable in liquidation proceedings."[23] The Court held that this was not the case here as the dispute between the parties was regarding the ownership of the assets. Not until a determination of ownership was made in favor of the liquidator would the liquidator be able to exercise control over the assets as empowered by the statute.

The disputed matter in *Pipoly* did not arise from a reinsurance agreement, but nonetheless the Court's holding is relevant. In *Pipoly*, the liquidator brought an action against several parties who were former officers and/or directors of the insolvent companies for breaches of numerous fiduciary duties owed to the companies. Each of the defendants moved the trial court to stay the proceedings and refer the liquidator's claims to arbitration pursuant to arbitration provisions contained in each of the employment agreements and various other agreements to arbitrate. The trial court granted the motions to stay and referred the dispute to arbitration. In its decision, the trial court followed *Fabe* and noted the presumption in favor of arbitration and concluded that it should give effect to both the liquidation statute and the arbitration provision when possible.

In overruling *Fabe*, the appellate court first examined the Ohio statutory scheme governing insurance company liquidations, and in particular, the broad powers that the statute vests in the liquidator, under the supervision of the Court, for the purpose of maximizing the assets available to the liquidator for discharging her duties. The Court noted that the statutes "require us to liberally construe them in favor of their stated purpose."[24] The Court then looked at the statute governing arbitration and stated that before the Court could make any determinations regarding the arbitrability of the parties' claims, it must determine whether the agreement being invoked was in fact enforceable under basic contract principles. In this examination, the Court noted that neither the liquidator nor her predecessor had signed the agreements to arbitrate and thus a presumption against their enforcement existed. The Court held that when a liquidator is appointed by court order she is not automatically bound by the pre-appointment contractual obligations of the insolvent insurer — she must affirmatively indicate her election to be responsible for those obligations.

continued on next page

The Court also noted that "where private arbitration impinges upon a broad statutory scheme that invests sweeping powers in a state official, enforcement of arbitration ipso facto violates public policy."[25] In language remarkably similar to that employed in *Knickerbocker*, the appellate court found that the statutory scheme was such that it was apparent that the legislature did not contemplate turning the administration of liquidation proceedings to private arbitrators "in forums shielded from public scrutiny, judicial review of which would be sharply limited."[26] Finally, in a reversal of the position the Court took in *Fabe*, the Court here held that "compelling arbitration against the will of the liquidator will *always* interfere with the liquidator's powers and will *always* adversely affect the insolvent insurer's assets."[27]

Just recently, Ohio's strong view against resolving an insolvent insurer's disputes through arbitration was reinforced.[28] In *Hudson v. John Hancock Financial Services, Inc.*, the Court of Appeals of Ohio affirmed the trial court's ruling that the liquidator of an insolvent insurer was not required to arbitrate reinsurance claims notwithstanding the existence of an arbitration clause in each of its reinsurance contracts. The cedent had brought litigation against the reinsurer prior to liquidation and the Court had dismissed the complaint in favor of arbitration. After the cedent was placed into liquidation, the liquidator continued the arbitration. After the Court's decision in *Pipoly*, however, the liquidator abandoned the arbitration and returned to court litigation. The trial court refused to dismiss the litigation based on *Pipoly* and the Court of Appeals affirmed.

In rejecting the theory that the liquidator stands in the shoes of the insolvent insurer, the appellate court held that public policy concerns dictate that the liquidator should not be compelled to arbitrate in forums shielded from public scrutiny. The Court followed the reasoning set forth in *Pipoly* and stated that the FAA was reverse-preempted by the state liquidation act under McCarran-Ferguson. The Court also held that the liquidator could renounce the arbitration provisions because those provisions were unenforceable for the public policy reasons articulated, but could seek to enforce the remainder of the reinsurance contracts.■

This article is based on the author's paper, Arbitration and Receiverships – Oil and Water?, printed in the 2005 LexisNexis® Mealey's™ Insurance Insolvency & Reinsurance Roundtable Conference Handbook. The author wishes to acknowledge the contributions to the original paper by Christopher A. Lynch, a former associate at Dewey & LeBoeuf LLP, and the contributions to this updated article by Fang Qi, an associate at Dewey & LeBoeuf LLP.

Part II will appear in the next issue of AIRROC Matters.

Notes

1 U.S.C. § 1011 *et seq.*

2 4 N.Y.2d 245 (1958).

3 *Id.* at 248.

4 N.Y. Ins. Law § 7401 *et seq.*

5 *Id.* at 251; *see also Michigan National Bank-Oakland v. American Centennial Ins. Co.*, 137 Misc.2d 575 (N.Y. Sup. Ct. 1987) (noting that the state statutory scheme as interpreted in *Knickerbocker* is controlling under McCarran-Ferguson, and therefore, arbitration is no longer available to resolve the dispute once liquidation proceedings against the insurer were commenced).

6 77 N.Y.2d 225 (1990).

7 9 U.S.C. §§ 201-208.

8 606 F. Supp. 98 (S.D.N.Y. 1984). The facts of *Bernstein* make it distinguishable from another New York federal court case in which an order compelling the liquidator to arbitrate was rescinded. In *Ideal Mut. Ins. Co. v. Phoenix Greek Gen. Ins. Co.*, 1987 U.S. Dist. LEXIS 11573 (Dec.11, 1987), the court entered an order compelling the insurance company to arbitrate matters arising from a reinsurance agreement *before* the company went into liquidation and the state court appointed a liquidator. The court noted that "[a]rbitration cannot go forward against a company which in contemplation of law no longer exists." In dicta, the court noted that the outcome may have been different "if the arbitration proceedings had concluded and resulted in awards."

9 9 U.S.C. § 1 *et seq.*

10 *Knickerbocker*, 4 N.Y.2d at 252.

11 643 F. Supp. 554 (S.D.N.Y. 1986).

12 *Stephens v. Am. Intern'l Ins. Co.*, 66 F.3d 41 (2d Cir. 1995).

13 *But see Nichols v. Vesta Fire Ins. Corp.*, 56 F. Supp. 2d 778, 780 (E.D. Ky. 1999) (finding section 304.33-010(6), and other statutes relied upon by the liquidator, inapplicable as the matter was not a "delinquency proceeding," but rather "a common law breach of contract which merely happens to involve an insolvent insurer.") As such, the liquidator was compelled to arbitrate consistent with the FAA.

14 The anti-arbitration provision appears inapplicable for proceedings commenced at a later time as set forth in the statute. See Ky. Rev. Stat. Ann. § 304.33-010(6) ([N]otwithstanding the foregoing, in any delinquency proceeding commenced against an insurer after July 15, 1996, nothing in this subtitle shall be construed to subordinate or restrict the rights of parties to submit their disputes to arbitration pursuant to a contractual arbitration clause contained in a reinsurance agreement.).

15 458 U.S. 119 (1982).

16 *Stephens,* 66 F.3d at 45.

17 *Goshawk Dedicated Ltd. v. Portsmouth Settlement Co.*, 466 F.Supp. 2d 1293 (N.D. Ga. 2008).

18 See *Bautista v. Star Cruises,* 396 F.3d 1289, 1294 (11th Cir. 2005) (defining four jurisdictional prerequisites for the enforcement of the New York Convention); *Industrial Risk Insurers v. M.A.N. Gutehoffnungshutte GmbH*, 141 F.3d 1434, 1441 (11th Cir. 1998) (stating that the New York Convention preempts all prior inconsistent rules of law.

19 *Id. at 1281.*

20 *Id. at 1282.*

21 155 Ohio App.3d 171 (Ct. App. Ohio 2003).

22 68 Ohio App.3d 226 (Ct. App. Ohio 1990).

23 *Id.* at 233.

24 *Pipoly*, 155 Ohio App.3d, at 180.

25 *Id.* at 183.

26 *Id.*

27 *Id.* at 184; *see also Womer v. Credit Gen. Ins. Co.*, No. 04AP-642, 2005 WL 704858 (Ohio App. 10 Dist. Mar. 29, 2005) (finding reinsurer's federal court actions, including to compel arbitration, were prohibited by the liquidation act).

28 *Hudson v. John Hancock Fin. Serv., Inc.*, No. 06AP-1284, 2007 Ohio 6997 (Ohio Ct. App. Dec. 27, 2007).

Think Tank

AIRROC Roundtable Discussion – March 5, 2008

To fully illuminate the run-off dispute resolution experience, we convened a roundtable panel with enormous experience in such matters including Brian Snover of Berkshire Hathaway, Mark Gurevitz of The Hartford, and Jonathan Rosen of The Home Insurance Company in Liquidation. When we met with the panel at our firm's offices in New York on March 5, 2008 we posed a variety of questions about run-off dispute resolution. Unsurprisingly, the panelists had plenty to say. We hope you enjoy the roundtable discussion as much as we enjoyed asking the questions and listening to the answers.

Mr. Maher: Good afternoon, Gentlemen. It's great to have you here. Let me ask a basic question: What are the goals of a run-off company for the dispute resolution process and are those goals different than a company with continuing operations?

Mr. Snover: There are two aspects of run-off that change the nature of dispute resolution. The first is that no more premium income is coming in. Your contractual obligations are largely fixed, they're history. Your income is largely fixed, it's history. So one of the most important things in run-off is to manage unnecessary expenses. That militates for avoiding formal dispute procedures that are expensive, whenever you can. That may be equally true outside run-off, but for run-off, you have far less of a cushion of expense to fall back on.

In addition, once in run-off, your contracts are written. You're stuck with that history. The prospect of getting an adverse outcome and being able to change the portfolio's fortunes based on drafting your insurance policies in a new or different way, drafting around an outcome, is much harder. You are taking a bigger risk on some level, because what you learn as a business consequence of a dispute resolution procedure, whether it's positive or negative, is difficult to make use of in terms of your new contractual undertakings. So the other characteristic of run-off is that it makes dispute resolutions that much more dangerous and fragile. You want to go that extra step to try to avoid it for those two reasons.

Brian G. Snover is Vice President and General Counsel, Reinsurance Division for the Berkshire Hathaway Group. He can be reached at: bsnover@berkre.com.

Mark S. Gurevitz is the Senior Vice President and Associate General Counsel, Law Department for The Hartford. He can be reached at: mgurevitz@thehartford.com.

Jonathan Rosen is the Chief Operating Officer of The Home Insurance Company in Liquidation. He can be reached at: jonathan.rosen@homeinsco.com.

William A. Maher is a Founding Member of Wollmuth Maher & Deutsch LLP where he leads the firm's Insurance and Reinsurance Dispute Resolution practice. He can be reached at wmaher@wmd-law.com.

Marc L. Abrams is a Partner at the firm of Wollmuth Maher & Deutsch LLP and practices in the areas of reinsurance, insurance and general commercial litigation and arbitration. He can be reached at mabrams@wmd-law.com.

> So one of the most important things in run-off is to manage unnecessary expenses. That militates for avoiding formal dispute procedures that are expensive, whenever you can. – *Snover*

Mr. Maher: How does a run-off company attempt to avoid dispute resolution in managing its run-off book?

Mr. Snover: Well, it's a double whammy because without ongoing businesses, you're now the unwanted, old friend of the brokers, and you're the unwanted, old friend of the counterparties. So just in that phase of your business cycle where you want to rely upon relationships and get things done in a mutually agreeable way, it's harder to do because nobody wants to hear from you. You don't have as much commercial leverage over the counterparties.

You get someone like Jonathan [Rosen] who bends over backwards to make sure people know how he is going to handle certain things. So that if you get a bill from Jonathan, you basically know how it's been put together. That saves time and it avoids expense. The relationship becomes that much more important to rely upon. If you can act transparently, that avoids disputes outside of

continued on next page

run-off, as well, but it's that much more important if you do it in run-off, because no one wants to hear from you, no broker wants to help you.

Mr. Rosen: One of the difficulties of run-off, which Brian [Snover] has alluded to, is you actually have no friends because your relationships are essentially finite, they are discrete and they are historical. For that reason, certainly from my perspective, consistency in presentation is the key. Also, a key objective is to try to mitigate expenses related to disputes, in conjunction with consistency in presentation, which may then lead you to enter into protocols with your counterparties. Consistency is one form of leverage in a protocol.

Once you get a decision you feel could be utilized to essentially springboard an ongoing resolution without going through the formal dispute process, but through the development of a protocol, that has to be the aim. So I would agree with Brian to try and essentially learn something from a dispute and resolution of that dispute in order to achieve a global resolution.

Mr. Gurevitz: I would add also that the goal of a run-off company in dispute resolution depends, in part, on what is the ultimate business plan of that run-off organization. To be sure, there are many run-off entities today that are looking for a resolution of all of their claims in a short period of time. In that sense, sometimes the dispute resolution process can be used effectively to try to quantify and determine those obligations. That can be done in some sort of an agreeable fashion. In other situations, the goal of the run-off operation is to delay the payment of claims. That's where I think that as to an entity in run-off the approach to dispute resolution may be very different. I think sometimes that the nonpayment of claims can be a source of leverage. The run-off entity may also use the dispute resolution process affirmatively to gain leverage for a commutation or some other sort of a resolution that they are trying to achieve.

Mr. Maher: In your experience, do arbitration panels take into account the different circumstances that run-off companies find themselves in when working through the resolution of these issues?

Mr. Snover: The honest answer is I don't know. It's difficult to know what drives the decisions. I will tell you that in most arbitrations, it is usually the case that one party wants the panel hyperaware of the status of a run-off involved and one doesn't. So I think that comes up. I think as the different entities in run-off have been in run-off longer and longer, they are more easily recognized as run-off entities. Some of them have very good reputations in that vein. Some don't, just like on-going entities. So I think panels are more aware of it.

I don't know what emphasis the panel has put on it. I think most arbitrators really do try to focus on the dispute that's before them. And unless there are arguments being made or positions being taken that are far beyond the pale, I think they really try to deal with the contractual issues before them without regard to the status of the entity.

Mr. Abrams: Is an arbitration panel interested in the atmospherics of whether a party is in run-off or not?

[C]onsistency in presentation is the key. Also, a key objective is to try to mitigate expenses related to disputes, in conjunction with consistency in presentation, which may then lead you to enter into protocols with your counterparties. Consistency is one form of leverage in a protocol. – *Rosen*

Mr. Rosen: I think that atmospherics can become important depending on the nature of the dispute. If one is dealing with a discrete claim that requires resolution, I think whether a company is in run-off or not becomes somewhat irrelevant. Conversely, if you are involved in a dispute that goes to the root of the relationship, such as rescission claim, it could influence the arbitration panel on the true hidden motivations that the parties may have in trying to achieve some form of closure or some finality in relation to the book and what really are their motivations. Really, the answer is it depends and it depends on the nature of the dispute, but as a general consideration, I think the fact that one company is in run-off (or not) is irrelevant in the overall analysis.

Mr. Gurevitz: I agree with that completely. I think that sometimes the circumstances of the dispute can make a difference. I think most of the time there is not much difference between how a case is viewed with respect to whether a run-off company is involved or not. In certain types of circumstances, it can make a difference.

If, for example, you're dealing with a contract that's been in existence for many, many years and very recently a third-party management company has come in to take over that book of business and the issues that are being raised are being raised for the first time after a 25-year history, I think that can have an effect on any arbitration panel.

I think also when you're seeing legitimate disputes where there are good-faith differences between the parties,

continued on next page

and you can understand that there could be a difference of opinion that both sides want an arbitration panel to help them decide, that is a standard type of dispute that could occur in run-off or not in run-off. However, if you have a dispute, for example, where balances have accrued across all of the contracts between the parties and there are literally hundreds of claims involved, and it is apparent that there is a build-up because there is a slow down in payment or there is essentially a cessation of payment, then it might be viewed somewhat differently.

> [W]hen you engage a third-party administrator, you need to be careful in the sense that it will take some time for it to really understand the book of business and to get involved and hit the ground running on day-to-day claim administration… – *Gurevitz*

The other point that I would make is that if the run-off company is stand-alone and not associated with some ongoing enterprise, and there is a question of pre-hearing security, there could be a difference in how a panel would view that, but it would really be based on the financial condition of that stand-alone, run-off company where there is no on-going business or premium flowing into that company.

Mr. Maher: For dispute resolution purposes, is there a difference between a run-off company that is being run off by a third-party administrator and a run-off company that's being run-off by an entity that was already in existence and is just using their same people to run off that operation?

Mr. Gurevitz: I think there can be. I wouldn't want to paint all third-party administrators with the same broad brush, nor would I want to say those concerns you have with a third-party administrator could not arise with the run-off associated with an ongoing enterprise, as well.

So I think it's hard to speak in generalities about the topic.

However, I will say that when you engage a third-party administrator, you need to be careful in the sense that it will take some time for it to really understand the book of business and to get involved and hit the ground running on day-to-day claim administration. So what happens sometimes is that claims get delayed because there is that learning period. I think third-party administrators need to be careful that it not be misconstrued as something other than what it is. I think there are different circumstances that may cause you to reach different conclusions in that regard, but it can happen for innocent reasons, as well as for reasons that are intended to reflect the fact that the third-party administrator was brought in to create a different business model for the run-off going forward in the future.

I think both parties and arbitration panels need to be sensitive to those particular issues in trying to discern what is at issue, because ultimately parties are trying to resolve differences and panels are trying to look at the real circumstances of what's going on. I think most panels are pretty astute at understanding what the real facts are and what is really happening in a particular dispute.

Mr. Rosen: Mark [Gurevitz] alluded to what I think is a critical point. When you bring a new kid on the block, just by definition you're going to lose a lot of institutional knowledge that existed prior to the new kid coming into play. You're also going to institute a completely different approach than that which had historically been conducted. I think those are factors that do change the face of what you're dealing with.

> You better have an arbitrator that is sensitive to where you're coming from. I believe in arbitration it's all about what the panel thinks of the bona fides of one's position. – *Snover*

Mr. Snover: It also depends on the incentives that the TPA has. Those aren't always transparent. If the third-party administrator is paid over time, it's human nature the run-off is not going to be accelerated and perhaps it's going to be dragged out. If the TPA is incentivized to accelerate it, it's going to take positions and assert positions that will achieve that goal. It's difficult not to have that come through in dispute resolution mechanism. You better have an arbitrator that is sensitive to where you're coming from. I believe in arbitration it's all about what the panel thinks of the bona fides of one's position.

Mr. Abrams: What strategies are available to use the dispute resolution process to accelerate payments of claims?

Mr. Snover: I think what you try to do is highlight for the panel the bigger picture of what is going on and sensitize them to what may be a fair charge of game playing or strategizing beyond this claim. The party you are making that charge against is going to do their best to fight it. Again, it's a small enough world – despite the population of people now attending ARIAS conferences. There are enough inter-party relationships going on where I think your reputation continues to be pretty

continued on next page

important and continues to be recognized by most of the industry players.

Mr. Gurevitz: I think that's an important point. The concept of reputation is important, even for run-off companies who may not have the business relationship, but certainly will be in front of multiple arbitration panels over the course of the administration. It is a small industry, and reputation is important in that regard.

Mr. Rosen: Yes. I think credibility is a critical element. One different strategy that might be adopted by a reinsurer that's either trying to accelerate or decelerate claims payments is audit rights. Audit rights can be an extremely attenuated process. And on the receiving end for attenuated auditing, you can actually try and curtail that process by having an audit conducted under the aegis of an arbitration proceeding rather than through the normal course of commerce. Then you can have the panel potentially set parameters and definitions that make the process a lot more efficient and performed on a shorter time frame through the discovery process rather than through a standard inquiry. I think the biggest bugbear of a cedent is huge delays in achieving cash flow. What you really try to do is accelerate cash flow and create efficiency in that acceleration, and you can use the dispute resolution process as a tool in that endeavor.

Mr. Gurevitz: I think that the concept that you were just talking about, acceleration or deceleration, is an issue that we will see as a development over the next few years. I think there are some different dynamics in the run-off context that arise. One is that there is a greater trend in bringing an arbitration action to collect balances sooner rather than later. When you had an ongoing relationship, there would be a considerable effort to try to resolve disputes without going to arbitration. Now companies don't want to have these balances sitting on their books. So there is a jump to the arbitration phase right away.

Mr. Abrams: Do you mean a trend toward issuing the arbitration demand and then attempting to work things out afterward?

Mr. Gurevitz: Absolutely right. So that's one point. The second point, where you are faced with a deceleration of claim handling, is that there will be an immediate request for payments to be made now, for future payments to be made within a limited time period and, in certain cases, for security to be posted right away. Then you have the issue of whether arbitration panels can create some sort of guidelines if the parties can't agree to the protocols that Jonathan [Rosen] was alluding to, because not everyone is necessarily as reasonable as Jonathan. There may be some ability of an arbitration panel to create some guidance for the parties in dealing with the future collection obligations. It may not be possible in some cases, but it may be possible. I think the parties should think about that, counsel should think about that, and the panels should think about that, as well.

Mr. Abrams: That's an interesting point because it leads to the mechanism of consolidation, to combine lots of slow-paying claims into one consolidated arbitration. Has anyone had success with that mechanism?

> **…[Y]ou can actually try and curtail that [attenuated audit] process by having an audit conducted under the aegis of an arbitration proceeding rather than through the normal course of commerce. Then you can have the panel potentially set parameters and definitions that make the process a lot more efficient and performed on a shorter time… – *Rosen***

Mr. Gurevitz: It's an interesting question. I think that several years ago the perceived inability to consolidate was viewed as one of the difficulties with arbitrations. Now after the Green Tree case, it is very clear that panels have tremendous discretion in ordering consolidation. Typically, panels have thought about consolidation in the case of a single claim that will involve multiple contracts and potentially multiple reinsurers in trying to get that into one consolidation. I think what we are just on the cusp of are requests for consolidations of unrelated claims across multiple contracts involving the single reinsurer to get all of that consolidated and in front of one panel so that the panel can understand what's really at issue.

That is relief you can get in court, but where there is an arbitration clause the question is whether arbitration panels will go far enough. I think, frankly, they should. It would help the industry a lot for that to happen.

Mr. Rosen: In my experience as an arbitrator, I'm seeing quite a lot of those types of consolidation requests and sympathy on the part of the panels to consolidate so you are evaluating relationships rather than discrete claims. I think that is good for the industry. I think it's good from a run-off perspective and an ongoing perspective, actually, but more critically from a run-off perspective because the dynamic changes when you go into run-off and one shouldn't be blind to people's agendas and motivations.

Mr. Snover: That's exactly right. As I said in the beginning, there are expenses attendant to these proceedings

continued on page 40

AIRROC Board of Directors

Back row (left to right): Jeff Mace, Legal Counsel (Dewey & LeBoeuf), John Parker (TIG), Art Coleman - Co-Vice Chair (Citadel Re), Keith Kaplan (Reliance), Dale Diamond, Frank Kehrwald (Swiss Re), Karen Amos (Resolute Mgmt. Services)

Front row (left to right): Marianne Petillo (ROM), Ali Rifai - Co-Vice Chair (Centre), Trish Getty - AIRROC CEO & Executive Director, Jonathan Rosen - Chair (The Home), Joe DeVito - Treasurer (Navigant Consulting), Mike Fitzgerald (CNA), Kathy Barker (Mitsui Sumitomo), Mike Zeller (AIG)

Not pictured: Janet Kloenhamer (Fireman's Fund) & Ed Gibney - Secretary (Global Resource Mgrs.)

Message from CEO and Executive Director

AIRROC's Education Thrust continued from page 1

During our February 27, 2007 membership meetings, we held breakout sessions addressing Collateral for Reinsurance Obligations, Fronted Programs and Program/Facility-Produced Business. Attendees expressed appreciation for lessons learned that day which they took back to their shops to implement….value.

On July 26, 2007, we benefited from the London Market Update panel moderated by Mike Palmer of Helix and then presented interactive sessions on the topics of Commutations, Audits and Intermediary Services. Later we heard a presentation on Reinsurance Law by Bill Popalisky of Cadwalader, Wickersham & Taft….value.

During our October, 2007 commutation event, an AIRROC/Cavell education program was presented by Mealey's for which CLE credits were offered, and which was extremely well received…. value.

AIRROC/Cavell again offers a one-day commutation forum on March 5, 2008, followed by an interactive auditing workshop on March 6, 2008. At our May 22, 2008 membership meeting, our education focus is ADR (alternative dispute resolution) where a mock mediation will be presented and the moderator will periodically "freeze" the process in order to offer advice as well as take input from the participants. We expect great insight into the mediation process, with a profound opportunity for our members to gain useful knowledge…. value.

Mark your calendars for October 20-22, 2008 when the AIRROC/Cavell Commutations & Networking Event will occur again at the Sheraton Meadowlands. REGISTER EARLY! Last year we had nearly 400 in attendance and expect that number to grow this year. Our plan is intermingled with entertainment including a dinner cruise around Manhattan on Wednesday evening, October 22. We will again coordinate with Mealey's to present our education program all day on Monday, October 20, allowing attendees to earn five CLE hours credits (those who plan to attend must

Present Value

By Nigel Curtis

Run-Off News

Aon Corporation has announced that it is to sell its Combined Insurance Company of America (CICA) business to ACE Limited and Sterling Life Insurance Company (Sterling) business to Munich Re Group. Once completed, Aon will have fully divested itself from underwriting insurance.

Runoff specialist Enstar is acquiring Cobalt/Gordian, the Australian-based run-off reinsurance and insurance operations of AMP Ltd. The sale, which is subject to regulatory approval, represents AMP's complete exit from general insurance and reinsurance business.

Axiom Consulting Ltd. has acquired the business, staff and proprietary software of JDC Consultants Ltd, specialists in reinsurance consulting.

JDCC will be integrated into Axiom's London-based consulting services division.

The law firms of Mayer Brown LLP, and Johnson Stokes & Master, a leading Asian law firm, have agreed to combine as of January 2008.

Hampden Insurance Group BV in Rotterdam has acquired the underwriting agency of M van Marle, which is in run-off, from ABN Amro.

In December 2007, the New Jersey Supreme Court affirmed the New Jersey Appellate Division's decision rejecting the liquidator's final dividend plan for Integrity Insurance Company. In January 2008, Richard White, liquidator of Integrity, advised the court of his intention to file a revised final dividend plan that would close the estate on a cut-off basis. The revised plan is to be filed by March 28. Interested parties may file comments by May 22, and a hearing on the plan will be held on May 27, 2008.

People

Frank Pecht has joined Citadel Risk Management, Inc. as a Business Project Manager. He has served in several capacities in the property, casualty, accident and health sectors of the industry, including consultant, claim analyst, and auditor on ceded and assumed business since 2001.

Stephen Kennedy, formerly Vice President and Claims Counsel at Odyssey America Reinsurance Corporation, has joined Clyde & Co's US insurance and reinsurance practice as a Partner.

Julie Rodriguez Aldort became a Partner of Chicago law firm Butler Rubin Saltarelli & Boyd LLP effective January 1, 2008. Julie concentrates on reinsurance and complex commercial litigation and has practiced law since 1998.

Mark A. Schwartz became a Partner of Chicago law firm Butler Rubin Saltarelli & Boyd LLP effective January 1, 2008. Mark concentrates on reinsurance and complex commercial litigation and joined Butler Rubin in 2000.

Colin Peck, formerly a Partner with Lawrence Graham, has joined UK law firm, Weightmans, to help develop their London office insurance and reinsurance capability. Colin specializes in insurance and reinsurance coverage disputes and recoveries involving arbitration, litigation and mediation, both in London and internationally.

Marc L. Abrams has been named as a partner of the law firm of Wollmuth Maher & Deutsch LLP effective January 1, 2008. Marc concentrates his practice in the areas of reinsurance, insurance and general commercial litigation and arbitration and joined the firm in 2006 after spending eight years at LeBoeuf, Lamb (now Dewey & LeBoeuf).

Oliver Horbelt is currently an independent consultant with advisory mandates in the areas of run-off management and insurance risk securitization.

John Finnegan has joined law firm of Chadbourne & Parke as a partner in the insurance and reinsurance practice, based in the New York office. He was previously a partner with Cadwalader, Wickersham & Taft LLP in New York.. ■

If you are aware of any items that may qualify for inclusion in the next "Present Value"; upcoming events, comments or developments that have, or could impact our membership; please email potential items of interest to Nigel Curtis of the Publications Committee at nigel.curtis@citadelriskmanagement.com.

notify us by September so that we can plan space, etc). And, a subcommittee of our Publications Committee will publish a year-end Special Edition exclusively covering all aspects of the Event (articles, CLE, pictures, interviews and more).

There is more to come!

We welcome your suggestion of topics with open arms as we strive to satisfy our goal of offering our members meaningful educational forums and opportunities…. value!!! ■

Ms. Getty has been active in the insurance and reinsurance industry for over forty years, specializing in reinsurance claims. She has significant experience evaluating liability and reserve adequacy and planning and implementing claims and operational audits. In 1996, Trish expanded her focus to include sales and marketing of reinsurance services. In addition to active business, Trish has provided consulting services to regulators for the reinsurance administration of troubled and liquidated companies. She can be reached at trishgetty@bellsouth.net.

Mark Your Calendar

May 22, 2008: AIRROC Membership Meeting at the offices of Dewey & LeBoeuf, New York City.

June 2 -5, 2008: The 12th Annual Cavell Rendez-Vous, Norwich, England. See: www.commutations-rendezvous.com.

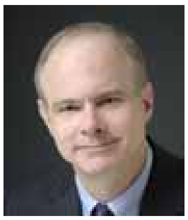
July 24, 2008: AIRROC Membership Meeting at the offices of Dewey & LeBoeuf, New York City.

September 6-11, 2008: Rendez-vous de Septembre, Monte Carlo. See: www.rvs-monte-carlo.com.

October 20-22, 2008: AIRROC/Cavell Commutation & Networking Event, Sheraton Meadowlands, New Jersey.

Feature Article

Arbitration Practice and Procedure in U.S. and U.K. Reinsurance Disputes: Is the Grass any Greener on the Other Side of the Pond? – *Part 1 (of a 2-part series)*



Philip J. Loree Jr.

Costas Frangeskides

By Philip J. Loree Jr. and Costas Frangeskides

Introduction

United States companies managing run-off portfolios are usually conversant in practice and procedure under the Federal Arbitration Act (the "FAA").[1] Sometimes these companies are summoned to what New York's highest court dubbed the "Mecca of the reinsurance world"[2] to arbitrate reinsurance disputes under a different set of rules – those of the English Arbitration Act 1996 (the "Act"). They may find that FAA-based strategies and tactics are ineffective or counterproductive in arbitrations governed by the Act. By the same token, U.K.-based companies administering London Market business frequently find themselves embroiled in U.S. arbitration proceedings. They, too, may need to rethink arbitration strategies and tactics.

Are the English rules any better than the U.S. rules? We suppose it depends on whom you ask, and even then, the answer may depend on the issue at stake and a myriad of other considerations.

Irrespective of which set of rules one might prefer, we believe that learning some of the key differences between them is a worthwhile endeavor, whether you are a business person or in-house or outside counsel. Understanding them may increase your effectiveness next time you arbitrate on the other side of the "Pond" or represent a company from the other side.

This multi-part Article shall briefly highlight some key similarities and differences in how the FAA and the Act address certain issues frequently encountered in English and U.S. reinsurance arbitrations. Our goal is to impart some basic information and background that may be of practical value to those dealing with trans-Atlantic reinsurance arbitrations. Let us begin Part I by examining the different expectations of arbitrator neutrality in the arbitration selection process and how they are enforced by the FAA and the Act.

Parties' Expectations of Neutrality in the Arbitrator Selection Process

The English and U.S. expectations of arbitrator neutrality are very different and are enforced through different procedures. The FAA emphasizes freedom of contract, allowing sophisticated parties to decide how impartial and disinterested they expect each arbitrator to be.

By contrast, the Act reflects a deeply-rooted, institutional preference for neutrality, importing judicial traditions into private dispute resolution. Unlike the FAA, the Act imposes a baseline standard for impartiality that *all* arbitrators – party-appointed or neutral -- must meet. They must act impartially and fairly at all times and cannot be predisposed for or against any of the parties or their positions. Like their American counterparts they are often expected to possess substantial industry expertise and experience. Yet they must also comply with strict standards of neutrality comparable to those imposed on judges.

Expectations of Neutrality: FAA

The principal purpose of the FAA is to enforce arbitration agreements according to their terms.[3] The parties are largely free to structure their agreement as they see fit, including the manner in which arbitrators are selected, their qualifications, and the degree of

continued on next page

Philip J. Loree is a Shareholder at Stevens & Lee, P.C.'s New York office, where he practices reinsurance dispute resolution. Prior to joining Stevens & Lee, Mr. Loree was a Partner in the Litigation Department of Cadwalader, Wickersham & Taft LLp and a member of the Firm's reinsurance practice group. He can be reached at pjl@stevenslee.com.

Costas Frangeskides is a Solicitor and Partner in the London-based law fim of Holman, Fenwick & Willan, where he practices reinsurance and insurance dispute resolution. He can be reached at costas.frangeskides@hfw.co.uk.

impartiality expected.[4] Though Section 10(a)(2) of the Federal Arbitration Act authorizes courts to vacate awards "where there was evident partiality...in the arbitrators," where the parties' agreement authorizes non-neutral arbitrators, courts: (a) deem the standard waived by consent;[5] (b) require the challenger to show that bias "prejudicially affected the award;"[6] or (c) figure into the evident partiality calculus the parties' diminished expectations of impartiality.[7]

Expectations of Neutrality in Tripartite Arbitration

Typically, arbitration clauses in reinsurance agreements providing for U.S. arbitration call for tripartite panels. Each party appoints an arbitrator who attempt to agree on an umpire or select one by lot drawing, coin toss, Dow Jones pick or like procedure. Unless the arbitration clause expressly provides otherwise, courts will presume that the parties intended their appointed arbitrators to be partial:

[I]n the main party-appointed arbitrators are *supposed* to be advocates. In labor arbitration a union may name as its arbitrator the business manager of the local union, and the employer its vice-president for labor relations. Yet no one believes that the predictable loyalty of these designees spoils the award. (Emphasis in original; citations omitted).[8]

In theory the tripartite structure is supposed to yield the best of two worlds: two experienced and knowledgeable industry professionals each of which advocates, to some degree, their appointing party's position to an equally experienced and knowledgeable umpire, who either casts a tie-breaking vote or facilitates a consensus. Acceptance of this model in reinsurance arbitration is further evidenced by panels (usually with the parties' consent) authorizing *ex parte* contact with appointed arbitrators to continue until the parties submit prehearing briefs.

While appointed arbitrators are supposed to act as advocates of a sort, they are not expected to advocate the appointing parties' positions with a lawyer's zeal. Some believe that party-appointed arbitrators should strive to be less partial than the tripartite model might permit. For example, ARIAS-US Code of Conduct, Canon II, commentary, urges them "to act in good faith with integrity and fairness," "not allow their appointment to influence their decision on any matter before them," and "make all decisions justly."[9] Yet reasonable persons may disagree on whether the standards embraced by Canon II's commentary are (or should be) followed in practice.

The line between the acceptable and unacceptable is difficult to draw, and pretty blurry to boot. To the extent that there are meaningful checks on rampant partisanship, they are not imposed by courts but arise from practical, business considerations. Arbitrators, neutral or party-appointed, presumably desire to maintain their reputations for integrity, honesty and fairness. Party appointed arbitrators who consistently overstep what other panel members perceive to be appropriate ethical boundaries risk diminished credibility, influence, and effectiveness – the result of which may be fewer future appointments.

Expectations of Neutrality: Umpires

Umpires are held to higher standards. Parties expect them to be fair, objective, open-minded in deliberations and not predisposed to rule in favor of either party before hearing the evidence.

The FAA does not hold neutrals to the same rigorous, statutorily prescribed standards of conduct and impartiality applicable to United States federal judges.[10] Most sought-after reinsurance arbitrators have many years of industry experience, which naturally may shape their perspectives on issues. They may know the lawyers and the parties both professionally and socially. Courts recognize that these practical realities demand a "tradeoff between impartiality and expertise" – if courts required umpires to be as far removed and free from entanglements as a judge, then qualified umpire candidates would be hard to come by.[11]

Expectations of Neutrality: Arbitration Act 1996

The Act applies to arbitrators standards of impartiality similar to those applicable to judges. Section 33(1) of the Act requires arbitrators to "(a) act fairly and impartially as between the parties, giving each party a reasonable opportunity of putting his case and dealing with that of his opponent". This standard flows from the Act's general statement of principles, which states that "the object of arbitration is to obtain the fair resolution of disputes by an impartial tribunal without necessary delay or expense." The neutrality requirements imposed by the Act cannot be varied by agreement.

Tripartite arbitration panels are commonplace in London reinsurance arbitrations. Typically the format consists of two party-appointed arbitrators with a third arbitrator (usually appointed as chairman). Unless the parties otherwise agree, Section 20 of the Act provides that:

continued on next page

- "Decisions, orders and awards shall be made by all or a majority of the arbitrators (including the chairman)"; and
- "The view of the chairman shall prevail in relation to a decision, order or award in respect of which there is neither unanimity nor a majority under subsection (3)."

The "chairman" in an English arbitration plays a role similar to the "umpire" in a U.S. arbitration. Some English arbitration panels feature an "umpire" (in lieu of a "chairman") who usually plays a different role than an "umpire" in the U.S. Unless the parties otherwise agree, an English umpire generally will attend the hearing but will not become actively involved in the decision-making process unless and until the two appointed arbitrators notify him in writing that they have reached an impasse. In that event, the umpire replaces the appointed arbitrators as the tribunal, and has the "power to make decisions, orders and awards as if he were sole arbitrator." [12]

The dynamics of U.K. tripartite arbitrations are very different from their U.S. counterparts. Each party may be able to select its own arbitrator but once the arbitrator accepts the appointment he or she must act as a completely impartial decision maker, not predisposed to rule in favor of or against any of the parties' positions. Ex parte contacts are not permitted.

While all arbitrators must be "impartial", it does not necessarily follow that they must also be entirely "independent". For example, an English barrister appointed as advocate for one of the parties may be from the same barristers' chambers as one of the arbitrators. Since barristers are self-employed practitioners, the sharing of chambers does not imply partiality (although it might suggest a lack of independence).

Enforcement of Neutrality Expectations: FAA

Just as the FAA and Act are substantively different on arbitrator neutrality, so too are they procedurally different in how they enforce the parties' expectations of neutrality. With certain rare exceptions, a court cannot entertain a challenge based on evident partiality until a final award is issued and the challenging party moves to vacate within the time permitted.[13] The FAA likewise does not set forth any procedures designed to ensure or monitor compliance with the parties' expectations of neutrality during the arbitration selection process, or any other time prior to an award.

Yet the selection process is when the parties expectations of neutrality are most vulnerable to frustration even though, paradoxically, it is arguably the time when the parties are best positioned to realize and protect those expectations. The selection process enables parties to influence the composition of the panel. Informed decision making is critical and the parties and their appointed arbitrators need to know whether umpire candidates have conflicts of interest which may substantially impair their ability to act with the requisite impartiality. As the Seventh Circuit aptly observed, an arbitrator unduly frustrating a party's right to such information may raise not only evident partiality but excess of powers concerns: "[f]ailure to comply with a[n] [express or implied] contractual requirement designed to facilitate the search for an acceptable neutral might imply that the neutral exceeded his authority, spoiling the award under 9 U.S.C. § 10(a)(4)."[14]

To address the problems raised by conflicts of interest, the United States Supreme Court imposed a requirement that neutral arbitrators disclose at the outset of the arbitration nontrivial conflicts of interest (such as ongoing business relationships with one of the parties).[15] Two circuits have added to that disclosure requirement an affirmative duty on the part of the arbitrator to investigate when there is reason to believe a nontrivial conflict *might* exist.[16]

Failure to disclose a conflict of which the arbitrator has or is deemed to have knowledge can result in vacatur of an award on the grounds of evident partiality *without* any independent showing that the arbitrator was actually biased or that the award was the product of bias.[17] Yet if a conflict has been adequately disclosed, a failure to object to the disclosed relationship will usually result in a waiver of the non-objecting party's right to challenge the award based on that disclosed potential conflict.[18]

The disclosure requirement, as applied to neutral arbitrators, also performs other functions. For example, once the panel is in place, it forces the parties and the panel to address at the outset whether the parties' expectations of neutrality have been satisfied. This reduces the risk that time and expense will be invested in a proceeding that results in an award that is subject to vacatur. In addition, prior to an award, parties are more likely to consider a disclosed, potential conflict to be trivial. But if undisclosed and not discovered until after an award has been issued, the losing party may understandably perceive the conflict to be much more serious and move to vacate the award.

continued on next page

Disclosure by Appointed Arbitrators

In reinsurance arbitrations, appointed arbitrators are generally expected to disclose their relationships to the parties, the other panel members and the dispute. Whether or not these disclosures are required by *Commonwealth Coatings* is an open question, which at least one circuit has answered in the negative.[19] Given the parties' lowered expectations of impartiality, ordinarily these disclosures will not yield anything that would be extraordinary enough to support a successful evident partiality challenge. Moreover, failure to disclose generally does not deprive the other party of information relevant to arbitrator selection. Appointed arbitrators are unilaterally and privately selected by the appointing party, and the other party and the other party generally has no say in matter as long as the arbitrator otherwise is qualified to serve.

Nevertheless, there is at least one important purpose arguably served by appointed-arbitrator disclosure. The information disclosed may be useful to the other arbitrators in determining what weight (if any) should be accorded the arbitrator's statements in deliberations. A failure to disclose that information might, in appropriate circumstances, establish that the arbitrator exceeded his powers under Section 10(a)(4) of the FAA[20]

Establishing Evident Partiality

Courts have struggled mightily to formulate a workable test for establishing "evident partiality." These tests run the gamut from "a reasonable person, considering all the circumstances, would have to conclude" the arbitrator was partial[21] to a standard which, for all intents and purposes, permits vacatur where circumstances creates an "appearance of bias."[22] None of these "tests" are particularly useful indicators of the outcome of any given case because reasonable minds may interpret them differently, and the facts in evident partiality cases are often complicated and raise policy considerations to which different courts may accord different weight. The relative strictness or laxity of a test, however, may be a useful indicator of a circuit's predisposition for or against finding evident partiality.[23]

Enforcing the Parties' Expectations of Neutrality: the Act

While there is no express English counterpart in the Act to the *Commonwealth Coatings* disclosure process, there is generally accepted to be an implied (and continuing) duty on arbitrators to disclose any relevant circumstances which could affect their neutrality. Arbitrators, like judges, are responsible for ensuring that they comply with the impartiality requirements imposed by the Act.

Section 24 (1) (a) of the Act provides for pre-award removal of an arbitrator on the ground "that circumstances exist that give rise to justifiable doubts as to his impartiality. . . and that substantial injustice has been or will be caused to the applicant. . . ." Courts have held that Section 24(1)(a) authorizes challenges for "apparent bias" as well as "actual bias." Lord Hope described the test for "apparent" bias as being *"...whether a fair-minded and informed observer, having considered all the facts, would conclude that there was a real possibility that the tribunal was biased"*.[24]

In "apparent bias" cases, courts have concluded that no independent showing of "substantial injustice has been or will be caused to the applicant" is required, despite the suggestion to the contrary in Section 24(1)(a). As long as Lord Hope's test for "apparent bias" is satisfied, then courts presume that the "substantial injustice" requirement has likewise been satisfied.

In addition to pre-award removal, in an appropriate case an award may be vacated on the ground that there is a "serious irregularity" affecting the award arising from "bias." Section 68(2) defines "serious irregularity" as *"irregularity . . . which the court considers has caused or will cause substantial injustice to the applicant – [including] …(a) failure by the tribunal to comply with section 33 (general duty of tribunal to act "fairly and impartially")…."*

Irrespective of the avenue through which a bias challenge is made, a party must act promptly if it believes there are grounds to challenge the impartiality of an arbitrator. Failure to do so may result in a waiver, unless he can show that, when he proceeded with the arbitration, *"he did not know and could not with reasonable diligence have discovered the grounds for the objection."*[25] ■

Part II will appear in the next issue of AIRROC Matters.

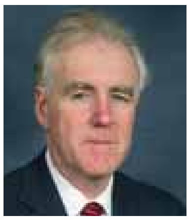
Notes

1 9 U.S.C. §§ 1, *et seq.*
2 *Sumitomo Marine & Fire Ins. Co. v. Cologne Reinsurance Co.*, 75 N.Y.2d 295, 302 (1990).
3 *See Volt Information Sciences v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 474 (1989).
4 *See, e.g.*, 9 U.S.C. § 5 ("If in the agreement provision be made for a method of naming or appointing an arbitrator or arbitrators or an umpire, such method shall be followed. . . ."); *Sphere Drake v. All American Life Ins. Co.*, 307 F.3d 614, 620 (7th Cir. 2002), *reh'g denied en banc*, Nov. 4, 2002, *cert. denied*, 538 U.S. (2003) ("Parties are free

continued on page 36

Think Tank

Some Thoughts on the Pre-Hearing Security Freight Train in the Run-Off Context


Kevin J. Walsh


William D. Foley

By Kevin J. Walsh and William D. Foley

Introduction

The Significance of Pre-Hearing Security Awards for Run-Off Reinsurers

As many have noted, in the run-off context, where claims issues cannot be resolved by promises of new premium on wonderful (loss free!) new business, run-off reinsurers find themselves with more disputes, many of which end up in arbitration. Subsequently, pre-hearing security has become a threshold issue with the possibility of significant adverse consequences for a run-off company.

Typically, cedents, contesting the adequacy of the reinsurers' reserves, assert there will be shortfall at the end of the day. They claim the reinsurer is in reality an extortionist seeking to force settlement with the insolvency card and frivolous defenses, and at the very start of the arbitration, ask the arbitrators to require the reinsurer to post security for the full amount in dispute *before* any consideration of the merits. The run-off reinsurer, in turn, asserts that it is simply taking a more objective, careful view of claims, and rather than simply paying quickly for reputation reasons, it is entitled to arbitrate legitimate disputes without elevating the cedent to preferred creditor status. With many reinsurance arbitrators being retired officers of insurers or reinsurers, who practiced in an era when run-off invariably meant a failed or likely to fail operation, there is a distinct possibility that the train will leave the station early, with a pre-hearing security order, leaving the reinsurer to ponder whether it can continue the fight. For a run-off reinsurer, a panel's grant of such relief can have disastrous consequences. As overall reserves get portioned off to elevate particular cedents to "secured creditor" status, the reinsurer's financials may take on a grim look and, in the most severe case, a death spiral to insolvency results, as other cedents and the regulators lose confidence in the run-off's ability to manage the book to a successful conclusion.

The run-off reinsurer, in turn, asserts that it is simply taking a more objective, careful view of claims, and rather than simply paying quickly for reputation reasons, it is entitled to arbitrate legitimate disputes without elevating the cedent to preferred creditor status.

Clearly, the run-off reinsurer must consider this possibility prior to initiation of any arbitration. This article: 1) focuses on the existing case law on pre-hearing security in the United States, the United Kingdom and Canada; and 2) offers a few suggestions on preparation for this issue in the run-off context.[1]

I. The United States — Deference to Arbitration Results in a Loose Standard

The problem (from the reinsurer's point of view) with the cases on pre-hearing security in the U.S. is that the reported decisions arise in the context of courts deciding motions to vacate an arbitration award. Under the Federal Arbitration Act (9 U.S.C. § 1, et seq.) to prevail on a motion to vacate such order, the cedent need only show that the power of the arbitrators can be "rationally derived" from the reinsurance agreement. *Yasuda Fire & Marine Ins. Co. of Europe v. Continental Cas. Co.* 37 F. 3d 345, 350 (7th Cir. 1994). This has led to decisions

Kevin J. Walsh is a Partner in the New York office of Locke Lord Bissell & Liddell LLP, and specializes in litigation and arbitration of reinsurance disputes. He has represented clients in private arbitrations, and cases filed under the American Arbitration Association and International Chamber of Commerce. He can be reached at kwalsh@lockelord.com.

William D. Foley is an Associate in the New York office of Locke Lord Bissell & Liddell LLP. He can be reached at wfoley@lockelord.com.

with broad language to uphold arbitrators' pre-hearing security awards, which security arbitrators may read as a grant of authority to do so, based on a mere showing that issuance of an award "might" be futile due to a reinsurer's possible insolvency in the future.

The stage for untrammeled arbitrator power to issue drastic pre-hearing relief was set by the Seventh Circuit in *Yasuda Fire & Marine Ins. Co .v. Continental Cas. Co.,* 37 F. 3d 345 (7th Cir. 1994), which set a low bar for court review of such awards, but offered no guidance to arbitrators as to when such relief should be ordered.

The Circuit Court affirmed the arbitrators' award requiring the reinsurer to post a letter of credit despite the fact that the arbitrators made no finding on the merits and apparently focused only on a possibility that an award *might* issue, and on the "risk" that assets to satisfy such award *might* not be available by the time such award was confirmed (of course always a risk in *any* litigation or arbitration). This is a slippery slope indeed.

In another U.S. case dealing with pre-hearing security in the reinsurance context, *British Insurance Co. of Cayman v. Water Street Ins. Co.*, 93 F.Supp.2d 506 (S.D.N.Y. 2000), an arbitration panel issued an interim order requiring the defendant reinsurer to post $1.7 million security before any hearing on the merits of the underlying claims was held. In confirming the order, the District Court again followed the path of giving great deference to any arbitral award. Even though the Court noted "that the panel's repeated decision to refuse to give any rationale for its acts has enhanced the task presented by the pending motions" and "here, the record is so full of contradictory information that [an inference that the panel's decision was based on adequate grounds] is not readily made," the Court refused to vacate the interim award. *Id.* at 515. Indeed, the Court went further and held, that when the parties committed to arbitration, they had chosen speed over procedural protections and arbitrators were thus left free to "do good" with little limitation or guidance as to use of essentially equitable powers. *Id.* at 515.

British Insurance appears to be a classic instance of a hard case making bad (or at least, questionable) law. Leaving aside the merits of the dispute in this case, it does appear that the ceding company was in fact faced with a fly by night reinsurer with shifting Caribbean domiciles. While the facts in *British Insurance* suggest that even under traditional equitable injunctive principles security would have been appropriate, the language in *Yasuda* and *British Insurance* seemed to suggest that arbitrators may issue the equitable relief of pre-hearing security, largely insulated from any real review by a court. That, in turn, has encouraged a lack of any real analysis by panels in considering the need for and the ramifications of such relief. It seems, in many instances, to boil down merely to a subjective analysis of the possibility that an award may be "rendered meaningless" by a potential lack of funds, with an automatic grant of security at the "specter" of possible insolvency.

However, there are District Court cases going the other way, which, contrary to the *laissez-faire* approach of *Yasuda*, suggest that, even under the low standard for confirmation under the FAA, courts will reverse arbitrators who issue orders of security at a preliminary stage as a prerequisite "ticket of admission" to an arbitration on the merits.

In *Recyclers Ins. Group, Ltd. v. Ins. Co. of North America,* Misc. No. 91-503, 1992 WL 150662 (E.D.Pa. 1992), an arbitration panel entered an interim award ordering that the reinsurer open an escrow account to cover a cedent's present (disputed) unreimbursed paid losses, outstanding losses, and incurred but not reported losses. *Id.* at *2. The panel also concluded – after the reinsurer requested reconsideration of the panel's award of the escrow account and initial deposit – that the reinsurer's compliance with the interim award of pre-hearing security was a condition to the arbitration even going forward on the merits. *Id.* at *3. Thus the reinsurer was precluded from litigating the merits until it complied with the arbitrators' order.

…even given the low standard for confirmation of arbitrators' awards, courts are wary of early grants of security, prior to any consideration of the merits, which may have the effect of precluding a litigant from a fair hearing of its case.

The motion to vacate was granted by the District Court. While noting that the reinsurance agreement contained a standard collateral/security clause, *Id.* at *1, the Court noted that the parties had agreed that the arbitrators could only issue an award "in writing based upon a hearing" which, the Court concluded, meant that a hearing on the merits was required before any such relief could be granted. *Id.* at * 5. Additionally the Court noted that, "the panel's award cannot be rationally derived from the terms

continued on next page

of the Reinsurance Agreement" because "nowhere in the Agreement…is it stated that the arbitration panel has the authority to require a party to post security **as a condition** to having its claims resolved by the panel or while the claims are being arbitrated." *Id.* at *5 (emphasis added). The decision indicates that, even given the low standard for confirmation of arbitrators' awards, courts are wary of early grants of security, prior to any consideration of the merits, which may have the effect of precluding a litigant from a fair hearing of its case.

A similar result was reached by a New York District Court in *Home Indemnity Company v. Affiliated Food Distributors, Inc.*, No. 96 Civ. 9707(RO), 1997 WL 773712 (S.D.N.Y. 1997). Here, an arbitration panel granted an interim award of security to the insurer and precluded the insured from discovery and review of disputed claim files for use in the arbitration unless and until the security award was posted. The Court held that arbitrators "…must, in any event, 'give each of the parties to the dispute an adequate opportunity to present its evidence and argument'" with a "touchstone" of "fundamental fairness". *Id.* at * 3. Here, where the arbitrators did not do so, the Court concluded that "fundamental fairness" was not present, which constituted "arbitrator misconduct" justifying reversal under 9 U.S.C. § 10(a)(3).

While *Home Indemnity* and *Recyclers* strongly suggest that the party opposing security is entitled to discovery and consideration of the merits prior to issuance of a security order, it appears that, with *Yasuda* affirming an award which appears to have been based solely on a finding that ultimately the reinsurer *might* not have sufficient assets to satisfy an award, the door is open to assertions that security ought to be awarded in any case in which is there is some doubt as to the reinsurer's viability if all liabilities were to mature at their highest cost – an argument which can be made against most run-off reinsurers. Given the confidentiality of reinsurance arbitrations,

> …the general background is that U.K.-Canadian case law runs strongly against pre-judgment security…

there is no easy way to gauge the frequency of pre-hearing security awards, but experience suggests the request for such relief is not an unusual occurrence. But, arbitrators acting under the influence of the British precedents face a different procedural landscape.

II. The United Kingdom – a More Difficult Standard Akin to Injunctive Relief

While we have not found a U.K. or Canadian case dealing specifically with an award of pre-hearing security by arbitrators, the general background is that U.K.-Canadian case law runs strongly against pre-judgment security, and arbitrators with this jurisdictional background view that case law as informing their judgment on whether pre-hearing security can be ordered in arbitration.

The general rule on pre-judgment security was laid out over a century ago in *Lister & Co. v. Stubbs,* [1886-90] All E.R. Rep. 797 at 799. In *Lister*, the English Court of Appeal held that, "I know of no case where, because it is highly probable if the action were brought the plaintiff could establish that there was a debt due to him by the defendant, the defendant has been ordered to give a security till the debt has been established by the judgment or decree."

Modern British courts still follow this principle, as is evidenced by language in *Barclay-Johnson v. Yuill*, [1980] 3 All E.R. 190 at 193.

> [T]he court will not grant an injunction to restrain the defendant from parting with his assets so that they may be preserved in case the plaintiff's claim succeeds. The plaintiff, like other creditors of the defendant, must obtain his judgment and then enforce it. He cannot prevent the defendant from disposing of his assets…merely because he fears that by the time he obtains judgment in his favour the defendant will have no assets against which the judgment can be enforced.

The U.K cases establish that a plaintiff cannot get pre-judgment security simply to allay his fears that defendant's assets may not – at some undetermined point in the future – be available to satisfy a judgment.

Of course, there are exceptions to every rule, and in Great Britain, the exception to the general principle in *Lister* of not granting pre-judgment security is known as a "Mareva Injunction." This phrase grew out of a series of cases litigated in Great Britain in the late 1970's-early 1980's, the most famous of which was *Mareva Compania Naviera S.A. v. Int'l Bulkcarriers S.A.,* [1980] 1 All E.R. 213, which provided for the freezing of assets within the jurisdiction when the absent shipowners failed to appear.

continued on next page

In granting security – the injunctive relief of freezing the defendants' assets – the court made sure to note that such an order was an exception, based mainly on the valid case presented by the plaintiffs for this injunctive relief and the fact that defendants were clearly out of the jurisdiction of the court.

In the seminal Canadian case of *Aetna Financial Services Ltd. v. Feigelman* [1985] 1 S.C.R. 2, 15 D.L.R. (4th) 161 (Supreme Court of Canada), which discusses the principles underlying the Mareva Injunction, the Canadian Supreme court presented the limited instances for such injunctions. The plaintiff must demonstrate "a strong prima facie case" and in addition must "persuade the court…that the defendant is otherwise dissipating or disposing of his assets, in a manner clearly distinct from his usual or ordinary course of business…so as to render the possibility of future tracing of the assets remote, if not impossible in fact or in law." *Id.* at 178.

Clearly, under common law rules, pre-judgment security is not – and should not be – easily granted. British arbitrators are aware of "the abhorrence which the common law has felt toward allowing execution before judgment." *Aetna*. at 167 and, experience suggests, are loathe to grant pre-judgment security lightly.

Regardless of what law will apply, what steps should counsel take top deal with the security issue?

III. Suggestions for Anticipating and Dealing With the Issue of Pre-Hearing Security

1. Get The Facts Regarding the Finances

For the cedent, careful review of the reinsurer's publicly filed accounts and public statements of employees are the basic tools. What is trend of reserves and claims? What was said when the reinsurer was put into run-off? What unexpected losses have recently been incurred? While many (retired executive) arbitrators are inherently suspicious of run-off companies, hard factual evidence which suggests that the run-off will not end well is necessary to provide a "hook" for a security award. On the other hand, the reinsurer should do the same, emphasizing any regulatory approval of reserve amounts, experience and reputation of current management, particularly prior successful run-off management. Is there a Reg. 114 Trust? Has the adequacy of it been accepted by a regulator?

2. Prepare the Party Arbitrator/Consider the Issue in Umpire Selection

While experienced reinsurance practitioners always sound out their party arbitrators on the facts of the dispute, in the context of a run-off situation, the party arbitrator should also be sounded and prepared on the pre-hearing security.

Has he/she dealt with it before? What evidence does he/she think would merit such award and at what stage of the proceedings? The issue should also factor into umpire nominations. As a general matter, arbitrators with legal training seem more likely to appreciate the inequity of reversing the usual litigation risk calculus by an award of pre-hearing security, while "business" types seem more inclined to the "where's the harm approach". Given the different approach in the U.K. and the U.S., nationality of the arbitrator/umpire is an issue to consider, particularly if the litigant has ties to the U.K.

While experienced reinsurance practitioners always sound out their party arbitrators on the facts of the dispute, in the context of a run-off situation, the party arbitrator should also be sounded and prepared on the pre-hearing security.

3. Know the Law

As suggested above, while there is language in the reported cases (particularly *Yasuda*) which suggest that arbitrators may simply award security on the basis of finding that a reinsurer's resources *might* not be enough to satisfy any judgment which *might* be awarded, there are also cases which suggest that some procedural protections need to be afforded and that failure to do so may constitute "arbitrator misconduct". Additionally, the reported decisions arise in the context of a low standard for confirmation of an award under the FAA – they do not establish standards as to when exercise of such power is appropriate.

4. Have a Plan

Arbitration panels acting under reinsurance agreements which provide few rules have virtually total flexibility in establishing their procedures, which offers litigants wide possibilities for creative approaches. Do you want an early hearing on the security issue alone? Is there particularized discovery which is needed on the issue? Are you prepared to trade an early hearing date

continued on page 39

Think Tank

The Future of Arbitration in Run-off: Is it (Mostly) the "Costs," Stupid?

James Veach

By James Veach

During a Helix-UK-sponsored panel discussion last summer, Art Coleman (CitadelRisk Management) posed this question for the London-based panel: "Is the cost of arbitrating deterring cedants from bringing arbitration proceedings?" AIRROC Matters, Panel Discussion Special: London Market Update, Winter Issue at p. 13. (The London Panel consisted of Philip Grant (Chairman of ARC), Julian Ward (JTW Reinsurance Consultants), Mike Walker (KPMG Restructuring), Peter Sharp (Dewey & LeBouef), and the London panel's moderator, Mike Palmer (Helix)).

Conceding that the amount of reinsurance litigation/arbitration in London had diminished, Mr. Sharp observed that "costs are rising" and along with those costs "the level at which a dispute is not commercially worth fighting has risen too." MATTERS, p. 22. Mr. Ward agreed that in London and internationally the number of litigated and arbitrated reinsurance disputes had fallen off, but ascribed this reduced activity to reasons other than cost. At the same time, Gregg Frederick (Legion, in liquidation) remarked that arbitration remained a "powerful tool" for distressed or liquidated companies, but without reference to costs.

This discussion continued at the AIRROC Rendez-vous (October 15-16, 2007), as well as at the ARIAS-U.S. Fall Conference and Annual Meeting in New York City (November 1-2, 2007). During the AIRROC Rendez-vous, Janet S. Kloenhamer, President of Allianz of America Resolution Services, spoke about incorporating mediation provisions in reinsurance contracts. Ms. Kloenhamer, a member of the Board of Directors and Executive Committee of the International Institute for Conflict Prevention and Resolution (CPR), included in her presentation several articles that discussed the CPR's International Reinsurance Dispute Resolution Protocol. ***See, e.g.****, S. Tuckey,* ***A Tool to Smooth Reinsurance Disputes,*** *National Underwriter, Online News Service, February 23, 2007.*

Two weeks later, the ARIAS-US Fall meeting featured a presentation on e-discovery from a reinsurance perspective. Mark Megaw, Director of Reinsurance Litigation for ACE Group Holdings, Inc., produced, in conjunction with his comments, a sample arbitration budget. Mr. Megaw's budget began with the amount in dispute and then analyzed and projected the cost of arbitrating the dispute to a conclusion.

These intersecting Helix -- AIRROC -- ARIAS-U.S discussions inspired what follows. Mr. Megaw sets out a budget model that takes into account the hard, soft, and other costs of a traditional reinsurance arbitration. Ms. Kloenhamer prescribes mediation as a cure to run-away costs.

Neither Ms. Kloenhamer's nor Mr. Megaw's presentation necessarily represents or even reflects the views of Allianz, ACE Group Holdings, the CPR, ARIAS-U.S., or any other organization or entity with which they are associated. (And any attempt to use these comments against their authors or their fine organizations will lead only to ridicule and shame.) ■

James Veach is a Partner at the New York office of Mound Cotton Wollan & Greengrass. He concentrates his practice on insolvency, reinsurance arbitration/litigation, commutations, contract wording, government relations, and other run-off-related matters. He can be reached at jveach@moundcotton.com.

Think Tank

"Alternatives and Minimum Taxes": The Real Cost of US Arbitration

Mark T. Megaw

By Mark T. Megaw

The costs associated with US-based[1] reinsurance arbitration are like a tax on the dispute resolution process. Cynics would say that these "taxes" are inevitable. Economists would observe that a tax will move the marketplace toward non-taxed or lower-taxed alternatives. This insight from the economists helps explain why creative minds – as exemplified by other authors in this Special Issue – are increasingly looking for alternatives to full-blown US reinsurance arbitration.

At the start of a potential arbitral dispute, each side will typically envision a budget associated with running the case to conclusion.

What is the Real Cost of a US Reinsurance Arbitration?

A. *Cash Outlays.* At the start of a potential arbitral dispute, each side will typically envision a budget associated with running the case to conclusion.

In doing so, veterans of the process will know to go beyond a multiplier that merely calculates the expected hours and hourly rates of outside counsel and panel members. Many less-obvious but likewise expensive costs are involved. Often overlooked budget elements, which are labeled "variable costs" by the economists, include:

1. court reporters - at depositions and hearings;
2. travel for witnesses/counsel/company representatives;
3. rent of a neutral venue for the hearing (and related neutral venue costs for depositions);
4. services at the hearing venue, including the rental of audio-visual equipment, coffee, breakfast, and (inevitably over-priced and over-abundant) lunches;
5. copying costs (multiple sets for the panel, the witnesses, and opposing counsel, as well as multiple mark-up copies for your counsel);
6. hotel rooms for panel members, counsel, witnesses; and
7. presentation aides, including software for document retrieval and highlighting.

B. "*Variable-Fixed*" *Costs*. The dispute resolution process includes other less obvious costs. Think of these as "variable-fixed costs" because all costs become "variable" if the time horizon for their measurement is sufficiently long. Stated charitably, staff can be asked to focus upon another part of the organization when disputes are speedily and amicably resolved. The variable-fixed costs include:

1. *Legal Department Staffing, including in-house counsel, administrative and para-legal support*. A single arbitration will not normally cause an organization to hire a full-time lawyer to manage it. However, an organization that has gone into runoff will (eventually) have a diminishing book of business and, as the runoff varies, so too will the need for in-house litigation lawyers. Indeed, after the initial triage that follows the announcement that an organization is going into run-off, the hourly cost of having in-house legal staff to manage a discrete portfolio becomes more transparent and, therefore, more easily managed and valued. The budget for each case should reflect a notional hourly rate for the in-house legal staff – and that rate should contemplate administrative and IT support, as well as non-salary employee benefits.
2. *Other Staff*: Run-off organizations, in particular, have to consider the added cost of keeping witnesses around to tell their story. Often employees that were involved in reinsurance buying or in underlying claims handling are retained to support the arbitral process. Managers have to balance the risk of losing a star witness when those people move to other careers.

   Of course, many former employees participate in disputes for no charge. This is particularly true

Mark T. Megaw is Director of Reinsurance Litigation at ACE Group Holdings and can be reached at mark.megaw@ace-ina.com.

continued on next page

Think Tank

"Alternatives and Minimum Taxes": The Real Cost of Arbitration continued from previous page

for those with minimal involvement and it has the side benefit of reducing the impeachment arguments about whether they are beholden to their paymaster. Likewise, professional pride plays a role: many professionals seek the chance to defend their judgment calls.

Some prevailing wisdom, however, indicates that when people are retained as analysts and fact checkers, they also tend to be more focused as witnesses. If they are paid as consultants, their rates – and thus the amount of the variable expense – becomes particularly transparent. Whichever way they are paid, a notional hourly cost associated with witnesses represents an appropriate part of a dispute resolution cost-benefit budget.

Run-off organizations also face the added dilemmas associated with having a short-term management problem (recovering or defending an asset) while their employees have longer term personal goals – their careers. This conflict causes run-off organizations to provide "stay bonuses" or other financial incentives that increase the staffing expense. These costs can be valued. A straightforward division of hours worked per year should have an impact on the notional hourly charge that should be associated with the arbitral budget.

3. *Opportunity Cost*: Active operations have a stark reminder of the opportunity cost in running arbitrations. Underwriters are expected to add value by parsing and pricing risk. Similarly, reserve actuaries rarely have a primary job objective to "testify in the dispute resolution process." And senior managers are paid to set strategic paths and to ensure that the organization can and will implement its goals.

Accordingly, managers, underwriters, and actuaries will often, logically, need to minimize the time that it takes to get properly prepared.

Successful dispute resolution management is almost certainly not the primary skill set for which these professionals have been hired. Accordingly, managers, underwriters, and actuaries will often, logically, need to minimize the time that it takes to get properly prepared. They recognize that the more time they spend on disputes, the less they will have available to underwrite and manage their business roles.

C. *Soft Costs*. Organizations that allow an arbitration to proceed have an additional cost that arises from the confrontational nature of any dispute resolution – think of it as "organizational angst."

This cost is most vivid for an anxious participant who cannot sleep the night before a deposition or before a meeting with the lawyers or before a hearing. Those hours do not go into the equivalent of a lawyers "billable time," but they have an impact nonetheless because that anxiety has some affect on everything else that the witness is otherwise doing for the organization.

Even a comprehensive arbitration budget may fail to account for the loss of trust that occurs when parties can not resolve disputes on their own.

Almost invariably, the dispute resolution process requires some of the witnesses to perform a level of uncomfortable retrospection. Most contract drafters, for example, will recognize that if they had accurately anticipated each circumstance of the dispute, they might have avoided the need for a third-party to impose a solution. Reinsurance buyers may have a level of regret for choosing the seller as a counterparty or the broker as an agent.

Likewise, senior managers can struggle with the deposition process because relentless questioning of their activity and/or their staff may not align with the personality attributes that have caused them to be "in control." All of these examples of organizational angst have a cost that is difficult to quantify, but nonetheless real. It is a hidden tax.

As this article seeks to point out, the cost of prosecuting or defending a US-based reinsurance arbitration requires its protagonists to prepare a thoughtful budget. The budget should set out a realistic "cost" number, thereby allowing an effective "cost benefit" analysis. However, even this approach has problems because it will tend to under-value the benefits of the relationships upon which the reinsurance industry is built. Even a comprehensive arbitration budget may fail to account for the loss of trust that occurs when parties can not resolve disputes on their own. ■

Think Tank

Mediation: A Costs-Effective Alternative

Janet Kloenhamer

By Janet Kloenhamer

Mediation of reinsurance disputes will generally deliver commercially reasonable financial outcomes better, faster and cheaper than other forms of dispute resolution.

This is true regardless of whether your book of business is live or in run-off, direct or reinsurance, ceded or assumed. If you are not certain you agree with me, ask yourself if you agree with any of the following statements:

Mediation of reinsurance disputes will generally deliver commercially reasonable financial outcomes better, faster and cheaper than other forms of dispute resolution.

- predictability of financial outcomes is better than uncertainty;
- a negotiated resolution between business principals is better than any result the lawyers or strangers to the transaction may dream up;
- in mediation, the parties keep control over the dispute and its economic outcomes;
- in arbitration or litigation, the parties *cede* control of the economic outcome to third parties;
- after you pay and close a claim it ceases to cost your company more money;
- after you pay and close a claim, your claims management staff can handle other matters (and the more matters your staff handles, the lower the cost per claim.;
- after you close a claim you can stop paying the lawyers;
- mediators can help business people reach financial outcomes that are in their best interests;
- arbitrators, judges and juries substitute their judgment for the judgment of business people (who know their business dispute best);
- since mediation is typically non-binding, it can be conducted early and often over the life of a dispute;
- mediation is faster than either arbitration or litigation because the parties set the schedule and, more importantly, retain control over the schedule.
- many mediators will negotiate a lower fee for their services than they charge when they are appointed as party arbitrators;
- mediation can be either facilitative (helping the parties to talk to one another to resolve their differences) or evaluative (giving the parties an answer which they may accept or reject based upon the professional mediator's judgment) or both.
- opposing parties who consider an offer of mediation to be a sign of weakness really do not know you very well.

The law of large numbers applies and data does not lie. If you measure the effectiveness of mediation over other forms of dispute resolution on a case-by-case basis, you will always find exceptions. But if you look systematically at your outcomes and measure the triple bottom line, including payments to the parties, lawyers' fees, and staff expense, it is all about the cost.

There is evidence of the growing use of mediation in resolving reinsurance disputes.

Whether you agree with some, none, or all of the foregoing statements, the question remains, are more reinsurance professionals turning to mediation to resolve complex reinsurance disputes, and is it effective? There is evidence of the growing use of mediation in resolving reinsurance disputes.

The ARIAS (AIDA Reinsurance and Insurance Arbitration Society) U.S. website, for example, now lists arbitrators who have completed mediation training and that includes 20 "Qualified Mediators." Collectively, the qualified arbitrators served as mediators in over 70 reinsurance disputes. More importantly, I hear anecdotal evidence of the success of mediation in the reinsurance area.

For example, Kevin Tierney, an ARIAS-certified arbitrator and umpire, reports that of five recent reinsurance disputes in which he served as the mediator, three settled on the day of the mediation and one settled

continued on next page

Janet Kloenhamer is President of Allianz of America Resolution Services and can be reached at janet.kloenhamer@ffic.com.

Think Tank

Mediation: A Costs-Effective Alternative continued from page 35

several months later. Even though the results of these mediations were four successful settlements, the process by which each was conducted varied. In one of the "same day" settled cases, the mediation began due to a clause that required mediation as a condition for arbitration. (Interestingly, in-house counsel for one of the parties went into the mediation convinced that the mediation would be a waste of time and money and attended only because of the mandatory clause.)

Another mediation began immediately after the selection of an arbitration panel because the *panel* suggested that mediation be tried before the parties spent large amounts of money on the arbitration process. In another mediation, counsel wanted to mediate after document discovery, but before costly depositions began. In some instances cost savings were achieved by using "organizational meetings" position statements as the materials to acquaint the mediator with the relevant background information.

In addition to these differences in how the mediations were initiated, the mediation processes varied. Although in several cases the parties requested that the mediator conduct the negotiations via "shuttle diplomacy," in one case the mediator kept the parties engaged in a group discussion for the entire day. Each mediation is different and requires a different approach based on mediator's assessment of the issues, the history of a dispute, and the participant's personalities.

One important constant, however, is that in mediation the parties remain in control to develop creative business solutions. The primary objective of claims administration should always be to negotiate principal to principal to resolve disputes. When unsuccessful, principals must engage a broad spectrum of alternatives to bring disputes to a conclusion that optimizes the financial result at the lowest cost.

If we assume that the alternatives to mediation in the aforementioned examples were arbitration or litigation, one must look collectively at the results and determine whether given the length of time to resolution, the amounts paid/recovered, and the fees and costs associated with doing so a different method of dispute resolution would have resulted in a better net outcome. If mediation enables business professionals to achieve their objectives of certainty and finality for the run-off portfolios they manage and lower their dispute resolution costs as well, then it is certainly a tool worthy of our continued and expanded attention. ■

Feature Article

Arbitration Practice and Procedure In U.S.and U.K. Reinsurance Disputes continued from page 27

to choose for themselves to what lengths they will go in quest of impartiality."); *Merit Ins. Co. v. Leatherby Ins. Co.*, 714 F.2d 673, 679 (7th Cir.), *cert. denied*, 464 U.S. 1009 (1983). 1983) (Posner, J.) ("parties . . .choose their method of dispute resolution, and can ask no more impartiality than inheres in the method they have chosen."); *see, generally, Aviall, Inc. v. Ryder System, Inc.*, 110 F.3d 892, 896-97 (1997).

5 *Sphere Drake*, 307 F.3d at 620 ("To the extent that an agreement entitles parties to select interested (even beholden arbitrators, § 10(a)(2) has no role to play.").

6 *Winfrey v. Simmons Foods, Inc.*, 495 F.3d 549, 552 (8th Cir. 2007) (noting that "Simmons presents no evidence indicating that Mr. Butler's partiality deceived or misled the other two arbitrators, prejudiced Simmon's ability to present its case, or in any way affected the [unanimous] award. . . .").

7 *See Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 429 F.3d 640, 645-46 & 648-49(6th Cir. 2005), *reh'g en banc denied*, Feb. 16, 2006.

8 *Sphere Drake*, 307 F.3d at 620; *see also Winfrey*, 495 F.3d at 552; *Nationwide IV*, 429 F.3d at 645-46; *Delta Mine Holding Co. v. AFC Coal Prop. Inc.*, 280 F.3d 815, 821-22 (8th Cir. 2001); *Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc.*, 10 F.3d 753, 759 (11th Cir. 1993); *Leatherby.*, 714 F.2d at 679-680, 683; *see, generally, Astoria Medical Group v. Health Ins. Plan*, 11 N.Y.2d 128,134 (1962) (construing New York Civ. Prac. L. & R., Art. 75).

9 ARIAS-U.S. Code of Conduct, Canon II, commentary (available online at www.arias.org).

10 *See Sphere Drake*, 307 F.3d at 621; *Morelite Constr. Corp. v. New York City District Council Carpenters Benefit Funds*, 748 F.3d 79, 83 (2d Cir. 1984); *see, generally*, 28 U.S.C. § 455 (disqualification standards for federal judges).

11 *See, e.g., Leatherby*, 714 F.2d at 679 ("people who arbitrate do so because they prefer a tribunal knowledgeable about the subject matter of their dispute to a generalist court with its austere impartiality but limited knowledge of subject matter. . . .").

12 *See* 1996 Act, Sec. 21(4).

13 *See, e.g., Aviall, Inc. v. Ryder System, Inc.*, 110 F.3d 892, 895-96 (2d Cir. 1997).

14 *Sphere Drake*, 301 F.3d at 623; *see also* 9 U.S.C. § 10(a)(4).

15 *Commonwealth Coatings Corp. v. Continental Cas. Co*, 393 U.S. 145 (1968).

16 *See Applied Indus. Materials Corp. v. Ovalar Marine Ticaret ve Sanayi, A.S.*, 492 F.3d 132, 138 (2d Cir. 2007) ("[w]here an arbitrator has reason to believe that a nontrivial conflict of interest might exist, he must (1) investigate the conflict (which may reveal information that must be disclosed under *Commonwealth Coatings*) or (2) disclose his reasons for believing there might be a conflict and his intention not to investigate."); *New Regency Productions, Inc. v. Nippon Herald Films*, 501 F.3d 1101, 1111 (9th Cir. 2007).

17 *See, e.g., Morelite*, 748 F.2d at 85 & n.6.

18 *See, e.g., Kiernan v. Piper Jaffray Cos.*, 137 F.3d 588, 593-94 (8th Cir. 1998); *Cook Indus. v. Itoh & Co.*, 449 F.2d 106, 107-08 (2d Cir. 1971), *cert. denied*, 405 U.S. 921 (1972).19 *See Winfrey*, 495 F.3d at 552.

20 *Cf. Sphere Drake*, 307 F.3d at 623 ("[W]e have not been given any reason to think that umpire Huggins wanted more information from [party-appointed arbitrator] Jacks in order to know what to make of Jacks' arguments during the panel's deliberations."); *Winfrey*, 495 F.3d at 552 ("Simmons presents no evidence indicating that Mr. Butler's partiality deceived or misled the other two arbitrators. . . .").

21 *See Ovalar*, 492 F.3d at 137-38 ("arbitrator is disqualified only when a reasonable person, considering all of the circumstances, would have to conclude that an arbitrator was partial to one side. . . ."; test is satisfied where the "arbitrator knows of a material relationship with a party and fails to disclose it."); *Apperson v. Fleet Carrier Corp.*, 879 F.2d 1344, 1359 (6th Cir.), *reh'g en banc denied* (1989); *Morelite*, 748 F.2d at 83-84 (formulating "reasonable person would have to conclude" test).

22 *See Schmitz v. Zilveti*, 20 F.3d 1043, 1047-48 (9th Cir. 1994) (adopting "reasonable impression of partiality" test which it construed as functional

continued on page 42

KPMG

Policyholder Support Update — Alert No. 22

KPMG's Restructuring Insurance Solutions practice has been providing Policyholder Support Alerts to the insurance industry regarding Schemes of Arrangement for many months. These alerts act as a reminder of forthcoming bar dates and Scheme creditor meetings. To subscribe to these alerts or access KPMG's online database of solvent and insolvent Schemes of Arrangement, please visit their web site at "http://www.kpmg.co.uk/insurancesolutions" www.kpmg.co.uk/insurancesolutions.

Solvent Schemes – Upcoming Key Dates

COMPAGNIE EUROPEENE D'ASSURANCES INDUSTRIELLES S.A.

The above company's Scheme was approved at the Meeting of Creditors on 11 May 2007. The Scheme became effective on 27 September 2007 and the bar date was set as 25 February 2008. Further information is available on "http://www.ceai.co.uk" www.ceai.co.uk.

ING RE (UK) LIMITED

The above company's Scheme was approved at the Meeting of Creditors on 19 December 2007. The Scheme became effective on 1 February 2008 and the bar date has been set as 31 July 2008. Further information is available on "http://www.ing-re.co.uk" www.ing-re.co.uk.

WILLIS FABER (UNDERWRITING MANAGEMENT) (WFUM) POOLS

By Order of the High Court of Justice of England and Wales, Meetings of Creditors, for the Scheme Companies who participated in the WFUM Pools, were convened on 27 October 2006. On 17 September 2007, the Court sanctioned the Schemes for the 14 WFUM Pools Scheme Companies for whom votes were taken. The Schemes became effective on 10 October 2007 and the bar date has been set as 7 April 2008. Further details are available at "http://www.kpmg.co.uk/insurancesolutions" www.kpmg.co.uk/insurancesolutions and "http://www.wfumpools.com" www.wfumpools.com.

SPHERE DRAKE INSURANCE LIMITED

By Order of the High Court of Justice of England and Wales, the Creditors Meeting for the above company's Scheme was reconvened on 19 October 2007. The Scheme was subsequently sanctioned by the Court on 5 November 2007 and became effective on 6 November 2007. The bar date has been set as 6 May 2008. Further details are available at "http://www.kpmg.co.uk/insurancesolutions" www.kpmg.co.uk/insurancesolutions and "http://www.wfumpools.com" www.wfumpools.com.

AXA INSURANCE UK PLC; ECCLESIASTICAL INSURANCE OFFICE PLC; GLOBAL GENERAL AND REINSURANCE COMPANY LIMITED; MMA IARD ASSURANCES MUTUELLES; SWISS REINSURANCE COMPANY (IN RESPECT OF THE GLOBAL LONDON MARKET (GLM) POOL BUSINESS)

The 25 January 2008 bar date for the above company's' Schemes has now passed. Further information is available on "http://www.glmpool.com" www.glmpool.com.

OSLO REINSURANCE COMPANY (UK) LIMITED; OSLO REINSURANCE COMPANY ASA

The 17 December 2007 bar date for the above company's' Schemes has now passed. Further information is available on "http://www.oslore.no" www.oslore.no and "http://www.kpmg.co.uk/insurancesolutions" \o "http://www.kpmg.co.uk/insurancesolutions" www.kpmg.co.uk/insurancesolutions.

WALTON INSURANCE LIMITED

The 26 October 2007 bar date for the above company's Scheme has now passed. Further information is available on "http://www.waltonscheme.com" www.waltonscheme.com.

GREAT LAKES REINSURANCE (UK) PLC

The 7 January 2008 bar date for the above company's Scheme has now passed. Further information is available on "http://www.gluksolventscheme.co.uk" www.gluksolventscheme.co.uk.

Other Recent Developments

SUNCORP METWAY INSURANCE LIMITED

By Order of the High Court of Justice of England and Wales, a Meeting of Scheme Creditors for the above company was held for the purpose of considering and, if thought fit, approving a Scheme of Arrangement on 7 September 2007. A date for the hearing to sanction the Scheme has yet to be set. Further information is available by e-mailing "mailto:suncorp.solventscheme@axiomcc.com" suncorp.solventscheme@axiomcc.com.

CAVELL INSURANCE COMPANY LIMITED

The above company's Scheme was approved at the reconvened Meeting of Creditors on 25 April 2005. The Company has postponed their application to the High Court of Justice of England and Wales for the Scheme to be sanctioned. The date of this application has yet to be announced. Further information is available by e-mailing "mailto:steve.aldous@castlewood.co.uk" steve.aldous@castlewood.co.uk.

GLOBALE RÜCKVERSICHERUNGS-AG (GLOBAL REINSURANCE COMPANY); GLOBAL GENERAL AND REINSURANCE COMPANY LIMITED

The above companies are proposing to implement a Solvent Scheme of Arrangement. A Practice Statement Letter was sent to brokers and known policyholders on 21 January 2008. The company's' application for leave to convene Meetings of Creditors is scheduled to take place on 17 April 2008. Further information is available on www.globalre.com/schemes www.globalre.com/schemes.

RIVERSTONE INSURANCE (UK) LIMITED; MITSUI SUMITOMO INSURANCE COMPANY (EUROPE) LIMITED; SIRIUS INTERNATIONAL INSURANCE CORPORATION (PUBL) (IN RESPECT OF THE ORION POOL BUSINESS)

The above companies expect to apply to the High Court of Justice of England and Wales for permission to convene Meetings of Creditors. The date of this application has yet to be announced. Further information is available on "http://www.rsml.co.uk/solvent" www.rsml.co.uk/solvent.

WINTERTHUR SWISS INSURANCE COMPANY

By Order of the High Court of Justice of England and Wales, a Meeting of Scheme Creditors for the above company was convened on 11 January 2008. The outcome of the meeting is not yet known. The Sanction hearing was scheduled for 22 February 2008. Further information is available on "http://www.winterthur-crdriver-scheme.co.uk" www.winterthur-crdriver-scheme.co.uk.

Insolvent Estates

WILLIS FABER (UNDERWRITING MANAGEMENT) (WFUM) POOLS (SOVEREIGN MARINE & GENERAL INSURANCE COMPANY LIMITED - INSOLVENT PARTICIPANT)

See Solvent Schemes. ■

*Please do not hesitate to contact Mike Walker at **mike.s.walker@kpmg.co.uk** should you require any further information or guidance in relation to insurance company Schemes and insolvencies.*

Feature Article

Some Thoughts on the Pre-Hearing Security Freight Train in the Run-Off Context from page 31

for avoidance of security (reserves are adequate now, and will likely also be so in *x* months), or adversely offer security in exchange for an early date (we are prejudiced by such grant and in exchange want a quick hearing)? Again, early consideration of alternatives and preparation will be key to achieving a result on this issue which will best serve your client.

Recently the authors were involved in three arbitrations involving the same run off reinsurer. The alien, non-admitted reinsurer had established a Trust Fund in the United States as security for U.S. Ceding Insurers and under the Deed of Trust, it was required to maintain a minimum amount in the Trust Fund which was equal to its U.S. liabilities plus $20 million. Its quarterly reports indicated that it had calculated reserves, maintained the required security and the New York Insurance Department had issued a certificate of recognition as an accredited reinsurer, certifying that the reinsurer "meets the applicable standards of solvency required in this State." In each case the amount sought by the cedent was far less than the Trust Fund amount, and the reinsurer operated under the supervision of the FSA in the United Kingdom.

In the arbitration in which the umpire was a U.K. Q.C., security was denied, with reference to the authorities noted. In the arbitrations with American umpires, security was granted on the approach that such relief would not harm the reinsurer and would simply insure that any award would not be rendered useless.

The varying results suggest the potential exposure on this issue in arbitration involving a run-off reinsurer and underscored the need for consideration and preparation for the fight. ■

Feature Article

AIRROC Roundtable Discussion – March 5, 2008 continued from page 21

and a management drain too. When you're an entity in run-off, your staff goes down, your premium dries up. It's more important and more efficient that you resolve these things. It's predictably the case on this issue that there will be one party who is favorably disposed towards consolidation and one who is not.

You would like to think if you have a host of issues, either across contracts or across parties, and the true incentive is to resolve it, then both people would be favorably disposed towards consolidation.

However, it's often the case that if you would like to take your shot at an issue across contracts on multiple occasions, you won't favor consolidation. It's principally the case where you may favor consolidation, but you've got an umpire who you believe isn't going to be favorably disposed to your position, so you hardly want to expand his ability to impact your financial future.

I think, in theory, everybody ought to be a fan of efficiently resolving disputes. These run-off disputes today may have contracts going back fifty, sixty years. People never anticipated what would happen. I don't think we anticipated it ten years ago, but fifty years ago people wouldn't appreciate the need for consolidated approach. I think you're absolutely right, Mark [Gurevitz], I think people are becoming more sensitive to it. I think we are going to see a trend certainly towards pressure on panels to be open to it.

Mr. Rosen: Absolutely. Arbitration clauses invariably require arbitrators to adopt the customs and practices of the industry. Run-off has developed its own customs and practices which arbitration panels cannot be blind to. That tends to lead towards an evolution in favor of consolidation when one is dealing with relationships and issues that evolve from these relationships rather than discrete claim issues.

Mr. Abrams: This seems to be a good time for discussing resolution of smaller run-off claims. Jonathan [Rosen], I know you wanted to speak about this issue, and particularly whether AIRROC has a new approach to resolving such matters?

Mr. Rosen: Within the world of run-off where you have both counterparties in run-off, AIRROC is, at present, considering the concept of a small claims court. I think there is a recognition generally in the market, whether you are in run-off or not, of the economic constraints that a company is confronted with when dealing with smaller claims and how you deal efficiently in getting those smaller balances paid without necessarily having to give away the store.

AIRROC is considering something which I think is a vacuum in the market, and that is to set up a small claims type process with whatever dollar threshold is deemed appropriate. It could be $200,000, a quarter of a million dollars or less, and having those resolved through a much more constrained procedure and before a single arbitrator who would be determined by a panel of acceptable people who may or may not be accredited by AIRROC, but at least to do it on the basis where you don't have to go through full-blown discovery and people don't have the mechanisms that they would otherwise have in order to force companies who have smaller balances into essentially an economic hostage situation.

Mr. Abrams: Mark [Gurevitz], I wonder if you care to comment because I know you are involved in ARIAS and they have guidelines for a resolution of smaller claims?

Mr. Gurevitz: I'm all in favor of finding an acceptable mechanism for the resolution of smaller claims. I think it's almost the Holy Grail in this industry to find the solution to that. I think the devil is in the details. ARIAS, as you mentioned, Marc [Abrams], has tried to create a mechanism for that, even trying to use arbitrators who would be willing to do it for lower fees or no fee at all to get the experience. The industry task force that developed procedures back in 1999 is also looking at the issue. They developed a process for that, I believe, either in the original procedures or when they revised the procedures in 2004. The task force is looking at that again to try to find something that would get some traction.

If AIRROC can come up with something, I think that would be most welcome by many people in the industry. What happens, I think, is while everyone is certainly supportive of that concept, when you get to particular disputes, you get into all of the types of issues that Brian [Snover] alluded to a few minutes ago in terms of how do I get an advantage in this or in that or is this one where I think I need discovery, I can't submit it on the papers, or other issues come up. While everyone is generally accepting of the concept, it sometimes doesn't work when it comes to the practical considerations of issues that are before parties at a particular point in time. So I think the industry is calling out for a solution, but it's been somewhat elusive.

Mr. Snover: I think that's exactly right. Another problem is the contracts are all written in run-off. Whether or not you can require someone who is not predisposed to giving

continued on next page

up the perceived leverage of a long, drawn-out fight to deviate from an arbitration clause where they are entitled to three arbitrators and they are entitled to discovery and, again, you would like to think everyone would be favorably disposed towards an accelerated mechanism for a small amount. All three of us have balances on our Schedule F's of small amounts where it's almost hard to justify management time, let alone legal expense.

Mr. Rosen: That's why I think there is an advantage of a trade organization like AIRROC trying to move forward with such an initiative. As they say with American Express, membership should have some benefits, so that's what we are trying to do through the trade organization and the benefits of being involved in the trade organization.

Mr. Snover: If it's popularly accepted, that's a sensible thing to do I think panels would start to become a bit jaded about the party that dragged them all together for a $20,000 dispute. I agree with you that if that's accepted out there as a custom and practice, hopefully it would be a self-fulfilling prophecy and at least reflect poorly on those who resisted it for reasons that aren't necessarily economic.

Mr. Gurevitz: Unfortunately, we are starting from a position where it's difficult for the parties to give up a live organizational meeting where it would be so easy to do it by telephone and save a lot of costs. You can't even get an agreement on simple issues like that. There may be a good reason to have it live, but in many cases there isn't one. So you have that problem.

I think in arbitrations that exist today, there is a tendency toward more discovery than ever before. It's almost a scorched earth policy. The fear is that something will be missing or that it relates to some sort of theory in order to prove particular issues that you need to depose fifty people and you need to see every possible document. And you see even in the course of arbitrations, that discovery doesn't get dealt with once, but it gets dealt with several times before you get to the hearing. So if you think of things in that context and then say you are going to move to a streamlined approach, you can see some of the difficulty in getting there.

Mr. Rosen: Which also reinforces why you need a very strong umpire in the middle.

Mr. Snover: That's absolutely true. What you say about discovery is true, Mark [Gurevitz]. There seems to be too much deference by the panels these days to the process and not the parties. They are being paid for a service. Particularly when you're in run-off, efficiencies that can assist both parties are avoided.

One thing I have been thinking about for a long time, not limited to run-off, although it would be helpful in a run-off situation, is the following suggestion:

We all play this game that the umpire is the deciding vote. Of course usually he or she is. We all play this game he or she is not supposed to have an opinion until after the hearing takes place. For a long time I have been advocating, because I think it can be read consistently with the decades long arbitration clause that we live under, that at the organizational meeting, which nobody seems to want to give up, the umpire performs a service. That is, having read the position statements of the parties which lay out their positions in a commonplace way, he says right then and there if he had to rule today, here is what he or she would say and why. Now, people would view that as offensive to the process, but they're being paid because they understand the business. Nine times out of ten I believe it would actually assist, first of all, the party against whom he might rule by allowing that party to understand what they have to do during the process to convince him otherwise. It might focus the parties on specific discovery areas instead of going crazy. But 60 percent of the time it would result in both parties having a sit-down to attempt to resolve their differences.

Mr. Maher: Are there other ways that the dispute resolution process can be altered or modified to accommodate the needs of run-off companies?

Mr. Rosen: I think there is an inherent problem because you are dealing with contracts that were formed prior to run-off and you are governed by those contracts. I echo what Brian [Snover] said. We need efficiency, we need cost control, we need discovery control, and we need acceleration of process.

Those are great concepts, but in the real world you need willing parties and willing counterparties in order to achieve that end. How you ultimately achieve these goals is extremely difficult. That's one of the reasons why AIRROC is looking at this initiative for resolution of small claims and why consolidation has become a more critical component in the analysis. The industry needs to change because the industry has changed. How that change is accomplished I think is a conundrum. I think if the industry shares a willingness, just by definition, the nature of commerce will force that change. So I don't think that it's incumbent on an arbitration panel to force that change. I think it's incumbent on the party participants. There is that old adage "but for clients you wouldn't need lawyers"; but for participants you wouldn't need arbitration panels either.

continued on next page

Mr. Gurevitz: I think Jonathan [Rosen] is right that it does have to start with the clients. Here is another partial solution: One of the problems I see is that in your typical dispute scenario, you have an organizational meeting. In many cases, the next time the parties get together is a year later at the hearing. There is a lot going on in the middle, but there is very little that the panels are doing then.

The biggest cost that's incurred in that arbitration takes place in that period between the organizational meeting and the hearing, when discovery is taking place. Panels are asked to deal with discovery issues, but they are not grabbing control of the proceeding and forcing parties to think about their issues and trying to narrow or focus them on what really needs to be decided, or in coming up with creative or interim ways of resolving the issue during that period.

I think parties may have different interests before they are in a dispute, but once they are in a dispute they have an interest in dealing so that they can achieve what is an appropriate result under the circumstances. – *Gurevitz*

I don't have a good answer for that, but I think if we can solve for that, I think we can solve a lot. I think parties may have different interests before they are in a dispute, but once they are in a dispute they have an interest in dealing so that they can achieve what is an appropriate result under the circumstances. That may not be so different between both sides to the dispute, although they are certainly not going to tell each other that. Or it may be they need to spend some time probing what's involved and then they can get back together again and try to resolve those issues.

Generally, once you're in a dispute, both parties really just want a fair resolution of the issues that are before the panel. That can be achieved in a lot of ways. If the parties and lawyers, the outside counsel, are willing to just let go a little bit of the control of the process and if you can get enough synergy around some concepts that everyone is reluctant to accept, but ultimately comfortable with, maybe you can achieve some types of improvements.

Mr. Snover: Mark [Gurevitz] not only is what you said sensible, but I can prove it's what people thought was going to happen forty years ago. I've got clauses that say the hearing will take place in sixty days from when they're named. As far as I'm concerned, that's an agreement the parties already made. Try and tell the panel at the organizational meeting the contract says your job is over in sixty days. You're laughed at! Unfortunately, with the system today, that's a disappointment from the panel's perspective. Most people in the room, except the parties, have a great incentive for the arbitration to go on as contentiously and as long as possible.

Mr. Rosen: The irony of it, Brian [Snover], is it's not necessarily just the panel that just laughs it off. Invariably, what happens is you have these time constraints that are contained in these historical agreements and the first thing the parties do at the organizational meeting is waive it.

Mr. Gurevitz: Once you get into a formal dispute, the parties are so focused on the mechanics of the dispute, sometimes they lose sight of the ultimate goal, which is to resolve the dispute.

Mr. Rosen: I do think the concept of meet and confer and the concept of narrowing of issues are really wonderful concepts. I think lawyers should be very, very sensitive to those concepts instead of entrenching themselves in the position and the game. They are playing a game with other people's money. They should be concerned about that.

Mr. Maher: Gentlemen, thank you very much for a very fascinating discussion here on these issues. We appreciate your participation. ■

The views expressed here are solely the views of the individual participants and do not necessarily reflect the views or positions of any companies affiliated with these participants. The views expressed here are offered solely for academic purposes and shall not be construed as representations of any kind in any matter.

Feature Article
Arbitration Practice continued from page 36

equivalent of the "appearance of bias" test suggested by the *Commonwealth Coatings* plurality opinion.); *see also Positive Software Solutions, Inc. v. New Century Mtg. Corp.,* 476 F.3d 278, 283, 286 (5th Cir.), *cert. denied,* 127 S. Ct. 2943 (2007) ("in nondisclosure cases, an award may not be vacated because of a trivial or insubstantial prior relationship. . . . The draconian remedy of vacatur is only warranted upon nondisclosure that involves a significant compromising relationship."); *Leatherby*, 714 F.2d at 680 ("having due regard for the different expectations regarding impartiality that parties bring to arbitration than to litigation, the relationship. . . [must be] so intimate – personally, socially, professionally or financially – so as to cast serious doubt on the [arbitrator's] impartiality[;]. . . . the circumstances must be powerfully suggestive of bias. . . ."); *ANR Coal Co. Inc. v. Cogentrix of North Carolina,* 173 F.3d 493, 500-501 (4th Cir.), *cert. denied,* 528 U.S. 877 (1999) ("a reasonable person would have to conclude that an arbitrator was partial to the other party. . . . [;] court should evaluate the facts in light of. . . . four [enumerated] factors[;] . . . [w]hen considering each factor the court should determine whether the asserted bias is direct, definite and capable of demonstration rather than remote, uncertain and speculative and whether the facts are sufficient to indicate improper motives on the part of the arbitrator.") (quotations omitted); *Gianelli Money Purchase Plan and Trust v. ADM Investor Serv. Inc.,* 146 F.3d 1309, 1312-13 (11th Cir.), *cert. denied,* 525 U.S. 1016 (1998) (evident partiality established "only when either (1) an actual conflict exists, or (2) the arbitrator knows of , but fails to disclose information which would lead a reasonable person to believe that a potential conflict exists.")

23 *Cf. Leatherby,* 714 F.2d at 682 ("Although it is difficult to extract from the cases more than a mood, the mood is one of reluctance to set aside arbitration awards for failure of the arbitrator to disclose a relationship with a party.").

24 *Porter v Magill,* [2002] 2 AC 357.

25 *See Arbitration Act 1996* § 73.