ARBITRATION: NEW DEVELOPMENTS TO BRING MORE CONFIDENCE TO AN OFTEN MALIGNED SYSTEM

By Debra J. Hall[1]

I. Introduction

The (re)insurance industry[2] has a long and deeply rooted history in alternative dispute resolution, with examples of arbitration clauses that can be found in reinsurance contracts dating back to the early 1800s,[3] pre dating the U.S. judicial recognition of arbitration as a legitimate method of resolving disputes.[4]

But for more than two decades, companies have questioned the efficacy of arbitration, today more than ever before. Some of these criticisms are sound, others are based on industry folklore, still others are based on a failure of participants to recognize and take responsibility for their own contribution to the continuing problems of the process. But overall, there appears to be a continuing lack of knowledge or time to focus on the various improvements that have been developed since the late 1990s. The goal of this article is to enhance that knowledge – and new developments in 2009 provide us with an excellent opportunity to examine what is available to help parties regain confidence in the arbitration system and consider what remains to be done.

II. Background --Important developments between 1990 and 2005

The beginning of the 1990s was characterized by complaints about (1) a lack of knowledgeable arbitrators, including those that were active officers, (2) dissatisfaction with existing arbitration rules, such as the American Arbitration Association (hereinafter "AAA") procedures, as being inconsistent with historical (re)industry practice, and (3) a lack of arbitration training, both for arbitrators as well as company personnel and law firms.

A small group of people and companies had the foresight to make a difference. One very important development was the creation of ARIAS U.S. While by no means its idea, the Reinsurance Association of America (hereinafter the "RAA")[5] was invited to be a part of those discussions and supported the

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[2] References to "(re)insurance" include both insurance and reinsurance.

[3] Reinsurance Association of America, Manual for the Resolution of Reinsurance Disputes, A Historical Perspective on the Growth of Arbitration in the U.S. and its Introduction to the Reinsurance Industry, 8 n. 17 (2008 ed.).

[4] Id. At 5.

[5] The author was pleased to be a part of that group which established goals for ARIAS, determination of where and how to incorporate the entity, the initial make-up of the Board, the selection of the original Board and the initial qualifications for being a certified arbitrator (particularly the need to provide an avenue for new arbitrators to become certified through the education process).

creation of ARIAS U.S., particularly its focus on education as a means of expanding and improving the arbitrator pool. The RAA, at the request of its membership, did several other things. It developed and hosted a number of arbitration training sessions; created the Arbitrators Directory;[6] developed the Manual for the Resolution of Reinsurance Disputes;[7] and conceived and staffed an effort to create arbitration procedures tailor made for the (re)insurance industry, reflecting the custom and practice that had developed over the preceding decades. It is this last effort that is particularly relevant to the goal of this article.

Creation of the first (re)insurance arbitration procedures[8]

The Insurance and Reinsurance Dispute Resolution Task Force (hereinafter the "Task Force") was established in the fall of 1997[9] with a mission to "improve the reinsurance dispute resolution process by identifying common problems and recommending industry-wide, flexible, business-like solutions." The Task Force, composed of primary and reinsurance company personnel as well as arbitration practitioners, U.S. and foreign, spent two years examining existing non-insurance industry specific arbitration procedures, documenting the custom and practice of arbitration in the (re)insurance industry and analyzing/debating the areas that did not work well and recommending the consideration of new methods, e.g., a new umpire selection process. The result of their efforts, the **Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes,** (hereinafter the " Task Force Procedures" or "Procedures" regardless of which version is referenced) originally published in 1999, was an important first for the industry.

Importantly, the Task Force was committed to revisiting the Procedures every several years to assess the extent to which they were being used and to consider any necessary changes or updates. Accordingly, the Procedures were updated in April 2004 and a new alternative, using neutral panels, was incorporated.

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[6] The RAA Arbitrators Directory contains the names and requisite experience of industry professionals available to serve as arbitrators or umpires. These professionals pay a fee to be listed in the Directory; there is no certification requirement or standard for inclusion. Parties seeking an arbitrator or umpire can determine whether a particular arbitrator/umpire has the qualifications they seek.

[7] The RAA Manual for the Resolution of Reinsurance Disputes was designed to be a "how to" book on (re)insurance arbitrations. It contains a narrative, checklist for an organizational meeting and other forms in the Procedural Mediation/Arbitration Guidelines, a listing of resources, ethical guidelines to consider and case law.

[8] ARIA (U.S.) undertook the creation of the ARIAS (U.S.) Practical Guide to Reinsurance Arbitration Procedure, 2004 (hereinafter "ARIAS U.S. Guide" or "Guide"). The Guide was intended to outline procedures for conducting arbitrations and forms for potential use. However, the Guide also offers commentary throughout and is not designed to be a set of procedures that could actually be incorporated into a reinsurance contract. This is the primary distinction between the Guide and the Task Force Procedures. For a copy of the ARIAS U.S. Guide see the ARIAS U.S. website at www.arias-us.org.

[9] While the RAA and its membership initiated the project, the Task Force was composed of a balanced group of consumers and providers of the arbitration process. It was not dominated by reinsurance interests or considered to be a creature of the RAA. This is evident by reviewing the members of the Task Force and the broad range of trade associations that signed the Statement found at the end of the Procedures.

The Task Force reconvened again in 2007 and the newly updated version of the Procedures was published in November 2009. A copy of the new Procedures can be found on the Task Force's website at www.ArbitrationTaskForce.org.

Procedures for less-complicated disputes

Another important part of the Task Force efforts culminating in 1999 was the creation of "Alternative Streamlined Procedures" for the "fair, fast and efficient" resolution of disputes in those cases where the parties agree that such procedures are appropriate.[10] Like the Procedures generally, these alternative procedures were updated and republished in 2004 and are due to be republished the end of October 2009.

In addition to the efforts of the Task Force, the Association of Insurance & Reinsurance Run-Off Companies (AIRROC) undertook an effort in 2008-2009 aimed at developing their own procedures for the resolution of "less-complicated disputes" or those that would be "cost prohibitive to submit to plenary industry arbitration practices." A discussion of the AIRROC procedures is beyond the scope of this article.[11]

The focus of this article is to provide an overview of the Procedures for the Resolution of U.S. insurance and Reinsurance Disputes and examine the changes made to the 2009 update.

III. Overview of the Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes and 2009 Updates

The increasing number and complexity of arbitrations caused the Task Force to spend significant time over two years discussing and debating fundamental changes to the 2004 Procedures. Notwithstanding that debate, significant changes are not evident in the 2009 update, at least with respect to the "Regular" and Neutral Panel versions.[12] As noted in the Task Force's Introduction to the Procedures, certain issues raised by the participants were either determined to be outside the scope of the Procedures or consensus in the industry remains elusive. Notwithstanding the relatively minor nature of the changes, an overview of the Procedures is useful to familiarize industry participants about the benefits offered by incorporating the Procedures into their reinsurance contracts or considering them as a means of dispute resolution management strategy.[13]

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[10] The Task Force declined to limit these alternative procedures to small dollar disputes, believing, instead, that they could be utilized in any scenario where the parties believed they might be appropriate.

[11] For a copy of the procedures, see www.airroc.org/arbitrators/overview.

[12] A somewhat different approach to the Alternative Streamlined Procedures has been taken as discussed below.

[13] Although beyond the scope of this paper, there is merit to considering these Procedures and other procedural resources on a counterparty by counterparty basis to resolve outstanding disputes tailored to the relationship, the book of business and other considerations.

Regular Panel Version

Though perhaps not the most descriptive name, the "Regular Panel Version" of the Procedures is intended for those arbitration clauses which call for a three-personal panel of two party-appointed arbitrators and a neutral umpire. The 2009 version departs from this title and simply references this version as the Procedures as distinguished from the Neutral Panel Version. For clarity, this article will continue to refer to the Regular Panel Version where necessary.

Qualifications of the Panel

Like the prior versions, the 2009 update resolves some longstanding issues[14] with traditional arbitration clauses by requiring the arbitrators to be "disinterested" and the umpire "neutral" and further, by defining those terms in a manner that avoids past problems. Additionally, it retains the prior alternative language that allows those who have not been officers of insurers or reinsurers to service as arbitrators as long as they have a minimum of ten years of service to the industry. This provision would permit very experienced members of law, accounting and actuarial firms as well as trade association officials to serve as arbitrators.[15]

Selection of the Panel

One of the most important contributions that the Procedures have made over the past 10 years is offering clarification and alternatives to the selection and retention of the three-person panel.

Some contracts, unfortunately, fail to anticipate the lack of cooperation that can occur when one party fails to appoint its arbitrator within the designated time period, or how a panelist is replaced in the event of ill-health or other reasons (i.e., is the entire panel replaced or just the individual who resigned?)

The primary concern with panel selection is the process for selecting an umpire. Some believe that selection of the umpire is determinative of the outcome. Whether this is accurate or not, umpire selection merits close scrutiny. Typically each side proposes three, strikes two of the other's candidates and selects between the two remaining candidates by lot. While easily implemented, there has long been concern about the ability to "game" the process.

The Procedures remedy both of these problems. Party appointed arbitrators are appointed within a fixed time schedule, failure to appoint allows the non-defaulting party to appoint a default arbitrator, and a vacancy created by a resigning panelist is refilled by the same process with explicit timeframes.[16]

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[14] Arbitration clauses often use various terms to describe the qualifications of the arbitrators such as "impartial" or "disinterested" without defining the terms. Sometime, Lloyds' underwriters were inadvertently excluded by reference to service with an insurance or reinsurance "company." Other times, a reference to "active or retired executives" calls into question the eligibility of a former officer who is not fully retired.

[15] *See* Procedures, at Article 6. The same alternative qualification requirement is also found in the Neutral Panel Version of the Procedures, again at Article 6. Because the numbering system of the Regular and Neutral Panel Version are parallel, all references in this article to a particular article of the Procedures apply to both the Regular and Neutral Panel Versions unless otherwise indicated.

[16] *See* Procedures, at Article 6.

Importantly, the Procedures provide a process for appointment of the umpire (in the event that the parties fail to agree on one) that is, in theory, less subject to potential manipulation. Each side proposes eight individuals from a designated group or list that the parties should identify in their contract (e.g., ARIAS U.S. certified arbitrators, AAA), distributes and receives questionnaires from the candidates and selects three candidates from the other party's list. If there is a common candidate, the parties have an umpire. If there are two matches, the umpire is chosen by lot. If there are no common candidates, the parties rank all six (with "1" being the most preferred) and the lowest ranking candidate is chosen. Again, if a tie results for the lowest ranking then the tie is broken by lot.

While a more involved process, the parties are more likely to end up with an umpire that is more acceptable, or at least less objectionable, than through the traditional method. Some companies have agreed to use this umpire selection method even if their contracts did not incorporate use of the Procedures or when they wanted to avoid selection by other contractually mandated methods they perceived to be less acceptable, such as judicial selection of the umpire. Parties have generally reported satisfaction with this umpire selection method and the Task Force decided to retain it in the 2009 update.[17]

The 2009 update includes a provision that requires that, unless the parties agree in advance, all members of the panel consult with one another on each and every decision presented to the panel and that the panel's decision be based in each case on a majority vote of two out of three possible votes. While this requirement would seem to be self-evident, experiences of some industry participants have shown that aberrations exist.[18]

Confidentiality

Few arbitration clauses require the process to be confidential but most consider confidentiality to be an implied assumption in the arbitration process, and indeed, a major benefit of the process. Panels almost universally prefer confidential proceedings and have long struggled with whether they had the authority to impose it in the event of opposition from one party, given the lack of specific contractual authorization. With recent court decisions, however, it is quite clear that panels have this inherent and administrative authority.

The Procedures impose confidentiality with certain well-recognized exceptions, e.g., the need to disclose information to retrocessionaires, comply with judicial proceedings, communicate with independent auditors and comply with other laws and regulatory mandates.[19] These exceptions are generally consistent with the ARIAS-U.S. Sample Form 3.3 Confidentiality Agreement.

[17] ARIAS also has an alternative umpire selection process. The fundamental difference is that its process starts with a random computer generated selection of arbitrators, a starting point that the Task Force rejected in 1999 and still has not embraced, preferring instead to have the candidates chosen by the parties.

[18] *See* Procedures, Section 6.11.

[19] *See* Procedures, at Article 7.

Interim Relief and Sanctions

There is little doubt that arbitration panels can issue interim rulings, such as those related to pre-answer security and discovery. Nonetheless, some arbitrators are unclear about this authority and have even greater doubt about what sanctions are available in the event that a party fails to comply with its orders. Doubt as to a panel's authority in either regard harms the arbitration process by making panels hesitant to act decisively to grant appropriate relief and to control the process when their decisions are ignored.

The Procedures specifically authorize interim rulings and they authorize sanctions for a failure to comply with the panel's decisions. Sanctions include, but are not limited to: striking a claim or defense; barring evidence on an issue; drawing an adverse inference against a party; and imposing associated costs, including attorneys' fees.[20]

Organizational Meeting

Matters to be addressed at organizational meetings are typically well understood and set forth in the ARIAS U.S. Agenda for the Organizational Meeting.[21] Section 10 of the Procedures also specifies the usual items and here, one can find the majority of changes in the 2009 update which provides more detail than earlier versions. The update also begins the section with a requirement that the parties meet and confer in an attempt to reach agreement on as may organizational matters as possible before the actual meeting. [22]

Mediation or Settlement

In a conscious decision to encourage the parties to settle, either through bilateral discussions or through a facilitated process, the earlier versions of the Procedures, as well as the 2009 update, provide an article which suggests that the panel may request that the parties consider settlement or mediation, as long as such efforts don't result in delaying the arbitration proceedings. This is consistent with the underlying goals of the Procedures, not the least of which is aimed at efficiency and restoring confidence in the process. The original drafters of the Procedures were seeking to send a message to panels – that where appropriate, the panel might be best advised to encourage parties to seek their own resolution, setting aside their own financial interests in proceeding with the arbitration.[23]

Summary Disposition

Some arbitrators continue to be hesitant to summarily dispose of issues because they are unfamiliar with legal procedure and standards and the authority of the panel to make such rulings prior to a full hearing on the merits.

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[20] *See* Procedures, Article 8.

[21] *See* ARIAS U.S. Guide, at p. 25.

[22] *See* Procedures, at Article 10.

[23] *See* Procedures, at Article 12.

The procedures specifically authorize summary disposition. Importantly, they authorize *ex parte* summary disposition of the entire case or of individual issues even when one party has notice of the proceedings but chooses not to participate.[24]

Arbitration Hearing
The Procedures, at Article 14, provide a structure for the hearing. While much of this section codifies current procedure, there are certain departures worth noting.

The Procedures do not assume that there will be oral evidence at the hearing. They provide that the panel shall decide whether and to what extent that oral or written submissions will be permitted. This leaves open for consideration alternative ways of proceeding. One example that parties might consider is the English style of entering evidence – the submission of written direct testimony with the opportunity for oral cross examination.

The Procedures state that the reinsurance contract is to be viewed as an honorable engagement subject to custom and practice and not to be interpreted by strict rules of law or evidence. Though this is traditional language often found in reinsurance contracts, it is not contained in all contracts. Given the increasing similarity between arbitration and litigation, this provision preserves a business-oriented approach to the resolution of the dispute.

Like earlier versions, the Procedures provide flexibility in how evidence is presented, whether it by telephone, affidavit, recorded transcript, videotape or other means. The opportunity for cross examination, however, is a key consideration. Additionally, the Procedures make it clear that the panel may limit evidence to exclude testimony that would be immaterial or unduly repetitious. The drafters recognized that while the Federal Arbitration Act ensures that parties are afforded the opportunity to present evidence "pertinent and material to the controversy," it does not afford the parties a right to present unlimited amounts of evidence in the format of their sole choosing.[25]

One seemingly minor but potentially important change made in 2009 was to clarify that the panel not only determines whether hearing witnesses can attend the hearing prior to giving their own testimony, but whether they are permitted to review hearing transcripts of testimony given. Permitting the review of transcripts is essentially tantamount to attending the hearing, undercutting the panel's decision to exclude witnesses where they determine such exclusion is warranted.

Final Award and Reasoned Opinions
Like the earlier versions, the 2009 update requires that, absent good cause shown, the panel's award be issued within 30 days following the close of the hearing or where there is no hearing, the date all written submissions are received by the panel. Of course, the "good cause shown" is determined by the panel,

[24] *See* Procedures, at Article 13. A drafting note is included which states that by authorizing a panel to grant summary disposition (by agreement to use the Procedures), the parties don't waive their rights under the Federal Arbitration Act to contest the appropriateness of such an action, where those rights have been reserved.

[25] United States Code, Title 9, Chap. 1, Sec. 10 (a)(3).

thus this provision does little to guard against a panel which is dragging its feet, other than to create an expectation of a 30 day period.[26]

The type of relief granted is governed by the parties' agreement, but in the absence of "explicit written agreement to the contrary," the panel is authorized to award any remedy or sanctions allowed by applicable law, including pre and post award interest, costs and attorneys fees.

The 2009 update retains the pre-existing provision which requires the panel to provide a written rationale for their decision if both parties agree. Similarly, it prohibits the panel from providing a written rationale if one party objects. There continues to be controversy about the issuance of a reasoned award. Sometimes the results of an arbitration award are difficult to understand in the absence of a reasoned award, contributing to the continued perception that panels split the baby when, in fact, there are often strong fact or policy based reasons for the decision. Opponents of reasoned awards contend that providing a rationale may increase the possibility that an award may be vacated. This concern is misplaced when one examines the very limited bases for vacating a decision under the Federal Arbitration Act and the case law interpreting the Act. Nonetheless, the 2009 update takes the traditional approach to the issue.

Post Hearing Communications
Often, after a final order is issued, counsel will seek feedback from their party arbitrator as to the basis for the award and for qualitative comments on the efforts and tactics of counsel. Commonly the feedback is provided in general terms which do not reveal the detail of the panel's deliberations.

It is important to note that Article 15 prohibits this communication until the parties waive their rights to challenge the final award, the period to challenge the award expires or the challenge is concluded.

Neutral Panel Version

The neutral panel version of the Procedures contemplates a three-personal panel of neutral arbitrators, one of whom acts as the chair. The qualifications of the panel are the same as discussed above.

Selection of the Neutral Panel
The selection of the neutral panel, as with the earlier versions of the Procedures, begins with the exchange of ten individuals (as opposed to eight in the regular panel version) by each party from a list previously identified by them. Like the umpire selection in the Regular Panel Version, following the distribution and return of questionnaires from the candidates, each party selects three names from the other's list. If there is one common name on the list of six, that individual shall act as the chair. Each party then selects one person from the other's remaining list. If there are two common names then the parties draw the chair by lot from those two names, the remaining name serves on the panel and the third is chosen by drawing lots between the two remaining names on the list. Like the Regular Panel Version, the procedures provide a process for replacement.[27]

The 2009 update of the Neutral Panel Version also contains a provision that requires that, unless the parties agree in advance, all members of the panel consult with one another on each and every decision

[26] *See* Procedures, at Article 15.

[27] *See* Procedures, Neutral Panel Version, at Article 6.

presented to the panel and that the panel's decision be based in each case on a majority vote of two out of three possible votes.

Remaining Provisions
The remaining provisions in the Neutral Panel Version of the Procedures are essentially the same as those with the Regular Panel Version. Accordingly, the 2009 changes discussed above were also made to the respective sections of the Neutral Panel Version.

Addition of Sample Contract Clauses

The prior versions of the Procedures contained guidelines for the use of the Procedures, highlighting the fact that the Procedures contained several choices that parties need to make in order to have an effective arbitration clause and process. These changes include the need to designate (1) the version of the Procedures being incorporated into the agreement, i.e. 1999 or 2004, and with respect to the 2004 version whether the agreement contemplated the use of the Regular or Neutral Panel Versions; (2) whether the qualifications of the arbitrators and umpire required them to be "current or former officers or executives" or the broader "ten years of experience in or serving" the industry; and (3) the list from which an umpire would be chosen (e.g., ARIAS U.S., AAA) in the event the parties do not agree.

The guidelines also provide optional considerations for additional contract clauses such as location of the arbitration, consolidation, choice of law and survivability of the arbitration clause.

Although the prior Task Force had declined to include sample arbitration clauses in the Procedures, the current Task Force opted to do so, a move which probably makes incorporation of the Procedures more clear and reduces the potential for parties to inadvertently fail to designate one of the essential items in their contract causing ambiguity and unnecessary turmoil down the road.

Appendix I in the 2009 version is a sample arbitration clause incorporating the Regular Panel Version of the procedures. Similarly, Appendix II provides a sample clause incorporating the Neutral Panel Version. These sample arbitration clauses address each of the three items identified in the previous guidelines and incorporate the optional considerations as well. The content of the guidelines has, for the most part, been retained in the 2009 version though they are now referred to as "considerations" for use with the Procedures.

Alternative Streamlined Procedures

Both the Regular Panel and Neutral Panel Versions contain an Article 16 which is a set of Alternative Streamlined Procedures wherein the arbitration is conducted by a single neutral arbitrator. The parties may either incorporate the use of the procedures into their reinsurance contract, e.g., for disputed amounts below a certain threshold, or they may agree to use Article 16 in a particular dispute as it arises. The most significant changes to the Procedures were made by the Task Force in both Articles 16.

Selection of the Single Neutral Arbitrator
The previous Procedures provided in Article 16 that if the parties could not agree to a single neutral arbitrator within 30 days of their agreement to utilize the streamlined procedures, the arbitration would default to the use of Articles 1 through 15 of the respective Regular or Neutral Versions under which the parties were generally operating. The theory of the Task Force when drafting the earlier versions of the Procedures was that if the parties could agree to the use of a streamlined process which contemplated a

prompt and efficient resolution of their dispute, then they ought to be able to agree to a single neutral arbitrator, and, if they could not --then they *should* be proceeding under Articles 1 through 15.

However, the current Task Force departed from this view and provided a similar approach to selecting the single neutral arbitrator as provided in the Articles 1 through 15 of the Regular Version: the selection of eight names by each party, distribution and receipt of umpire questionnaires (with specific questions aimed at ensuring that the arbitrator is available in the near term to proceed), and selection of three names from either parties' list. Again, one common name results in the selection of the neutral arbitrator, two common names results in a drawing of lots and no common names results in the ranking process previously described.

Other Specific Provisions Not Common to the Regular and Neutral Panel Versions
As a streamlined process, the Procedures depart from the Regular and Neutral Panel Versions in the following ways:

- A requirement that the organizational meeting be held within 21 days and that it be conducted by telephone;
- Any hearing must be concluded within 180 days unless the parties agree otherwise;
- Voluntary exchange of documents within 30 days of the organizational meeting or a date established by the arbitrator;
- No discovery unless the parties agree otherwise or, upon application of a party, the arbitrator orders limited additional discovery;
- No hearing with the dispute submitted only on briefs, unless (1) the parties agree otherwise, (2) upon the application of a party the arbitrator orders a hearing not lasting more than one day, or (3) the arbitrator believes that a hearing (not exceeding one day) will assist in the resolution of the dispute.

Ex parte communications with the single arbitrator are prohibited, as they are with a candidate considered for default umpire under the Regular Panel Version[28] and with respect to the entire panel under the Neutral Panel version.[29]

Awards are rendered consistent with Article 15 of the Regular and Neutral Panel Versions.

IV. Conclusion

As noted at the outset, the (re)insurance industry has a long established history for the resolution of disputes through arbitration. While arbitrations have clearly morphed from an informal business-like resolution to one cloaked in the attendant garb of litigation, we do a disservice to the industry and to its future to simply throw up our hands and resort to litigation. This realization has been the motivation for many to work to improve the process over the past couple of decades.

We are all well aware of the pros and cons of the never-ending discussion about arbitration versus litigation and this article will not waste the reader's time in repeating them here. Rather it is more

[28] *See* Regular Panel Version, at 6.7.

[29] *See* Neutral Panel Version, at 6.2

fruitful to bear in mind that support for the arbitration process is still alive in our industry or busy people would not spend significant amounts of their time continuing to improve the system as the Task Force has recently done.

Perhaps those of us who are understandably dissatisfied with the current system should consider ways to bring more certainty and efficiency and less gamesmanship to the process. But that analysis, like most, needs to begin at home.