ARE FORMAL HEARINGS NECESSARY FOR INTERIM ISSUES IN REINSURANCE ARBITRATIONS?

By
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Introduction

Some have colloquially described reinsurance as insurance for insurance companies. In recent years, reinsurance arbitrations have become more heavily contested, if not more complex. This leads not only to higher costs, but also to difficulties in scheduling arguments before the panel that, in turn, causes delays and dissatisfaction with the arbitration process. One means of streamlining the process and reducing time and costs is to decide interim disputes (*e.g.*, security or discovery) based on written submissions without oral argument by counsel. The purpose of this article is to determine the compatibility of such a practice with the Federal Arbitration Act and notions of fundamental fairness in the arbitration process.

One court defined fundamental fairness in the following manner: "A fundamentally fair hearing requires the procedural steps of notice, an opportunity to be heard, the opportunity to present evidence which is relevant and material, and arbitrators who are not infected with bias." *Prudential Securities, Inc. v. Dalton*, 929 F. Supp. 1411, 1416 (N.D. Okla. 1996).

Case Law on the Necessity for a Formal Hearing

One of the better articulations of the obligation of arbitrators to accept and consider evidence is the following:

> Arbitrators must give both parties to the dispute an opportunity to present their evidence and argument. An award can be vacated if an arbitrator refuses to hear material and pertinent evidence. However, arbitrators are not required to hear *all* of the evidence, and are afforded broad discretion in

> determining what evidence is necessary, as long as they allow each party an "adequate opportunity to present its evidence and argument." It does not violate due process to issue a decision based on a written submission. An arbitrator has the discretion to choose not to hold oral hearings, as long as his decision based on the other evidence is reasonable and not fundamentally unfair. This court has previously found that the lack of a formal, oral hearing does not violate F.A.A. 10 (a)(3) and is not fundamentally unfair.

Yonir Technologies, Inc. v. Duration Systems, Ltd., 244 F. Supp. 2d 195, 209 (S.D. N.Y. 2002) (emphasis in original; internal citations omitted); *see also Hoteles Condado Beach v. Union De Tronquistas*, 763 F.2d 34, 40 (1st Cir. 1985). Therefore, the lack of a formal hearing is neither fundamentally unfair nor a violation of the Federal Arbitration Act as long as both parties have the opportunity to make their respective cases before the panel.

Cases in Which Panel Orders Were Not Vacated Due to Lack of a Formal Hearing

One of the earlier cases on point is *Atlas Assurance Co. of America v. American Centennial Ins. Co.*, 1991 WL 4741 (S.D. N.Y Jan. 16, 1991). The panel ordered the reinsurer to post security after the organizational meeting, without a formal hearing on security. The court declined to vacate, finding no violation of fundamental fairness. The court characterized the security as a no-risk, reasonable interim step and not a final adjudication on the merits.

In *British Ins. Co. of Cayman v. Water Street Ins. Co.*, 93 F. Supp. 2d 506 (S.D. N.Y. 2000), the ceding insurance company requested security from the reinsurer. The panel granted the security after extensive written submissions but without the formal, oral hearing requested by the reinsurer. The court ruled that there was no misconduct under § 10(a)(3) of the Federal Arbitration Act or lack of fundamental fairness:

> In this case, it can hardly be said that Water

> Street was denied its opportunity to present its position on the security issue, given its many long and forceful submissions. Although the panel's decision to abandon its earlier openness to oral argument, … may give rise to an appearance of unfairness, Water Street has simply not shown that it was specifically or actually prejudiced by the panel's decision to decide the security issue on submission.

93 F. Supp. 2d at 517. *British Ins. Co.* was followed on the issue of the arbitrator's decision to render an award on the submissions and without an evidentiary hearing in *Shait v. Millenium Broadway Hotel*, 2001 WL 536996 (S.D. N.Y May 18, 2001).

Another case involving a panel order of security was *In re Cragwood Managers, L.L.C. (Reliance Ins. Co.)*, 132 F. Supp. 2d 285 (S.D. N.Y. 2001). The court declined to vacate based on lack of fundamental fairness or misconduct under § 10(a)(3) of the Federal Arbitration Act, stating:

> Both parties were given every opportunity to present evidence. Each party submitted extensive briefs and numerous exhibits and affidavits to the panel before its initial determination, and additional supporting materials (through letters and conference calls) before each of the panel's subsequent re-considerations. Cragwood did not request an oral hearing at any point in the arbitration proceedings.
>
> The arbitrators' decision to issue the interim award on the voluminous papers submitted was reasonable, and not a violation of fundamental fairness.

132 F. Supp. 2d at 289.

The arbitration panel awarded costs against Home Insurance Co. in *Nationwide Mutual Ins. Co. v. Home Ins. Co.*, 278 F.3d 621 (6th Cir. 2001). Home argued that this was misconduct under § 10(c)(3) of the Federal Arbitration Act since the panel did not allow

discovery into Nationwide's list of its costs or a formal, oral hearing thereon. The court declined to vacate the panel order stating:

> Because Home received copies of Nationwide's submissions on the costs it incurred in defending against rescission, and the arbitration panel gave Home an opportunity to respond to these submissions, it is not clear what purpose discovery or a hearing on this issue would have served. At the very least, Home had notice of Nationwide's claims and an opportunity to present counter-arguments. We therefore conclude that the arbitration panel's procedure met the minimal standard of fundamental fairness.

278 F.3d at 625.

A non-insurance case on point is *In re Arbitration Between Griffin Industries, Inc. and Petrojam, Ltd.*, 58 F. Supp. 2d 212 (S.D. N.Y. 1999). The respondents proposed that certain issues in the arbitration could be resolved on submitted documents without a hearing. The petitioners failed to file their brief when due and the panel informed the petitioners that the panel was prepared to rule based on the documents submitted. Petitioners subsequently filed their brief and the panel ruled without a formal, oral hearing. Petitioners sought to vacate order on the basis that the arbitrators engaged in misconduct and exceeded their powers under §§ 10(a)(3) and 10(a)(4) of the Federal Arbitration Act. The court declined to vacate the order stating:

> [P]etitioners were given notice that a decision by the arbitrators based solely on the papers submitted by the parties was a distinct possibility....
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> ... In the instant case, the decision of the arbitrators was based on the documents and written submissions of the parties, including Petitioners' twenty-eight page, fifteen exhibit brief. The lack of oral hearings does not amount to the "denial of fundamental fairness" required to warrant vacating the award.

58 F. Supp. 2d at 220 (Internal citations omitted).

Yonir Technologies, Inc. v. Duration Systems, Inc., 244 F. Supp. 2d 195, 209 (S.D. N.Y. 2002), involved a series of interim directives by the arbitrators without hearings and prior to a hearing on the merits of the dispute. The plaintiffs sought to have these directives vacated on the basis that they were in violation of procedural due process and fundamental fairness and exceeded the panel's power in that they were irrational. The court rejected the proposition that formal, oral hearings were necessary on interim issues and refused to vacate the ruling:

> Nothing in the record before me suggests that the Panel failed to give Plaintiffs an opportunity to submit evidence and argument. The record before me indicates that no award even issued from the Panel before the parties had ample opportunity to make their positions known to the Panel. Both sides presented information and arguments on every question implicated by the awards. The Panel did not dictate what the parties were or were not to submit. Plaintiffs were free to submit testimony by affidavit if they wished and, significantly, there is no evidence that either party ever attempted to present any evidence that the Panel refused to receive....
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> ...
>
> ... There is no support for the proposition that written submissions cannot provide a rational basis for an arbitral award.

244 F. Supp. 2d at 209-10.

Lack of participation in a proceeding leading to an adverse ruling is not a basis to vacate a panel award, when the party aggrieved by the award chooses not to participate in the proceeding. *In re Arbitration Between Northwestern Nat. Ins. Co. and Generali Mexico Compania de Seguros, S.A.*, 2000 WL 520638 (S.D.N.Y. May 1, 2000); *see also Euromarket Designs, Inc. v. McGovern & Co.,* 2009 WL 2868725 (S.D. N.Y. Sept. 3, 2009).

Lack of a formal hearing is not a basis to vacate an award where the parties were able to present their positions through documents and a telephonic hearing. *Berkley v. Merrill Lynch*, 2008 WL 755875 (S.D. Ohio Mar. 19, 2008). Dismissing a counterclaim prior to a hearing on the merits was well within the authority of the arbitrator. *Americredit Fin. Servs., Inc. v. Oxford Mgt. Services*, 627 F. Supp. 2d 85 (E.D. N.Y. 2008).

Cases in Which Panel Orders Were Vacated Due to Lack of a Formal Hearing

Teamsters, Chauffeurs, Warehouseman and Helpers v. E.D. Clapp Corp., 551 F. Supp. 570 (N.D. N.Y.1982), presents a challenging factual context for a labor arbitration. Due to a disturbance created by one or both parties, the arbitration ended prematurely, before one of the parties could complete its presentation. The arbitrator, nonetheless, rendered a decision that the disputes were not arbitrable under the collective bargaining agreement. The court vacated the order on the basis that it violated § 10(c) of the Federal Arbitration Act related to refusing to consider the evidence of both parties.

Coty Inc. v. Anchor Construction, Inc., 2003 WL 139551 (N.Y. Sup. Jan. 8, 2003), is a similar case. Both sides were to contribute to the costs of the arbitration, but during the hearing the panel learned that Anchor had not paid its share of the costs to the administrator. Thereafter, the panel did not allow Anchor to put in its evidence and prohibited Anchor's counsel from cross-examining Coty's witnesses. The court vacated the subsequent award in favor of Coty ruling:

> Finally, the panel's award should be set aside because the award was procured by arbitrator misconduct. ... While it is true that arbitration panels are afforded great latitude in determining what evidence they hear, arbitrators are guilty of affirmative misconduct when they refuse to hear evidence pertinent and material to the controversy in "bad faith." ... The panel had a direct monetary interest in being paid. Ruling that they would only hear the side that paid them was

improper.

2003 WL 139551, at *5 (internal citations omitted).

Cases with Interim Rulings Precluding Decisions on the Merits

There are statutes in New York and Illinois and considerable case law that support the right of arbitration panels to require security. *See* Robert M. Hall, *Pre-Answer Security and Reinsurance Arbitrations*, XII MEALEY'S REINS. RPT. No. 18 at 20 (2002). However, there are several cases in which the court vacated a security order by an arbitration panel due to a preclusive effect on a decision on the merits of the dispute.

One such case is *Recyclers Ins. Group, Ltd. v. Insurance Co. of North America,* 1992 WL 150662 (E.D. Pa. June 15, 1992), involving a dispute over quantification of the insurer's reserves and collateralization thereof. The panel required the reinsurer to post security after several rounds of written submissions but without a formal, oral hearing. The reinsurer took the position that it did not have sufficient assets to post the security and that the order, in effect, precluded it from making its case to the arbitration panel. The court vacated the security order, stating:

> [N]owhere in the Agreement, whether in the arbitration clause or elsewhere, 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. Thus, although the Agreement states that Recyclers may be required to post additional collateral, whether such collateral must be posted in this instance is one of the ultimate issues to be decided by the arbitrators.

1992 WL 150662, at *5.

Another such case is *Home Ins. Co. v. Affiliated Food Distributors, Inc.,* 1997 WL 773712 (S.D. N.Y. Dec. 12, 1997). At an organizational meeting the panel ordered the posting of security by

Affiliated as a precondition to discovery. The court vacated this order as fundamentally unfair. The court stated:

> The awarded security is directly linked to the preclusion of Affiliated's discovery. Thus, Affiliated is obstructed from both defending itself against Home's allegations, as well as substantially asserting its counter-allegations in any future arbitration. Moreover, this result was reached without any examination as to whether Home had a meritorious claim.

1997 WL 773712, at *4.

A similar situation was presented in an arbitration between a securities broker and his employer in *Prudential Securities Inc. v. Dalton,* 929 F. Supp. 1411 (N.D. Okla. 1996). At a pre-hearing conference, the panel voted to dismiss the broker's claim for failure to state a claim upon which relief could be granted. However, the panel did not hear the broker's motion to compel the production of documents necessary to prove the claim nor was the broker given the opportunity to present factual evidence supporting his claim. The court vacated the dismissal order stating:

> Before an arbitration panel should be able to dismiss a claim for failure to state a claim upon relief can be granted, the claim should be facially deficient. Such is not the case here for if the allegations of the claimant's complaint are taken to be true, he would be entitled to some form of relief.... Thus, to assure fundamental fairness, claimant is entitled to offer evidence relevant to his claim.

929 F. Supp. at 1418-19.

Case Law on Related Issues

Late Submissions

In *Transit Cas. Co. v. Trenwick Reins. Co.,* 659 F. Supp.

1346 (S.D. N.Y. 1987), the panel received extensive pre-hearing briefs and heard the testimony of several dozen witness at a live hearing but excluded a tardy written submission by Transit during the hearing. The court ruled that such exclusion was not misconduct under § 10(c) of the Federal Arbitration Act stating:

> Even assuming arguendo that [the arbitrator] was not justified in refusing the submission, Transit was not prejudiced inasmuch as both parties submitted comprehensive briefs covering all the relevant issues at the conclusion of the hearings. Transit's other evidentiary objection is equally unavailing. Acceptance of evidence at the hearing falls within the ample discretion allowed the arbitration panel.

659 F. Supp. at 1354.

In re Arbitration Between North River Ins. Co. and Philadelphia Reins., 1998 WL 78177 (S.D.N.Y. Feb. 24, 1998), involved an arbitration in which the reinsurers attempted to call as a witness the in-house counsel of the insured, despite the fact that he had not been on any pre-hearing witness lists. The panel excluded the witness and the reinsurers sought to vacate the ultimate award based on misconduct of the panel under § 10(a)(3) of the Federal Arbitration Act. The court noted that the panel properly considered the apparent misconduct of the reinsurers in concealing the witness and the disruptive influence on the proceeding. The court declined to vacate the order ruling:

> Respondents do not demonstrate a degree of prejudice tantamount to manifest injustice. Respondents had ample opportunity to present their case. Over the course of four days they submitted abundant evidence, and introduced many witnesses. They were denied the use of only one witness who (by their own admission) would only have offered fifteen minutes of testimony. … The panel made this decision to *preserve* the fundamental fairness of the proceeding, not to undermine it.

1998 WL 78177, at *4 (emphasis in original).

Failure to Postpone

In *P.T. Reasuransi Unum Indonesia v. Evanston Ins. Co.,* 1992 WL 40073 (S.D. N.Y. Mar. 3, 1992), the reinsurer sought to have an adverse panel order vacated for bias and misconduct under the Federal Arbitration Act. The reinsurer had asked for a postponement four days before a hearing which had been scheduled nine months previously and did not provide a reason for such the postponement. The court declined to vacate noting that the panel was well within its discretionary authority in declining postponement.

In *Tempo Shain Corp. v. Bertek, Inc,* 120 F.3d 16 (2d Cir. 1997), the wife of a witness became seriously ill shortly before the hearing and the witness was unable to testify. The panel declined to postpone or extend the hearing to include his testimony. The witness was the former president of one party to the arbitration who was the central negotiator for that party in the transaction that generated claims and counterclaims that were the subject matter of the arbitration. As a result of an adverse arbitration award, that party attempted to have the award vacated bases on misconduct under § 10(a)(3) of the Federal Arbitration Act. The court vacated the order on the basis that excluding the witness' testimony was the functional equivalent of precluding that party from putting on its case, ruling:

> Because Pollock as sole negotiator for Bertek was the only person who could have testified in rebuttal of appellees' fraudulent inducement claim, and the documentary evidence did not adequately address such testimony, there was no reasonable basis for the arbitrators to conclude that Pollock's testimony would have been cumulative with respect to those issues.

120 F.3d at 21.

Excluded Witness and Failure to Consider Criminal Trial Transcript

An arbitration with the union of an employee dismissed for indecent exposure was the subject matter of *Hoteles Condado Beach v. Union De Tronquist,* 763 F.2d 34 (1st Cir. 1985). The sole witness to the incident declined to testify when the arbitrator sequestered her husband pursuant to the union's motion. In addition, the arbitrator accepted into evidence but gave no weight to the transcript of a criminal trial in which the sole witness testified and the individual in question was convicted. The arbitrator issued an order in favor the union due to lack of evidence. The hotel asked that the order be vacated under § 10(e) of the Federal Arbitration Act for failure to consider relevant evidence. The court found that the sequestration alone did not warrant a vacation of the order but that the failure to consider the criminal trial testimony did:

> The testimony was unquestionably relevant to a determination of whether Otero actually engaged in immoral conduct in violation of the Company's disciplinary regulations. Moreover, no other evidence was available to substantiate or to refute the Company's charges that Otero had violated the rules regarding employment. The evidence effectively excluded by the arbitrator was both "central and decisive" to the Company's position; therefore, the arbitrator's refusal to consider this evidence was, as the district court concluded, "so destructive of [the Company's] right to present [its] case, that it warrants the setting aside of the arbitration award."

763 F.2d at 40 (internal citations omitted).

In *Commercial Risk Ins. Co. v. Security Ins. Co.,* 526 F. Supp. 2d 424 (S.D. N.Y. 2007), two days before the hearing, and long after the close of discovery, one party added its CFO to its witness list and identified a number of new documents about which he would testify. The panel heard extensive arguments concerning pertinence, materiality and import of the evidence offered by the CFO but chose to bar his testimony. The court found that this was well within the panel's authority given the factual circumstances. *See also Supreme Oil Co. v. Abondolo,* 568 F. Supp. 401 (S.D. N.Y

2008) in which the court upheld a panel order barring the testimony of a party's counsel offered during the arbitration.

Lack of Discovery

An arbitration over the terms of a coal sublease was the subject of *Louisiana D. Brown 1992 Irrevocable Trust v. Peabody Coal Co.*, 2000 WL 178554 (6th Cir Feb. 8, 2000). The panel decided the issue without discovery or an evidentiary hearing but after briefing and oral argument. The losing party asked the court to vacate the order based on misconduct under § 10(a)(3) of the Federal Arbitration Act. The court declined to do so on the basis that arbitrators may have legitimately found that the sublease was unambiguous and that discovery would not have produced relevant and material evidence.

Roberts v. A.G. Edwards & Sons, Inc., 2007 WL 597371 (S.D. Tex. Feb. 21, 2007), was an arbitration under the rules of the New York Stock Exchange for simplified arbitrations that did not require discovery or hearings. Two investors sought to recover against a dealer and the dealer sought discovery about the investors, understanding of their investments, their level of sophistication and their damages. The arbitrator declined to order discovery and ruled for the investors based on written submissions. The dealer sought to vacate the award but the court declined to do so finding that there was no evidence that the lack of discovery or a hearing impinged on the fundamental fairness of the proceeding. The court stated: "For an arbitration to be fundamentally fair, the only requirements are that each party receive notice of the proceeding, that each party be given an opportunity to present material evidence and arguments to the arbitrators and that there be no bias on the part of the arbitrator or arbitrators." 2007 WL 597371, at *9. On lack of discovery, *see also Nationwide Mutual Ins. Co. v. Home Ins. Co.,* 278 F.3d 621 (6th Cir. 2001).

Limitations on Cross Examination

Generica Limited v. Pharmaceutical Basics, Inc., 125 F.3d 1123 (7th Cir. 1997), involved an arbitration between the parties to

a pharmaceutical contract. Both parties presented extensive briefing and testimony to the arbitrator. The issue before the court was the cross-examination of a third party witness. After an initial cross examination, the opposing party attempted to initiate additional cross-examination which the arbitrator believed to be collateral to the issue in the arbitration and which would have put the witness in legal jeopardy. Nonetheless, the arbitrator allowed the proposed area of cross-examination to be otherwise developed in the record. The opposing party sought to vacate an adverse award on the basis of violation of fundamental due process requirements of the New York Convention on Arbitral Awards. The court declined to do so on the basis that the arbitrator's handling of the cross-examination was proper and that the record fairly contained the contentions of the parties.

Conclusions

The case law described above indicates that an arbitration panel has broad discretion concerning the manner in which the arbitration is conducted. The lynch pin is that each side has an equal opportunity to make its case before panel. Therefore, the presence or absence of a formal, oral hearing, at least on interim issues, is not a significant factor in determining whether or not there is a violation of the Federal Arbitration Act or a lack of fundamental fairness.

The case law suggests that what is decisive, however, is: (1) an unequal opportunity to make one party's case as was the situation in *Teamsters, Chauffeurs, Warehouseman and Helpers v. E.D.Clapp Corp.* and *Coty Inc. v. Anchor Construction, Inc., supra*; or (2) no opportunity to make one party's case at all as was the situation in *Tempo Shain Corp. v. Betek* and *Hoteles Condado Beach v. Union De Tronquist, supra.* To the extent that a party has had the opportunity to present the panel with the its position and supporting arguments, panel rulings on discovery, oral argument and the conduct of the proceeding generally are very unlikely to provide a basis for vacating a final order on the merits due to violation of the FAA or for lack of fundamental fairness.

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