Posting Collateral Under the Foreign Sovereign Immunities Act:

Arbitration v. Litigation[1]

By

Robert M. Hall

Mr. Hall is an attorney, a former law firm partner, a former insurance and reinsurance executive and acts as an insurance consultant as well as an arbitrator and mediator of insurance and reinsurance disputes and as an expert witness. He is a veteran of over130 arbitration panels and is certified as an arbitrator and umpire by ARIAS - US. The views expressed in this article are those of the author and do not reflect the views of his clients. *Other articles may be viewed at Mr. Hall's website: www.robertmhall.com.*

I. Introduction

Reinsurers owned by foreign nations are often required to post collateral by reinsurance contracts. Some state statutes require collateral when disputes arise.[2] However, the Foreign Sovereign Immunities Act ("FSIA"), 28 U.S.C.S. § 1609 states: "Subject to existing international agreements to which the United States is a party at the time of the enactment of this Act the property in the United States of a foreign state shall be immune from attachment arrest and execution subject only to the exceptions set forth in §§ 1610 – 1611." This purpose of this article is to examine, through selected case law, the application of this statute in a litigation versus arbitration context.

II. Collateral under the FSIA in Litigation

Stephens v. National Distiller et. al, 69 F.3d 1226 (2nd Cir. 1995) was a suit by the liquidator of a US reinsurer against a number of retrocessionaires, including Institudo de Resseguros do Brazil ("IRB") which was owned by Brazil. The liquidator sought to have unlicensed foreign and alien retrocessionaires post collateral as required by New York law.[3] The court found that the collateral requirement, as applied to the IRB, ran afoul of the FSIA:

> The pre-judgment security requirement before us would force foreign sovereign retrocessionaires to place some of their assets in the hands of the United States courts for an indefinite period. During that time, the retrocessionaires would have no access to those assets. All this is precisely the same result that would obtain if the foreign sovereign's assets were formally attached. There is, therefore, no significant distinction between New York's security requirement and an attachment of the property.[4]

A Uruguayan-owned reinsurer was the target of a collateral demand in *TIG Ins. Co. v. Banco de Seguros del Estado*, 2007 U.S. Dist. Lexis (N.D. Ill). TIG moved to strike the reinsurer's answer

to the complaint on the basis of 215 Ill. Comp. Stat. 5/123 (5)[5] that requires collateral. The court rejected TIG's argument that the collateral requirement was not an "attachment," as well as case law involving disputes in arbitration, and followed *Stephens.*

The Illinois collateral statute was again the focus in the recent case of *Pine Top Receivables v. Banco de Seguros del Estado,* 2012 U.S. Dist. Lexis 176560 (N.D. Ill. 2012). In this case, the plaintiff argued that the Uruguayan reinsurer had waived its immunity through the collateralization clause of the reinsurance contract. The court rejected this argument and found for Banco commenting:

> As far was we can tell from our own review of the contracts, provisions requiring reserves of cash and letters of credit make no mention of legal proceedings. They simply require the reinsurer to be sufficiently capitalized to meet its contractual obligations.[6]

III. Collateral Under the FSIA in Arbitration

A US insurer was seeking to enforce a default arbitration award against a reinsurer owned by the Argentinian government in *International Ins. Co. v. Caja Nacional de Ahorro y Seguro,* 293 F.3d 392 (7th Cir. 2002). Caja National de Ahorro y Seguro ("Caja") filed an affirmative defense to the motion to confirm the arbitration award and the cedent demanded security under the same Illinois statute described above. The cedent argued that Caja had waived its immunity pursuant to § 1610 (d) of the FSIA:

> [T] property of a foreign state . . . used for a commercial activity in the United States, shall not be immune from attachment prior to the entry of judgment in any action brought in a court of the United States . . . if – (1) the foreign state has explicitly waived its immunity from attachment prior to judgment . . ., and (2) the purpose of the attachment is to secure the satisfaction of a judgment that has been or may ultimately be entered against the foreign state, and not to obtain jurisdiction over it.

The court ruled that Caja had so waived its immunity under the New York and Panama Conventions which support the recognition of international arbitration awards and authorize courts to order suitable security.

Banco de Seguros del Estado v. Mutual Marine Office et. al, 344 F. 3d 255 (2nd Cir. 2003) was a consolidated appeal of two pre-hearing security orders in arbitrations pursuant to the New York statute described above as well as the collateral provisions of the reinsurance contacts. The court found that the reinsurer had waived its immunity pursuant to a broad arbitration clause in the reinsurance contract combined with the collateral clause that requires that reserves be secured.

The court observed that an arbitration panel may order relief that a court cannot grant and distinguished the *Stephens* line of cases as applying to litigation, not arbitration.

IV. Comments

It is evident from the case law above that a cedent can obtain security from a reinsurer owned by a foreign nation through arbitration when it cannot do so through litigation. It appears that cedents can use as their vehicles to do so either: (a) statutes such as those in New York and Illinois which require unlicensed foreign or alien reinsurers to post security when disputes arise; or (b) the broad arbitration clauses and collateral provisions commonly found in reinsurance contracts.

ENDNOTES

[1] The author acknowledges that assistance of Robert Badgley, Esq. of Locke Lord who represented Banco de Seguros del Estado in the Pine Top case and assisted in gathering material for this article.

[2] Robert M. Hall, *Pre-Answer Security and Reinsurance Arbitrations*, XII Mealey's Reins. Rpt. No. 18 at 20 (2002)

[3] N.Y. Insurance Law § 1213 (c) (1) provides:

> Before any unauthorized foreign or alien insurers files any pleading in any proceeding against it, it shall either:
> (A) deposit with the clerk of the court in which the proceeding is pending, cash or securities or file with the clerk a bond with good and sufficient sureties . . . in an amount to be fixed by the court sufficient to secure payment of any final judgment which may be rendered in the proceeding . . . .
> (B) procure a license to do an insurance business in the state.

[4] 69 F.2d 1226 at 1229.

[5] This statute provides:

> Before any unauthorized foreign or alien company shall file or cause to be filed any pleading in any action or proceeding, including any arbitration, instituted against it, such unauthorized company shall either (1) deposit with the clerk of the court in which such action or proceeding is pending or with the clerk of the court in the jurisdiction in which the arbitration is pending cash or securities or file with such clerk a bond with good and sufficient sureties, to be approved by the court, in an amount to be fixed by the court sufficient to secure the payment of any final judgment which may be rendered in such action, proceeding, or arbitration; or (2) where the unauthorized company continues to transact the business of insurance by issuing new contracts of insurance or reinsurance, procure a certificate of authority to transact the business of insurance in this State.

[6] 2012 U.S. Dist. Lexis. 176560*12.