**INTERMEDIARIES AND DISCOVERY IN**

**REINSURANCE ARBITRATIONS**

**By**

**Robert M. Hall**

[*Mr. Hall is 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. The views expressed in this article are those of the author and do not reflect the views of his clients.*  *Questions or comments may be addressed to the author at bob@robertmhall.com]*

## I. Introduction

As a veteran of over 50 reinsurance arbitrations, I can attest that one of the more frustrating features of the arbitration process for me and many of my colleagues is the difficulty in obtaining the cooperation of some reinsurance intermediaries in the discovery process. One would imagine that these intermediaries would perceive at least a business obligation to assist their clients and their markets in resolving their differences over contracts which they (the intermediaries) drafted. Too often, this is not the case.

This lack of cooperation is particularly troublesome when (a) records of the parties are missing; and (b) the contracts are ambiguous and the intent of the parties is at issue. Under these circumstances, lack of cooperation by intermediaries in producing documents or giving testimony materially can change the outcome of the proceeding. Arguments can be made that arbitrations should not mimic litigation in the ability to require tangential players to participate in the process. However, the intermediary's business is putting itself in the middle of reinsurance transactions, even requiring that all funds and communications between the parties flow through it (the intermediary). This being the case, the intermediary's cooperation in the arbitration process is essential.

The purpose of this article is to explore the legal barriers to requiring intermediaries to provide documents and give testimony in the arbitration process and to suggest remedies which will enhance the ability of arbitration panels to make proper rulings based on all relevant evidence.

## II. The Issue Under The Federal Arbitration Act

Although most if not all states have arbitration statutes, arbitration of matters in interstate commerce is governed by the Federal Arbitration Act[1] ("FAA"). With respect to non-parties to the arbitration, the FAA states that the panel may "summon . . . any person to attend before them . . . and . . . to bring with them any book, record, document or paper which may be deemed material as evidence in the case."[2] Thus, it is clear that the panel can subpoena a third party, such as an intermediary, to appear before it with records. However, it is not clear whether a panel can subpoena such a third party to provide documents in advance of the hearing, through discovery or to give a deposition in advance of the hearing.

As the financial stakes have risen in modern arbitrations, counsel have become increasingly wary to putting any witness on the stand without having deposed them and reviewed their documents at length. Thus, there is increased pressure to fill this apparent gap in discovery created by § 7 of the FAA.

## III. The Case Law

Several excellent articles have published recently which explore the details of relevant case law under the FAA. One is "Non-Party Depositions in Reinsurance Arbitration" by E. Paul Kanefsky and Stephen M. Prignano of Edwards & Angell and published in that firm's Insurance and Reinsurance Update dated June 2002.[3] Another such article is "Even Infinity May Have Its Limits: Issuance and Enforcement of Nonparty Discovery Subpoenas in

Arbitration" by Susan A. Stone, Thomas D. Cunningham and Patricia Petrowski of Sidley Austin Brown & Wood and published in the ARIAS-US Quarterly for the second quarter of 2002.[4] For the purposes of this article, it is possible to demonstrate the relevant problems with obtaining discovery from intermediaries under the FAA by exploring a subset of the relevant cases.

### A. Pre-Hearing Document Discovery Allowed

Perhaps the leading case in this category is In the Matter of Arbitration Security Life Ins. Co. and Duncanson & Holt, 228 F.3d 865 (8th Cir.2002). Security Life was the cedent to a reinsurance facility managed by Duncanson & Holt with Transamerica as a participant in the facility. When a dispute arose with Security Life, it appears that Duncanson & Holt defended the action on behalf of the facility. Transamerica refused to comply with a subpoena duces tecum on several bases, including the fact that it was not a party to the arbitration. Noting that Transamerica was a party to the reinsurance contract and not an innocent bystander, the court ordered Transamerica to comply with the subpoena:

Although the efficient resolution of disputes through arbitration necessarily entails a limited discovery process, we believe this interest in efficiency is furthered by permitting a party to review and digest relevant documentary evidence prior to the arbitration hearing. We thus hold that implicit in an arbitration panel's power to subpoena relevant documents for production at a hearing is the power to order the production of documents for review by a party prior to the hearing.[5]

Several other cases are in accord, at least as to document discovery. *See* In Re Arbitration Between Douglas Brazell v. American Color Graphics, 2000 WL 364997 (S.D.N.Y.); In the Matter of the Arbitration Between Integrity Ins. Co. v. American Centennial Ins. Co., 885 F.Supp. 69 (S.D.N.Y.1995); Meadows Indemnity Co. Ltd., 157 F.R.D. 42 (M.D.Tenn.1994).

### B. Pre-Hearing Document Discovery Not Allowed

The opposing view on document discovery is represented by Comsat Corp. v. National Science Foundation, 190 F.3d 269 (4th Cir.1999). A third party to the arbitration, the National Science Foundation, declined to comply with the arbitrator's subpoena on the basis that it was not authorized by the FAA. The court found for the National Science Foundation: "Nowhere does the FAA grant an arbitrator the authority to order non-parties to appear at depositions, or the authority to demand that non-parties provide the litigating parties with documents during prehearing discovery."[6] However, the court noted that a "special need" might be the basis for enforcing such a subpoena.[7]

### C. Distinction Between Documentary and Testimonial Evidence

In the Matter of the Arbitration Between Integrity Ins. Co, v. American Centennial Ins. Co., 885 F.Supp. 69 (S.D.N.Y.1995) involved a subpoena for pre-hearing testimony and documents. The court upheld the right to obtain pre-hearing documentary evidence as being inherent in the power to compel documents at the hearing but ruled that requiring testimony form a third party as too intrusive with respect to a non-party. *See also* In the Matter of the Arbitration Between Commercial Solvents Corp. v. Louisiana Liquid Fertilizer Co., 20 F.R.D. 359 (S.D.N.Y.1957).

### D. Geographical Limitations on Subpoena Power

Legion Ins. Co. v. John Hancock Mutual Life Ins. Co., 2002 WL 537652 (3rd Cir.) involved an attempt by an arbitration panel to subpoena a managing general agent in Florida. The federal district court in Philadelphia ruled that it could not enforce the subpoena since § 45 of the Federal Rules of Civil Procedure limits a district court's jurisdiction to enforce subpoenas to 100 miles. The appellate court affirmed:

In light of the territorial limits imposed by Rule 45 upon the service of subpoenas, we conclude that the District Court did not commit error in denying John Hancock's motion to enforce the arbitration subpoena against SCIS, which, as a nonparty located in Florida, lies beyond the scope of the court's subpoena enforcement powers.[8]

Rule 45 did not present an insurmountable problem in In the Matter of the Arbitration Between Security Life Ins. Co. and Duncanson & Holt, 228 F.3d 865 (8thCir.2000). The party who sought to enforce the subpoena retained counsel authorized to practice in the district where the third party was located. This attorney issued the subpoena and asked the court to enforce it.[9] The object of the subpoena, Transamerica, protested that this violated Rule 45. The court brushed aside this argument:

Whether or not Transamerica is correct in insisting that a subpoena for witness testimony must comply with Rule 45, we do not believe an order for the production of documents requires compliance with Rule 45(b)(2)'s territorial limit. This is because the burden of producing documents need not increase appreciably with an increase in the distance those documents must travel.[10]

### E. Comments

As the above case law demonstrates, there is significant split of authority as to: (a) whether intermediaries are subject to pre-hearing discovery; (b) the nature of discovery allowed; and (c) the ability of an arbitration panel to subpoena intermediaries which are more than 100 miles away. Means of remedying this split of authority are examined below.

## IV. Options for Reform

### A. Depend on Developing Case Law

It is possible that developing case law will require intermediaries to provide documents and testimony upon the order on an arbitration panel. It is more possible that developing case laws will not provide an adequate remedy to correct these problems or that there will be a confusing patchwork of conflicting case law as there is now. Thus, doing nothing is not a solution.

### B. Amendments to the Federal Arbitration Act

It would not be difficult to craft amendments to the FAA which would require third parties to provide documents and give testimony upon the order of an arbitration panel. The effort, however, to amend a federal statue is significant. Moreover, any amendments would impact many industries with consequences which are difficult to predict. The insurance industry, or a portion thereof, may be an insufficient constituency to overcome both the opposition of other constituencies and the inertia involved in the legislative process. Thus, amendments to the FAA may not be the best remedy available.

### C. Contractual Agreement

It is possible to bind an intermediary to a certain level of cooperation in the arbitration by making it a party to the reinsurance contract. However, there are mechanical problems in placing affirmative obligations on an third party in what is normally a two party contract. Dividing up responsibility among three parties is sufficiently challenging to suggest that few contract drafters will take it on. Moreover, most reinsurance contracts are written by intermediaries who have little incentive to place additional obligations on themselves. As a result, relying on reinsurance contracts to solve the problem is unrealistic.

Intermediaries commonly enter into a sort of engagement agreement with their ceding company clients. State statutes and regulations pertaining to intermediaries require certain provisions be contained in these engagement agreements, however none relate to reinsurance arbitrations. Since intermediaries draft these documents, they are not likely voluntarily to include language which places additional affirmative duties on themselves. Requiring such

language by statute or regulation which provide an incomplete remedy since obligations with respect to discovery in an agreement between the cedent and the intermediary would not necessarily benefit the reinsurer who may also seek the documents and testimony of intermediaries.

### D. Reinsurance Intermediary Laws and Regulations

Virtually every intermediary in the United States is subject to the laws and regulations of one or more states governing the activities of intermediaries within their jurisdictions. Most of these laws and regulations are based on the NAIC Reinsurance Intermediary Model Act. It would be possible to insert appropriate language within the list of prohibited acts which would allow an insurance department to penalize the intermediary for non-compliance. Such language could read as follows:

Failure to comply with the order of a reinsurance arbitration panel to produce documents or testimony with respect to a dispute being considered by the panel unless the intermediary obtains an order of a court of competent jurisdiction quashing the panel's order on non-jurisdictional grounds.

Such language would allow the intermediary to protest the scope of discovery to the panel, which deals with similar protests from the parties in many arbitrations, and to a court. If the only the court's only basis for quashing the subpoena is the 100 mile limit in Rule 45 of the Federal Rules of Civil Procedure, this is not a substantive basis for the objection and the intermediary should be held to account.

## V. Summary

Since they put reinsurance transactions together and often draft the contracts, intermediaries are in a unique position to provide useful documents and testimony in reinsurance arbitrations. However, intermediaries are often reluctant provide this information notwithstanding the disservice it can render to their clients and markets in the arbitration process.

Because of a gap in the Federal Arbitration Act, there is a split of authority as to the ability of an arbitration panel to order that such documents and testimony can be provided before the hearing. Of the various remedies available, the most effective would be to amend state intermediary laws and regulations to allow regulators to penalize intermediaries who do not comply with the subpoenas issued by arbitration panels.

## ENDNOTES

---

[1] . 9 U.S.C. § 1 *et seq*.

[2] . *Id.* § 7.

[3] . A copy of this article may be obtained by calling Mr. Prignano at 401/276-6670.

[4] . A copy of this article may be obtained by calling Mr. Cunningham at 312/853-7594.

[5] . 228 F.3d at 870 - 1.

[6] . 190 F.3d at 275.

[7] . *Id.* at 276.

[8] . 2002 SL 537652*2.

[9] . Such a practice was authorized in Amgen Inc. v. Kidney Center of Del. County, Ltd., 879 F.Supp. 878 (N.D.Ill.1995).

[10] . 228 F.3d 865 at 872.