JUDICIAL ISSUES IN

ARBITRATION PANEL SELECTION

By

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I. Introduction

The ostensible purpose of arbitration is to avoid the time and expense of litigation and to obtain a higher level of expertise of the triers of fact. Unfortunately, judicial orders are sometimes needed to overcome disputes between the parties over the selection of the panel. Below is an examination of the case law on four panel selection issues:

- Time limitations on selection of party arbitrators
- The impact of references to AAA procedures in the arbitration clause
- Active officer requirements
- The willingness of the court to appoint an umpire

While the issues of arbitrator partiality, bias, prejudice or interest in the outcome are of significant interest also, they merit a separate treatment. [1]

II. Time Limitations on the Appointment of Party Arbitrators

Some arbitration clauses give the parties a limited period of time, typically 30 days, to select a party arbitrator once a demand for arbitration has been issued. The penalty for failure to adhere to this deadline is that the other party has the opportunity to select both party arbitrators who then select the umpire. The fear this generates is that the entire panel will consist of close friends who will be closely aligned with the interests of the party that selected them, directly or indirectly.

Such a result may be overestimated, however, for several reasons. Most basically, the party arbitrator who is appointed for a dilatory party wants to get paid for his or her services and to be held harmless for any personal liability arising out of the arbitration. Also, many arbitrators are aware that a ground for vacature under the Federal Arbitration Act is failure to allow a party

fairly to present its case. Moreover, arbitrators are and should be concerned with the perceived fairness of the arbitration process so as to support it as a means of dispute resolution.

In any case, there is a split of authority on compliance with deadlines in appointing party arbitrators. There are cases within and without the insurance field which might be consulted but this paper will focus on case law emanating from reinsurance disputes.

A. Cases Excusing Tardy Appointment

The treaty at issue in New England Reinsurance Corp.v. Tennessee Ins. Co., 780 F.Supp.73 (D.Mass. 1991) contained an arbitration clause which allowed one party to appoint the arbitrator for the other party if the other party did not appoint an arbitrator within 30 days of a demand for arbitration ("30 day provision"). The reinsurer was 8 days late providing the name of its party arbitrator to the cedent and in the interim, the cedent had appointed a second arbitrator. Following a number of non-insurance cases, the court excused the late appointment noting the strong policy in favor of arbitration and ruling:

The plaintiff's counsel's lack of diligence in transmitting his letter of appointment does not rise to a level sufficient to deprive the plaintiff of its right to appoint an arbitrator, especially considering the lack of prejudice to the defendant. . . . Moreover, nothing indicates that the parties intended time to be of the essence. [2]

Matter of Arbitration between Evanston Ins. Co. and Kansa General Intern. Ins. Co. Ltd involved an arbitration clause containing a 90 day provision and requiring that arbitrators be disinterested. By way of background, Gerling and Kansa both reinsured Evanston on the same treaty. A senior officer of Gerling accused Evanston of misrepresentation, concealment and breach of contract but the dispute was ultimately settled. Later, a dispute arose between Kansa and Evanston over the same contract and Kansa appointed the Gerling officer as their party arbitrator. Eventually, the Gerling officer resigned as Kansa's party arbitrator and Kansa named a replacement. Evanston alleged that Kansa's original appointment was a nullity, that the replacement arbitrator was named past the 90 day deadline and that Evanston should be able to pick the second arbitrator. The holding of the court was that: "Kansa did not 'fail to designate' an arbitrator and the Court declines to subscribe to the fiction proposed by Evanston that the nomination of [the Gerling officer] was the equivalent of no nomination at all." [3] In *dicta*, however, the court suggested a more liberal approach to resolving such disputes:

[T]he Court must endeavor to effectuate the intention of the parties. The Court notes that the overriding intent of the parties was to submit their disputes to binding arbitration before a three arbitrator panel, with each party nominating one disinterested arbitrator. The Court can effectuate that intent by allowing Kansa's designation of [the replacement arbitrator] to stand. [4]

B. Cases Which Do Not Excuse Tardy Appointment

Four days after the expiration of a 30 day provision for "qualification" of party arbitrators, the cedent appointed an arbitrator for the reinsurer in Evanston Ins. Co. v. Gerling Global Reins.

Corp., 1990 WL 141442 (N.D.Ill). The reinsurer admitted that it failed to notify the cedent of its selection within 30 days but argued that selection took place prior to the deadline and that this met the "qualification" standard of the arbitration clause. The reinsurer also argued that the omission was excusable since there was no "time is of the essence" provision in the contract. The court rejected the reinsurer's first argument finding that "qualification" necessarily includes notice to the opposing party. With respect to the reinsurer's second argument, the court ruled for the cedent:

Th[e] express language [of the 30 day provision] demonstrates that the parties intended to create contingent rights: Gerling had the right to appoint an arbitrator *only if* it qualified its arbitrator within one month of a request from Evanston. Failure to do so would result in Evanston having the right to appoint both arbitrators. Thus, the language of the arbitration clause itself makes the timing of qualification consequential regardless of a "time is of the essence" clause. [5] (emphasis in the original).

Due to a clerical error in recording the deadline for appointment of a party arbitrator, the reinsurer was four days late appointing its arbitrator and in the interim, the cedent had appointed a second party arbitrator in Universal Reins. Corp. v. Allstate Ins. Co, 16 F.3d 125 (7th Cir. 1993). The lower court ruled for the reinsurer on the basis that the reinsurer's late appointment was a technical, procedural oversight which is overborne by the expressed desire of the parties to arbitrate with each side appointing a party arbitrator. The court of appeals reversed. The 30 day provision allowed a party to appoint a second arbitrator if the other "refuses or neglects" to appoint an arbitrator within 30 days. The court found that the late appoint constituted "neglect" and that bad faith or gross negligence need not be shown. The court went on to state:

In this case the agreement is crystal clear, specifying a particular course for the appointment of a second arbitrator when one of the parties fails to make its selection within thirty days. This provision does not command less deference simply because it concerns a procedural rather than substantive aspect of the parties' decision to arbitrate. On the contrary, the [Federal] Arbitration Act states in no uncertain terms that contractual provisions for the appointment "*shall* be followed. 9 U.S.C. Sec. 5 . [6] (emphasis in the original).

Employers Ins. of Wausau v. Jackson, 505 N.W.2d 147 (Wis.App.1993) involved notice to the reinsurers' claim counsel that an arbitrator had to by appointed by a specific date. The claim counsel disclaimed authority to accept this notice and transmitted it to the intermediary in London. 18 days after the expiration of the 30 day provision, the reinsurers appointed an arbitrator and the cedent appointed a second party arbitrator 2 days later. The lower court accepted the second arbitrator appointed by the cedent and the reinsurers appealed. The appellate court noted that its standard of review was whether the lower court erroneously exercised its discretion in allowing the cedent to appoint the second arbitrator. The court noted that the Federal Arbitration Act and a similar Wisconsin statute (sec. 788.03) allows the court to appoint an arbitrator when there has been in lapse in appointments and ruled:

Because of the dispute as to who the second named arbitrator should be and therefore the lapse in selecting the umpire, the circuit court simply required the parties to follow their agreement's method for naming the arbitrators who then will select the umpire. In its limited intervention, the

circuit court concluded that Wausau had properly followed the clearly established method for appointing the second arbitrator and therefore confirmed the appointment by naming [the cedent's second arbitrator]. [7]

This decision was affirmed on appeal. Employers Ins. of Wausau v. Jackson, 527 N.W.2d 681 (Wis. 1995).

The treaty at issue contained a 90 day provision with the California Insurance Commissioner appointing the second arbitrator in Cravens, Dargan & Co. v. General Ins. Co. of Trieste and Venice, 1996 WL 41825 (S.D.N.Y. 1996). The Insurance Commissioner declined to do so and the parties each asked the court to appoint their candidate. The reinsurer, which attempted to appoint its candidate three months late, justified its position on the basis that there was no "time is of the essence" provision in the treaty and citing certain non-insurance cases which forgave a one to three day delay on arbitrator appointment. The court ruled for the cedent:

Both cases [excusing the delay], however, are inapposite to the circumstances at bar. Neither case involved the protracted delay in the appointment of an arbitrator that occurred here, where Generali did not name an arbitrator until it filed its Cross Notice of Petition to Appoint and Arbitrator with this Court on April 17, 1995, more than six months after [the cedent] demanded arbitration.

In light of Generali's lengthy delay, the Court will enforce the arbitration clause as written. [8]

American Trust v. United Intern. Ins. Co., 1991 WL 281164 (N.D.Ill) involved an arbitration clause which allowed one party to choose both arbitrators if the other defaulted on appointment but cited no particular deadline for appointment. United demanded arbitration against three related offshore reinsurers on the same program: Old American, American Marine and American Trust. An arbitrator was named for American Trust but not for the other reinsurers. Thereafter, United selected second arbitrators for Old American and American Marine and two separate arbitrations proceeded toward hearings. When Old American and American Marine were notified on the their hearings with United, their attorney sought a continuance and consolidation with the other arbitration. United declined and the hearing resulted in a finding against Old American and American Marine. The court confirmed the award against Old American and American Marine stating:

While the arbitration provision is hardly a model of clarity, it can reasonably be read as allowing a party demanding the appointment of an arbitrator to name a second arbitrator if the opposite party fails to act. It is clear that in this case Old American and American Marine failed at any time to name a second arbitrator. Accordingly, United was entitled to do so. [9]

III. Reference to AAA Procedures in the Arbitration Clause

On occasion, arbitration clauses contain a sentence which incorporates, in some fashion, the rules of the American Arbitration Association. While well intentioned, the incorporation of such a reference can lead to unanticipated results. For instance, the rules of the AAA may be significantly different from those usually followed in reinsurance arbitrations and may contradict

the procedures specifically stated in the arbitration clause. The AAA disfavors party appointed arbitrators, prefers its own list of umpires and often wishes to act as the administrator of the proceeding, which can cause confusion with reinsurance arbitrators who are accustomed to administering proceedings on their own. The point is not that AAA procedure is any worse than that normally followed by reinsurance arbitrators. That is a matter of personal preference. The point is that AAA procedure is different and should be understood before it is incorporated into arbitration clauses. Several cases bear this out.

In RLI Ins. Co. v. Kansa Reins. Co., Ltd., 1991 WL 243425 (S.D.N.Y.), the arbitration clause contained fairly standard language: (a) a 30 day provision; (b) selection of the umpire by lot if there is no agreement; and (c) arbitrators to be active or retired officers of insurers with no financial interest in the outcome of the arbitration. At the end of the arbitration clause was the following sentence: "Except as provided above, arbitration will be based on the procedures of the American Arbitration Association." AAA Rule 16 provides that if one of the parties is domiciled outside of the United States, the umpire must come from neither country of domicile. In the instant case, the cedent, a US company nominated a slate of three US arbitrators and the reinsurer, being Finnish, declined to accept them. The court ruled that Rule 16 would apply since the remainder of the arbitration clause was silent on the issue. The court ordered the cedent to nominate three non-US candidates.

Northwestern National Ins. Co. v. Kansa General Ins. Co., Ltd., 1992 WL 367085 (S.D.N.Y.) involved an arbitration clause virtually identical to that addressed by the RLI court. Indeed, the fact situation was also virtually identical with the US cedent nominating three US umpire candidates and the Finnish reinsurer objecting based on AAA Rule 16. However, the court ruled that in this case, the reinsurer had waived Rule 16 by not raising it with 10 days as was required by AAA Rule 15.

IV. Requirement that Arbitrators be Active Officers

Some of the older arbitration clauses require that all arbitrators be active officers of insurance or reinsurance companies. The apparent purpose of such a requirement is to assure that the candidate is knowledgeable about the current marketplace. While this purpose has merit, it is very difficult to find active officers who are willing to devote the necessary time to arbitrations or incur the possible disfavor of a current or potential client. As a result, there is some litigation around the margins of this requirement which has produced some mixed case law.

In Argonaut Midwest Ins. Co. v. General Reinsurance Corp., 1998 WL 474142 (N.D.Ill), the reinsurer's party arbitrator was active when appointed but retired before an umpire was selected. When the reinsurer refused to replace him, the cedent attempted to appoint a second arbitrator. The court noted that a challenge to an arbitrator nominee based on his or her resume qualifications might present an appropriate case for court review but that nothing in the arbitration clause addressed the issue of an active officer retiring. The court ruled for the reinsurer stating:

If this court accepts [the cedent's] theory, then nullification of the proceedings would occur *any* time that an arbitrator retires, regardless of how late in the arbitration such retirement occurs in *any* arbitration requiring active employment as a senior executive at the time of nomination. . . . Such a result is contrary to the purpose of arbitration and, in the case of a complex arbitration, could conceivably force an arbitration to continue indefinitely as arbitrators retire, thus continually requiring the arbitration clause to begin anew.[10] (emphasis in the original).

The arbitration clause required that each of the three arbitrators be executive officers of insurance companies in In re Arbitration Between Northwestern Nat. Ins. Co. and Generali Mexico Compania de Seguros, S.A., 2000 WL 52638 (S.D.N.Y.). The party arbitrators appointed as the umpire a well-known insurance company executive who was then characterizing himself as a "consulting officer" to the Reliance Group. At the organizational meeting, the reinsurer's counsel questioned the umpire about his position and reserved his rights on whether the umpire fulfilled the requirements of the arbitration clause. After several adverse interim awards, the reinsurer moved to vacate on the grounds that the umpire did not possess the necessary contractual qualifications. The court found that the reinsurer failed to counter the cedent's evidence that the umpire was, in fact, a vice president of Reliance. The court also noted that the umpire was the principle officer of "[name of umpire] & Company, Insurance Consulting" and that the arbitration clause did not define what type of companies fall within the term "insurance company." Notwithstanding the reinsurer's reservation of rights at the organizational meeting, the court found that the reinsurer had accepted the umpire and raised a protest only after adverse rulings. While the court probably reached the right result, its reasoning on certain points is hard reconcile.

Arbitrator qualification issues also arose in Ins. Co. of North America v. Pennant Ins. Co., Ltd., 1998 WL 103305 (E.D.Pa.) The arbitration clause required that arbitrators be active or retired disinterested officials of insurance or reinsurance companies. The reinsurer named as its arbitrator an individual who had been an agent/broker/intermediary for 6 years before becoming a consultant. The cedent protested arguing that the reinsurer's candidate did not meet the qualifications of the arbitration clause. The court ruled that under the Federal Arbitration Act, a challenge to the qualifications of an arbitrator comes in the form of a motion to vacate an award which can be made only after the panel has rendered its decision. As the court noted in Argonaut Midwest Ins. Co, v. General Reinsurance Corp, supra., this might have been a case for a resume review by the court before incurring the time and expense of an arbitration.

V. Court Selection of the Umpire

When there is a dispute over the selection of an arbitrator or umpire, the court typically enforces the method of selection stated in the arbitration clause rather than makes the selection itself. *See e.g.* RLI Ins. Co. v. Kansa Reins. Co., Ltd.; Northwestern Nat. Ins. Co. v. Kansa General Ins. Co., Ltd. supra. Under unusual circumstances, such as where the contractual method of selecting an umpire breaks down, the court will appoint an umpire. *See* Cravens, Dargan & Co. v. General Ins. Co.. Of Trieste and Venice, supra, where an insurance commissioner was designated to select the umpire and he refused.

Another such an unusual circumstance arose in Pacific Reins. Management Corp. v. Ohio Reins. Corp., 814 F.2d 1324 (9th Cir. 1987) which was a dispute between a pool manager and the pool members. Of the 12 contracts at issue, 5 did not structure the umpire selection process and 7 called for selection by lot. The pool manager moved to compel arbitration and the district court ordered that the panel be selected in accordance with arbitration clause. Party arbitrators were selected but one wanted the umpire for all contracts to be selected by lot and the other arbitrator want the umpire for all contracts selected by negotiation.

After this dispute continued for 5 months, another motion was made to compel arbitration and the court selected an umpire. The pool manager appealed on the basis that the district court exceeded its authority. The court of appeals noted that section 5 of the Federal Arbitration Act gives the court the power to select an arbitrator when there has been a lapse in the process. The court upheld the district court's selection of an umpire stating:

It must be remembered that the statute also allows the court to appoint umpires when the parties fail to utilize the given procedures, or if there is a lapse of time, for whatever reason, in the naming of an umpire. In this case, the appellees had failed to utilize the selection procedure, because their arbitrator objected to the randomness of the lot drawing method. In addition, there was a significant lapse in the naming of the umpire because of the deadlock which existed between the parties. Thus, when the district judge stepped in and named the umpire, he was entirely within the powers granted to him by the statute. [11]

V. Conclusion

One might draw a number of conclusions about the case law summarized above. First, courts perceive an obligation under the Federal Arbitration Act to leave arbitrable disputes to the arbitrators. If judicial intervention is necessary in the panel selection process, the courts will apply, in literal fashion, the terms of the arbitration clause. If the terms are ambiguous or inapposite to the facts, the courts will often construe them in a fashion consistent with the intent of the parties to arbitrate a dispute with two arbitrators selected by each party and an umpire selected by the party arbitrators. Finally, to the extent the panel selection process breaks down, thus thwarting the intent to arbitrate, the courts will select an umpire in order facilitate the arbitration of the dispute.

Endnotes

[1]. *See* Robert M. Hall, *Partiality Among Arbitration Panelists*, VIII Mealey's Reins. Rep., No. 3 at 18 (1997) . This and other articles on arbitration may be accessed at the author's web site: robertmhall.com.

[2] . 780 F.Supp. 73 (D.Mass. 1991) at 77.

[3] . 1995 WL 23063 (N.D.Ill.) at 3.

[4] . *Id*.

[5] . 1990 WL 141442 (N.D.Ill) at 3.

[6] . 16 F.3d 125 (7th Cir. 1993) at 129.

[7] . 505 N.W.2d 147 (Wis.App.1993) at 153.

[8] . 1996 WL 41825 (S.D.N.Y.) at 2.

[9] . 1991 WL 281164 (N.D.Ill.) at 5.

[10] . 1998 WL 474142 (N.D.Ill.) at 3.

[11] . 814 F.2d 1324 (9th Cir. 1987) at 1328.