PROCEDURES FOR THE RESOLUTION OF U.S. INSURANCE AND REINSURANCE DISPUTES

By

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I. Introduction

A. Background to the Procedures

The Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes (hereinafter "Procedures") were drafted by representatives of primary insurers and reinsurers, domestic and foreign, as well as their trade associations and practicing arbitrators.[ii] These are the only procedures currently in use which were designed specifically for insurance and reinsurance arbitrations.[iii] Currently, the Procedures are incorporated by reference in at least some of the contracts of a number of major insurers (*e.g.* AIG, Fireman's Fund and The Hartford). Intermediary Guy Carpenter is suggesting that its clients consider doing the same.

B. Need for Procedures

Highly experience arbitration practitioners, both arbitrators and counsel, are aware of a number of informal but well-understood mores concerning procedural matters. For such practitioners, these Procedures may have limited benefit. However, there are many less experienced practitioners, both attorneys and arbitrators, who can benefit from the structure of the Procedures.

The target market for the Procedures are the insurance and reinsurance companies which must incorporate the Procedures into their contracts by reference or agree to their use after the fact. While there are many arbitrations ongoing, individual companies may have few disputes which reach the arbitration or litigation stage. Those setting policy for contract drafting may have little experience with the arbitration process and baulk at an alternative dispute resolution process which has no rules of evidence, no fixed procedures

and no right to appeal panel orders (although there are limited bases to vacate orders). The Procedures can assist company personnel in achieving an appropriate level of comfort with the predictability of the process.

III. Qualifications of the Panel

Reinsurance contracts generally require that arbitrators have experience as insurance or reinsurance company executives but the particular terms used to describe qualifications are variable and sometimes murky. Contracts sometimes require panelists to be "impartial" or "disinterested" without defining these terms. Sometimes, underwriters at Lloyd's are inadvertently excluded by a reference to service with insurance or reinsurance companies. Other times, a reference to "active or retired executives" calls into question the eligibility of an individual who otherwise qualifies but who has not formally "retired."

§ 6.1 - .2 of the Procedures resolve these issues by requiring the arbitrator to be "disinterested" and the umpire "neutral" and by defining these terms. Its language is crafted to avoid the Lloyd's and "retired" problems. In addition, there is an alternative that allows those who have not been officers of insurers or reinsurers to serve as arbitrators as long as they have a minimum of ten years of experience of service to the industry. The latter provision would allow very experienced members of law, accounting and actuarial firms as well as trade association officials to serve as arbitrators.

IV. Selection of the Panel

Some contracts do not anticipate a failure of cooperation in appointing an opposing party arbitrator or the umpire. For instance, some contracts to do not allow one party to appoint both party arbitrators if the opposing party declines to appoint an arbitrator within a designated period of time. This can lead to stasis or a time consuming proceeding to obtain a court order to require the recalcitrant party to proceed with the arbitration process. In addition, questions have arisen as to the proper procedure when a panelist resigns for ill-health or other reasons - need the entire panel be replaced or just the individual who resigned?

However, the primary concern with panel selection is the process of selecting the umpire. Some believe that the outcome of the dispute is determined once the umpire is selected. While this is very seldom the case, the process is sufficiently important to merit close scrutiny. Usually, both sides propose three qualified candidates, strike two of the other side's candidates and select the umpire by lot *e.g.* an odd or even digit in the Dow Jones Industrial Average for a particular day. While this process works well generally, there is concern about the ability to "game" the process by a party which proposes three weak or partisan candidates and then gets lucky in the selection by lot. When this

occurs, the result is a one-sided proceeding or one in which the umpire is over his or her head in terms of both procedure and substance. Either is both painful to experience and detrimental to the integrity of the arbitration process.

§ 6.3 - .10 of the Procedures provide a remedy for these problems. Arbitrators are appointed within a fixed time schedule. If the respondent fails to appoint its party arbitrator, the moving party may do so and the arbitrators so selected may pick an umpire. If a panelist resigns, that individual is replaced using the same procedure as for the initial appointment *i.e.* the entire panel is not reappointed.

§ 6.7 of the Procedures applies to appointment of the umpire when the party arbitrators cannot agree. Each side proposes eight individuals for a designated group to candidates (*e.g.* ARIAS - US list of certified umpires). Each side then strikes candidates from the other side's list until three are left on each side. If there is a common candidate on each list, he or she is the umpire. If there are two common candidates, the umpire is chosen by lot. If there are no common candidates, each candidate is ranked by the parties with the highest ranked candidate being appointed umpire. The theory is that number of candidates originally proposed plus the striking and ranking process will prevent a party from "gaming" the process.

V. All Neutral Panel Alternative

It is well understood that the use of party appointed arbitrators results on something less that a totally neutral panel. How much less depends largely on the attitude of the party arbitrators. A few act simply as advocates of the party by which they were appointed. Most make sure their party's position is well-articulated but in the final analysis, try to make their decisions based on the merits. Perhaps the threshold issue is whether the party arbitrator system is a contributing element to problems identified with the arbitration process *e.g.* arbitrations which are too long and expensive with too much discovery and contentiousness. Does some degree of identification with a party by party arbitrators prevent a panel from acting decisively to avoid these problems? A growing number advocate all neutral panels as a better alternative.

§ 6.3 - .6 of the all neutral alternative to the Procedures provides a process for selection of an all neutral panel. It begins with the submission by the parties of ten individual from a designed group of candidates with a strike procedure used to reduced the candidates to three on each side. If there is a common individual on each list, that person is the umpire. If there are two common individuals on each list, both are panelists, the umpire is chosen by lot, and the remaining arbitrator is chosen by lot. If there are three common individuals on each list, all are panelists and the umpire is chosen by lot. If there are no common individuals on each list, each party selects one from the other's list and the third panelist is chosen by lot with the umpire chosen by lot from the first two

panelists. It is believed that the number of candidates originally proposed plus the striking process will produce a neutral panel.

VI. Confidentiality

Very few arbitration clauses require the process to be confidential but most consider confidentiality to be an implied assumption to the arbitration process. Some oppose confidentiality for "sunshine" or precedential reasons. Others oppose confidentiality so that they can share their briefs and testimony with other similarly situated parties. Panels, almost universally, prefer a confidential proceeding but in the event of opposition from one party, may struggle with the lack of specific contractual authorization.

§ 7 of the Procedures imposes confidentiality with certain well-recognized exceptions *e.g.* retrocessionaires, judicial proceedings, independent audit and laws and regulations. These exceptions are largely reflective of the exceptions contained in the ARIAS - US recommended Confidentiality Agreement.[iii]

VII. 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. However, there is greater doubt as to what sanctions are available to a panel for failure to comply. Doubt as to available sanctions makes panels hesitant to act decisively to control the arbitration.

§ 8 of the Procedures specifically authorizes interim rulings. Sanctions for failure to comply: "shall 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 costs, including attorneys fees, associated with such abuse or failure to comply."

VIII. Organizational Meeting

Matters to be addressed at organizational meetings are well understood generally and the ARIAS - US guidelines provide a checklist and commentary thereon. § 10 of the Procedures specify the usual items to be discussed plus some which are somewhat less usual:

- revelation of the fact of ex parte communication plus identification of documents exchanged
- continuing obligation of disclosures by the panelists
- desire by the parties for a written rationale from the panel for the ruling on the merits

IX. Summary Disposition

Some arbitrators are hesitant to summarily dispose of issues because they are unfamiliar with the procedure, the bases therefore or the authority of the panel to make such a ruling prior to a full hearing on the merits. Nonetheless, it can be helpful to rule on issues when the material facts are not at issue so as to better focus the hearing on the merits and avoid unnecessary costs.

§ 13 of the Procedures specifically authorizes summary disposition. In addition, it allows ex parte summary proceedings when one side is aware of them but chooses not to participate.

X. Hearing on the Merits

§ 14 of the Procedures provides a structure for the hearing. Much of this section codifies current procedure but there are some departures.

A. Honorable Engagement

§ 14.3 provides 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. While this is traditional language, it is not contained in all contracts. Given the increasingly legal tone of arbitrations, this provision preserves a business-oriented approach to resolution of the dispute.

B. Nature of Testimony

§ 14.6 allows testimony by telephone, affidavit, transcript, videotape and by other means. However, testimony that is not subject to cross examination may be permitted by the Panel only for good cause shown. This gives the panel broad discretion to consider available evidence but that discretion is balanced the need of each party to confront adverse witnesses.

C. Proposed Orders

Panels sometimes ask counsel to provide proposed orders, usually as a means of avoiding inadvertent failure to rule on a relevant issue. The proposed orders are sometimes overstated both in terms of rhetoric and findings of fact and rulings of law. Nonetheless, § 14.9 requires counsel to provide proposed orders at the end of a hearing.

XI. Award

A. Types of Award Available

Panels routinely award consequential damages for breach of contract and interest on sums due. Less routinely, they order rescission for more outrageous

behavior. Some question the right to order attorneys' fees and costs as well as punitive damages. Panels are often unfamiliar with injunctive relief.

§ 15.3 of the Procedures grants panels the authority to grant any remedy or sanction allowed by applicable law, in the absence of a contractual provision to the contrary. This provision specifically includes monetary damages, interest, costs, attorneys' fees and equitable relief. It implicitly includes punitive damages where authorized by applicable law.

B. Reasoned Opinions

There is considerable disagreement in the arbitration community concerning the wisdom "reasoned opinions" *i.e.* final orders which contain a rationale for the result such as findings of fact and conclusions of law. Some believe that providing a rationale for an award provides fodder for efforts to vacate them. Others believe that the bases for vacation are so limited and the need for feedback so significant that reasoned opinions should be the rule rather than the exception. With tens of millions sometimes at stake, some rationale for a ruling can provide guidance with respect to other disputes and future behavior.

§ 15.4 deals with this issue by requiring the panel to provide a rationale for its ruling only if both parties agree.

C. Post Hearing Communications

Often, after a final order is handed down by the panel, 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 deliberations.

§ 15.5 is notable in that it prohibits this communication until the parties waive their rights to challenge the award or the period to challenge the award expires. The obvious intent is to restrict challenges to an award on the merits. Absent a written rationale for the panel's order, this severely restricts the ability of counsel to obtain timely feedback to evaluate their own performance and the panel's rational for its rulings.

XII. Streamlined Procedures

Some disputes are of such modest size that the costs of an arbitration pursuant to the usual procedure is prohibitive. In addition, there are some preliminary issues arbitrated (*i.e.* whether a reinsurer must pay balances before auditing or whether the cedent must allow the audit before the reinsurer is required to pay) that do not justify the time and cost involved in the standard procedures.

§ 16 of the Procedures contain streamlined procedures for such matters:

- single neutral arbitrator
- no discovery
- no evidentiary hearing - submission on briefs and documents only
- very limited time frames

XIII. Conclusion

The Procedures described herein are the first such to be designed specifically for insurance and reinsurance arbitrations. They were drafted by the major stakeholders in the process, insurers and reinsurers, domestic and foreign, their trade associations and practicing arbitrators. Too a large extent, the Procedures codify the "best practices" already in use. However, they also clarify procedure in grey areas and establish policy in some controversial ones. Perhaps most important, the Procedures provide a structure which allows the arbitration process to be more logical, more transparent and therefore more acceptable to those is means to serve.

ENDNOTES

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[i]. A copy of the Procedures as well as guidelines for their use can be obtained from website www.ArbitrationTaskForce.org. While the Reinsurance Association of America (hereinafter "RAA") staffed the process of creating the Procedures and participated in the drafting process, they are not "RAA Procedures."

[ii]. ARIAS - US offers a very useful "Practical Guide to Reinsurance Arbitration Procedures" on its website www.arias-us.org. This guide discusses procedural issues but does not provide procedures as such.

[iii]. *See* recommended forms at www.arias-us.org.