ARBITRATION RULINGS WHEN

NO SUBSTANTIVE LAW IS DESIGNATED

By

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I. Introduction

Absent a designation of substantive state law in the arbitration clause, arbitrators of reinsurance disputes commonly do not engage in a choice of law analysis or try to apply the substantive law of a particular state. Commonly, they do attempt to apply prevailing law or the "better" rulings in an effort to achieve an equitable and just resolution of the dispute. Recent caselaw supports this approach.

II. Recent Case Law

Reliance Ins. Co. of Illinois, 2007 U.S. Dist.5487 (S.D. Ind.) involved an arbitration between a commercial insured and several of its insurers with respect to pollution losses. The policies involved contained absolute pollution endorsements. Indiana was the only one of 48 states that have ruled on the issue to declare such endorsements ambiguous and, therefore, unenforceable.[1] Naturally, the insured argued that Indiana law applied.

The arbitration clause did not designate the substantive law to apply. The arbitration was conducted pursuant to the rules of the AAA and three retired judges acted as the arbitrators. In a well reasoned (and well written) opinion, the panel declined to apply Indiana law and ruled for the insurers:

> In this case, there is nothing in the arbitration provision or in any of the policies that compels the application of the substantive law of any particular jurisdiction. Nothing suggests the parties intended that a contract dispute resolvable based on a plain reading of the language of the

> contract had to be decided under substantive law. Had the parties wanted to impose substantive law on the arbitrators, they were free to do so. They did not. We agree with the Seventh Circuit's analysis: the parties' silence leaves them with the traditional approach of arbitrators, which, in the panel's collective experience, allows an arbitrator to interpret the contract without regard to substantive law.[2]
>
> The panel has already concluded that it is not required to apply the law of a particular jurisdiction to interpret the pollution exclusion, and given our interpretation of the arbitration provision, it is not necessary to undertake a choice-of-law analysis to determine which state substantive law would apply.[3]
>
> Applying universal principles of contract construction, the panel has examined the language of the pollution exclusion and determines that it plainly and unambiguously excludes the costs of government-mandated clean-up of sites contaminated by pollutants. This is a conclusion that would be reached by the courts on 47 jurisdictions.[4]

The insured challenged this ruling arguing that it was manifest disregard of the law for the panel not to apply Indiana substantive law. The district court noted that in the Seventh Circuit, the manifest disregard argument had been applied so narrowly as to equate to the "arbitrators exceeding their powers" statutory basis under the Federal Arbitration Act for a court to vacate a panel order.[5] The court rejected this argument on the basis that the panel was not required by the arbitration clause or the rules of the AAA to apply the substantive law of any state.[6]

A supporting case cited by the panel in Reliance is also instructive: Baravati v. Josephthal, Lyon & Ross, 28 F.3d 704 (7th Cir. 1994). In this case, a terminated stockbroker sought damages for defamation from his former employer. The arbitration panel granted both compensatory and punitive damages. The NASD Code of Arbitration Procedure, which governed the arbitration, was silent on the power of the panel to grant punitive damages as a remedy. The employer challenged the panel ruling arguing that it was in manifest disregard of the law and exceeded the panel's powers. The court ruled for the employee:

> It is commonplace to leave the arbitrators pretty much at large in the formulation of remedies, just as in the formulation of the principles of contract interpretation. (citations omitted) So far as appears, that is what the parties intended here. No negative inference can be drawn

> from the failure of the NASD's Code of Arbitration Procedure to say anything about the scope of the arbitrators' powers. Silence implies - - given the tradition of allowing arbitrators flexible remedial discretion - - the absence of categorical limitations. Since that is the norm, we assume that the parties would have said something in the arbitration clause had they wanted to depart from it.[7]

III. Conclusion

Case law indicates that absent a designation in the arbitration clause or the governing rules of the arbitration forum, arbitrators are not bound by the substantive law of a particular jurisdiction.

ENDNOTES

1 *See* American States Ins. Co. v. Kiger, 662 N.E.2d 891 (Ind. 1996).
2 Arbitration ruling at 4.
3 *Id.* at 8.
4. *Id.* at 6.
5. 2007 U.S. Dist. 5487 *7-8.
6. *Id.*at *9-10.
7. 28 F.3d at 710.