WAIVER OF ARBITRATION RIGHTS

By

Robert M. Hall

[*Mr. Hall is an attorney, 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

Reinsurance contracts typically contain arbitration clauses which govern the manner in which disputes between the parties will be resolved. On occasion, a party to the contract will prefer litigation and raise one of two arguments in favor a waiver of arbitration by the other party. The first argument is waiver by conduct *i.e.* that the other party has waived its right to arbitrate through actions which are inconsistent with arbitration as the exclusive remedy. This usually requires a fact intensive examination of how far the parties have traveled down the litigation path before the right to arbitrate is asserted.

The other argument is that the reinsurance contract contains language which gives the parties an option to litigate or arbitrate. The language usually takes the form of a service of suit clause which is required by state credit for reinsurance laws if the cedent wishes to take financial statement credit for the reinsurance. In essence, the reinsurer agrees to be subject to the jurisdiction of a U.S. court should reinsurance collection problems arise.

Both of these arguments must be viewed in the light of the strong federal preference for arbitration enunciated by the Supreme Court:

[A]s a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay or a like defense to arbitrability.[1]

This article will review the case law addressing these two arguments on the waiver of arbitration rights.

II. Waiver of Arbitration Rights by Conduct

A. Test for Waiver

The test for waiver has been articulated in several ways by the courts. For instance, the Eleventh Circuit has stated the test as follows:

In determining whether a party has waived its right to arbitrate, we have established a two-part test. First, we must decide if, "under the totality of the circumstances," the party "has acted inconsistently with the arbitration right," and, second, we look to see whether, by doing so, that party "has in some way prejudiced the other party" (citations omitted).[2]

While the Third Circuit agrees that prejudice to the opposing party is the "touchstone for determining whether a right to arbitration has been waived" five additional factors are to be considered:

(1) the degree to which the party seeking to compel arbitration has contested the merits of its opponent's claims; (2) whether that party has informed its adversary of the intention to seek arbitration even if it has not yet filed a motion to stay the district court proceeding; (3) the extent of the non-merits motion practice; (4) its (sic) assent to the district court's pre-trial orders; and (5) the extent to which both parties have engaged in discovery.[3]

The Tenth Circuit also has a rather complicated test for waiver:

(1) whether the party's actions are inconsistent with the right to arbitrate; (2) whether the "litigation machinery has been substantially invoked" and the parties are well into preparation of a lawsuit" before the party notified the opposing party of an intent to arbitrate; (3) whether a party either requested arbitration enforcement close to the trial date or delayed for a long period before seeking a stay of proceeding; (5) "whether important intervening steps [e.g. taking advantage of judicial discovery procedures not available in arbitration] had taken place"; and (6) whether the delay "prejudiced" the opposing party (citations omitted).[4]

However the Southern District of New York uses a much more simple formula: "Under these principles, a party's participation in the litigation does not constitute waiver of the right to compel arbitration unless prejudice to the opposing party is demonstrated."[5]

B. <u>Cases Ruling No Waiver</u>

In the Matter of the Arbitration of Mutual Reinsurance Bureau v. Great Plains Mutual Reinsurance Co., Inc., 750 F.Supp. 455 (D.Kan.1990) involved a reinsurance dispute over whether certain property losses were caused by one or two storms. The reinsurer made several payments before issuing a reservation of rights and thereafter made several payments subject to such reservation. The reinsurer then invoked arbitration and the cedent declined to participate. When the arbitration panel rendered an award for the reinsurer, the cedent sought to have the award vacated on the basis that the reinsurer waived its right to arbitrate by making partial payments on the losses. The court declined to vacate, given the limited authority to vacate under the FAA, but also noted that the reinsurer took no action which was inconsistent with the right to arbitrate.

An action by an agent against a reinsurer was involved in *Windward Agency, Inc. v. Cologne Life Reinsurance Co.*, 1997 WL 164269 (E.D.Pa.). The insurer was contractually entitled to terminate the program if the reinsurance was canceled. When this occurred, the agent brought an arbitration proceeding against the insurer and prevailed. The agent then brought an action

against the reinsurer for tortious interference and breach of the reinsurance contract. The reinsurer sought summary judgment, which was denied, and then moved for arbitration on the basis that the agent claimed to be the third party beneficiary of the reinsurance contract. The agent alleged a waiver of the right to arbitrate as a result of the summary judgment proceeding but the court ruled for the reinsurer:

In this case, the Plaintiff has not been prejudiced by the Defendant's conduct. The parties have not engage in extensive motion practice nor have they taken unfair advantage of discovery proceedings which would not have been available in arbitration. Summary judgment was sought, not on the merits of the Plaintiff's breach of contract claim, but only as to threshold issues including whether, as a matter of law, the Plaintiff has standing to sue as a third party beneficiary of the contract.[6]

In *Argonaut Ins. Co. v. Reinsurance Corp. of New York*, 1994 WL 178293 (N.D.Ill.), the treaty contained an arbitration clause but the cedent asked the reinsurer to respond in 30 days if it was amenable to litigating the dispute. The reinsurer failed to respond, the cedent filed suit, the reinsurer moved to compel arbitration and the cedent claimed that arbitration had been waived. The court did an in depth analysis of cases in which waiver had been found.[7] Noting that no motions to dismiss or summary judgment had been filed and that no discovery had occurred, the court ruled that no waiver had taken place:

In light of the relevant case law, Defendant's assertion of its right to arbitrate only two months after Plaintiff filed its Complaint and the absence of any significant pre-trail activity militates against a finding that Defendant waived its right to arbitrate.[8]

The insured impleaded the reinsurer in *China Union Lines v. American Marine Underwriters, Inc.*, 458 F.Supp. 132 (S.D.N.Y.1978). The reinsurer did not raise the issue of arbitration in its answer and moved to compel arbitration 21 months after the litigation was filed. Nonetheless, the court found no prejudice to the plaintiff and ruled that no waiver had taken place.

A dispute between the receiver of a life insurance company and its reinsurer was involved in *In Re Liquidation of Inter-American Ins. Co. of Illinois*, 707 N.E.2d 617 (App.Ct.Ill.1999). The parties litigated the issue of whether the contract involved was executory. When the reinsurer moved to compel arbitration of the remaining issues, the receiver argued that the right to arbitration had been waived. The court ruled for the reinsurer:

The liquidator and Alabama Re agree that the executory contract issue was not arbitrable. Thus, Alabama Re could only have raised it in the liquidation court. The parties also agree that, at least before the alleged waiver, there were arbitrable issues. The fact that Alabama Re litigated and lost one complete defense does not entail waiver of its right to arbitrate other clearly distinct defenses where, as here, the one defense is not arbitrable and the others are.[9]

Underwriting Members of Lloyd's of London v. United Home Life Ins. Co., 549 N.E.2d 67 (Ct.App.Ind.1990) involved arbitrable and non-arbitrable issues. The cedent sought to litigate claims for compensatory damages and for punitive damages for tortious behavior by Lloyd's. The trial court ruled that the arbitrable issues were so intertwined with the arbitrable ones that

they could not be separated and that litigation should be used to resolve the dispute. The appellate court disagreed and ordered that the arbitrable issues be arbitrated. In the course of its opinion, the court rejected the cedent's argument that Lloyd's had waived its right to arbitrate by filing an answer and counterclaim, responding to discovery demands and participating in a deposition. The court found that Lloyd's filed pleadings and complied with discovery when ordered to do so by the court but continued to assert its right to arbitrate. In addition, the deposition was to preserve the testimony of a gravely ill witness.

Non-insurance cases finding no waiver of arbitration rights under circumstances similar to those above include *Ivax Corp. v. B. Braun of America, Inc.*, 2002 WL 480099 (11th Cir.2002); *Rush v. Oppenheimer & Co.*, 779 F.2d 885 (2nd Cir.1985); *Thyssen, Inc. v. M/V Markos N*, 1999 WL 619634 (S.D.N.Y.); *Kolacek v. Gemexco Trading, Inc.*, 1991 WL 2857 (S.D.N.Y.); *Clar Productions, Ltd. v. Isram Motion Pictures Production Services*, 529 F.Supp. 381 (S.D.N.Y.1982); *American Dairy Queen Corp. and DFQ, Inc. v. Tantillo*, 536 F.Supp. 718 (M.D.La.1982).

B. Cases Ruling in Favor of a Waiver

A fewer number of cases with more extreme factual circumstances exemplify true waivers of arbitration rights. One such is *Menorah Ins. Co. Ltd. v. INX Reinsurance Corp.*, 72 F.3d 218 (1st Cir.1995). The cedent asked the reinsurer to assent to arbitration in accordance with the contract but the reinsurer declined to do so citing its precarious financial condition. The cedent obtained a default judgment in Israel and a year later attempted to enforce it in Puerto Rico, the reinsurer's domicile. At that point, the reinsurer asserted its right to arbitrate. After a thorough examination of case law on point, the court ruled that the reinsurer had waived its right to arbitrate:

Neither efficiency nor economy are served by adopting INX's arguments. The scenario here - in which a party knowingly opts out of the arbitration for which it has contracted (even if driven by looming insolvency) sits on its hands while a default judgment is entered against it after service, refuses to pay, requires an enforcement action be filed against it, and only then cries "arbitration" - undermines both the certainty and predictability which arbitration agreements were meant to foster.[10]

An exclusive agent under a canceled contract with an insurer was the plaintiff in *Caribbean Ins. Services, Inc. v. American Bankers Life Assurance Co. of Florida*, 715 F.2d 17 (1stCir.1983). The agent filed suit against the insurer and the court made an interim award of commissions and threatened sanctions for non-compliance with its orders. To avoid sanctions, the insurer entered into a stipulation with the agent for a speedy trial, for which the agent gave up its effort to obtain sanctions. Thereafter, six months after the litigation was filed and during discovery, the insurer first asserted its right to arbitrate the dispute. The court found that the insurer had waived its right to arbitration by its agreement to a speedy trial on the merits and could not rescind this waiver:

American Bankers argues that it was free to rescind its waiver of arbitration because Caribbean will not be prejudiced (citations omitted). However, Caribbean expressly bargained for a speedy

trial and gave up its claims to additional provisional remedies in exchange for such a trial. Caribbean's surrender of these remedies, with prejudice, constitutes adequate consideration under traditional contract principles to bind American Bankers to an agreement to proceed to trial.[11]

American Home Assurance Co. v. Fremont Indemnity Co., 1992 WL 135809 (S.D.N.Y.) involved litigation among numerous parties. The initial suit was filed in 1989 and a consolidation agreement was reached in 1991. A year later, certain parties asserted a right to arbitrate. The court noted the free ranging discovery which had taken place since the suits were filed and the possible prejudice resulting from the fact that such discovery might not be available in arbitration. However, the stipulation of consolidation was an implicit waiver of arbitration rights. Further, the court noted, withdrawal of these parties from the litigation could require other parties to litigate the same issues in two fora with the possibility of inconsistent results.

Non-insurance cases finding a waiver of arbitration rights are summarized in endnote 7 and are examined in *Menorah Insurance Co. Ltd. v. INX Reinsurance Corp., supra***.**

III. Service of Suit Clause as Waiver

A. Cases Ruling No Waiver

Security Life Insurance Co. of America v. Hannover Life Reassurance Co., 167 F.Supp.2d1086 ((D.Minn.2001) is one of a series of cases which harmonize the potential conflict between an arbitration clause and a service of suit clause. In essence, the service of suit clause required the reinsurer to submit to the jurisdiction of any court of competent jurisdiction in the United States should such reinsurer fail to pay any amount claimed by the cedent. When the cedent filed suit against the reinsurer, the reinsurer moved to compel arbitration. The cedent argued that the service of suit clause carved out an exception to the arbitration requirement. The court ruled for the reinsurer holding that since the treaty:

[F]alls under the protection of the FAA, any inconsistency between the arbitration and service of suit clauses should be resolved in favor of arbitration. (citation omitted) Moreover, the service of suit clause . . . can be read in "harmony" with the clause requiring the arbitration of all disputes; the service of suit clause provides a means to compel arbitration or enforcement (of) any arbitration award. (citation omitted) The fact that the service of suit clause specifies that it applies to a "failure to pay any amount claimed" does not exempt these specific claims from broad arbitration agreements.[12]

Other cases in accord with *Security Life* are *Montauk Transportation Corp. v. Steamship Mutual Underwriting Assoc.*, 79 F.3d 295 (2nd Cir. 1996); *Hart v. Orion Insurance Co.*, 453 F.2d 1358 (10th Cir.1971); *Ideal Mutual Insurance Co. v. Phoenix Greek Insurance Co.*, 1984 WL 602 (S.D.N.Y.); *NECA Insurance Ltd. v. National Union Fire Insurance Co. of* Pittsburgh, 595 F.Supp. 955 (S.D.N.Y.1984); China *Union Lines Ltd. v. American Marine Underwriters, Inc.*, 458 F.Supp. 132 (S.D.N.Y.1978); *NRMA Insurance Ltd. v. Vesta Fire Insurance Corp.*, 2000 U.S.Dist. 8435 (N.D.Ala.); *Ochsner/Sisters of Charity Health Plan, Inc. v. Certain Underwriters at Lloyd's*, 1996 WL 49515 (E.D.La.); *Underwriting Members of Lloyds v. United Home Life*

Insurance Co., 549 N.E.2d 67 (Ct.App.Ind.1990); *Old Dominion Insurance Co. v. Dependable Reinsurance Co.*, 472 So.2d 1365 (D.Ct.App.Fl.1985).

The treaty at issue in *Continental Casualty Co. v. Certain Underwriters at Lloyd's,* 1993 WL 299232 (N.D.Cal.) contained a typical service of suit clause required by credit for reinsurance laws for the cedent to obtain financial statement credit for the reinsurance. When the cedent filed suit over a claim dispute, the reinsurer made a motion to compel arbitration pursuant to the arbitration clause. When the court ruled for the reinsurer, the cedent moved for reconsideration. This case provides unusual detail in terms of the arguments made by the cedent and the reasoning behind their rejection by the court.

In its original motion, Continental argued that: (a) the plain language of the service of suit clause permits litigation; (b) the service of suit clause is more specific than the arbitration clause and as such should be given more weight than the general language of the arbitration clause; and (c) ambiguous language should be interpreted against the drafter.[13] The court rejected these arguments on the bases that they would render the arbitration a nullity and that the purpose of the service of suit clause was to enforce an arbitration award.

On reconsideration, Continental argued that the failure to pay language of the service of suit clause applied when the reinsurer failed to pay a claim and the arbitration clause applied when the reinsurer paid under a reservation of rights and then contested liability. The court also rejected this argument ruling:

Even if the court were to reconsider its decision based upon plaintiff's new interpretation of the contract, it would decline to alter its previous decision. Plaintiff's novel interpretation of the two clauses eviscerates the arbitration clause and runs contrary to common sense. According to plaintiff's version of the two clauses, the arbitration clause would come into effect when Lloyd's pays a disputed amount and then seeks reimbursement. This stands in stark contrast to the express language of the arbitration clause, which applies to all "differences and disputes" between the parties.[14]

B. Cases Ruling in Favor of a Waiver

style="font-size:12.0pt" class="Normal">Transit Casualty Co. in Receivership v. Certain Underwriters at Lloyd's class="Normal">, 963 S.W.2d 392 (Mo.Ct.App.1998) was a suit by the receiver of Transit Casualty for reinsurance recoverables. When the reinsurers removed to federal court to compel arbitration, the suit was remanded to state court for lack of jurisdiction. At the time, Missouri had a statute which superceded the Federal Arbitration Act by precluding arbitration agreements in contracts of insurance. The court found the arbitration clause and service of suit clause to be in conflict and noted that a reinsurance contract should be construed against its drafter, in that case, Lloyd's. The court ruled in favor of the receiver:

The language of the service of suit clause cannot, as the Reinsurers here assert, pertain only to the enforcement of an arbitration award. The plain language of the clause does not mention or otherwise refer to the word "arbitration," nor does it refer to Art. XXII governing arbitration. Moreover, the Reinsurers' interpretation would render the words "amounts claimed to be due"

meaningless; it would change the contract to read "amounts awarded by an arbitration panel." Such is not what the service of suit clause specifies. Rather, the clause clearly refers to a unilateral claim by Transit, not an arbitration award resolving disputed claims of both parties.[15]

See also Thiokol Corp. v. Underwriters at Lloyd's, 1997 U.S. Dist. Lexis 8264 (N.D.Utah) in which the arbitration clause called for the situs for the arbitration to be in London but the service of suit clause called for the reinsurer to submit to jurisdiction of a U.S. court. The court found the two clauses in conflict and allowed the claim to be litigated.

IV. Conclusion

Given the clear directive of the Supreme Court that all doubts are to be resolved in favor of arbitration, it is unsurprising that would be litigants face a high hurdle in their efforts to avoid arbitration. With respect to waiver by conduct, it is clear that the parties have to be in litigation for a waiver to take place since that is the point at which the parties are forced to elect their remedy. Beyond that, it appears that the general rule is that prejudice to the other party must be proven and that this can turn on a number of factors: (a) failure by the other party to timely assert arbitration rights; (b) the amount of motion practice which has taken place; (c) the length of time since the litigation began or the proximity to trial; (d) the litigation involves preliminary or non-aribitrable issues; and (e) use of discovery to obtain information which might not be available in arbitration. A strong fairness theme runs through the cases finding a waiver of arbitration rights.

Similarly, most courts have found that a service of suit clause is not a waiver of arbitration rights on the basis that the purpose of the service of suit clause is merely to help enforce the result of the arbitration. Perhaps a better reason would be that state laws create the anomaly. While the parties prefer to arbitrate their disputes, state credit for reinsurance laws require a service of suit clause for the cedent to take credit for the reinsurance on its financial statements. Thus, the intent of the parties should not be thwarted due to a regulatory requirement which is intend to preserve jurisdiction if all else fails.

ENDNOTES

---

[1] . *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 103 S.Ct. 927, 941 (1983).

[2] . *Ivax Corporation v. B. Braun of America, Inc.*, 2002 WL 480099 (11th Cir.) *4.

[3] . *Hoxworth v. Blinder*, 980 F.2d 912, 925 (3rd Cir.1992).

[4] . *Peterson v. Shearson/American Express, Inc.*, 849 F.2d 464, 467-8, (10th Cir.1988).

[5] . *Kolacek v. Gemexco Trading, Inc.*, 1991 WL 2857 *3 (S.D.N.Y.1991).

[6] . 1997 WL 164269 *4.

[7] . There was a ten month delay between the plaintiff's filing of the complaint and the defendant's motion to compel arbitration in *St. Mary's Medical Center v. Disco Alum. Products*' 969 F.2d 585 (7th Cir.1992). The defendant participated in the litigation, including filing a motion for summary judgment and used interrogatories and depositions to obtain information not necessarily available in arbitration. The court found that arbitration had been waived. Similarly in *Ohio-Sealy Mattress Mfg. Co. v. Kaplan*, 712 F.2d 270 (7th Cir. 1983) *cert. denied* 464 U.S.1001 (1983), the plaintiff offered Sealy the choice between litigation and arbitration and Sealy choose litigation by filing its answer and counterclaim and engaging in extensive pre-trial activities. The court ruled that the plaintiff could not then compel arbitration given the amount of time and money spent on extensive discovery and briefing in the litigation.

[8] . 1994 WL 178293 *4.

[9] . 707 N.E.2d 617 at 622.

[10] . 72 F.3d 218 at 223.

[11] . 715 F.2d 17 at 20.

[12] . 167 F.Supp2d at 1089-90.

[13] . This argument presumes that the reinsurer was the drafter of the treaty which is not evident from the case itself and often is not the case in reality. More often than not, the drafter is the intermediary who generally is the agent of the cedent.

[14] . 1993 WL 299232 *5.

[15] . 963 S.W.2d at 397-8.