WHEN THE OTHER SIDE WILL NOT ARBITRATE: JUDICIAL APPOINTMENT OF UMPIRES AND ARBITRATORS[(1)]

By Robert M. Hall[(2)]

Introduction

Many reinsurance contracts involving U.S. insurers contain arbitration clauses because arbitration of disputes is considered to be faster, simpler and cheaper than litigation. In addition, the use of experienced industry executives as arbitrators is thought to produce results which are more reflective of the business climate in which the dispute arises.

Regardless of whether these hypotheses are correct, a number of situations exist in which one party to the arbitration agreement uses the umpire or arbitrator appointment process as a means of interminable delay or refusal to arbitrate. This paper is designed to explain what remedies exist for the party who wishes to go forward with the arbitration.

Arbitration Clauses

The typical arbitration clause contained in most reinsurance contracts calls for each party to select an arbitrator who shall be a disinterested, current or former executive officer of an insurer or reinsurer. Once chosen, the arbitrators are to select a mutually agreed upon umpire. Some contracts provide no time limits for the appointment of the arbitrators or umpire and no methodology by which to select an umpire. The lack of procedures in choosing the umpire has led to considerable delays and disputes over umpire-selection. Such delays and disputes are not surprising, given the fact of partisan arbitrators which, some believe, make the selection of the umpire critical to the outcome of the arbitration.

Some reinsurance contracts try to remedy the umpire selection problem with a provision designed to prevent an impasse in choosing an umpire. Typically, each side proposes a number of candidates and then may strike the other side's candidates until one candidate for each side is left. If there is no agreement between the remaining candidates, an umpire is selected by lot or a similar method.

Some reinsurance contacts attempt to remedy the problem of delay by requiring the respondent to select an arbitrator within a certain time period. If one is not chosen, the petitioner can select a second arbitrator and the two so chosen can select an umpire.

There are a variety of situations in which the contractually mandated method for selection of arbitrators and umpires breaks down. Typically, this occurs when the contract in question does not contain appropriate impasse avoidance mechanisms or when a party simply refuses to go forward with the arbitration. Obviously, this undercuts the purpose of the agreement to arbitrate and puts the dispute back into a litigation context which the parties contracted to avoid.

Federal Arbitration Act

The Federal Arbitration Act, 9 U.S.C. § 1 *et seq*. (1970 and 1996 Supp.) (hereinafter "FAA"), states a strong preference for arbitration over litigation when the parties have agreed contractually to arbitrate disputes. Other than as noted below, neither the FAA nor case law interpreting the FAA make any distinction in application between insurance and non-insurance cases.

The FAA allows a district court to compel arbitration when a party fails or refuses to comply with a contractual arbitration agreement:

- A party aggrieved by the failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court . . . for an order directing that such arbitration proceed in the manner provided for in such agreement. . . . The court shall hear the parties, and . . . shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.

9 U.S.C. § 4.

Once the arbitration has commenced, the primary remedy[3] for failure to appoint an arbitrator or umpire is § 5 of the FAA. With respect to a contract that contains an agreement to arbitrate:

- [I]f no method [of selecting an umpire or arbitrator] is provided therein, or *if a method be provided and any party thereto shall fail to avail himself of such a method*, *or* if for any reason *there shall be a lapse in naming of an arbitrator or arbitrators or umpire*, or in filling a vacancy, *then* upon the application of either party to the controversy *the court shall designate and appoint an arbitrator or arbitrators or umpire*, as the case may require, who shall act under the said agreement with the same force and effect as if he or they had been specifically named therein . . . (emphasis added).

This power to appoint an arbitrator or umpire is not limited, as is § 4, to a U.S. district court.

The United States Supreme Court has given broad application to the FAA. In *Southland Corp. v. Keating*, 465 U.S. 1 (1984), the court considered a conflict between arbitration pursuant to the FAA and a state statute. The Court noted that in enacting the FAA, "Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Id*. at 10. The Court went on to rule that the FAA creates a body of federal substantive law which was applicable in both state and federal courts. *Id*. at 11.

It appears, however, that the scope of the FAA is limited by the reverse pre-emption contained in the McCarran-Ferguson Act (hereinafter "McCarran-Ferguson").[4] For example, *Stephens v. American Int'l Ins. Co.*, 66 F.3d 41 (2d Cir. 1995), dealt with the interaction between an arbitration clause in a reinsurance treaty and a provision of the Kentucky Liquidation Act that superseded that provision.[5] The *Stephens* court found that reinsurance falls within the definition of the "business of insurance" for McCarran-Ferguson purposes and then examined whether the Kentucky statute was enacted for the purpose of regulating insurance. The court concluded that it was so intended:

- The Liquidation Act "protects" policyholders - whether they are individual policyholders or ceding insurance companies - by assuring that an insolvent insurer will be liquidated in an orderly and predictable manner and the anti-arbitration provision is simply one price of that mechanism.

Id. at 45. Thus, state anti-arbitration laws[6] regulating the business of insurance appear to be the only material limitation on the power to enforce arbitration clauses in reinsurance contracts pursuant to the FAA.

Waiver of Arbitration Rights

The threshold question for the party seeking a prompt resolution of the dispute is whether to litigate or arbitrate. If both parties prefer to litigate, notwithstanding the arbitration clause, there is no impediment in the FAA to litigation under these circumstances. Litigation is also possible if one party has waived its rights to arbitrate by actions contrary to the arbitration agreement. *See, e.g.*, *Nortuna Shipping Co. v. Isbrandtsen Co.*, 231 F.2d 528 (2d Cir. 1956) (waiver of right to arbitrate established by commencing suit in court, answering on merits, setting forth counterclaim or stipulating for some other mode of settlement); *see also Caribbean Ins. Services, Inc., v. American Bankers Life Assur. Co.*, 715 F.2d 17 (1st Cir. 1983). If such a waiver has taken place, the party seeking a prompt resolution may choose to litigate or arbitrate the dispute.

In *Galt v. Libbey-Owens-Ford Glass Co.*, 376 F.2d 711 (7th Cir. 1967), the petitioner demanded arbitration, and a panel was selected to hear the dispute. Thereafter, the respondent sought an injunction to halt the arbitration proceedings due to related litigation. The court ordered that the arbitration go forward but observed: "[the respondent's] motion to enjoin the arbitration proceedings was a repudiation of its own promise to arbitrate, giving [the petitioner] an election to put an end to the arbitration clause or to insist upon its performance." *Id*. at 714.

Appointment When One Party Refuses to Participate

In a non-reinsurance decision, two parties had agreed on arbitration by an accounting firm to be mutually agreed upon. When a dispute arose, one party simply refused to cooperate in selecting an arbitrator. The court appointed an accounting firm to serve as arbitrator. *See CAE Industries Ltd. v. Aerospace Holdings Co.*, 741 F. Supp. 388 (S.D.N.Y. 1989); *see also In re Neptune Maritime, Ltd. v. H&J Isbrandtsen, Ltd.*, 559 F. Supp. 531 (S.D.N.Y. 1983).

In another non-reinsurance decision, *Schulze & Burch Biscuit Co. v. Tree Top, Inc.*, 831 F.2d 709 (7th Cir. 1987), the contract merely provided that "all disputes under this transaction shall be arbitrated in the usual manner." The court found that this language was not too vague to be enforced and appointed an arbitrator pursuant to the FAA.

Appointment to Resolve an Impasse

The arbitration of multiple reinsurance contracts was considered in *Pacific Reins Mgmt. Corp. v. Ohio Reins. Corp.*, 814 F.2d 1324 (9th Cir. 1987). Some contracts contained a provision for selecting the umpire by drawing lots while others did not. After a five month impasse over selection of the umpire, the district court appointed one. The court of appeal ruled that the impasse was a lapse in the appointment of an umpire which allowed the district court to appoint an umpire pursuant to § 5 of the FAA.

The court found that a similar lapse occurred in *Astra Footwear Indus. v. Harwyn Int'l, Inc.*, 442 F. Supp. 907 (S.D.N.Y. 1978), *aff'd*, 578 F.2d 1366 (2d Cir. 1978). In this non-reinsurance case, the entity named to act as arbitrator had ceased to act in that capacity. The court appointed another arbitrator.

In a reinsurance decision, *In re Employers Ins. of Wausau v. Jackson*, 505 N.W.2d 147 (Wis. Ct. App. 1993), *aff'd*, 527 N.W.2d 681 (Wis. 1995), the reinsurance contract contained a provision allowing the petitioner to appoint a second arbitrator if the respondent did not do so in thirty (30) days. The reinsurer was sixteen (16) days late in appointing its arbitrator and the cedent appointed a second arbitrator. The reinsurer refused to recognize the umpire selected by the cedent's two arbitrators and a two year impasse developed. The appellate court found that the lower court was within its discretion to appoint the second arbitrator selected by the cedent and the umpire selected the two arbitrators who were appointed by the cedent. Similarly, in *Universal Reins. Corp. v. Allstate Ins. Co.*, 16 F.3d 125 (7th Cir. 1994), the court affirmed the appointment of a second arbitrator by the petitioner when the respondent's choice was five (5) days late due to a secretarial error.

Conclusion

While the case law is still evolving, there appears to be strong precedent under the FAA for a state or federal court to appoint an umpire or arbitrator when: (1) one party refuses to appoint an arbitrator or cooperate in the selection of an umpire; or (2) the parties reach an impasse in the selection of an umpire. This serves to increase the effectiveness of arbitration as a faster and less costly alternative to litigation.

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ENDNOTES

1. An earlier version of this article was published by Mealy's Reinsurance Reports.

2. Mr. Hall practices insurance and reinsurance law, and is active in both arbitrations and mediations. The views expressed in this article do not represent the opinions of Mr. Hall's clients. Copyright 1996 Robert M. Hall. Comments and questions can be addressed to *robertmhall@erols.com*.

3. One other remedy is § 3 of the Uniform Arbitration Act which has been adopted in a variety of states. This provides:

> - If the arbitration agreement provides a method of appointment of arbitrators, this method shall be followed. In the absence thereof, or if the agreed upon method fails or for any reason cannot be followed, or when an arbitrator appointed fails or is unable to extend his succession has not been duly appointed, *the court on application of a party shall appoint one or more arbitrators*. An arbitrator so appointed has all the powers for one specifically named in the agreement (emphasis added).

Unfortunately, there is very little case law applying this provision. *See In re Cres Rivera Concrete Co.*, 21 B.R. 153 (Bankr. D.N.M. 1982) in which a bankruptcy court appointed an arbitrator pursuant to New Mexico's version of the Uniform Arbitration Act.

4. "[N]o Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any state for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." 15 U.S.C. § 1012(b) (1976 and 1996 Supp.).

5. Ky. Rev. Stat. Ann. § 304.33.010(b) provided:

If there is a delinquency proceeding under this subtitle, the provisions of this subtitle shall govern those proceedings, and all conflicting contractual provisions contained in any contract between the insurer which is subject to the delinquency proceeding and any third party, including, but not limited to, the choice of law or arbitration provisions, shall be deemed subordinated to the terms of this subtitle.

Since the *Stephens* decision, this statute was repealed.

6. In addition to the Kentucky statute cited in note 3 above, *see* Wis. Stat. Ann. § 645.59.

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