

## WHICH REINSURANCE DISPUTES ARE COVERED

### BY ARBITRATION CLAUSES?

By

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#### **Introduction**

While arbitration clauses are often considered standard or “boilerplate” provisions in reinsurance contracts, there are many variations used in the marketplace. For instance, the Contract Wording Reference Book compiled by the Brokers & Reinsurers Market Association contains eighteen different arbitration clauses. The variety in scope of the many arbitration clauses used in the industry may produce unexpected gaps in the types of disputes which are subject to arbitration. The purpose of this article is explore reinsurance case law in disputes between solvent companies<sup>[1]</sup> to determine the arbitrability of specific disputes under specific contractual language.

#### **Presumption in Favor of Arbitration**

The Federal Arbitration Act<sup>[2]</sup> (“FAA”) evinces a strong policy position in favor of arbitrations. For instance, the Seventh Circuit observed in *Houston General Ins. Co. v. Realex Group*,<sup>[3]</sup> that the FAA:

[E]stablishes a strong national policy favoring arbitration whenever the parties opt for that method of dispute resolution. . . . The Supreme Court has directed that all doubts about arbitrability of a given dispute are to be construed in favor of arbitration [citation omitted]. . . . We have consistently adhered to that position, insisting that arbitration should not be denied “unless it can be said with positive assurance that an arbitration clause is not susceptible of an interpretation which would cover the dispute at issue . . . .”[citation omitted].<sup>[4]</sup>

Notwithstanding this policy, a number of reinsurance disputes have been found to be outside the scope of arbitration clauses.

## Non-Arbitrable Disputes

Arbitrability of alleged violations of the Racketeer Influenced and Corrupt Organizations (“RICO”) Act was the issue in *Washburn v. Societe Commercial de Reassurance*.<sup>[5]</sup> The arbitration clause stated: “Should any difference of opinion arise between the Reinsurer and [Reserve] which cannot be resolved in the normal course of business with respect to the interpretation of this Agreement or the performance of the respective obligations of the parties under this Agreement, the difference shall be submitted . . . .” The receiver of Reserve, who opposed arbitration, alleged a broad conspiracy by which the Reserve ceded profitable business to the reinsurer which retroceded it to an affiliate of Reserve. The affiliate then paid the premiums to a corporation owned by the officers and directors of Reserve which paid the premiums to the officers and directors as dividends and loans.

The *Washburn* court ruled that the alleged RICO violations were not arbitrable:

The litigation does not involve a controversy arising under the [reinsurance] agreement itself, but rather a conspiracy in which the conspirators used the reinsurance agreement, a retrocession agreement, a guaranty agreement and several other devices involving [many parties], to drive Reserve further into insolvency . . . . In short, the central allegation of this litigation does not involve an issue “with respect to the interpretation of this Agreement or the performance of the respective obligations of the parties under this Agreement” as the arbitration agreement requires.<sup>[6]</sup>

*First National Life Ins. Co. v. California Pacific Life Ins. Co.*,<sup>[7]</sup> involved a transfer of a book of business pursuant to an assumption and reinsurance agreement which required “arbitration of all disputes arising out of the coverage under these transferred policies.”<sup>[8]</sup> The court found that the dispute was not arbitrable since the party seeking arbitration did not demonstrate that the policy in question was a transferred policy.

The arbitration clause in *Phoenix Mutual Life Ins. Co. v. North American Co. for Life and Heath Ins.*<sup>[9]</sup> stated that “[a]ll disputes and differences upon which an amicable understanding cannot be reached are to be decided by arbitration.”<sup>[10]</sup> The issue was whether one of the law firms involved in the controversy was disqualified from representing a party due to a conflict of interest. The court found that this dispute was not contemplated by the arbitration clause: “Not all ‘disputes’ and ‘differences’ in the world can fairly be viewed as arbitrable because of the treaties’ mandate, but only those relating to the parties’ duties to each other under the reinsurance treaties themselves.”<sup>[11]</sup> The court confirmed this through other language in the arbitration clause that has no relation to a conflict of interest by counsel *e.g.* interpretation based on custom and practice of the industry and executive officers of life insurance companies as arbitrators.

*Application of General Security Assur. Corp. of N.Y.*,<sup>[12]</sup> involved a reinsurance contract with an arbitration clause which stated: “Should an irreconcilable difference of opinion arise as to the interpretation of this agreement, it is hereby mutually agreed that such difference shall be submitted to arbitration.”<sup>[13]</sup> The issue was performance by the cedent of its contractual

obligation to properly investigate claims and report them to the reinsurer. Taking a very literal view of the arbitration clause language, the court ruled that the dispute was not arbitrable: “The controversy here related deals only with the subject of performance or non-performance of the agreement and not the interpretation of the language of the agreement.”<sup>[14]</sup>

### **Mixed Results**

A case producing mixed results on the arbitrability question is *Mutual Benefit Life Ins. Co. v. Zimmerman*.<sup>[15]</sup> This is factually complicated case involving the consolidation of four actions and multiple parties, some of which were parties to a reinsurance pool management agreement (“Management Agreement”). The Management Agreement contained an arbitration clause stating that “any dispute or difference hereafter arising with reference to the interpretation, application or other effect of this Agreement or any part hereof, . . . shall be referred to a Board of Arbitration. . . .”<sup>[16]</sup>

Initially, the *Mutual Benefit* court found the arbitration clause to be a narrow one since it does not apply to any dispute but only those which arise under the Management Agreement.<sup>[17]</sup> Second, the court found that alleged RICO violations were not within the arbitration clause but rather involved a complex scheme of which the Management Agreement was a peripheral part. Next, the court ruled that fraud and conspiracy claims against certain defendants were not arbitrable since these defendants were not signatories to the Management Agreement.

Nonetheless, the court found that a charge of breach of common law fiduciary duties against the principal of the pool manager was arbitrable: “Although the Management Agreement does not identify Zimmerman’s fiduciary duties as managing agent of the 1988 Pool, without the Management Agreement Zimmerman would not have a fiduciary relationship. . . . [T]he allegations have reference to the interpretation, application or effect of [the Management Agreement].”<sup>[18]</sup> However, a charge of tortious interference with fiduciary duties was not arbitrable since this charge focused on individuals who were not parties to the Management Agreement.

The *Mutual Benefit* court found non-arbitrable a series of breach of contract and breach of duty of fair dealing and good faith claims as being based on a separate contract without an arbitration clause. The court rejected the argument that defenses related to the Management Agreement were sufficient to encompass these claims noting that the arbitration clause applies to causes of action under the Management Agreement, not defenses. Finally, the court rejected the arbitrability of certain counterclaims by defendants who were not parties to the Management Agreement and which did not involve interpretation or performance of such agreement.

The court in *Universal Marine Ins. Co. v. Beacon Ins. Co.*<sup>[19]</sup> addressed a dispute involving two arbitration clauses, one of which provided for arbitration “[i]n the event of any irreconcilable dispute between the Company and the Reinsurer in connection with the Agreement.” The other stated that “[s]hould an irreconcilable difference of opinion or dispute arise between the parties to this Agreement as to the interpretation of this Agreement, or

transactions with respect to this agreement, such difference or dispute” shall be submitted to arbitration.<sup>[20]</sup> The court held the arbitration clauses sufficiently broad to cover fraud in the inducement to contract generally but that RICO claims are not arbitrable. As to the argument that this holding would result in piecemeal litigation, the court replied: “It is correct that arbitration will result in piecemeal adjudication of the litigation, as all of the claims are not arbitrable. That untoward result, however, is the result of the parties’ agreement to arbitrate.”<sup>[21]</sup>

### **Arbitrable Disputes**

*Life of America Ins. Co. v. Aetna Life Ins. Co.*<sup>[22]</sup> involved an arbitration clause which stated: “[I]n the event that any dispute arises by the parties hereto as to the rights or liabilities incident to this Agreement, the same shall be settled by arbitration . . . .”<sup>[23]</sup> The reinsurer sought to avoid arbitration on the basis that an arbitration panel was unable to grant treble damages pursuant to the Texas Deceptive Trade Practices Act. The court ruled that the dispute was arbitrable stating:

Were we to deny arbitration on the assumption that an arbitrator was unable to award treble damages, we would be deciding prematurely the propriety of Texas treble damages and their availability in this arbitration. We refuse at this juncture to predict whether actual damages should be awarded in this case. Furthermore, we expressly pretermitt any ruling on the propriety of awarding treble damages in this arbitration.<sup>[24]</sup>

Whether the reinsurance agreement had terminated prior to the loss was the issue in *Houston General Ins. Co. v. Realex Group, N.V.*<sup>[25]</sup> The arbitration clause required arbitration “if any dispute shall arise between the Company and the Underwriter(s) with reference to the interpretation of this Agreement or their rights with respect to any transaction involved, . . . .”<sup>[26]</sup> The court ruled in favor of arbitration stating: “The disagreement is whether, under the terms and the operative facts, [the reinsurance] agreement has run its course and expired. That is an arbitrable issue.”<sup>[27]</sup>

The arbitration clause in *Schacht v. Beacon Ins. Co.*<sup>[28]</sup> required arbitration “[s]hould any difference of opinion arise between the Reinsurer and the Company which cannot be resolved in the normal course of business with respect to the interpretation of this Agreement or the performance of the respective obligations of the parties under this Agreement . . . .”<sup>[29]</sup> The reinsurer alleged that the cedent agreed to pay certain premium as a condition precedent to coverage and that it was fraudulently induced to enter the reinsurance contract. The court stated that it was for a court to decide if a party was fraudulently induced to enter into the arbitration clause itself, but in this case the allegation ran to the entire contract and, thus, was arbitrable. The court likewise rejected the claim that the arbitration clause was not sufficiently broad to cover enforceability of the contract. Finally, the court rejected the argument that the payment of premium as a condition precedent was not “in the normal course of business” under the arbitration clause.

*NECA v. National Union Fire Ins. Co.*<sup>[30]</sup> involved an arbitration clause which stated that “[a]ll disputes or differences arising out of the interpretation of this Agreement shall be submitted to” arbitration.<sup>[31]</sup> The reinsurer sought: (1) to recover against the cedent for negligence, bad faith and breach of contract in not settling and ultimately paying a claim pursuant to a judgement; (2) to avoid paying a fine based on delayed claim payment; (3) to recover sums drawn down on a letter of credit; and (4) to recover for breach of duty in attempting to establish a competing reinsurance program. The court found that all of these claims were encompassed within the arbitration clause since the reinsurance agreement had to be interpreted in order to determine the viability of the reinsurer’s allegations.

The arbitration clause in *Ohio Reinsurance Corp. v. British National Ins. Co.*<sup>[32]</sup> called for arbitration “[i]n the event of any dispute at any time arising out of or in any way connected with or relating to the Agreement.”<sup>[33]</sup> The American cedent sought to reform the reinsurance contract concerning the amount of casualty business to be ceded. The reinsurer resisted arbitration since the contract was governed by English law which did not allow arbitrators to reform contracts. The court ruled the dispute arbitrable since the FAA requires courts to enforce agreements to arbitrate.

In *Schacht v. Hartford Ins. Co.*<sup>[34]</sup> arbitration was required for “any dispute arising out of this contract.”<sup>[35]</sup> A reinsurer charged that other members of the pool and their parent, Hartford, fraudulently concealed and misrepresented material facts about the transaction and committed RICO violations. In an earlier decision, the court compelled arbitration and the reinsurer moved for reconsideration on the basis that Hartford was not a party to the contract. The court confirmed its earlier ruling stating that arbitration can be compelled with respect to a non-signatory when the non-signatory is the parent of the signatory, the claims against the parent and subsidiaries are identical and the dispute is otherwise arbitrable.

Claims of fraudulent inducement and lack of timely reporting were involved in *St. Paul Fire & Marine Ins. Co. v. Employers Reinsurance Corp.*<sup>[36]</sup> The reinsurance contract required that “any dispute arising out of this Agreement shall be submitted to the decision of a board of arbitration . . . .”<sup>[37]</sup> The cedent conceded that the lack of timely notice allegation was arbitrable but contended that fraudulent inducement did not arise out of the reinsurance contract. The court found that the arbitration clause did cover fraudulent inducement as long as the inducement applied to the contract as a whole, rather than to the arbitration clause in particular.

*Certain Underwriters at Lloyd’s London v. Colonial Penn Ins. Co.*<sup>[38]</sup> was a motion to compel arbitration by the primary company against a retrocessionaire. Colonial Penn ceded to Mutual Fire, Marine which retroceded to Certain Underwriters. Mutual Fire, Marine assigned its rights under the retrocessional agreement to Colonial Penn which sought arbitration under a clause of the retrocessional agreement which called for arbitration “if any dispute shall arise between the parties to this agreement, either before or after its termination, with reference to the interpretation of this agreement or the rights of either party with respect to any transactions under this agreement . . . .”<sup>[39]</sup> The court compelled arbitration rejecting the retrocessionaires’ arguments that Colonial Penn was not a party to the retrocessional agreement and that the assignment of rights by Mutual Fire, Marine did not encompass the right to arbitrate with the retrocessionaires.

Thirty four reinsurance treaties were involved in *Meadows Indemnity Co. Ltd. v. Baccala & Shoop Ins. Ser.*<sup>[40]</sup> Thirty-two of the contracts stated that “any dispute arising out of this contract shall be submitted to the decision of a board of arbitration . . .” and the remainder provided that “[i]f any dispute shall arise between the reinsured and the reinsurer, . . . with reference to the interpretation of this contract, or the rights of either party with respect to any transactions under this contract, the dispute shall be referred . . .”<sup>[41]</sup> A reinsurer made various allegations against the members of a reinsurance pool and its manager and took the position that certain of its allegations (fraud, RICO and civil conspiracy) were not within the scope of the arbitration clause. Furthermore, the reinsurer argued that fraud was not arbitrable under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (“Convention”) since fraud was not arbitrable in Guernsey, the reinsurer’s domicile. The court ruled that fraud claims were arbitrable under the Convention which used an international standard for arbitrability of issues rather than the standard of one signatory. In any case, any ruling on the fraud claim would be enforced in the United States where the cedents were located. Noting that any ambiguity in the language of the arbitration clause should be resolved in favor of arbitration, the court ruled that the reinsurer’s claims were encompassed by the arbitration clauses.

Reinsurance coverage for a malicious prosecution suit against the cedent was the issue in *Security Mutual Cas. Co. v. Harbor Ins. Co.*<sup>[42]</sup> The reinsurer contended that the cause of action arose after the reinsurance terminated. The reinsurance contract provided: “In the event of any dispute between the Company and the Reinsurer in connection with this Agreement, such dispute shall be submitted to arbitration.”<sup>[43]</sup> The court held the dispute arbitrable:

Simply stated, the argument is that the arbitration clause cannot exceed the scope of the reinsurance agreement, and before it can be determined whether the dispute was arbitrable, it must be determined whether the agreement was in force and effect when [the claimant’s] cause of action arose. We do not agree. Acceptance of [the reinsurer’s] contention would require resolution of the merits of the cause prior to reaching the threshold question and the sole question presented by this appeal [is] whether under the agreement between the parties the dispute was subject to arbitration. Whether [the cedent’s] claim is meritorious is not the issue; if under the language of the agreement the claim is arbitrable, it is arbitrable whether valid or invalid.<sup>[44]</sup>

The cedent had purchased excess of loss reinsurance with a retention of \$50,000 in *Nationwide General Ins. Co. v. Investors Ins. Co.*<sup>[45]</sup> The cedent resisted paying a liability claim on a policy with limits of \$50,000 and was required to pay its limits plus a judgement in excess of policy limits. The reinsurer argued that the dispute was not arbitrable since the reinsurance contract only covered policies with limits in excess of \$50,000. The reinsurance contract provided: “In case of any question or dispute between the Company on the one hand and the Reinsurer on the other touching the construction, meaning or effect of this Agreement or any article therein contained or any fact or matter connected with the carrying out of these presents or the rights or the liabilities of either or the said parties hereto, the same shall be submitted . . .”<sup>[46]</sup>

The court held that “[t]his is a dispute ‘touching the construction meaning or effect of the agreement’ and the courts may not stay arbitration by deciding the merits of whether or not the claim is tenable.”<sup>[47]</sup> The court went on to explain its role in the inquiry:

Once it appears that there is, or is not a reasonable relationship between the subject matter of the dispute and the general subject matter of the underlying contract, the court’s inquiry is ended. Penetrating definitive analysis of the scope of the agreement must be left to the arbitrators whenever the parties have broadly agreed that any dispute involving the interpretation and meaning of the agreement should be submitted to arbitration [citation omitted].<sup>[48]</sup>

*Cologne Reinsurance Co. v. Southern Underwriters, Inc.*<sup>[49]</sup> was a suit by a reinsurer for rescission based fraudulent inducement in the form of misrepresentations with respect to geographic concentration of risk in an area devastated by hurricane Andrew. The reinsurance contract stated that “any dispute arising out of or related to the interpretation of this Agreement or the rights of either party with respect to any transaction involved, . . . shall be submitted . . .”<sup>[50]</sup> The court ruled that the language of the arbitration clause was sufficiently broad to cover allegations of fraudulent inducement to enter the contract itself. The court dismissed as conclusory and insufficient the reinsurer’s arguments that the cedent’s actions were part of a grand scheme which was beyond the scope of arbitration clause.

## **Conclusion**

The FAA created a presumption in favor of arbitration for disputes arising out of contracts in which the parties chose to insert an arbitration clause. Notwithstanding a few aberrations, case law applying the FAA to reinsurance contracts, generally, has compelled arbitration for those disputes reasonably within the scope of arbitration clauses. This case law suggests that for the garden variety disputes between cedent and reinsurer, the following description of the scope of the clause is sufficient: **Any dispute between the Company and the Reinsurer relating to the negotiation, interpretation or performance of this Agreement, including but not limited to its terms and conditions, shall be submitted to arbitration, regardless of when such dispute arises.**

Disputes which are not of the garden variety type are more difficult to address with standard clauses. Case law suggests that problems with the scope of an arbitration clause arise most often when there are multiple parties to the transactions (*i.e.* pool managers, managing agents and their sub-agents and intermediaries) who may be dominant players but who are not signatories to the reinsurance contract and, therefore, are not subject to the arbitration clause. Making these additional entities parties to the reinsurance contract is inherently troublesome both from a technical and a substantive standpoint. In an appropriate situation, however, an insurer should consider: (1) entering into agreements to arbitrate disputes with these additional entities; and (2) having the option to consolidate such an arbitration with the arbitration between the cedent and the reinsurer. This would provide an expert forum for a consolidated and more efficient adjudication of the entire dispute.

## Endnotes

- [1]. When one of the parties to the reinsurance contract is insolvent, arbitrability is often complicated by issues of jurisdiction of the receivership court, abstention and the McCarran-Ferguson Act which are beyond the scope of this article. As a result, this article will include arbitration cases involving an insurer in receivership only to the extent they do not involve these complicating factors.
- [2]. 9 U.S.C. sections 1 - 14.
- [3]. 776 F.2d 514 (7<sup>th</sup> Cir.1985).
- [4]. *Id.* at 516.
- [5]. 831 F.2d 149 (7<sup>th</sup> Cir.1987).
- [6]. *Id.* at 151.
- [7]. 876 F.2d 1345 (11<sup>th</sup> Cir.1989).
- [8]. *Id.* at 878.
- [9]. 661 F.Supp. 751 (N.D.Ill.1987)
- [10]. *Id.* at 752.
- [11]. *Id.* at 753.
12. 179 N.Y.S.2d 124 (S.C.Spec.Term 1958).
- [13]. *Id.* at 125.
- [14]. *Id.* at 126.
- [15]. 783 F.Supp. 853 (D.N.J.1992).
- [16]. *Id.* at 858.
- [17]. *Id.* at 872.
- [18]. *Id.* at 873.

[19]. 588 F.Supp. 735 (W.D.N.C.1984).

[20]. *Id.* at 737 - 8.

[21]. *Id.* at 738.

[22]. 744 F.2d 409.

[23]. *Id.* at 410.

[24]. *Id.* at 412.

[25]. 776 F.2d 514 (5<sup>th</sup>Cir.1985).

[26]. *Id.* at 515.

[27]. *Id.* at 516.

[28]. 742 F2d 386 (7<sup>th</sup>Cir.1984).

[29]. *Id.* at 388.

[30]. 595 F.Supp. 955 (S.D.N.Y.1984).

[31]. *Id.* at 957.

[32]. 587 F.Supp 710 (S.D.N.Y. 1984).

[33]. *Id.* at 711.

[34]. 1991 WL 247644 (N.D.Ill.).

[35]. *Id.* at \*1.

[36]. 919 F.Supp. 133 (S.D.N.Y.1996).

[37]. *Id.* at 134.

[38]. 1997 WL 316459 (S.D.N.Y.).

[39]. *Id.* at \*2.

[40]. 760 F.Supp. 1036 (E.D.N.Y.1991).

[41]. *Id.* at 1039.

[42]. 397 N.E.2d 839 (Ill.1979).

[43]. *Id.* at 841.

[44]. *Id.*

[45]. 332 N.E.333 (N.Y.1975).

[46]. *Id.* at 334.

[47]. *Id.* at 336.

[48]. *Id.* at 335.

[49]. 630 N.Y.S.2d 548 (S.C.App.Div.1995).

[50]. *Id.* at 549.