Vacating the Orders of Arbitration Panels – Did the Arbitrators Exceed Their Powers?

By

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I. Introduction

One of the few bases upon which the order of an arbitration panel may be vacated is "where the arbitrators exceeded their powers . . . ." under § 10 (a) (4) of the Federal Arbitration Act. Citing a variety of prior case law, one court interpreted this to mean:

> Arbitration is a creature of contract, and an arbitration panel has the authority to decide only the issues that have been submitted for arbitration by the parties. If arbitrators rule on issues not presented to them by the parties, they have exceeded their authority and the award must be vacated. While an arbitrator has broad power to fashion remedies on issues the parties have empowered him to resolve, he lacks the authority to decide questions the parties have not agreed to submit to him.[1]

But what types of orders run afoul of this rule? The purpose of this article is to provide practical examples of orders that were and were not vacated as exceeding the power of the arbitrators.

II. Arbitration Orders Vacated as Exceeding the Authority of Arbitrators

A. Failure to Apply a Treaty Exclusion

The reinsurer sought to vacate panel orders on a number of bases in *Amerisure Mut. Ins Co. v. Everest Reinsurance Co.*, 109 F.Supp. 3d 969 (E.D.Mich. 2015). One such basis was that the arbitration panel failed to apply a treaty exclusion for asbestos exposures known to the cedent. The record showed that the panel was made aware that the insured had asbestos exposure and

the cedent may very well have been aware of it. But the panel found that there were no asbestos-related claims so that the "encapsulated asbestos gaskets used did not constitute a known exposure."[2]

The *Amerisure* court vacated the related order stating:

> But the relevant question under the Asbestos Exclusion has nothing to do with [the cedent's] subjective "underwriting judgment." The question is whether [the cedent} objectively knew about [the insured's] asbestos exposures. The Panel did not answer the question. Instead, it replaced the contractually mandated inquiry into [the cedent's] knowledge of the exposure with its own inquiry into [the cedent's] subjective assessment about the extent of the exposure. Even under the deferential review mandated by the FAA, such a wholesale departure from the plain language of the contract cannot stand.[3]

B. Going Beyond Issues Submitted to Panel and Ignoring the Contract

The issues for the panel in *PMA Capital Ins. Co. v. Platinum Underwriters Berm. LTD.,* 659 F. Supp. 2d 631 (E.D. Pa. 2009) were the amount of a deficit carry forward and the ability to carry it forward into the 2003 year of account. Apparently realizing that essentially the same dispute could replicate itself in future years as the business ran off, the panel set a value for the deficit for years prior to 2003, allowed that to be offset and then deleted the carry forward provision for future years. The panel's decision was "unreasoned" so the court probably did not understand that the panel was trying to bring finality to the dispute. The court vacated the panel's order on the bases that the panel could not ignore the relevant contract by effectively eliminating the deficit carry forward provision and was never asked to make such a ruling.

C. Wrong Arbitrator, Wrong Arbitration Forum

PoolRe Ins. Corp. v. Organizational Strategies, Inc., 783 F.3d 256 (5th Cir. 2105) involved two contracts with arbitration clauses. One contract was between a captive manager and the owner of a captive insurer and the other was between the captive insurer and a reinsurer. When disputes arose, an arbitrator was selected pursuant to the contact between the captive manager and the owner of the captive that called for a particular arbitration forum. However, the contact between the insurer and the reinsurer called for a different arbitrator appointment procedure and a different arbitration forum. All the disputes proceeded to an arbitration hearing using the arbitrator and arbitration forum in the captive manager – captive owner contract.

When the motions to vacate were filed, the *PoolRe* court granted them. The court ruled that the arbitrator selection process is a material part of the reinsurance contract between the captive insurer and reinsurer and failure to comply therewith caused the arbitrator in the captive manager – captive owner dispute to exceed his authority under the reinsurance contact. Similarly, the court found, the forum selection clause was integral to the reinsurance contract and violation of this clause was a proper basis to vacate the award.

D. Failure to Disband After Issues Decided

In *KX Reinsurance Company v. General Reinsurance Corp.,* 2008 U.S. Dist. LEXIS 92717 (S.D. N.Y), the panel decided all issues put before it but declined to disband in order to address any further issues which might arise among the parties in the future. The court ruled that such a declination exceeded the authority of the panel:

> Such an open-ended submission would effectively allow the Panel unlimited authority and the power to exist indefinitely, thereby conferring upon it an unintended judicial character and obviating its clear function as an alternative to judicial proceedings. It would also deprive [the reinsurer] of its implicit right under the Treaties to choose the arbitrators and umpires it deems most suitable to resolve the specific issues in contention.[4]

E. Certain Fines and Penalties

The reinsurer failed to comply with a panel order of security in *Certain Underwriters at Lloyd's London v. Argonaut Ins. Co.*, 264 F.Supp 2d 926 (N.D. Cal. 2003) and the panel ordered a fine of $10,000 per day during non-compliance. The court acknowledged the authority of a panel to impose sanctions but ruled that this order exceeded the panel's authority:

> [Th]e imposition of a fine of $10,000 per day for each day of non-compliance with Interim Order No. 3 is akin to a civil contempt issued by the court. . . . [C]ontempt power derives from a statutory grant of authority. . . . Nothing in the explicit language of the FAA authorizes such inherent power upon arbitrators.
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> . . . .
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> There is no clear grant of authority to impose mounting punitive sanctions equivalent to civil contempt in the Treaty herein even though the panel's grant of authority is generally broad. . . .
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> . . . .

> In addition, the amount of the daily sanction imposed - - $10,000 per day - - does not relate to any provision in the Treaty. [5]

III. Arbitration Orders With Which Vacature Was Denied

A. Pre-Hearing Security

In the past, at least, reinsurance contracts commonly required that reinsurers not licensed in any state in which the cedent is licensed, to post security for losses. In the process of enforcing such clauses, or when there is doubt as to the solvency of the reinsurer, arbitration panels often require the reinsurer to post security in the form of a letter of credit or trust fund. The authority of panels to issue such an order has been challenged often and has been upheld as a measure to preserve the integrity of the arbitration by assuring that there will be assets to recover if the cedent prevails. *See Pacific Reins. Mgmt. Corp. v. Ohio Reins. Corp.,* 935 F.2d 1019 (9th Cir. 1991); *Banco de Sequros del Estado v. Mutual Marine Office, Inc.,* 344 F.3d 255 (2nd Cir. 2003); *British Ins. Co. of Cayman v. Water Street Ins. Co.,* 93 F.Supp. 2d 506 (S.D.N.Y. 2000), *Certain Underwriters at Lloyd's London v. Argonaut Ins. Co.,* 264 F. Supp. 926 (N.D. Cal. 2003); *Insco Ltd. v. Meadows Indem. Co.,* 1993 U.S. Dist. LEXIS 21452 (C.D. Cal.).

B. Lack of "Irrationality" *i.e.* Some Support for Ruling in Contract

The receiver of an insolvent insurer sought recovery under four reinsurance contracts in an arbitration proceeding and the reinsurers moved that the treaties be rescinded for misrepresentation in *ARIO v. Underwriting Members of Syndicate 53 at Lloyds,* 618 F.3d 277 (3rd Cir. 2010). The receiver argued that the arbitrators exceeded their authority and that the order should be vacated for irrationality as it was unsupported by the evidence. The court found that the receiver's arguments were just a disagreement with the import of the evidence presented to the panel. As to the "irrationality" argument, the court observed:

> We review the form of the relief awarded by the arbitrators to determine if the form of the arbitrators' award can be rationally derived either from the agreement between the parties or from the parties' submissions to the arbitrators and we do not revise the terms of the award unless they are completely irrational.
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> . . . .
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> There must be absolutely no support at all in the record justifying the arbitrator's determination for a court to deny enforcement of an award.[6]

C. Protocol for Reporting and Payment of Claims

First State Ins. Co. v. National Cas. Co. , 781 F.3d 7 involved an arbitration by which the cedent sought to collect losses from the reinsurer. The arbitration panel found for the cedent and issued an order establishing a protocol for reporting and payment of claims. The court rejected the cedent's motion to vacate ruling:

> Only if the arbitrators acted so far outside the bounds of their authority that they can be said to have dispensed their own brand of industrial justice will a court vacate the award. Put another way, as long as an arbitration award draws its essence from the underlying agreement, it will withstand judicial review – and it does not matter how "good, bad or ugly" the match between the contract and the terms of the award may be.[7]

*See also, Harper Ins. Ltd. v. Century Indem. Co.,*819 F. Supp. 2d 270 (S.D.N.Y. 2011).

D. Application of Occurrence Definition and Finding of Incidental Exposure

An arbitration panel ruled that multiple asbestos-related losses fell within a single occurrence and that the incidental exposure exception to the asbestos exclusion applied in *American Mutual Ins. Co. v. Everest Reinsurance Co.,* 109 F. Supp. 3d 969 (E.D.Mich. 2015). The court rejected the argument that these findings exceeded the panel's authority. The definition of occurrence was ambiguous on the number of losses that may constitute one occurrence and the panel reached their conclusion based on evidence presented by the parties. The panel's factual finding on incidental exposure was not contradicted by the treaty language and the "standard governing review of arbitrator's factual findings is even more stringent than already-deferential standard of review for awards and even silly fact-finding is an insufficient basis to vacate the arbitrator's award."[8]

E. Remedy Not Specifically Requested by the Parties

The arbitration panel ordered payment of losses in a somewhat different fashion than that requested by the cedent in *Harper Ins. Ltd. v. Century Indem. Co.*, 819 F. Supp.2d 270 (S.D.N.Y. 2011). The reinsurer argued that the panel had exceeded its power but the court rejected this argument:

> Petitioners conflate the questions of whether an issue was presented to the arbitrators with the question of whether a *potential remedy* was presented to the arbitrators. It is indisputable that arbitrators have no authority to rule on an issue not submitted to them. However, there is no parallel per se rule

> that it is beyond the authority of the arbitrators to issue a remedy directed to an issue squarely before them unless it was requested by one of the parties.[9]

F. Insufficient Quantification of Damages and Reasoning of the Order

The parties to the treaty had three separate but related arbitrations related to the reinsurer's claim payment obligations in *American Centennial Ins. Co. v. Global Int'l Reins. Co.,* 2012 U.S. Dist. LEXIS 94754 (S.D.N.Y. 2012). While the third panel issued a seven page, single spaced order, the cedent moved to vacate the order arguing that the panel exceeded its authority by failing to tie the award to damages caused as well as failure to provide reasoning for the panel order. The court rejected this motion noting that the panel did provide a modicum of reasoning behind its decision and, in any case, the treaty did not require reasoning and the parties did not request findings of fact and conclusions of law.

G. Failure to Re-Open Issue and Award of Attorneys' Fees

In *Century Indem. Co. v. AXA Belgium,* 2012 U.S. Dist. LEXIS 136572 (S.D.N.Y.), the panel resolved an issue as to the proper termination date of a treaty, assessed attorneys' fees against a party that did not act in good faith and continued its jurisdiction for nine months to resolve any disputes that arose in implementation of the panel's order. The panel initially scheduled a hearing to resolve such disputes but cancelled when the only issue surfaced by the parties was a motion to modify the panel's previous order. The panel then issued a final order confirming its previous order.

The reinsurer argued to the court that the panel exceeded its authority by establishing a termination date for the treaty, by failing to hold a hearing on the motion to modify and in awarding attorneys' fee. The court rejected these arguments ruling: (1) that the termination date of the treaty was a central issue in the arbitration and was argued extensively on both sides; (2) the subsequent hearing was for problems in implementation and not to re-argue decided issues; and (3) the panel has broad authority to fashion appropriate remedies, it found that reinsurer acted in bad faith and, in addition, the reinsurer asked the panel to grant it attorneys' fee against the cedent.

H. Failure to Restrict the Scope of the Award

The cedent believed that the ruling of the arbitration panel went beyond the submission of issues to the panel in *Industrial Risk Insurers v. Hartford Steam Boiler Inspection & Ins. Co.,* 779 A.2d 737 (Ct. 2001). The court disagreed commenting:

> A challenge of the arbitrator's authority is limited to a comparison of the award to the submission. Where the submission does not otherwise state, the arbitrators are empowered to decide factual and legal questions and an award cannot be vacated on the grounds that the construction placed upon the facts or the interpretation of the agreement by the arbitrators was erroneous. Courts will not review the evidence nor, where the submission is unrestricted, will they review the arbitrators' decision of the legal questions involved.[10]

IV. Commentary

The above caselaw suggests a simple pathway to defeat an allegation that the panel exceeded its powers under § 10 (a)(4) of the Federal Arbitration Act. The panel should: (1) follow the procedures stated in the relevant arbitration clause; (2) address the issues submitted by the parties for resolution and the contract provisions relevant thereto; (3) disband once the issues presented to it have been resolved; and (4) avoid contempt-like fines (*i.e.* $X per day until a party complies) but other penalties (*i.e.* interest, attorneys' fees) should not be problematical.

ENDNOTES

1 *PMA Capital Ins. Co. v. Platinum Underwriters Berm.*, *LTD*, 659 F.Supp. 2d 631, 638 (E.D. Pa. 2009) (internal citations omitted).
2 109 F. Supp. 3rd at 995.
3 *Id.*
4 2008 U.S. Dist. Lexis 92717 *19.
5 264 F. Supp. 2d at 944 – 5 (internal citations omitted).
6 618 F.3d at 296 – 6 (internal citations omitted).
7 781 F.3d at 11. (internal citations omitted).
8 109 F. Supp. 3d at 997 (internal citations omitted).
9 818 F. Supp. 2d at 277 internal citations omitted, emphasis in the original).
10 779 A.2d at 746 – 7 (internal citations omitted).