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In This Issue...

Article

The Right Under the Federal Arbitration Act to Challenge the Neutrality of an Umpire Prior to the Issuance of an Award 1

Recent Decisions

Latent Ambiguity Used to Show Reinsurance Contract Dispute Must Be Arbitrated 6

Court Dismisses Claims Based on Statute of Limitations 7

Seventh Circuit Holds Arbitrator to Decide Whether to Consolidate Reinsurance Disputes..... 8

Contacts

Reinsurance Group Contacts 8

Since its founding in 1901, Hunton & Williams has prided itself on excellence and hard work. Over the course of the last 100 years, the firm has experienced tremendous growth and currently consists of more than 850 attorneys in 17 offices in the United States, Europe, and Asia.

The Right Under the Federal Arbitration Act to Challenge the Neutrality of an Umpire Prior to the Issuance of an Award

An important component of any reinsurance arbitration is the selection of an umpire. Most arbitration provisions in reinsurance agreements contemplate the selection of two party-appointed arbitrators and a neutral umpire. Although the contractual processes for selecting arbitrators and an umpire differ from agreement to agreement, the approach to the selection process is generally similar. For example, most agreements require that each arbitrator, including the umpire, meet certain minimum qualifications, such as having served as an officer in a property and casualty insurance company or having been certified as an arbitrator by an industry organization such as the AIDA Reinsurance and Insurance Arbitration Society ("ARIAS"). Under most agreements, a party names its proposed party-appointed arbitrator together with the candidate's qualifications and disclosures. Each party then has the opportunity to object to the other party's proposed arbitrator on grounds that the arbitrator fails to meet the minimum qualifications under the agreement or is biased.

The umpire selection process usually differs from the process of selecting

the party-appointed arbitrators. Some agreements provide that the two party-appointed arbitrators will select the umpire and specifically set forth the process by which the arbitrators will select the umpire. Other provisions, however, do not provide any guidance regarding the



method by which the arbitrators or the parties will choose the umpire. Under one common industry selection process each party nominates three umpire candidates, each of whom provides the parties with current *curriculum vitae*, discloses former and current business relationships with the parties, and sometimes completes standard industry questionnaires aimed

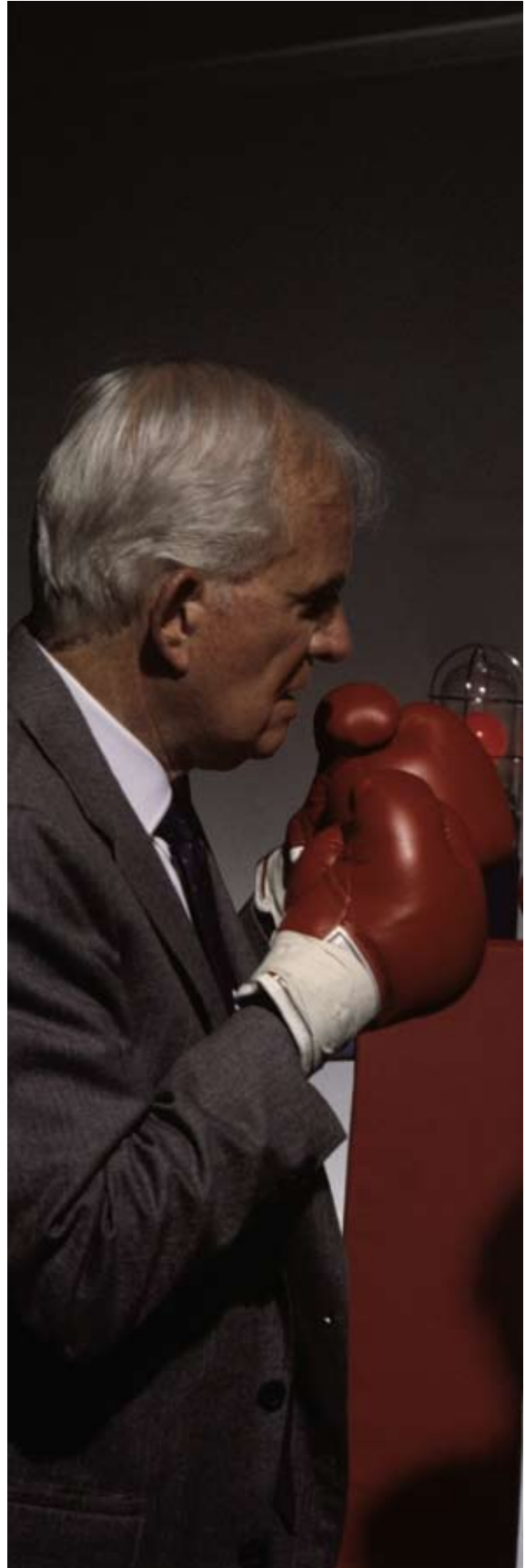
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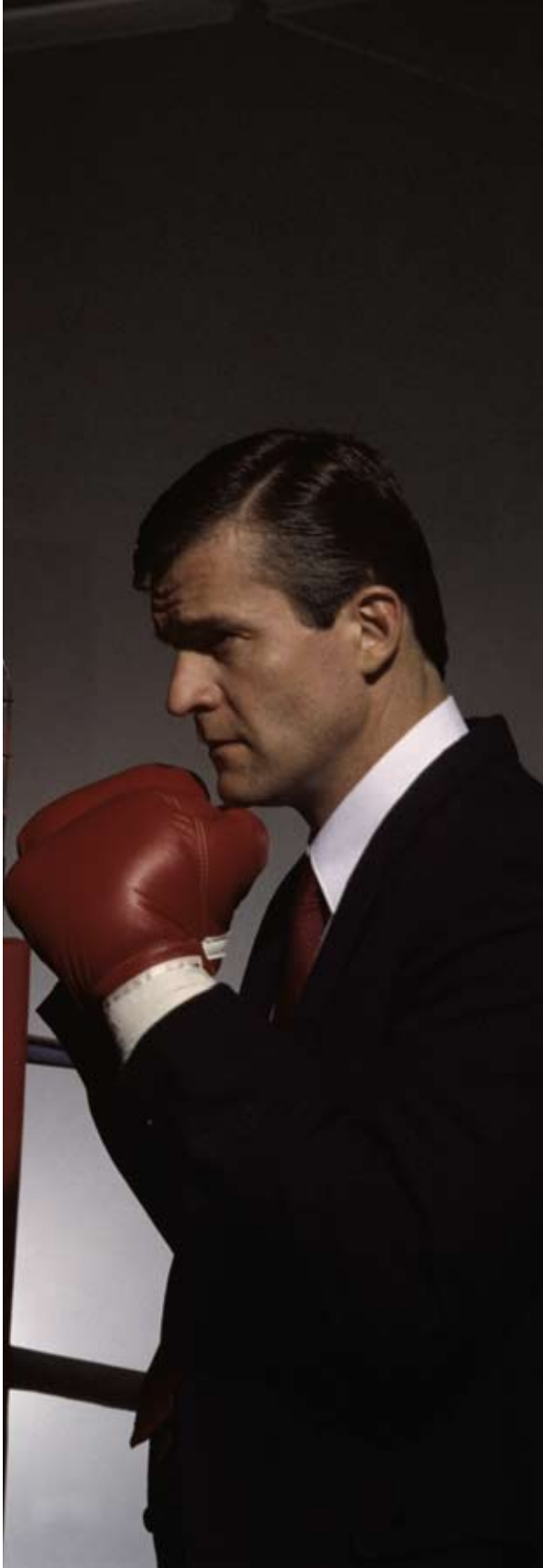
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at eliciting additional information about the candidates' qualifications and relationships. Next, each party strikes two candidates from the other parties' lists, leaving two remaining candidates. The parties (or their respective party-appointed arbitrators) then randomly select the umpire from the two remaining by a coin toss or other similar chance method.

An issue arises when one party believes that all of the umpire candidates proposed by its adversary are unfairly biased and that no matter which candidates the party chooses to strike it faces a fifty-fifty chance of ending up with what it believes is a biased umpire. The party can take its chances with the coin toss and, if it loses, file a petition in federal district court challenging the neutrality of the umpire. In some instances, however, the party files the petition instead of proceeding with the umpire selection process, arguing that all three umpire candidates are biased. The other party opposes the petition on the ground that the Federal Arbitration Act ("FAA"), which governs the interpretation of reinsurance arbitration provisions, *does not* authorize parties to challenge the neutrality of an arbitrator prior to the issuance of an arbitration award.

The FAA disfavors judicial intervention into what is widely recognized as a privately contracted alternative dispute method. The whole point of privately contracted arbitration clauses is to avoid court. The "purpose of the [FAA] is to 'move the parties...out of court and into arbitration as quickly and easily as possible.'" *Gulf Guaranty Life Ins. Co. v. Connecticut Gen. Life Ins. Co.*, 304 F.3d 476, 489 (5th Cir. 2002), citing *Moses H. Cone Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 22 (1982). Under the FAA, jurisdiction by the courts to intervene into the arbitral process prior to issuance of an award is very limited. See *Larry's United Super, Inc. v. Werries*, 253 F.3d 1083, 1085 (8th Cir. 2001). While the FAA does authorize judicial intervention into the umpire selection process prior to the issuance of an award where a party refuses to participate in the appointment of the umpire or there otherwise is a lapse in the naming of an umpire, it does not authorize a party that refuses to participate in the umpire selection process to seek judicial intervention based on the alleged bias of the other party's umpire candidates. The proper method by which a party may challenge the neutrality or suspected bias of an arbitrator under the FAA is to seek vacatur of the arbitration award after it has been issued on the ground that either a party-appointed arbitra-





tor or an umpire demonstrated “evident partiality.”

Recent federal appellate court decisions have held that parties to an arbitration governed by the FAA cannot challenge the neutrality of an umpire or arbitrator before an award is issued. In *Aviall, Inc. v. Ryder Sys., Inc.*, 110 F.3d 892 (2d Cir. 1997), Aviall was a former wholly-owned subsidiary of Ryder. Pursuant to the contract governing a spin-off of Aviall to Ryder’s shareholders, Aviall sought arbitration of the dispute before Ryder’s outside auditor. Subsequently, however, Aviall filed a petition in federal court to disqualify the auditor as the arbitrator, claiming that the auditor was partial to Ryder on account of its business relationship with Ryder, and that it had assisted Ryder in preparing for the arbitration. The Second Circuit affirmed summary judgment in favor of Ryder. According to the court, “Although the FAA provides that a court can vacate an award ‘[w]here there was evident partiality or corruption in the arbitrators,’ it does not provide for pre-award removal of an arbitrators.... It is well established that a district court cannot entertain an attack upon the qualifications or partiality of arbitrators until after the conclusion of the arbitration and the rendition of an award.” 110 F.3d at 895. (citing *Michaels v. Mariforum Shipping, S.A.*, 624

F.2d 411, 414 n. 4 (2d Cir. 1980); *Florasynth, Inc. v. Pickholz*, 750 F.2d 171, 174 (2d Cir. 1984); *Alter v. Englander*, 901 F. Supp. 151, 153 (S.D.N.Y. 1995); and *Marc Rich & Co. v. Transmarine Seaways Corp.*, 443 F. Supp. 386, 387 (S.D.N.Y. 1978).

In *Gulf Guaranty Life*, a cedent brought suit against a reinsurer in federal district court and then moved to strike the reinsurer’s party-appointed arbitrator. The Fifth Circuit reversed the district court’s ruling granting the cedent’s motion to strike. It found that “[t]here is no authorization under the FAA’s express terms for a court’s power to remove an arbitrator from service [T]he FAA does not expressly endorse court inquiry into the capacity of any arbitrator to serve prior to issuance of an arbitral award.” 304 F.3d at 490. According to the court, “The FAA does not provide ... for any court intervention prior to issuance of an arbitral award beyond the determination as to whether an agreement to arbitrate exists and enforcement of that agreement by compelled arbitration of claims that fall within the scope of the agreement even after the court determines some default has occurred.” *Id.* at 487. Relying on *Aviall*, the *Gulf Guaranty Life* court held that the FAA’s prohibition on removal of arbitrators prior to issuance of an award

continued on page 4

continued from page 3

extends to prohibit judicial scrutiny of either an arbitrator's qualifications to serve or an arbitrator's alleged bias. *Id.* at 490-91. To hold otherwise, the court stated, could "spawn endless applications [to the courts] and indefinite delay." *Id.* at 492 [citing *Marc Rich & Co. v. Transmarine Seaways Corp.*, 443 F. Supp. 386, 387-88 (S.D.N.Y. 1995)].

Federal district courts have consistently followed the holdings in *Gulf Guaranty* and *Aviall* that the neutrality of arbitrators cannot be challenged prior to the issuance of an award. For example, the court in *National Union Fire Ins. Co. v. Holt Cargo Sys., Inc.*, 99 CIV 3699, 2000 U.S. Dist. LEXIS 3956 (S.D.N.Y. March 28, 2000), citing *Aviall*, held that parties could not challenge a party-appointed arbitrator for bias or qualifications until after issuance of the award. Likewise, the court in *Certain Underwriters at Lloyds v. Argonaut Ins. Co.*, 264 F. Supp.2d 926, 935 (N.D. Cal. 2003), citing *Gulf Guaranty* and *Aviall*, held that an umpire of a tripartite panel in a reinsurance dispute could not be challenged for bias before the award. According to the court, "[T]here are ...no federal cases in which a court has issued an order disqualifying a neutral arbitrator once arbitration had commenced but prior to a final arbitration award." *Id.*

Travelers Indemn. Co. v. Gerling Global Reinsurance Corp., 2001 WL 546600 (S.D.N.Y. 2001), is also instructive. There, the parties were unable to agree as to how the umpire selection process would proceed and Travelers filed a petition to appoint an umpire in federal

district court. The court concluded that there was no lapse in the selection of an umpire and directed the parties to select their own umpire in accordance with the common practice of striking two names from each list of the three candidates with the umpire to be chosen at random from the two remaining names. In reaching its conclusion, the court observed:

Challenging the neutrality of an arbitrator, and by logical extension a candidate to serve as an arbitrator, is only proper after an arbitration award has been entered. See *Florasynt, Inc. v. Pickholz*, 750 F.2d 171, 174 (2d Cir. 1984) ("The [FAA] does not provide for judicial scrutiny of an arbitrator's qualifications to serve, other than in a proceeding to confirm or vacate an award, which necessarily occurs after the arbitrator has rendered his service.") Therefore, if either party wishes to challenge the qualifications, including neutrality, of the selected umpire, or any candidate nominated to serve as an umpire, that party may do so only after an arbitration award has entered by three person panel.

Id. (emphasis added).

As both *Aviall* and *Gulf Guaranty* recognized, the lone exception to this rule is where the alleged bias of an arbitrator implicates the validity of the agreement to arbitrate under general contract principles such as, for example, where the bias frustrates the agreement's purpose

or the nondisclosure of a relationship amounted to fraud in the inducement. 110 F.3d, at 895-897 (citing *Erving v. Virginia Squires Basketball Club*, 349 F. Supp. 716 (E.D.N.Y.), *aff'd*, 468 F.2d 1064 (2d Cir. 1972); *Masthead Mac Drilling Corp. v. Fleck*, 549 F. Supp. 854 (S.D.N.Y. 1982); and *Cristina Blouse Corp. v. International Ladies Garment Workers' Union, Local 162*, 492 F. Supp. 508 (S.D.N.Y. 1980)); *Gulf Guaranty*, 304 F.3d at 490-91. In *Erving*, for example, the basketball star Julius Erving had entered into a contract that provided for arbitration by the Commissioner of the American Basketball Association, but, when the dispute arose, the new Commissioner was a partner in the law firm representing the defendant. Because the potential bias frustrated the parties' contractual intent to submit their dispute to a specified neutral expert, and not to an umpire later selected by the parties, the district court reformed the contract by substituting a neutral arbitrator in the Commissioner's place. *Erving*, 349 F. Supp. at 720. Similarly, in *Masthead Mac*, the arbitrator designated in an arbitration provision had a long-time business relationship with the defendant. The plaintiff argued not that the FAA authorized the replacement of the allegedly biased arbitrator but that the defendant fraudulently induced the plaintiff to enter into the contract by concealing the designated arbitrator's relationship with the defendant. The district court agreed and, as a remedy, designated a neutral arbitrator. *Masthead Mac*, 549 F. Supp. at 856.

Several federal district courts have entertained a party's challenge to the neutrality of an arbitrator prior to the

issuance of an award. In *Third Nat'l Bank v. WEDGE Group Inc.*, 749 F. Supp. 851 (M.D. Tenn. 1990), the plaintiff asserted that the accountant designated as the arbitrator by the defendant would be unable to render an unbiased award on account of its fiduciary duty to the defendant. Relying on *Erving and Masthead Mac*, the court allowed the arbitration to proceed, subject to the appointment of a neutral arbitrator. *Id.* at 855. In *Jefferson-Pilot Life Ins. Co. v. LeafRe Reinsurance Co.*, No. 00-C-5257, 2000 WL 1724661,

of an insurance company prior to the issuance of an arbitration award.

Aviall and *Gulf Guaranty* are critical of these decisions. *Aviall* says that the *WEDGE* court's reliance on *Erving* and *Masthead Mac* was misplaced because, unlike the situation in *WEDGE*, "the touchstone in each of those cases was that the arbitrator's relationship to one party was undisclosed, or unanticipated and unintended, thereby invalidating the contract." 110 F.3d at 896. *Gulf Guaranty* finds that the Illinois federal

question the validity and enforceability of the agreement itself, the arbitrator cannot be judicially challenged prior to the issuance of an award. This rule prevents parties from filing petitions in federal court every time they do not like the opposing party's slate of umpire candidates or are unhappy with the umpire selected. It also promotes the purpose underlying arbitration of keeping the parties out of court and deters the strategic use of such petitions for the sole purpose of delaying the arbitration process.



If in fact an umpire or an umpire slate is biased, the aggrieved party is not without recourse. Once the award is issued, the party may file a petition in federal court challenging the award on the ground that the umpire demonstrated "evident partiality." In order to strengthen its challenge, the party may take a number of steps beginning as early as the outset of the umpire selection process, such as asserting formal objections to the umpire candidates with the specific grounds for these objections, requesting additional information from the candidates concerning their respective backgrounds and business relationships, and conducting its own investigation into the candidates' qualifications and relationships. Once the umpire is selected, the party could ask the umpire follow-up questions on the record during the organization meeting about the umpire's disclosures. The party could further lay the groundwork for a possible post-award challenge by requesting a reasoned award and asking the umpire to state the grounds for its evidentiary rulings before and during the hearing.

at *2 (N.D. Ill. Nov. 20, 2000), the district court concluded that it was not "necessary" to wait until the post-award stage to challenge an arbitrator's qualifications or neutrality. Similarly, the court in *In re Arbitration Between Certain Underwriters at Lloyds, London*, 1997 WL 461035, at *4, *5 (N.D. Ill. Aug. 11, 1997), concluded that it could entertain a party's challenge to an arbitrator's qualification as an "executive officer"

district court decisions in *Jefferson-Pilot Life and Certain Underwriters at Lloyds* "conflict with the purpose of the FAA and its policy favoring arbitration of disputes prior to court intervention." 304 F.3d at 491 n. 15. These cases therefore are at odds with the principal federal appellate cases and represent the minority viewpoint on this issue.

The majority rule on this issue consistently holds that, unless the alleged bias of an arbitrator or umpire calls into

Latent Ambiguity Used to Show Reinsurance Contract Dispute Must Be Arbitrated

Cedent Bound by Intermediary's Knowledge

The United States District Court for the Northern District of California recently held that an arbitration clause in reinsurance contracts required parties to arbitrate their dispute, despite language in the contract that on its face appeared to provide an exception to arbitration. See *Medical Insurance Exchange of California v. Certain Underwriters at Lloyds, London*, No. C 05-2609 PJH, 2006 U.S. Dist. LEXIS 10158 (N.D. Cal. Feb. 24, 2006).

Medical Insurance Exchange of California ("MIEC"), was reinsured through a reinsurance program by AXA Corporate Solutions Reinsurance Company, Axis Reinsurance Company, Odyssey America Reinsurance Company, Continental Casualty Reinsurance Company, Transatlantic Reinsurance Company and Converium Limited, as well as certain underwriters at Lloyds' of London (the "Reinsurers"). MIEC settled 774 lawsuits brought against its policyholders by way of a global \$24 million settlement and sought reimbursement from the Reinsurers for a large portion of the

settlement. The reinsurers denied the claim, asserting that because the settlement was allocated among all the underlying lawsuits the individual allocations fell beneath a \$75,000 per claim retention.

MIEC filed suit against the Reinsurers alleging, among other things, misrepresentation, concealment, non-disclosure and fraud in the performance of the reinsurance contracts because the Reinsurers allegedly failed to inform MIEC that the settlement would not be covered in the time period leading up to the settlement. The Reinsurers moved to compel arbitration. In response, MIEC asserted that the arbitration clauses in the reinsurance contracts granted an exception for claims it was asserting. The arbitration clause provided that "all disputes or differences arising out of or connected with this contract" be referred to arbitration, except "[i]n the event that any of the issues which form the subject matter of the arbitration involve allegations of misrepresentation, non-disclosure, concealment or fraud."

The Reinsurers asserted that the exception was intended to only apply to the "formation or validity" of the reinsurance contracts and not to matters involving performance under them. The court provisionally allowed the Reinsurers to introduce extensive extrinsic evidence of the drafting history of prior reinsurance contracts between the Reinsurers and MIEC's reinsurance intermediary to show that the contracts were "reasonably susceptible" to the meaning asserted by the Reinsurers. After reviewing the Reinsurers' evidence, which the court found showed that the Reinsurers and MIEC's intermediary intended the exception to only apply to issues of "formation or validity," the court held that exception was latently ambiguous. It then used the same evidence presented by the Reinsurers to find that the Reinsurers and MIEC's intermediary intended the exception to narrowly apply to questions of "formation or validity." Finally, the court held that MIEC was bound by its intermediaries' knowledge under the laws of agency.

Court Dismisses Claims Based on Statute of Limitations

Holds Reinsurance Agreement Was Formed when Essential Terms Were Agreed To

A New York federal court has held that the statute of limitations for claims of mutual mistake and fraud began running the date a reinsurance binder was issued and not when other terms of the reinsurance agreement and a related document were finalized. See *Mills v. Everest Reinsurance Co.*, 410 F. Supp. 2d 243 (S.D.N.Y. 2006). In *Mills*, the New York Superintendent of Insurance brought suit, as the Rehabilitator of Frontier Insurance Company, against Everest Reinsurance Company alleging, among other things, mutual mistake and

before the date the Rehabilitator filed suit.

The Rehabilitator argued that the binder did not contain all the essential terms and conditions of the contract because: (1) the operative terms of a related trust agreement had not been agreed upon when the binder was issued; and (2) Frontier modified the definition of “gross net written premium” in a later issued “Reinsurance Confirmation” and noted that its acceptance was “subject to the changes noted....” It asserted that a

trust agreement, for which the specific terms had not been finalized, the parties had agreed on the operative terms and conditions of the trust at the time the binder was issued by specifying that it had to conform with New York Insurance Regulation 114. Second, the court held that Frontier’s modification of the definition of “gross net written premium” did not alter the fact that the parties had entered into a contract through the binder. It reasoned that “Frontier’s change was at most a proposed modification to an already-



fraud in the formation of a reinsurance contract. Everest moved to dismiss, alleging that the causes of action were time barred under a six-year statute of limitations, which began to run when the contract was formed. Everest asserted that the contract was formed when the binder was issued, just over six years

later date, after these events took place, was the date of contract formation.

The court rejected the Rehabilitator’s arguments and held that the parties had formed a contract when the binder was issued. First, the court held that although the binder called for a related

existing contract,” and the fact that the change was accepted and incorporated into the formal policy did not negate the already valid contract.

The court allowed the Rehabilitator leave to re-file its fraud claim if it could allege fraud not barred by the statute of limitations.

Seventh Circuit Holds Arbitrator to Decide Whether to Consolidate Reinsurance Disputes

The United States Court of Appeals for the Seventh Circuit has held that questions involving whether reinsurance arbitrations must be consolidated are procedural questions for arbitrators, not for courts to decide. See *Employers Insurance Company of Wausau v. Century Indemnity Co.*, 2006 U.S. App. LEXIS 8070 (7th Cir. April 4, 2006). The Seventh Circuit noted that neither it nor the Supreme Court had resolved this question concerning consolidation previously.

In *Employers*, Century Indemnity Company ("Century") entered into two reinsurance contracts with Employers Insurance Company of Wausau ("Wausau"), and other reinsurance contracts with other reinsurers, pertaining to direct insurance contracts between Century and Aqua-Chem, Inc. ("Aqua-Chem"). Century paid a number of asbestos-related bodily injury claims for Aqua-Chem and sought reimbursement from its reinsurers for a portion of the claims. Several of the reinsurers, including Wausau, did not pay Century. In response, Century demanded that the reinsurers participate in a consolidated arbitration. Wausau filed suit, asserting that while it was required to arbitrate, it was not required to submit to a consolidated arbitration.

Wausau moved for summary judgment asserting that the issue of consolidation was a question of "arbitrability" for a court to decide. Century retorted that the question was a procedural one, for the arbitrator to decide. The Seventh Circuit rejected Wausau's argument, relying on *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002). In *Howsam*, the Supreme Court described questions of arbitrability as narrower than "any potentially dispositive gateway," and limited to "the kind of narrow circumstance where contracting parties would likely have expected a court to have decided the gateway matter, where they are not likely to have thought that they had agreed that an arbitrator would do so..." The *Howsam* court went on to hold that "'procedural' questions which grow out of the dispute and bear on its final disposition are presumptively not for the judge, but for an arbitrator, to decide." *Id.* at 84 (quoting *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 557 (1964)).

Holding that the question of consolidation does not involve whether Wausau and Century are bound by the arbitration clause or whether the arbitration clause covered the Aqua-Chem policies, the Seventh Circuit determined it was a procedural question, which under *Howsam* had to be determined by the arbitration panel.

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