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Four Recent Court Decisions Present a Case for Reinsurance Arbitration Reform

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feature

Have Courts Declared Open Season on Reinsurance Arbitrators? Four Recent Court Decisions Present a Case for Reinsurance Arbitration Reform

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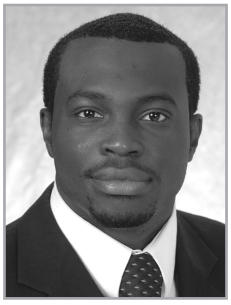

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Four recent, high profile decisions from courts in Pennsylvania, New York, and Illinois suggest a growing judicial intolerance for certain practices in reinsurance disputes

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I. Introduction

Just two years ago, in *Hall Street Associates L.L. C. v. Mattel, Inc.*,[1] the Supreme Court shook the arbitration world by throwing into question the continued use of "manifest disregard of law" as a basis for challenging arbitration awards under the FAA.[2] The FAA authorizes a court to vacate or modify arbitration awards where: (i) the award was procured by corruption, fraud, or undue means; (ii) there was "evident partiality" or corruption by the arbitrators; (iii) the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or (iv) the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.[3] In *Hall Street*, the Court held that these four enumerated grounds were exclusive and could not be expanded by agreement among the parties. Since then, a number of federal courts addressing the issue have interpreted *Hall Street* to mean that the FAA grounds are exclusive and that "manifest disregard of the law" is no longer a basis to vacate or modify arbitration awards.[4] Some commentators anticipated that the potential elimination of this well-known vehicle for challenging arbitration awards would result in a substantial expansion of the arbitrators' power, particularly in reinsurance disputes where the parties frequently employ "honorable engagement" clauses providing arbitration panels with substantial discretion and authority. But in the wake of *Hall Street*, courts have still shown a willingness to examine rigorously the conduct of reinsurance arbitration panels. Courts have done so by utilizing the authority granted by the FAA, state law, and the contractual language contained in the reinsurance treaties themselves to exercise oversight over arbitration panels. Four recent, high profile decisions from courts in Pennsylvania, New York, and Illinois suggest a growing judicial intolerance for certain practices in reinsurance disputes.

In *PMA*, the court vacated an award for "exceeding authority" and criticized the arbitration panel for reaching a decision that was contrary to the express language of the treaty. The court characterized the panel's award as "completely irrational," despite the presence of an honorable engagement clause authorizing the panel to stray from the law or the language contained in the treaty in the interests of fairness.[5] In *Scandinavian Re*, the court struck a panel's award for "evident partiality" because two of the arbitrators failed to disclose non-economic conflicts of interest that arose out of their service on a panel hearing a related dispute.[6] In *Trustmark*, the court issued a preliminary injunction preventing a party-appointed arbitrator from serving on a panel because of an alleged breach of a confidentiality agreement by the arbitrator stemming from his service as an arbitrator on a prior related arbitration between the parties. The court suggested that the arbitrator could be liable to the opposing party for the breach.[7] Finally, in *Amerisure*, the court found that the arbitrators "exceeded their powers" by awarding attorneys' fees where neither the

parties' contract nor governing state law authorized the panel to issue such an award despite the panel's conclusion that the award was based on a violation of the duty of utmost good faith.[8] Each of these decisions is being (or is likely to be) appealed.

These decisions each touch on a number of "hot button" issues at the heart of the debate on the direction of modern reinsurance arbitration practice, including the reliance on "honorable engagement" clauses, the parameters of the duty of utmost good faith, the failure to provide reasoned awards, conflicts of interest stemming from the relatively insular nature of the industry, disclosure of conflicts, and repeat appointments of arbitrators in related proceedings. Each of these four decisions warrants examination.

II. Discussion

A. *PMA Capital Ins. Co. v. Platinum Underwriters Bermuda, Ltd.*

On September 17, 2009, the United States District Court for the Eastern District of Pennsylvania vacated an arbitration award for "exceeding authority" under FAA Section 10(a)(4). The court found that the award was "completely irrational" because it departed from the provisions of the treaty at issue. The court did so notwithstanding an "honorable engagement clause" that provided the panel with discretion in fashioning its award in the case. This decision is particularly noteworthy because it suggests that arbitrators cannot depart from the agreed upon language contained in a treaty just because the treaty contains an "honorable engagement" clause.

1. Background

In PMA, St. Paul Re provided reinsurance coverage to PMA Capital Insurance Company under an excess of loss reinsurance contract covering 1999 to 2001. The St. Paul Re agreement provided for an "experience account" into which PMA paid funds. To the extent that losses exceeded funds in the account, St. Paul Re was obligated to pay the excess amount. If any amounts remained in the account at the end of the contract, PMA was entitled to a "profit commission" in the amount of the account balance. In 2002, St. Paul transferred its reinsurance business to Platinum Underwriters Bermuda, Ltd., and in 2003 Platinum entered into a new excess of loss agreement with PMA. The 2003 agreement contained a "deficit carry forward" provision stating that any deficit in the 1999-2001 agreement with St. Paul Re would be applied to the experience account in the 2003 agreement and would offset any positive balances. Platinum was then obliged to return any remaining balance in the experience account at the earlier of the time that losses had reached Platinum's limits (or were commuted) or December 31, 2021. The 2003 agreement had this honorable engagement clause:

> The arbitrators will interpret this Agreement as an honorable engagement and not merely as a legal obligation. They are relieved of all judicial formalities and may abstain from following the strict rules of law. They will make their award with a view to affecting the general purpose of this Agreement in a reasonable manner rather than in accordance with a literal interpretation of the language.[9]

When a dispute arose concerning the validity and scope of the deficit carry forward provision in the 2003 agreement, PMA demanded arbitration against Platinum. PMA sought a determination by the panel that Platinum was not entitled to the benefit of the deficit carry forward provision because it was not a party to the 1999-2001 agreement, and that there was no deficit under the 1999-2001 agreement (although PMA had reported to the Pennsylvania Insurance Department that there was a $6 million deficit). Platinum in response sought a declaration that it was entitled to the deficit carry forward provision and that there was a deficit of $10.7 million. The parties requested that the panel retain jurisdiction over the dispute after the completion of the arbitration. After a hearing on the merits, the panel issued an award stating in its entirety that (i) PMA pay Platinum $6 million, (ii) all references to the deficit carry forward provision in the 2003 agreement be removed from the contract, and (iii) all other requests of the parties be denied. The panel provided no reasoning for its decision.

PMA filed a petition to vacate or modify the panel's award on the basis that the panel exceeded its authority under the FAA because the award was contrary to the relief sought by the parties and the language of the 2003 agreement.

The court agreed with PMA and vacated the panel's award. The court held that the award

In *PMA*, the court vacated an award for "exceeding authority" and criticized the arbitration panel for reaching a decision that was contrary to the express language of the treaty. The court characterized the panel's award as "completely irrational," despite the presence of an honorable engagement clause authorizing the panel to stray from the law or the language contained in the treaty in the interests of fairness.

The result might have been different if the *PMA* panel had simply explained itself in a reasoned award. While many reinsurance disputes are relatively straightforward and do not require the panel to express itself in a reasoned award, one lesson from *PMA* is that it is imperative for a panel to explain itself where it seeks to alter the written agreement between the parties or otherwise fashion a "creative" result that differs from the relief requested by the parties.

could not be rationally derived from the 2003 agreement because the conditions in the contract necessary to trigger the deficit carry forward had not been achieved. Although the court acknowledged that the honorable engagement clause gave the arbitrators broad powers to fashion remedies, the court concluded that the clause did not empower the panel to modify the contract or eliminate provisions negotiated by the parties and written into the treaty:

> The [Honorable] Engagement Clause allowed the Arbitrators to stray from "Judicial formalities" and the 2003 Contract's "literal language" to effect in a "reasonable manner" the Contract's "general purposes." No court has held that such a clause gives arbitrators authority to rewrite the contract they are charged with interpreting. Rather, courts have held just the opposite [...]. The 2003 "contract itself" requires the enforcement of the Deficit Carry Forward Provision, not its elimination.[10]

Relatedly, the court criticized the panel's award because it was not derived from the parties' submissions. Neither party had requested that the panel eliminate the deficit carry forward provision or order PMA to pay any deficit to Platinum.

As a result, the court held that the panel's award did not "draw its essence" from the 2003 agreement and thus concluded that the award was "completely irrational."[11] The court specifically criticized the panel for failing to provide a reasoned award: "Any evaluation of the Arbitrators' decision is made more difficult by their failure to offer any supporting explanation or reasoning."[12] Without the ability to analyze the panel's reasoning, the court concluded that the panel simply sought to dispense "rough justice" by eliminating the deficit carry forward provision and compensating Platinum for the loss of the provision through the $6 million payment:

> The Panel apparently believed that it could "reasonably" resolve these disagreements by eliminating the Provision itself. Accordingly, acting on [the honorable engagement provision's] "rough justice" imperative, the Arbitrators simply took the Provision out of the contract. This, in my view, is "completely irrational," the Panel's broad authority notwithstanding. [...]. I have found no decision [...] that an Honorable Engagement Clause authorizes arbitrators, acting *sua sponte*, to eliminate material provisions of the contract they are charged with interpreting.[13]

2. Lessons From *PMA*: Reliance on the "Honorable Engagement Clause" to Reach Creative Results Contrary to the Parties' Agreement Risks Vacatur of the Award

There are several important lessons from *PMA*. Panels that use an honorable engagement clause in reinsurance agreements to achieve the "right" or "just" result may risk vacatur of their award when they seek to circumvent or otherwise undo express contractual provisions bargained for by the parties in the treaty. The *PMA* court perceived that the arbitrators were doing "rough justice." This case represents a major challenge to the broad use of the honorable engagement clause, particularly where the clause is invoked to undo express contractual provisions.

The case is also interesting because it is not clear that the *PMA* panel's decision was, in fact, "completely irrational." Indeed, the court acknowledged that the arbitrators were trying to prevent further disputes over the carry forward provision: "The Panel apparently believed it could "reasonably" resolve these disagreements by eliminating the [deficit carry forward provision] itself."[14] It appears that the panel sought to give Platinum the value of the deficit carry forward (at the amount that *PMA* itself had represented to the Pennsylvania Insurance Department) in order to end further disputes by simply removing the provision from the 2003 agreement altogether. The panel's effort to minimize the opportunity for future litigation is not necessarily "irrational" in light of the fact that (i) the parties asked the panel to retain jurisdiction over their dispute after the conclusion of the arbitration and (ii) the treaty at issue did not conclude until December 31, 2021. Rather than subject the parties to the potential for years of future litigation, the panel apparently determined to fashion an award that provided finality and clarity for both parties.[15]

The result might have been different if the *PMA* panel had simply explained itself in a

reasoned award. While many reinsurance disputes are relatively straightforward and do not require the panel to express itself in a reasoned award, one lesson from *PMA* is that it is imperative for a panel to explain itself where it seeks to alter the written agreement between the parties or otherwise fashion a "creative" result that differs from the relief requested by the parties. Other courts have expressed frustration where a panel fails to provide a reasoned award.[16] And had the *PMA* panel provided reasons for its decision, the court might not have had a basis to rule that its decision was "completely irrational."

B. Scandinavian Reinsurance Co. Ltd. v. St. Paul Fire & Marine Ins. Co.

On February 23, 2010, the United States District Court for the Southern District of New York vacated an arbitration award for "evident partiality" of the arbitrators under FAA Section 10(a)(2). *Scandinavian Re* arose out of the same group of parties and agreements at issue in the PMA arbitration discussed above. In *Scandinavian Re*, two of the arbitrators (a party-appointed arbitrator and the umpire) failed to disclose their involvement in the PMA arbitration. The PMA arbitration involved a common witness, similar issues, and the entity that succeeded St. Paul as the reinsurer. *Scandinavian Re* illustrates the perils associated with service of arbitrators in related proceedings and the failure to provide robust and continuing disclosure of potential conflicts.

1. Background

Scandinavian Reinsurance Company Limited reinsured St. Paul under a finite retrocessional casualty stop loss agreement. An arbitration clause in the contract required that the panel be "disinterested." In September 2007, after a dispute arose concerning, among other things, whether the retrocessional agreement created one experience account that applied to the entire term of the agreement or separate experience accounts for each year of the agreement, St. Paul demanded arbitration against Scandinavian Re. The panelists disclosed their relationships with the parties and affiliates both prior to and at the organizational meeting. The arbitrators subsequently made supplemental disclosures, including disclosures concerning their relationships with the witnesses. But at no time did two of the arbitrators disclose that they had also been chosen to arbitrate the PMA case or that a witness in the Scandinavian Re arbitration had been a witness in the PMA case. After conducting a full hearing on the merits, in August 2009, a majority of the panel issued an award in St. Paul's favor. Scandinavian Re did not discover that the two arbitrators had served on the PMA panel until October 2009.

Scandinavian Re moved to vacate the arbitration award on the basis that there was "evident partiality" on the part of the two arbitrators under FAA Section 10(a)(2). St. Paul in response argued, *inter alia*, that the undisclosed relationships were not material because neither of the arbitrators had any financial interest in the outcome of the Scandinavian Re arbitration or any direct relationship with St. Paul.

The court vacated the Scandinavian Re award. The court found that (i) the two arbitrators failed to disclose that they were involved in the PMA arbitration, (ii) there was a common witness and common issues in both arbitrations, and (iii) those facts were material. The court rejected St. Paul's argument that the lack of a financial interest on the part of the arbitrators was dispositive: "[T]he absence of these factors is not dispositive as to whether a relationship is material-all of the circumstances must be considered, including the timing of the arbitrators' relationships with each other, and with witnesses to the arbitration."[17] The court reasoned that, by virtue of their participating in both arbitrations, there was a risk that the arbitrators (i) received *ex parte* information about the kind of reinsurance business at issue in the Scandinavian Re arbitration, (ii) were influenced by credibility determinations about the witness from the PMA arbitration, and (iii) could have influenced one another on issues relevant to the Scandinavian Re arbitration because of their experience in the PMA arbitration. According to the court, the arbitrators' failure to disclose the potential conflict deprived St. Paul of the opportunity to object to the arbitrators' service in both arbitrations or to adjust its arbitration strategy. The court also rejected the argument that the arbitrators subjectively believed in good faith that they would not be influenced by the information they learned during the PMA arbitration. Instead, the court followed Second Circuit precedent "that' evident partiality' [...] will be found where a reasonable person would have to conclude

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In this case, the court acknowledged that the nature of reinsurance arbitration practice lends itself to potentially troublesome "relationship" conflicts: "'a principal attraction of arbitration is the expertise of those who decide the controversy,' that '[e]xpertise in an industry is accompanied by exposure [...] to those engaged in it, and the dividing line between innocuous and suspect relationships is not always easy to draw."

that an arbitrator was partial to one party to the arbitration."[18]

2. Lessons From Scandinavian Re: Courts Will Strictly Review Disclosed and Undisclosed Conflicts of Interest

On its face, the result in the *Scandinavian Re* matter—vacating an expensive and thoroughly litigated arbitration before a respected panel—seems harsh. But it is not at all surprising that a federal court reviewing a dispute would take a strict view of conflict issues. Federal judges themselves are, in theory, subject to rigorous recusal standards: "Any justice, judge, or magistrate judge of the United States **shall** disqualify himself in any proceeding in which his impartiality might reasonably be questioned."[19] In this case, the court acknowledged that the nature of reinsurance arbitration practice lends itself to potentially troublesome "relationship" conflicts: "'a principal attraction of arbitration is the expertise of those who decide the controversy,' that '[e]xpertise in an industry is accompanied by exposure [...] to those engaged in it, and the dividing line between innocuous and suspect relationships is not always easy to draw."[20] Nevertheless, the court decided to vacate the award after determining that the conflict evidenced partiality (from the perspective of an objective, third-party observer) on the part of the panel.

The decision has broad implications for counsel and arbitrators evaluating potential conflicts. *First*, it is noteworthy that the conflict identified here did not involve a financial interest or other relationship with a party or counsel. The court focused on the unfairness to Scandinavian Re resulting from the fact that its adversary's party appointed arbitrator and the umpire had access to information and testimony given in similar proceedings in which Scandinavian Re did not participate. Obviously, that reasoning has potentially broad implications for reinsurance practice, where the pool of arbitrators qualified to serve on any given matter is often relatively limited and the industry participants in the proceedings frequently have familiarity with the litigants outside of their service in the dispute in which they are retained to serve. *Second*, the court noted that a substantial deficiency was the failure of any disclosure of the related proceedings. Nevertheless, the court did not hold that the disclosure failure was itself dispositive, suggesting that the nature of the conflict was such that open disclosure might not have cured the potential for partiality. *Third*, the *Scandinavian Re* decision underscores that the "evident partiality" inquiry is not subjective. An arbitrator's personal view about whether he or she can be impartial is irrelevant. Instead, the court will make the determination of the arbitrator's impartiality from the perspective of an objective "reasonable person." *Finally*, this was a conflict that appears to have been entirely avoidable. The PMA engagement apparently arose after the organizational meeting conducted in the Scandinavian Re matter. This suggests that counsel and potential arbitrators would be well advised to evaluate conflicts more broadly than current practice, particularly where there is the possibility that a new engagement is somehow related to an existing engagement involving different parties.

C. *Trustmark Ins. Co. v. John Hancock Life Ins. Co.*

The United States District Court for the Northern District of Illinois, on January 21, 2010, disqualified a party-appointed arbitrator serving in a dispute substantially similar to a prior proceeding in which he had served as the party-appointed arbitrator for the prevailing party. The prior proceeding involved the same parties, the same contracts, and substantially similar issues in dispute. Unlike *Scandinavian Re*, the arbitrator at issue in *Trustmark* fully disclosed whatever potential conflict of interest might have existed at the outset of the proceedings. We anticipate that the result in *Trustmark* will be thoroughly criticized by commentators within the reinsurance community.[21] For present purposes, however, the decision suggests that parties need to carefully negotiate confidentiality agreements at the outset of any engagement and consider whether, in an abundance of caution, it is ever advisable to engage a party-appointed arbitrator used in a prior related proceeding.

1. Background

Trustmark provided both retrocessional and reinsurance coverage to Hancock under certain reinsurance agreements. Each of the agreements contained an arbitration clause, requiring that the party-appointed

arbitrators and the umpire be "disinterested." In 2002, Trustmark challenged billings from Hancock, arguing that the reinsurance agreements did not cover retrocessional business and could not be ceded. Hancock initiated arbitration on this issue in 2002. The parties and the arbitrators signed a confidentiality agreement prohibiting disclosure of information from the arbitration . The confidentiality agreement did not contain an arbitration clause. In March 2004, after a hearing, the panel found that retrocessional business was covered under the agreements and issued an award in Hancock's favor. The United States District Court for the Northern District of Illinois confirmed the award. When Hancock submitted a new billing, Trustmark again refused to honor the billing. Hancock initiated a second arbitration against Trustmark and appointed the same arbitrator that it had used in the first arbitration. At the organizational meeting in the second arbitration, Trustmark nevertheless expressed concern over the ability of Hancock' s party appointed arbitrator to honor the confidentiality agreement from the first arbitration. The arbitrator too voiced his concern about being able to segregate information he had learned in the prior arbitration. Trustmark eventually agreed to the appointment.

Following the panel's appointment, Hancock asked the second panel to "'authorize the use of all materials from [the first arbitration], without limitation [,]' so that the parties could avoid relitigating issues decided in [the first arbitration]-namely, whether retrocessional business was covered under the agreements." [22] Over Trustmark's objection, a majority of the panel, *i.e*, Hancock's arbitrator (who did not recuse himself from deliberations on the request) and the umpire, ordered that the confidentiality agreement be accepted and extended to the second arbitration, thus allowing materials from the first arbitration to be used in the second arbitration. Soon after, Hancock moved the panel for an order prohibiting Trustmark from litigating several issues that Hancock argued had been resolved in the prior proceeding, including the issue of whether retrocessional business was covered under the agreements. The majority of the panel- again comprised of Hancock's arbitrator from the first arbitration and the umpire- granted Hancock's motion.

After some discovery had occurred and before the full hearing, Trustmark sought a preliminary injunction in federal court requesting, among other relief, an order enjoining the second arbitration from going forward to (i) prevent the second panel from resolving disputes between the parties over the confidentiality agreement (which Trustmark contended was non-arbitrable) and (ii) prevent Hancock's arbitrator from continuing to serve on the second panel because he breached the confidentiality agreement in deliberating on whether the agreement should apply to the second arbitration and, as a result, was no longer "disinterested" as required under the reinsurance agreements.

The court agreed with Trustmark that Hancock's arbitrator was not "disinterested" and granted the preliminary injunction. The court reasoned that Hancock's arbitrator breached the confidentiality agreement (and the court's earlier order confirming the first award), and therefore he could be subject to liability to Trustmark depending on the circumstances that arise in the second arbitration. The court also observed that Hancock's arbitrator had (as a result of his breach of the confidentiality agreement) become "a fact witness not subject to examination" and that he had demonstrated that he could not "disregard the knowledge he already had" from the prior proceeding. Consequently, the court held that Hancock's arbitrator was not disinterested and concluded that a preliminary injunction was appropriate

2. Lessons From *Trustmark*: Take Care in Drafting Confidentiality Agreements and Appointing an Arbitrator to a Subsequent Related Dispute

The *Trustmark* court plainly disapproved of Hancock's party-appointed arbitrator's service in the second arbitration in light of the confidentiality agreement executed during the first arbitration. It is, however, difficult to see how *Trustmark* was harmed by this service and why sophisticated counsel could not have addressed any perceived harm through educating the panel in the second arbitration. Nevertheless, the precedent set forth in the *Trustmark* matter counsels in favor of caution in negotiating the terms of confidentiality agreements and in appointing arbitrators to a panel when they have

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Nevertheless, the precedent set forth in the Trustmark matter counsels in favor of caution in negotiating the terms of confidentiality agreements and in appointing arbitrators to a panel when they have previously served in a related dispute. Indeed, the precedent set by the *Trustmark* court will undoubtedly have a chilling effect on reinsurance practice: the court went so far as to rule that the party-appointed arbitrator acting on behalf of Trustmark had potentially incurred personal liability in acting in contravention of the confidentiality agreement.

previously served in a related dispute. Indeed, the precedent set by the *Trustmark* court will undoubtedly have a chilling effect on reinsurance practice: the court went so far as to rule that the party-appointed arbitrator acting on behalf of Trustmark had potentially incurred personal liability in acting in contravention of the confidentiality agreement.

Practitioners should also note that, as suggested above, disclosure does not necessarily cure any potential taint in the eyes of a reviewing court. Trustmark's party-appointed arbitrator's previous service was disclosed and plainly apparent to the parties. Nevertheless, the court was willing to enjoin the proceedings until the panel was reconstituted. While disclosure of a potential conflict often serves to excuse the potential taint, disclosure is certainly not a panacea in the eyes of the courts reviewing reinsurance arbitration disputes. And cautious counsel and arbitrators would be well served to address potential conflicts and step aside or decline to serve where there is a possibility that their prior service or relationships might cause an objective observer to question whether they are "disinterested."

D. *Amerisure Mut. Ins. Co. v. Global Reinsurance Corp. of Am.*

Most recently, on March 15, 2010, the Appellate Court of Illinois vacated a portion of an arbitration award for a panel "exceeding its powers" under the Uniform Arbitration Act.[23] The court rejected the panel's award of attorneys' fees for breach of the duty of utmost good faith because neither the treaty at issue nor governing state law authorized the award of attorneys' fees to the prevailing party. Similarly to the *PMA* matter, this decision highlights the fact that courts are loathe to permit arbitrators to use the discretion accorded them under a treaty to affirmatively rewrite the parties' written agreement.

1. Background

In 2001, Global Reinsurance Corporation of America (f/k/a Gerling Global Reinsurance Corporation of America) agreed to reinsure Amerisure Mutual Insurance Company under a quota share reinsurance treaty. When Global refused to pay a $1.5 million claim, Amerisure demanded arbitration. Amerisure sought the amounts due under the treaty as well as "interest, costs and exemplary damages." The treaty provided that the AAA rules[24] and Illinois law governed any disputes between the parties.

Before the arbitration hearing, Amerisure argued in its prehearing briefing and in meetings with the panel that it was also seeking attorneys' fees pursuant to Illinois Insurance Code Section 155, which punishes an insurer for "vexatious and unreasonable" conduct in settling claims, and "reinsurance custom and practice" which imposes a duty of utmost good faith on the parties. Global responded that Section 155 did not apply to reinsurance relationships and could not support an award of attorneys' fees. After conducting the arbitration hearing, the panel issued an award in Amerisure's favor that comprised of the principal amount due, interest, and Amerisure's attorneys' fees "as billed and paid in an amount not to exceed $1,500,000 *based on the finding by this panel of [Global's] violation of its duty of utmost good faith* to [Amerisure]."[25] Amerisure ultimately sought $861,176 in attorney's fees.

Global paid the principal amount due and interest, but did not pay Amerisure's attorneys' fees. Amerisure moved in state court to confirm the award. Global filed an answer and a counter application to reject the award on the basis that the panel "exceeded its authority" by awarding the attorneys' fees. Global then filed a summary judgment motion, arguing, among other things, that the panel exceeded its authority because the award was not authorized by Illinois law and was not based on an issue submitted by the parties. The circuit court denied Global's summary judgment motion, granted Amerisure's motion to confirm, and entered judgment for Amerisure. Global appealed.

The Illinois appeals court reversed the circuit court's decision. The appeals court held that the panel exceeded its authority by awarding attorneys' fees because it relied on Section 155 of the Illinois Insurance Code although Section 155 does not authorize arbitrators to award attorneys' fees. The appeals court explained that AAA Rule 43(d)(2), which governed the arbitration, provided three bases to award attorneys' fees: (i) if all of the parties had requested the award, (ii) if it was authorized by law, or (iii) if it was authorized by the parties' agreement. Because both parties did not request an award of attorney's fees and the agreement was silent on fee

shifting, the court examined whether such an award was authorized under Illinois law. The court concluded that Section 155, as interpreted by Illinois courts, reserved the authority to award attorneys' fees for courts, and not arbitrators. Therefore, the panel's award of attorneys' fees exceeded its authority and there was a "gross error on the face of the award.[26] The court rejected the panel's efforts to rely on the duty of utmost good faith, noting that the treaty expressly provided that the AAA rules govern the dispute and that those rules provided the only parameters under which attorney's fees might be awarded.

2. Lessons From *Amerisure*: The Duty of Utmost Good Faith Does Not Permit a Panel to Rewrite a Treaty

The *Amerisure* decision underscores that reviewing courts will scrutinize any effort by a panel to impose "rough justice" by disregarding the negotiated terms of the treaty. In *Amerisure*, the panel relied on a violation of the duty of utmost good faith (stemming from the failure of the reinsurer to pay a *bona fide* claim) to justify an award of attorneys' fees.

The panel's urge to compensate Amerisure for having to prosecute a claim in the face of what the panel concluded was a meritless defense is certainly understandable. Indeed, Amerisure incurred over $860,000 in fees litigating a $1.5 million claim. But nothing in the treaty permitted the panel to award attorneys' fees. The parties could have negotiated and written such a provision into the treaty. Instead, the parties agreed to be bound by the AAA rules, which expressly governed when and how attorneys' fees could be awarded. For arbitrators, the decision is another example of how courts are limiting their ability to contravene or otherwise depart from the written terms of a treaty. For industry participants, the decision underscores the notion that a party seeking to recovery its fees incurred in a successful arbitration best provide for a fee shifting provision in the treaty itself.

III. Conclusion: The Case for Reform

Each of these decisions provides insight into possible avenues for reform in the industry. *PMA* suggests that arbitrators can no longer rely solely on "honorable engagement" provisions to justify reaching creative results not contemplated by the language of the reinsurance agreement before them. Similarly, *Amerisure* suggests that arbitrators cannot rely on the broad duty of utmost good faith to rewrite negotiated written provisions within a treaty. *Scandanavian Re* illustrates that disclosures of potential conflicts of interest are a continuing obligation and that courts will review undisclosed and disclosed conflicts through an objective standard without regard to the subjective good faith of the arbitrators involved. Similarly, *Trustmark* illustrates that courts will scrutinize confidentiality agreements, particularly in the context of subsequent proceedings where a party seeks to appoint an arbitrator who served on a prior panel.

It may be that the courts have declared "open season on arbitrators" in the reinsurance industry. But it is more likely that the courts, through judicial oversight and scrutiny, have identified conduct within the industry that all would be well served to review and consider whether reform is necessary and appropriate.▼

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1 552 U.S. 576 (2008).
2 The Federal Arbitration Act, 9 U.S.C. § 1 et seq. (West 2010).
3 9 U.S.C. § 10(a).
4 *See Householder Group v. Caughran*, No. 09-40111, 2009 U.S. App. LEXIS 25507, at *8 (5th Cir. Nov. 20, 2009) ("based on the Supreme Court's recent decision in *Hall Street*, manifest disregard of the law is no longer an independent ground for vacating arbitration awards under the FAA"); *AIG Baker Sterling Heights, LLC v. Am. Multi-Cinema, Inc.*, 579 F.3d 1268, 1271 (1l th Cir. 2009) ("As the Supreme Court recently confirmed, sections 10 and 11 of the FAA offer the exclusive grounds for expedited vacatur or modification of an award under the statute"); *Comedy Club, Inc. v. Improv West Assocs.*, 553 F.3d 1277, 1289 (9th Cir. 2009) (holding that "manifest disregard of the law remains a valid ground for vacatur [but only as] a part of § 10(a)(4)"); *Stolt-Nielson SA v. AnimalFeeds Int'l Corp.*, 548 F.3d 85, 95 (2d Cir. 2008) (same); *Crawford Group,Inc. v. Holekamp*, 545 F.3d 971, 976 (8th Cir. 2008) (citing *Hall Street* for the proposition that"[a]n arbitral award may be vacated only for the reasons enumerated in the FAA"). *But see Grain v. Trinity Health, Mercy Health Servs. Inc.*, 551 F.3d 374, 380 (6th Cir. 2008) ("It is true that we have said that 'manifest disregard of the law' may supply a basis for vacating an award, at times suggesting that such review is a 'judicially created' supplement to the enumerated forms of FAA relief. *Hall Street*'s reference to the 'exclusive' statutory grounds for obtaining relief casts some doubt on the continuing vitality of that theory. But, either way, we have used the 'manifest disregard' standard only to vacate arbitration awards, not to modify them").
5 *PMA Capital Ins. Co. v. Platinum Underwriters Bermuda, Ltd.*, 659 F. Supp. 2d 631, 638-39 (E.D. Pa. 2009).
6 Scandinavian Reinsurance Co. Ltd. v. St. Paul Fire & Marine Ins. Co., 09 Civ. 9531 (SAS), 2010 U.S. Dist. LEXIS 15952, at * 45 (S.D.N.Y. Feb. 23, 2010).
7 *Trustmark Ins. Co. v. John Hancock Life Ins Co.,* No. 09 C

It may be that the courts have declared "open season on arbitrators" in the reinsurance industry. But it is more likely that the courts, through judicial oversight and scrutiny, have identified conduct within the industry that all would be well served to review and consider whether reform is necessary and appropriate.

3959, 2010 U.S. Dist. LEXIS 4698, at * 15 (N.D. Ill. Jan. 21, 2010).

8 *Amerisure Mut. Ins. Co. v. Global Reinsurance Corp. of Am.*, No. 1-09-0820,2010 Ill. App. LEXIS 198, at *34 (Ill. App. Ct. Mar. 15, 2010).

9 *PMA Capital Ins. Co.*, 659 F. Supp. 2d at 636.

10 *Id.* at 636-37.

11 The PMA court analyzed whether the award was "completely irrational" within the confines of FAA § 10(a)(4). *See also Silicon Power Corp. v. GE Zenith Controls, Inc.*, 661 F. Supp. 2d 524, 537 (E.D. Pa. 2009) ("In order to obtain vacatur under § 10(a)(4), the movant must establish that the terms of the arbitration award are 'completely irrational'") (citing *Southco, Inc. v. Reell Precision Mfg. Corp.*, 556 F. Supp. 2d 505, 511 (E.D. Pa. 2008), *aff'd Southco, Inc. v. Reell Precision Mfg. Corp.*, 331 Fed. Appx. 925 (3rd Cir. 2009)). However, the Third Circuit has not specifically addressed whether the "completely irrational" test survives *Hall Street* as a non-statutory ground for vacating arbitration awards. *See, e.g., Danieli Corus, Inc. v. ATSI, Inc.*, No. 09-78, 2009 U.S. Dist. LEXIS 45458, at *12-13 (W.D. Pa. May 29, 2009) (declining to consider non-statutory grounds for vacating arbitration awards, including whether the award was "completely irrational," in light of *Hall Street*).

12 *PMA Capital Ins. Co.* 659 F. Supp. 2d at 639

13 *Id.* at 639.

14 *Id.*

15 Indeed, courts have struck down attempts by arbitration panels to retain jurisdiction over subsequent disputes between the parties after resolving the immediate dispute before the panel. *See, e.g., KX Reinsurance Co. v. General Reinsurance Corp.*, 08 Civ. 7807 (SAS), 2008 U.S. Dist. LEXIS 92717, at *19-20 (S.D.N.Y. Nov. 14, 2008) (vacating portion of award that vested subsequent jurisdiction over disputes in the same panel because "[s]uch an open-ended submission would effectively allow the Panel unlimited authority and the power to exist indefinitely [...]. It would also deprive [the petitioner] of its implicit right under the Treaties to choose the arbitrators and umpires it deems most suitable to resolve the specific issues in contention").

16 *See, e.g., British Ins. Co. of Cayman v. Water St. Ins. Co.*, 93 F. Supp. 2d 506, 515 (S.D.N.Y. 2000) (internal citations omitted) ("We note, though, that the panel's repeated decision to refuse to give any rationale for its acts has enhanced the task presented by the pending motions. [...] A greater effort on the part of the panel's majority to explain their actions would have made this decision, and any subsequent decision, easier to confirm").

17 *Scandinavian Reinsurance Co.*, 2010 U.S. Dist. LEXIS 15952, at *37.

18 *Id.* at *24 (citing *Morelite Construction Corp. v. New York City District Carpenters Benefit Funds*, 748 F.2d 79, 84 (2d Cir. 1984)); *see also Applied Indus. Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi, A..S.*, 492 F.3d 132, 137 (2d. Cir. 2007) (upholding vacatur of award for evident partiality where one arbitrator failed to investigate potential conflict of interest between a branch of his company and a parent of the petitioner); *New Regency Prods., Inc. v. Nippon Herald Films, Inc.*, 501 F.3d 1101, 1109 (9th Cir. 2007) (internal citations and quotation marks omitted) (upholding vacatur of arbitration award for evident partiality and reasoning that "[the arbitrator's] decision to accept a new high-level executive job at a company in the same industry as the parties during the arbitration is precisely the type of situation where an arbitrator has reason to believe that a nontrivial conflict of interest might exist and should investigate to determine the existence of potential conflicts").

19 28 U.S.C. § 455(a) (emphasis added); *see also* Code of Conduct for United States Judges, Canon 3C.

20 *Scandinavian Reinsurance Co.*, 2010 U.S. Dist. LEXIS 15952, at * 25 (internal citations omitted).

21 *See, e.g., Daniel L. FitzMaurice, Trustmark v. John Hancock: A Significantly Flawed Decision with the Potential to Wreak Havoc for Confidentiality Agreements in Arbitration*, 20-22 Mealey's Litig. Rep. Reinsurance, Mar. 19, 2010, at 14.

22 *Trustmark Ins. Co.*, 2010 U.S. Dist. LEXIS 4698, at *3.

23 710 Ill. Comp. Stat. 5/1 *et. seq.* (2009).

24 The American Arbitration Association's Supplementary Procedures for the Resolution of Intra-industry United States Reinsurance and Insurance Disputes. The parties agreed that all AAA rules were waived except Rule 43(d).

25 *Id.*, at *5 (emphasis in original).

26 26 *Id.*, at *31.

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