SQUIRE PATTON BOGGS

Reinsurance Newsletter

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Recent Case Summaries

Second Circuit Makes Vacating an Arbitration Award for Evident Partiality Harder

Certain Underwriting Members of Lloyd's of London v. State of Florida, No. 17-1137, 2018 U.S. App. LEXIS 15377 (2d Cir. Jun. 7, 2018).

Vacating an arbitration award has always been tough. The Federal Arbitration Act only has limited bases to seek vacatur. One of those bases is when there is "evident partiality" by the arbitrator. 9 U.S.C. § 10(a)(2). In "traditional" reinsurance arbitrations, the arbitration panel includes two party-appointed arbitrators, each of whom may be predisposed toward the position of the party that appointed them, and a third arbitrator or umpire, who is neutral. Where there is a challenge to an arbitration award rendered by an arbitration panel that includes party-appointed arbitrators who are not required to be neutral, what does the challenging party need to show to obtain vacatur based on evident partiality? In other words, what is the standard or burden of proof? Is it based on the standard governing neutral arbitrators, or should there be a higher standard of proof needed when there are party-appointed arbitrators? The Second Circuit Court of Appeals has now answered that question.

The district court had vacated a reinsurance arbitration award in the cedent's favor based on evident partiality of the cedent's party-appointed arbitrator for failure to disclose close relationships with parties associated with the cedent. The district court found that the arbitrator's pre-existing and concurrent relationships with the cedent's representatives were considerably more extensive than what the arbitrator disclosed. The district court held that the failure to disclose those relationships was significant enough to demonstrate evident partiality.

In reversing and remanding the case for reconsideration by the district court, the circuit court found that the district court weighed the arbitrator's conduct under the standard governing neutral arbitrators. The Second Circuit held that "a party seeking to vacate an award under Section 10(a)(2) must sustain a higher burden to prove evident partiality on the part of an arbitrator who is appointed by a party and who is expected to espouse the view or perspective of the appointed party."

The court noted that, while evident partiality will be found where a reasonable person would have to conclude that an arbitrator was partial to one party in the arbitration, the challenging party must prove the existence of evident partiality by clear and convincing evidence. The court distinguished between what must be shown in a neutral arbitration setting from a party-appointed setting. In determining that there will now be a distinction in the Second Circuit between party-appointed and neutral arbitrators in considering evident partiality challenges, the court stated that "[e]xpecting of party-appointed arbitrators the same level of institutional impartiality applicable to neutrals would impair the process of self-governing dispute resolution." In other words, because reinsurance parties continue to seek out arbitral panels with expertise by using party-appointed arbitrators who are expected to serve as de facto advocates, the degree of partiality tolerated is set, in part, by the parties' contractual bargain.

The distinction, held the court, "is salient in the reinsurance industry, where an arbitrator's professional acuity is valued over stringent impartiality." But, said the court, "a party-appointed arbitrator is still subject to some baseline limits to partiality." For example, an undisclosed relationship is material if it violates the arbitration agreement. If, in this case, the party-appointed arbitrator had a personal or financial stake in the outcome, it would violate the "disinterested" qualification in the arbitration clause. Also, if the undisclosed fact results in a prejudicial effect on the award, it is material and warrants vacatur. But in "the absence of a clear showing that an undisclosed relationship (or the non-disclosure itself) influenced the arbitral proceedings or infected an otherwise-valid award, that award should not be set aside even if a reasonable person (or court) could speculate or infer bias."

On remand, the district court is charged with determining whether the reinsurers have shown, by clear and convincing evidence, that the failure to disclose by the cedent's part-appointed arbitrator either violates the qualification of disinterestedness or had a prejudicial impact on the award. This might require further proceedings.

Notably, the same "expertise" that the Second Circuit discusses that comes with using party-appointed arbitrators in reinsurance disputes is still available to the parties by using the ARIAS•U.S. Neutral Panel Rules, but without the heightened scrutiny now required when challenging an award for evident partiality where the arbitrator is party-appointed and non-neutral.

New York Federal Court Allows Damages for Reinsurance Payments Under Equitable Subrogation

Continental Casualty Co. v. Al Qaeda Islamic Army, No. 03 MDL 1570, 04 Civ. 5970, 2018 U.S. Dist. LEXIS 108722 (S.D.N.Y. Jun. 25, 2018).

A New York federal court, in one of the September 11, 2001 lawsuits against Al Qaeda, granted plaintiff insurance carriers' motion for an award of damages on a default judgment against the terrorist organization. The damages requested included both insurance payments made to insureds as a result of the September 11 terrorist attacks and reinsurance payments made to cedents. The decision is interesting because of the potential conflict between the traditional concept of privity in reinsurance and the scope of equitable subrogation.

The court was asked to address the calculation of damages to the plaintiff-insurers after entering a default judgment against the defendant terrorist organization. The issue was referred to a Magistrate Judge who issued a report and recommendations on the amount of damages awarded. The Magistrate Judge found that the insurers could not recover for their reinsurance claims under principles of subrogation because there was no contractual privity between the reinsurer and the original insured.

In rejecting the Magistrate Judge's determination on this issue, the district court held that the insurer-plaintiffs "can recover for the payments made on their reinsurance contracts under general principles of equitable subrogation, regardless of whether they are in privity with the insureds." The court held that its finding was consistent with prior cases and its prior orders within the MDL case itself.

As to the doctrine of equitable subrogation, the court found that, under New York law, the doctrine allows insurers to stand in the shoes of their insured to seek indemnification by pursuing claims that the insured may have had against third parties legally responsible for the loss. Because equitable subrogation is an equitable doctrine, and not a doctrine founded on contract, under New York law it is established that privity is not required.

So what we find in this case is an exception to the contractual privity rule in reinsurance because of equitable subrogation. Reinsurers are entitled to recover damages from third parties based on payments they made on the loss through their reinsurance contracts.

New York Federal Court Allows Evidence That Follow-the-Settlements or Follow-the-Fortunes Should Be Implied in Facultative Reinsurance Certificates

Utica Mut. Ins. Co. v. Munich Reins. Am. Inc., No. 6:12-cv-196, 2018 U.S. Dist. LEXIS 106970 (N.D.N.Y. Jun. 27, 2018).

A New York federal court has denied a reinsurer's motion *in limine* to preclude the cedent from presenting evidence in support of the existence of a follow-the-fortunes or a follow-the-settlements clause.

The parties' dispute concerns money owed under two facultative reinsurance certificates issued in 1973 and 1977. Neither of the certificates contains an express follow-the-fortunes or follow-the-settlements clause, which would bind the reinsurer to accept (1) the cedent's good faith decisions regarding the terms of the underlying insurance and the claims against the insured, and/or (2) the cedent's good faith settlements, arguably within the scope of the insurance coverage that was reinsured, and reasonable decisions regarding post-settlement allocation.

On the parties' motions for summary judgment, the court previously declined to imply a follow-the-settlement clause into the reinsurance certificates at issue. The reinsurer then filed motions *in limine* seeking to preclude the cedent from presenting any evidence at trial that the follow-the-fortunes and follow-the-settlement should be implied as a matter of custom and practice.

In their reports, three of the cedent's experts opined that (1) the principles of follow-the-fortunes and follow-the-settlements are generally applicable even where not specifically referred to in the reinsurance contract, (2) a "basic and customary tenant" of the reinsurance industry is that reinsurers follow the fortunes of the cedent's decisions regarding settlement and claims handling and (3) all reinsurance contracts follow the fortunes or settlements of the underlying coverage unless expressly stated otherwise.

Under New York law, which applies to the facultative reinsurance certificates, custom and usage evidence must establish that the omitted term is "fixed and invariable" in the industry in question. In other words, a party seeking to use trade usage to add a term to a contract must show either that (1) the other party to the contract is actually aware of the usage or (2) the existence of the usage in the business is so notorious that a person of "ordinary prudence" would be aware of it.

In support of its motion, the reinsurer argued that the cedent's experts had – at most – identified a general custom and practice in the industry and, therefore, the cedent could not satisfy the "fixed and invariable" standard. In response, the cedent argued that it need only show a custom and practice that is "generally understood" in the particular business – not one that is fixed and invariable.

In denying the reinsurer's motion *in limine*, the court held that it will allow the cedent to present evidence about this issue. The court, however, was not persuaded by the cedent's arguments regarding the applicable standard. The court held that the cedent will bear the burden of proof on the issue, and it will have to demonstrate a fixed and variable custom and practice in the reinsurance industry to import the follow-the-fortunes or follow-the-settlements clauses into the reinsurance certificates.

DC Federal Court Dismisses Insured's Claims Against Reinsurers in a Credit Insurance Dispute

Vantage Commodities Fin. Servs. 1, LLC v. Assured Risk Transfer PCC, LLC, No. 1:17-cv-01451 (TNM), 2018 U.S. Dist. LEXIS 131401 (D.C. Aug. 6, 2018).

A finance company provided credit to an energy company and purchased a credit insurance policy to secure its risk of loss. The credit insurer was reinsured for 90% of the risk with a series of reinsurance companies on a reinsurance program organized by a reinsurance intermediary. A claim arose and, after winning an arbitration against the credit insurer, the insured found itself unsatisfied because the credit insurer had a letter of credit that covered just over 10% of the loss and because the reinsurers disputed the claim with the cedent credit insurer and refused to pay.

Stymied by these circumstances, the insured brought suit in federal court against the credit insurer, all the reinsurers and the reinsurance intermediary and its affiliates. In response, the reinsurers and the intermediary filed motions to dismiss. The court granted the reinsurers' motion to dismiss based on lack of personal jurisdiction and granted the reinsurance intermediary's motion in part.

In deciding in favor of the reinsurers, the court found that it had specific jurisdiction over the insured's claims against the reinsurers because the reinsurers purposely entered into the reinsurance contracts with a substantial connection to the District of Columbia. But, importantly, the court found that the insured failed to serve the reinsurers properly. The issue came down to whether the service provisions in the reinsurance contracts that name a law firm for service of process allowed for service in all circumstances or whether that provision has a more narrow construction.

In ruling that service was improper, the court found that it cannot show that it has a direct contractual relationship with the reinsurers. The court noted that, even though the insured argued that the credit insurer held only 10% of the risk and disclosure of the reinsurers was necessary to get the insured to purchase the insurance policy, it was not sufficient to overcome the lack of contractual privity. Thus, held the court, the insured had not validly asserted personal jurisdiction over the reinsurers. The court also denied the request to allow for alternative service because it found that the effort would be futile given that the insured had no rights under a direct contract with the reinsurers.

The court also dismissed the insured's contract claims against the reinsurance intermediary and its affiliates, but allowed the insured's negligence claims to survive.

Texas Court of Appeals Upholds Summary Judgment Ruling in Favor of Reinsurer

Capitol Life Ins. Co. v. Newman, No. 05-16-01476-CV, 2018 Tex. App. LEXIS 4602, 2018 WL 3062495 (Tex. Ct. App. Jun. 21, 2018).

A Texas appellate court affirmed an order granting summary judgment in favor of a reinsurer in a cedent's breach of contract action. The reinsurer and the cedent, a life insurer, had entered into an assumption reinsurance agreement in 1985, pursuant to which the reinsurer agreed to reinsure certain fixed annuity contracts and certificates, and defend and indemnify the cedent against claims regarding specific policies.

Starting in 2008, a policyholder began contacting the cedent and others insisting that she had invested in a life insurance annuity policy back in 1978. The policyholder later sued the cedent, asserting claims for breach of contract, conversion, unjust enrichment, bad faith, deceptive insurance practices and violations of the deceptive trade practices act. The cedent notified the reinsurer of the policyholder's claims, but the reinsurer refused to defend or indemnify the cedent or pay the policyholder's claims.

The cedent filed a third-party claim against the reinsurer for breach of contract, and the reinsurer moved for summary judgment on the ground that the cedent had failed to provide sufficient evidence of its claim. The Texas trial court granted the reinsurer's motion.

To support its breach of contract claim under Colorado law, which governed the reinsurance agreement, the cedent had to prove (1) the existence of a contract, (2) performance by the cedent or some justification for non-performance, (3) failure to perform the contract by the reinsurer and (4) resulting damages to the cedent. Although the cedent had provided evidence as to the existence of the reinsurance agreement, the reinsurer insisted that sufficient evidence as to the remaining elements was lacking.

On appeal, the cedent argued that the record showed the cedent had performed under the reinsurance agreement because the agreement had been amended. According to the cedent, that would not have occurred if the cedent had not performed under the agreement. The appellate court disagreed. It affirmed the lower court's grant of summary judgment in favor of the reinsurer. Ultimately, the appellate court held that it could not conclude that the amendment to the reinsurance agreement constituted more than a "scintilla" of probative evidence to raise a genuine issue of material fact as to whether the cedent had performed under the reinsurance agreement.

Recent Speeches and Publications

- Eridania Perez will be moderating the Arbitrator and Umpire Seminar – 2018, "Making Hard Decisions on the Road to a Fair and Efficient Arbitration," on November 7, 2018, the day before the ARIAS• U.S. Fall Conference, at the New York Marriott Brooklyn Bridge.
- Larry Schiffer will be speaking on "ETHICS: Vacating an Award: Lessons from the *ICA v. Underwriters Decision*," on November 9, 2018, at the ARIAS• U.S. Fall Conference and Annual Meeting in Brooklyn, NY.
- Mary Jo Hudson spoke on an NAIC Regulatory Roundup panel at the ACLI Compliance & Legal Sections Annual Meeting on July 11, 2018, in West Virginia.
- Larry Schiffer's commentary, "Insurtech, Disruptive Technologies, and Reinsurance" was published on IRMI.com in June 2018.
- Congratulations to the Squire Patton Boggs insurance team for being ranked in *The Legal 500* for Advice to Insurers. The editors said that "Squire Patton Boggs' insurance and reinsurance practice 'brings a rock-solid commitment to client service' and is well known for its litigation and arbitration expertise." Recommended lawyers listed are Larry Schiffer, ranked within Leading Lawyers – Reinsurance, Suman Chakraborty, Eridania Perez, Patrick Dugan, Mary Jo Hudson, Mark Sheridan, Deirdre Johnson and Paul Kalish.
- Congratulations to Larry Schiffer for being one of the inaugural members of *The Legal 500* Hall of Fame, which recognizes individuals who have received constant praise by their clients for continued excellence and have been recognized by *The Legal 500* as one of the elite leading lawyers for six consecutive years.
- Congratulations to Paul Kalish for being ranked in *Best Lawyers in America* 2019 for Insurance.

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