

# AN ANALYSIS OF THE 2004 PROCEDURES FOR THE RESOLUTION OF U.S. INSURANCE AND REINSURANCE DISPUTES

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In 2004, the Insurance and Reinsurance Dispute Resolution Task Force ("Task Force") issued a comprehensive revision of their seminal 1999 effort, the "Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes." A copy of the Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes (the "Procedures") is available at [www.arbitrationtaskforce.org](http://www.arbitrationtaskforce.org). The Procedures are an attempt by a group of veteran arbitrators, insurers, and reinsurers to collect and codify best practices for U.S. reinsurance arbitrations<sup>1</sup>. The 2004 version of the Procedures expands upon the 1999 work in several ways. Most fundamentally, it offers two sets of protocols: one for traditional tripartite panels consisting of two party-appointed arbitrators and one neutral umpire, and another for all-neutral panels. The Procedures also address several important and timely issues, including what it means for a party-arbitrator to be "disinterested," replacement of an arbitrator due to death or incapacity, and streamlined methods of document discovery. This article will briefly discuss the new Procedures for both traditional and all-neutral arbitration panels.

## Discussion

### *I. The Procedures as a Compilation and Refinement of Best Practices With Traditional Panels*

#### **The Incorporation by Reference Model**

The use of arbitration to resolve reinsurance disputes is almost as old as the idea of reinsurance itself. Over time, the standard reinsurance arbitration clause has evolved into its present form. Generally speaking, the standard clause prescribes mandatory arbitration of all disputes arising with respect to the contract; provides for appointment of two party-appointed arbitrators who then choose a neutral umpire pursuant to a stated procedure; states the place where the hearing is to be held; prescribes the method of splitting expenses; and characterizes the arbitration as an honorable engagement to which the strict rules of law are not applicable. Other provisions, such as governing law provisions, award enforcement provisions, and multiple reinsurers provisions, are sometimes added as well.

This typical form of arbitration clause has become so familiar in the market, and to attorneys in the field, that it is easy to forget that it is not the only form of clause, or even the only type of clause, available. But the usual form must be seen as embodying only one of many methods of providing for arbitration – a method that is not necessarily the best, and certainly is not the only, means to that end. Specifically, the standard clause provides for arbitration by laying out, in the contract itself, a full and complete procedure for settling differences. There is another methodology, and the Procedures opt for it. This is the model of incorporation by reference, whereby the contract itself contains only a simple agreement to resolve disputes by arbitration, and a reference to externally established procedures, not recited in full in the contract, to be employed.

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<sup>1</sup>Task Force participants include senior members of insurance and reinsurance companies, industry trade associations, and experienced reinsurance arbitrators.

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This is the methodology employed in many other industries,<sup>2</sup> and it has inherent advantages. An arbitration clause incorporated by reference can be short and concise, thus facilitating the contracting process, while the procedures themselves can be as detailed as necessary. Indeed, arbitration procedures incorporated by reference can be more detailed than "usual" arbitration procedures set forth in full in the contract, because, as a practical matter, there are limits to the amount of procedural detail the parties will load into their contracts. Moreover, an incorporation methodology allows the parties to adopt procedure that can be revised over time, whereas it may not be feasible to frequently modify express contract language.

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### **Best Practices**

The individual members of the Task Force are all reinsurance veterans well versed with existing arbitration practices. As such, they are well suited to frame a compilation of the "best practices" being employed. This is precisely what they have done. The Procedures generally prescribe rules that foster expeditious arbitration before quality panels fully equipped to do equity between the parties.

The Procedures encourage speedy disposition of disputes in many ways, some of which are well-known to practitioners and others which are quite innovative. These methods include:

- *Definition of disinterested.* Accusations that an arbitrator is not disinterested have become an all too common event. The Procedures state clearly that all arbitrators must be "disinterested," but define that term in the practical sense of not being "under the control of either party, nor shall any member of the panel have a financial interest in the outcome of the arbitration." (Procedures, 2.3.) This simple and limited definition should eliminate the growing trend of challenges to party-appointed arbitrators on the basis that they have an indirect interest in the case, such as a familiarity with the parties or prior exposure to the underlying issue.<sup>3</sup>
- *Summary disposition.* The Procedures expressly grant the panel the power to hear and determine the case via summary disposition. (Procedures, 13.1.) This should encourage panel members to decide matters on the papers when a full-blown hearing is unnecessary.

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<sup>2</sup> See, e.g., *Volt Info. Sciences, Inc. v. Board of Trustees of the Leland Stanford Jr. Univ.*, 489 U.S. 468 (1989), which deals with a contract incorporating the Construction Industry Arbitration Rules promulgated by the American Arbitration Association ("AAA"). Other industries in which contracts frequently incorporate rules promulgated by the AAA or other independent authors include securities and real estate.

<sup>3</sup> An oft-discussed case on point is *Sphere Drake Ins. Ltd. v. All American Life Ins. Co.*, 307 F.3d 617 (7th Cir. 2002), in which a party challenged an adverse award on the basis that the other party's party-appointed arbitrator showed "evident partiality" due to his prior business contacts with one of the parties. The Seventh Circuit reversed the lower court's vacatur of the award, noting that "in the main, party-appointed arbitrators are supposed to be advocates." *Id.* at 620.

- *Death or incapacity of an arbitrator.* The Procedures state that if a party-appointed arbitrator or a neutral umpire is unable or unwilling to serve, a replacement shall be chosen within 14 days. (Procedures, 6.8, 6.9.) This should eliminate the harsh effect of requiring proceedings to start "from scratch" in the event of a panel member's death or incapacity.<sup>4</sup>
- *Mandatory document disclosures.* Akin to the Federal Rules of Civil Procedure, the Procedures require a "voluntary, prompt and informal exchange of all non-privileged documents and other information relevant to the dispute" prior to formal discovery. (Procedures, 11.1.) The voluntary exchange should eliminate some of the delay inherent in the arbitration discovery process.
- *Streamlined proceedings.* A separate set of streamlined procedures is prescribed for cases deemed appropriate by the parties. (Procedures, 16.) These alternative procedures, which provide for shorter time periods, no discovery, and a hearing via written submission, should result in expeditious disposition of smaller cases.

The Procedures also suggest a new process for appointing arbitration panels. Many parties are unhappy with the "name, strike and draw" process whereby a party may try to "stack the deck" by advancing a short list of umpire candidates with a favorable disposition in the hopes that one will be chosen by lots. The Procedures call for a more complicated, but hopefully more equitable, process. Specifically, the Procedures require party-appointed arbitrators to be appointed simultaneously within 30 days of commencement of the arbitration. (Procedures, 6.2.) If the party-appointed arbitrators are unable to agree upon an umpire within 30 days, then each party submits a list of eight umpire candidates. After the candidates complete umpire questionnaires, each party strikes five candidates from the other's list, leaving two lists of three names each. If one individual appears on both lists, he or she is appointed umpire. If more than one individual appears on both lists, one umpire is chosen from that set by lots. If there is no overlap between the lists, each party ranks the six names on the lists in order of preference, and the person with the best total numerical ranking becomes the umpire. (See generally Procedures, 6.7.) While a detailed discussion of the merits of this numerical protocol is beyond the scope of this article, its intent - to curb abuses in the umpire selection process - is laudable.

The Procedures also seek to expand the pool of qualified arbitrators. Traditional reinsurance arbitration clauses required an arbitrator candidate to be a "current or former officer or executive of an insurance or reinsurance company." The Procedures offer that traditional language, or alternative language that the parties may elect to have "professionals with no less than

<sup>4</sup> See *Trade & Transport, Inc. v. Natural Petr. Charterers Inc.*, 931 F.2d 191, 194-95 (2d Cir. 1991) (collecting authorities). The Procedures provide that if the umpire is unable or unwilling to serve, a replacement shall be promptly appointed, and prescribe procedures for this eventuality. A more complete treatment of the subject might have added that the resulting, reconstituted panel is empowered to resolve the dispute, but the intent is clear and the lack of this recitation appears harmless.

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ten years of experience in or serving the insurance or reinsurance industry" act as panel members. (Procedures, 6.2.) This expanded qualification clause would presumably allow experienced attorneys to serve as panel members.

Finally, the Procedures contain rules designed to ensure that the panel has full power to control the proceedings before it and make an award that fully resolves all aspects of the dispute, in a realistic business manner:

- Paragraph 14.3 sets forth the "honorable engagement" concept long familiar in the industry, in standard language (including the stipulation that the panel need not follow "the strict rules of law.") The paragraph goes on, however, to set forth language concerning the method of resolving the dispute which, while equally familiar to practitioners, has less uniformly been included in arbitration clauses: "In making their Award, the panel shall apply the custom and practice of the insurance and reinsurance industry, with a view to effecting the general purpose of the underlying agreement which is the subject of the arbitration." (Procedures, 14.3.)
- Settling a frequently controversial issue, the Procedures give the panel power to grant interim relief, including pre-hearing security. (Procedures, 8.1.)
- Similarly, the panel is given express authority to impose sanctions (including costs, attorneys fees and orders of preclusion) for failure to comply with interim rulings, or for discovery abuse. (Procedures, 8.2.)
- The parties, if all agree, are given the right to require a reasoned decision of the panel. (Procedures, 15.4.)
- The proceedings, hearing and award are expressly made confidential, thus allowing the parties the freedom of expression required for full airing of the issues without adverse repercussions in the marketplace. (Procedures, 7.1.) Certain exceptions to confidentiality are established, such as for judicial proceedings relating to the award, and the list of exceptions accords with currently prevalent practice. (Procedures, 7.2.)

**A Missed Opportunity?**

To the extent there is room for criticism of the Procedures, the Task Force may have devoted too much attention to compiling the best existing practices and not enough attention to curing defects that exist even when best practices are employed. It is no secret that the current arbitration system is plagued by too much litigation and controversy. There are too many challenges to the neutrality of the panel, too many parties stonewalling the process through challenges to arbitrability, too many motions for vacatur of the award, too many discovery disputes; in short, too much litigation at the margins of the process and too much abuse. The Procedures could have done more to stem the litigation tide by resolving areas of uncertainty within existing practices. Three examples typify the problem.

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The first relates to the definition of "neutral" as an umpire qualification. The Procedures require the umpire to be "neutral," but the definition of that term set forth in paragraph 2.4 - "disinterested, unbiased and impartial" - is somewhat tautological. The Procedures do not tell us what facts must be present to indicate an interest, bias or partiality, or what type of interests, biases and partialities the umpire must be free of in order to qualify as "neutral" (or, to put the matter more starkly, what interests, biases and partialities the umpire may have yet still be deemed "neutral"). If the intent is that an umpire must be free of any such impediment (as we must conclude if we give the Procedures their literal meaning), this is an open invitation for parties to litigate over a potential umpire's slightest previous contacts with the parties, their appointed arbitrators, or the potential witnesses. In the insular world of reinsurance arbitration, it will be difficult indeed to find umpire candidates so utterly removed from any given dispute.

The Task Force could have adopted the same definition for "neutral" as it did for "disinterested," or a variant thereof, or a definition offering more specific and practical guidance. By adopting the broad definition expressed in paragraph 2.4, it has invited continued litigation over the concept of neutrality, with concomitant delay and expense.<sup>5</sup>

A second example is the problem of disputes involving multiple reinsureds or reinsurers under the same contract, especially where there are differing interests among those reinsureds or reinsurers. These cases present a myriad of procedural issues, such as whether one proceeding or multiple proceedings should be had and who controls the nomination of the party-appointed arbitrators. See, e.g., *Connecticut Gen. Life Ins. Co. v. Sun Life Assur. Co.*, 210 F.3d 771 (7th Cir. 2000). The Procedures have precious little to say about such cases, thus leaving these issues fertile for litigation.

A final example is discovery. The Procedures include only general rules regarding discovery; they give the panel the power to order the production of such documents "as it considers necessary for the proper resolution of the dispute" and "such depositions as are reasonably necessary." (Procedures, 11.2-11.3.) The Task Force chose not to limit and regularize the discovery process by adopting one or more of the specific rules that have been proposed in recent years (e.g., to confine discovery to the contract at issue or to limit the number and length of depositions). Perhaps this is as it should be, in that the scope and duration of discovery must be tailored to the circumstances of each case. But the Procedures' broad guidelines may do little to stem the discovery disputes that occur all too often.

## *II. The Neutral Procedures: A Comparison with English Arbitration Law*

The Task Force also prepared an alternate set of procedures for neutral arbitration panels (the "Neutral Procedures"). Neutral panels are, of course, a mainstay of arbitration under English law. One meaningful way in which to analyze the Neutral Procedures, then, is by comparing them to the rules of arbitration under the English Arbitration Act of 1996 (the "Arbitration Act") and the arbitration rules of the A.I.D.A. Reinsurance Arbitration Society of the UK (the "UK Rules"), which are often used to supplement the procedures for arbitration conducted under the auspices of the Arbitration Act. There are several useful points of comparison among the Neutral Procedures, the Arbitration Act and the UK Rules as follows:

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<sup>5</sup> Paragraph 2.4 of the Procedures does contain a caveat recognizing that an umpire may be "neutral" even if he has had "previous knowledge of or experience with respect to issues involved in the dispute." While this language is helpful, it does not address the common problem of a prospective umpire who has had previous contacts with the parties, their appointed arbitrators, or the witnesses.

**The Task Force also prepared an alternate set of procedures for neutral arbitration panels.**

**The custom and practice under the Arbitration Act and the UK Rules is to permit a party to have limited pre-appointment discussions with a prospective arbitrator concerning the general nature of the dispute and the identity of the parties. The Neutral Procedures, by contrast, prohibit even this limited pre-appointment *ex parte* communication.**

**The absence of any *ex parte* communication or a mandatory reasoned award may leave parties with little insight into the Panel's reasoning after an award is issued in an arbitration conducted pursuant to the Neutral Procedures.**

**The 2004 Procedures and Neutral Procedures represent a significant step forward in establishing best practices for both traditional arbitration panels and all-neutral panels.**

*Ex parte communications.* The Neutral Procedures, the Arbitration Act and the UK Rules all require that arbitrators be neutral and have no *ex parte* communication with any party once the panel has been formed. These procedures differ, however, with respect to the permissibility of pre-appointment *ex parte* communication. The custom and practice under the Arbitration Act and the UK Rules is to permit a party to have limited pre-appointment discussions with a prospective arbitrator concerning the general nature of the dispute and the identity of the parties. The Neutral Procedures, by contrast, prohibit even this limited pre-appointment *ex parte* communication. Specifically, the Neutral Procedures state that "[u]nder no circumstances shall either Party or anyone acting on the Party's behalf engage in any communication with any prospective panel member that could reasonably lead such panel member to identify the Party that initiated the proposed panel member's selection. *Ex parte* communications between the Parties and the panel in relation to the arbitration is prohibited." (Neutral Procedures, 6.4 (emphasis added.)) Although party-appointed arbitrators may be able to surmise who appointed them, the Neutral Procedures' strict prohibition against *ex parte* communication may further foster the spirit of complete neutrality.

*Confidentiality.* The Neutral Procedures and the UK Rules both expressly state that arbitrations are confidential. (Neutral Procedures, 7.1; Rule 11.5, UK Rules.) English case law interpreting the Arbitration Act likewise has held that arbitrations are confidential.

*Chairman Qualifications.* The trend in London market practice has been towards having a three party tribunal, consisting of two London market individuals and a third arbitrator or "chairman" being an experienced reinsurance lawyer. The Neutral Procedures recognize this trend by offering that "professionals with no less than 10 years of experience in or serving the insurance or reinsurance industry" can qualify as an arbitrator. This would allow a reinsurance lawyer to sit as chairman, which may prove especially useful in drafting reasoned awards that withstand appellate scrutiny.

*Reasoned Awards.* Both the Arbitration Act (§ 52(4)) and the UK Rules (Rule 16.2) require the panel to set out their reasons for the award unless the parties agree otherwise. By contrast, the Neutral Procedures mandate a reasoned award only by agreement of both parties. The absence of any *ex parte* communication or a mandatory reasoned award may leave parties with little insight into the Panel's reasoning after an award is issued in an arbitration conducted pursuant to the Neutral Procedures.

*Interim Relief and Pre-Hearing Security.* The Arbitration Act and the Neutral Procedures both permit the panel to award interim relief as it deems necessary. (Arbitration Act, § 41; Neutral Procedures, 8.2.) The UK Rules, by contrast, specify certain powers which are not granted to the arbitration panel, including, the posting of pre-hearing security and the payment of exemplary or punitive damages. (UK Rules, Rule 14.)

*Hold Harmless Agreements.* The Arbitration Act and the UK Rules both provide that an "arbitrator is not liable for anything done or omitted in the discharge or purported discharge of his functions as arbitrator unless...in bad faith." (Arbitration Act at § 29; UK Rules at Rule 21.2.) The Neutral Procedures, by contrast, are silent regarding the immunity of the arbitrators. In practice, we would expect that an arbitration panel operating under the Neutral Procedures may simply refuse to serve unless all parties to execute a hold harmless agreement.

## **Conclusion**

The 2004 Procedures and Neutral Procedures represent a significant step forward in establishing best practices for both traditional arbitration panels and all-neutral panels. Reinsurers, cedents and reinsurance intermediaries should review the Procedures and consider whether to incorporate them, or certain of their features, into future reinsurance arbitration clauses.