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Goldberg Segalla's *Reinsurance Review* provides timely summaries of and access to the latest reinsurance law developments worldwide, and is published monthly. Cases are organized by court and date. In addition, we provide the latest information regarding news in the insurance and reinsurance industries. Your interest in our publication is appreciated and we welcome your feedback. Please feel free to share this publication with your colleagues. If others in your organization are interested in receiving the publication, or if you do not wish to receive future issues, please contact **Jeffrey L. Kingsley.**

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UNITED STATES CIRCUIT COURT DECISIONS

NINTH CIRCUIT

UNITED STATES LIFE INSURANCE V. SUPERIOR NATIONAL INSURANCE CO.

(CIVIL ACTION NO. 07-55938 MARCH 9, 2010)

Ninth Circuit Refuses Rehearing of $500,000 Judgment Against Reinsurer

The Ninth Circuit refused to grant United States Life Insurance Company's ("US Life") petition for a rehearing *en banc* regarding its $500,000 judgment against US Life. Earlier this year, the Ninth Circuit confirmed that the arbitration panel did not exceed its express and implied authority by ordering US Life to pay $500,000 to Superior National Insurance Co. The Order stemmed from a reinsurance contract covering workers compensation risks for five California insurers. Due to an economic downturn, the insurers declared bankruptcy.

Ten years ago, US Life requested arbitration pursuant to the reinsurance contract seeking: (1) rescission or reformation of the contract because the insurers misrepresented the reserves during the underwriting process and (2) damages for the insurers' bad faith performance. The arbitration panel bifurcated the arbitration into two phases; the first addressed rescission and reformation and the second determined whether the insurers engaged in improper handling of claims that resulted in bills to US Life in excess of the amount(s) due under the reinsurance agreement.

In the first phase, the panel reformed the agreement so that US Life was liable for only 90% of the risks insured by the underlying policies because of the insurers' failure to be forthright during the contract formation period. In the second phase, the panel found that all bills prior to December 6, 2006 were due and all post-December 6, 2004 bills were required to be paid within thirty days of receipt. In addition to interest, the panel directed US Life to disgorge its actual investment earnings of all monies due under the reinsurance agreement as of June 30, 2004.

The United States District Court for the Central District of California confirmed the award and US Life sought review in the Ninth Circuit Court of Appeals. The Ninth Circuit affirmed the award and rejected any request for a rehearing. It declared that the arbitration panel did not abuse its discretion by allegedly refusing to hear material evidence regarding the insurers' handling of the claims by closing the meeting of the panel with the neutral experts. Although an *ex parte* meeting between an arbitrator and a neutral expert is not a routine arbitration practice, the panel had the authority to adopt its own rules of procedure. The arbitration panel gave each of the parties adequate opportunity to present evidence and arguments. The impact of the arbitration panel's *ex parte* meeting with the reviewers was mitigated by the notice, extensive correspondence, and other, more inclusive procedures. The Ninth Circuit Court again held that the arbitration panel did not engage in misconduct, that the parties were provided with a

fundamentally fair arbitration and that the arbitration award rested on a plausible interpretation of the governing arbitration documents.

IMPACT (ARBITRATION): It is not surprising that the Ninth Circuit would reject the cedents' claim. As outlined in this decision, while the arbitrators' conduct and rules were a bit unusual, the course and conduct of an arbitrator is usually discussed and agreed to by the parties before the evidentiary portions of the arbitration. Usually the parties are aware of the extent of the discretion an arbitrator will exercise with respect to communications between parties and witnesses before the substantive portions of the arbitration. As such, practitioners should understand the procedural conduct of the arbitration panel in advance of any final determination to minimize possible issues of misconduct.

UNITED STATES DISTRICT COURT DECISIONS

SOUTHERN DISTRICT OF NEW YORK

SCANDINVIAN REINSURANCE CO. LTD. V. ST. PAUL FIRE & MARINE INSURANCE CO.

(CIVIL ACTION NO. 09-CV-9531 FEBRUARY 23, 2010)

Reinsurance Arbitration Award Vacated Where Arbitrators Failed to Disclose Involvement in Another Arbitration Involving a Common Witness

A reinsurance company petitioned the federal district court to vacate an arbitration award on the basis that two of the arbitrators failed to disclose that they were simultaneously involved in two separate arbitrations. The other arbitration involved a pivotal common witness, similar disputed contract terms and issues, and a company that succeeded to the business of the defendant in this arbitration. During the selection process, the arbitrators submitted a completed questionnaire and made supplemental disclosures regarding their current and previous service as arbitrators and their experiences with affiliates and subsidiaries of the parties. At no time, however, did they disclose that they had been chosen to be arbitrators in the other proceeding or that the issues involved the same pivotal witness.

The reinsurer asserted that, had it known of the arbitrators' involvement in the other proceeding, they would have objected to their service and sought their recusal if they refused to voluntarily resign prior to the arbitration moving forward. Applying the Second Circuit test of "evident partiality," the court noted that "an arbitrator who knows of a material relationship with a party and fails to disclose it meets *Moralite's* 'evident partiality' standard: A reasonable person would have to conclude that an arbitrator who failed to disclose under such circumstances was partial to one side." The court held that the undisclosed relationship with the other arbitration constituted a material conflict of interest since the arbitrators placed themselves in a position where they could receive *ex parte* information regarding the type of reinsurance business at issue, be influenced by credibility determinations of the common witness' testimony, and sway the other

arbitrator's thinking on issues relevant to the arbitration. By failing to disclose their participation in the other arbitration, the conflicted arbitrators deprived the reinsurer of an opportunity to object to their service or to adjust their arbitration strategy. As such, the nondisclosure was material and exhibited "evident partiality."

IMPACT (REINSURANCE): This is the first of two cases in this month's publication where a court vacated an arbitration panel's ruling. In this case, the court found "evident partiality" on the basis that two of the arbitrators were arbitrators in another proceeding where there was a common witness that involved a strikingly similar contract. On its face, the ruling appears to be harsh and places an arbitrator in a difficult position when defining the scope of his or her obligation to disclose information at the onset. Moreover, as discussed in our prior publications, courts typically impose a higher burden on the party asking to vacate an award. In fact, recent case law seems to suggest that courts are showing greater deference to arbitration panels which makes this decision very interesting. We believe this decision will be appealed.

B.D. COOKE & PARTNERS LIMITED V. CERTAIN UNDERWRITERS AT LLOYD'S

(CIVIL ACTION NO. 08-3435 MARCH 9, 2010)

District Court Rejects Pleas to Reconsider its Decision in Sending Reinsurance Dispute to Arbitration

In determining that the issue before the court fell within the scope of the arbitration provision, the Southern District of New York denied cedent's request to reconsider its decision. The dispute arose when one of the parties, Citizens Casualty Company, became a member of a reinsurance pool. Each of the members of the reinsurance pool reinsured several companies, including an English pool consisting of B.D. Cooke. In the early 1970's, Citizens Casualty Company went into court ordered liquidation and, as a result, assigned its rights under the reinsurance agreements to B.D. Cooke. After being awarded the reinsurance contracts, the cedent requested that the reinsurers pay the proceeds of the agreements. When the reinsurer refused to pay the claims, B.D. Cooke commenced this action seeking court intervention to compel the reinsurer to pay the claim.

The District Court, in analyzing the reinsurance agreements, determined that the arbitration clause contained in the reinsurance agreements was broad enough to determine "collateral issues." As a result, the court found that the arbitration clause was in full effect despite the liquidation and sent the action to arbitration.

B.D. Cooke, in turn, made a motion for reconsideration on the grounds that the court failed to take into consideration the decision, *In re Kinosita & Co.* 287 F.2d 951 (2d Cir. 1961). There, the Second Circuit decision in that case found that an arbitration clause, substantially similar to the clause at issue here, was not broad enough to compel the parties to arbitration over indirect issues that involved the reinsurance agreement. The court responded to Cooke's arguments by stating that the decision did consider *In re Kinosita* but the facts were distinguishable from the case at bar. As a result, the court rejected the motion for reconsideration and the parties were ordered to arbitration.

IMPACT (ARBITRATION): Again, the court interpreted the terms and conditions of an arbitration provision broadly enough to allow the parties to go to arbitration based upon the terms and conditions of the contract. While this set of circumstances may be unique, the decision ordering the parties to arbitration is consistent with several recent cases in allowing an arbitration panel to address "collateral issues."

SOUTHERN DISTRICT OF OHIO

OHIC INSURANCE COMPANY V. EMPLOYERS REINSURANCE CORPORATION

(CIVIL ACTION NO. 08-CV-0083 MARCH 8, 2010)

District Court Confirms that An Award for Pre-Judgment Interest Was Covered Under the Reinsurance Agreement

The district court, in applying Wisconsin law, found that the prejudgment interest awarded in an underlying medical malpractice case is within the terms and conditions of the reinsurance agreement in question. The parties entered into an excess cession reinsurance agreement for three years. The reinsurance agreement reinsured a 40 million dollar umbrella policy along with a primary policy involving the Children's Health System.

An unlicensed doctor in-training within the Children's Health System was sued for medical malpractice, specifically, for failing to adequately determine that a patient had a twisted small intestine. Given the fact that the doctor was unlicensed, the state cap of $400,000 did not apply and therefore, the plaintiffs were free to seek an unlimited amount of punitive damages. At trial, the jury awarded the plaintiff and his family $26,000,000. The trial court also awarded costs and prejudgment interest. The OHIC Insurance Company made a claim to its reinsurer but the reinsurer refused asserting that prejudgment interest was outside the scope of cover under the reinsurance agreement.

The court found that an award for prejudgment interest constituted a "loss" under the reinsurance agreement. According to the court, "[t]he fact that OHIC was directly liable for statutory interest, including prejudgment interest, does not change the fact that its liability to pay prejudgment interest arose due its agreements covering the liability … [h]ence OHIC obligation to pay the interest was not independent of the umbrella policy … [w]ithout the existence of the umbrella policy, OHIC would have no obligation to pay statutory interest beyond that covered by the primary policy." The court did rule, however, that the reinsurer was not obligated to pay post-judgment interest and legal fees.

IMPACT (ARBITRATION): This is an interesting case where the court, not the arbitration panel, was asked to determine the scope of the reinsurance agreement. Not surprisingly, the court found that pre-judgment interest was within the scope of coverage which requires the

reinsurer to pay the necessary claim. In an interesting twist, the court did not expand the agreement to include post-judgment and legal fees. In recent decisions, courts have obligated a reinsurer to pay legal fees if a party failed to object to said costs at the conclusion of the hearing.

UNITED STATES STATE COURT DECISIONS

STATE OF NEW YORK

AMERICAN HOME ASSURANCE CO. V. NAUSCH HOGAN & MURRAY

(CIVIL ACTION NO. 602858/08 MARCH 23, 2010)

New York Appellate Court Upholds Trial Court's Decision to Allow Cedent to Pursue Action Against Reinsurance Broker for Rescission of Contract

At issue here is whether a cedent can commence a direct action against a broker because its reinsurance policy was rescinded. In a separate action, the reinsurer compelled arbitration requesting that the policy it issued to the cedent be rescinded due to the fact that the cedent's broker failed "to mention a fundamental change to the contracts of reinsurance in writing to the reinsurance underwriter." Moreover, the broker failed to disclose problems with the financial information provided by the cedent. After an 11 day arbitration, the arbitration panel ordered rescission on the basis that the duty of utmost good faith applies equally to cedents and its agents.

Shortly after the rescission order, the cedent commenced an action against the broker for breach of fiduciary duty, negligent placing of reinsurance and unjust enrichment. The broker moved to dismiss the action claiming that the cedent's own financial information was the cause of the rescission. The trial court denied the motion to dismiss and the Appellate Court affirmed the decision.

The Appellate Court found that the trial court properly "upheld the common-law indemnity claim." In affirming the trial court, the Appellate Court relied on Civil Rules of Civil Practice 1401 ("CPLR 1401") which states that "two or more persons … are subject to liability for damages for the same personal injury, injury to property, or wrongful death." In applying CPLR 1401, the Appellate Court determined that the brokers are subject to liability for the "same" injury because the brokers "stand accused of the same misrepresentations for which the insurer-plaintiff were held responsible in the underlying arbitration."

IMPACT (ARBITRATION): Under New York law on contribution, a party can assert a complaint against several parties for the same complained of act. In this case, what is interesting is that the court accepted the reasoning that brokers, like cedents, are under the obligation of utmost good faith without much discussion.

STATE OF ILLINOIS

AMERISURE MUTUAL INSURANCE CO. V. GLOBAL REINSURANCE CORPORATION OF AMERICA

(CIVIL ACTION NO. 08-CH-42242 MARCH 15, 2010)

Illinois Appellate Court Reverses Arbitration Panel's Decision to Award Attorneys Fees' Finding the Decision Was in "Gross Error"

The issue before the Illinois Supreme Court was whether to uphold an arbitration panel's decision that awarded the cedent attorneys' fees pursuant to a reinsurance dispute. By way of background, in 2001, the parties entered into a quota share reinsurance agreement. According to the agreement's express terms, the reinsurer agreed to reinsure certain policies issued by the cedent.

In 2006, the cedent submitted an approximate 1.5 million dollar claim to the reinsurer seeking reimbursement. The reinsurer allegedly requested that it review certain documents relative to the claim in order to determine whether the claim was made in good faith. The cedent contended that the reinsurer never expressed its intention to review the documents prior to paying the claim and demanded arbitration. In addition to the principal claim, the cedent requested attorneys' fees based on Section 155 of the Illinois Insurance Code. In opposition, the reinsurer argued that the arbitration panel did not have authority to award attorneys' fees. In 2008, the arbitration panel issued an award of 1.56 million dollars which included interest and attorneys' fees. When the cedent moved to confirm the arbitration award in Illinois State Court, the reinsurer made a motion to reject the portion of the award regarding attorneys' fees. The reinsurer's principal argument was that the arbitration panel exceeded its express and implied authority in making such a determination.

In attempting to confirm the entire award, the cedent replied that the reinsurer waived its rights to dispute the award by failing to challenge the issue while the arbitration was being conducted.

The Illinois Appellate Court overturned the arbitration panel's decision with respect to attorneys' fees. The court based its decision on the interpretation of Section 155 of the Illinois Insurance Code. According to its review of Section 155, the court found that the section expressly precluded awarding attorneys' fees to a party "by way of an arbitration panel." As such, the arbitration panel's award was a gross "mistake in law."

IMPACT (ARBITRATION): This is the second case in this month's edition involving a court vacating an award, or a portion of an award, issued by an arbitration panel. Here, the court found that the arbitration panel did not interpret the law correctly when it attempted to shift legal costs from one party to another. What this holding demonstrates is that courts, while acknowledging the growing power of arbitration panels, will not avoid an inquiry into the adequacy of a decision. That being said, the Second Circuit decision in *ReliaStar* indicates that some jurisdictions allow awards to be upheld despite the fact the arbitration panel may have misapplied the law.

OTHER NEWS AND NOTES

UNITED STATES HOUSE BILL WOULD HAVE A BIG IMPACT ON OFF-SHORE INSURERS

Recently, the United States House of Representatives passed a jobs bill that included a provision which will attempt to raise 7.7 billion dollars from corporations who forward their U.S. profits through offshore affiliates to attempt to cut their U.S. tax bill. The provision targets countries that do not have a tax treaty with the U.S., such as Bermuda and the Cayman Islands. It is expected that the United States Senate will review this bill later this year but it is expected to pass both houses.

ODYSSEYRE ANNOUNCES THAT IT IS LICENSED AS A REINSURER IN BRAZIL

On March 24, 2010, representatives from OdysseyRe announced that it obtained a license to conduct business as an admitted reinsurer in Brazil pending the approval from the Brazilian Superintendent of Private Insurance. The United States Reinsurer is currently the 14th largest reinsurer in the world.

MOMENTUM FOR A BERMUDA INSURANCE EXCHANGED HAS DIED DOWN

Those interested in seeing a Bermuda Insurance Exchange similar to that of Lloyd's of London are set to be disappointed as the Bermuda Government has rejected the idea for the time being. The rationale behind putting a hold on the Bermuda Insurance Exchange resulted from New York's attempt to reinstitute the New York Insurance Exchange. Given New York's intention to move forward with the idea, Bermuda did not want to compete and undermine New York's efforts.

ISLAMIC COALITION DEVELOPS ISLAMIC REINSURANCE MODEL

Several Islamic financial researchers in conjunction with the efforts of the Malaysian Central Bank announced the development of a new insurance model. The fundamental purpose of the new insurance model is to provide greater protection for local insurers who have expressed a desire for additional protection.

RIMS SUPPORTS MARSH'S STANCE ON CONTINGENT COMMISSIONS

The Risk and Insurance Management Society (RIMS) recently gave Marsh public support for its position that it will not accept controversial contingent commissions in its U.S. core insurance brokerage sector. The President of RIMS is asking "the insurance industry to develop alternative forms of compensation that do not place the broker in the position of a conflict of interest in the insurance purchase transaction."

FLAGSTONE ATTEMPTING TO MOVE OPERATIONS TO LUXEMBOUG

On March 22, 2010, Flagstone Reinsurance Holdings Ltd., a Bermuda corporation, asked its shareholders to approve a move of the company's domicile from Bermuda to Luxembourg. The justification for the move is to better position the company in preparation for the future financial issues facing the reinsurance industry. As Flagstone's CEO explained "Luxembourg is a major financial center known for its stability as well as its financial sophistication, and we believe this move will increase our strategic and capital flexibility while maintaining our operating model and our long-term strategy." If approved, the move is expected to take place over the next several months.

Goldberg Segalla LLP is a Best Practices law firm with offices in Philadelphia, New York, Princeton, Hartford, Buffalo, Rochester, Syracuse, Albany, White Plains and on Long Island and with affiliated offices in Europe. The **Global Insurance Services** Practice Group routinely handles matters of national and international importance for both domestic and foreign insurers, cedents and reinsurers. This includes: comprehensive audits, policy reviews, regulatory advice, positioning dispute for resolution at the business level (either through interim funding or non-waiver agreements), negotiations among counsel, mediation or fully-involved arbitration or litigation. For more information on Goldberg Segalla's **Global Insurance Services** Group, please contact either **Daniel W. Gerber** or **Richard J. Cohen** . Our **Global Insurance Services** team consists of the following attorneys:

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