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Revisiting the Scope of the Panel's Authority to Rewrite the Reinsurance Contract: Harper Insurance Limited v. Century Indemnity Company 10 Civ. 7866 (S.D. N.Y. July 28, 2011)

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In recent years, the question of whether the arbitration panel has the authority to rewrite terms of the reinsurance contract in resolving disputes between cedents and reinsurers has played prominently in the courts in the United States. In visiting the question in 2010, the U.S. Court of Appeals for the 3rd Circuit affirmed the trial court's vacatur of an arbitration award where the panel crafted a remedy beyond the terms of the contract. In *PMA Capital Insurance Company v. Platinum Underwriters Berm., Ltd.*, 659 F. Supp. 2d 631 (E.D. Pa. 2009), *aff'd* 400 Fed. Appx. 654 (3d Cir. 2010), the trial court vacated an arbitration award finding that the arbitration panel exceeded its authority by removing a "Deficit Carry Forward Provision" from the reinsurance agreement.

In that case, the parties, an insured and reinsured, disputed whether a reinsurer, pursuant to the Deficit Carry Forward provision, could carry forward losses from years that it was not a party to the agreement. Providing no explanation, the arbitration panel held, among other things, that "'any and all references to a deficit carry forward in the [2003 Agreement will be] removed from the contract.'" The arbitration panel reached this conclusion notwithstanding the fact that the agreement contained an "honorable engagement" provision. The district court vacated the award, finding that the arbitrators acted outside the scope of their authority in removing the Deficit Carry Forward provision from the agreement. The 3rd Circuit affirmed, finding that although courts have generously read "honorable engagement" provisions to provide the panel with wide discretion, such discretion is not without limits.

Most recently, the U.S. District Court for the Southern District of New York reached a different result confirming an arbitration award where the panel in a reinsurance arbitration crafted a remedy requiring a prepayment obligation on the reinsurer not found in the original contracts. In *Harper Insurance Limited v. Century Indemnity Company*, the trial court denied the reinsurers' motion to vacate an arbitration award setting a prepayment provision governing the payment of covered claims under the reinsurance treaty. *See* Memorandum and Order at 10 Civ. 7866 (S.D. N.Y. July 28, 2011). In this case, the petitioners, Harper Insurance Limited, River Thames Insurance Company Limited, and Guildhall Insurance Company Limited, were London market companies (referred to as petitioners or LMCs). These entities comprised a subset of a larger group of London Market Reinsurers (LMRs), which were parties to "Treaty 101," a reinsurance agreement with Century Indemnity Company (Century). Treaty 101 was effective beginning January 1, 1965 through December 31, 1967. Pursuant to Treaty 101, the LMRs were obligated to indemnify Century against certain levels of liability arising out of asbestos-related bodily injury claims. Treaty 101 provided that the "'liability of the Reinsurers shall follow that of the Company in every case' and that 'all payments of claims … in which this reinsurance is involved shall be binding upon the Reinsurers, who shall be bound to pay or all, as the case may be, their proportion of such payment.'" Treaty 101 did not contain a Reports and Remittance clause, which ordinarily dictates when claims must be compensated by the petitioners.

Treaty 101 also contained an arbitration clause, broadly providing that the arbitrators were to "'interpret this Agreement as an honorable engagement and shall make their award with a view to effecting the general purpose of this Agreement in a reasonable manner, rather than in accordance with a literal interpretation of the language.'" The arbitration clause further provided that New York law would govern the arbitration proceedings.

As a result of a significant number of asbestos bodily-injury claims in the early 2000s, the LMRs established a program which required Century to meet certain Reinsurance Documentation Requirements (RDRs) in order to be indemnified. Century initiated arbitration proceedings as it "believed that these unilaterally-imposed requirements were extra-contractual and a departure from the parties' long course of dealing." While eight arbitration panels were formed to address the dispute surrounding the RDRs, only one panel's finding was at issue in this case (the panel). On December 10, 2006, in response to Century's claims for declaratory relief and breach of contract arising out of the RDRs, the panel issued the following interim order:

> Within 106 days of the delivery of a billing … LMRs must pay the entire amount billed or the undisputed portion plus 75 percent of the disputed portion, and present their written objections, if any, to full or partial payment, providing reasonable detail for the grounds for their objections.

The panel established the 106 day amount by adding 31 days to Article IX of the treaty, which provided for a monthly settlement in account and payment 75 days after the close of the month. The panel further noted that nothing in this order precluded the LMRs from asserting "'any objection prior or subsequent to payment of disputed amounts relating to any particular account, loss notice or billing prior or subsequent to billing.'" The panel also promised to "'endeavor to decide any dispute referred to it pursuant [to the prepayment protocol] within a period of three months.'" The panel also provided that the prevailing party would likely be awarded interest at a commercial rate on the sum directed to be paid. The interim order also permitted the panel to retain jurisdiction such that it may resolve any future disputes.

Because three and a half years passed without a dispute involving the prepayment provision, one of the arbitrators asked the parties to submit briefs as to whether the panel should retain jurisdiction over this matter. The LMCs requested that jurisdiction be terminated and that the prepayment provision requiring 75 percent of disputed claims to be paid be eliminated. Century requested that the panel enter a final order which would terminate the panel's jurisdiction and finalize the interim order, except that the protocol was to be amended to require the parties to pursue arbitration before a new arbitration panel with respect to any disputes concerning the prepayment provision. On July 15, 2010, the panel entered a final order, terminating its jurisdiction and incorporating the interim order, with the modification that either party could initiate arbitration within 10 days of a failure to agree on payments of disputed claims.

The LMCs moved the Southern District of New York to vacate the final order entered by the panel. At the outset, the court addressed the parties' dispute as to whether New York's Civil Practice Law or the Federal Arbitration Act governed the petition. This was significant as the petition would have been time-barred under New York law. While the court hinted that New York law would have barred the claims had the LMCs presented a successful argument, the court reasoned that it did not need to address this choice of law issue as the LMCs had failed to meet their substantive burden of showing that the arbitrators acted outside the scope of their authority.

The court then set forth well-settled principles governing arbitration practices, including that "awards 'are subject to very limited review in order to avoid undermining the twin goals of arbitration, namely settling disputes efficiently and avoiding long and expensive litigation.'" The court also noted that "an award may only be vacated on extremely limited grounds" and, pursuant to 9 U.S.C. § 10(a)(4), vacatur is warranted where "'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.'" Quoting the 2nd Circuit case, *Banco de Seguros del Estado v. Mutual Marin Office, Inc.*, 344 F. 3d 255 (2d Cir. 2003), the court held that "'where an arbitration clause is broad, as here, arbitrators have the discretion to order remedies they determine appropriate, so long as they do not exceed the power granted to them by the contract itself.'" The court also quoted *Reliastar Life Ins. Co. v. EMC National Life Co.*, 564 F.3d 81 (2d Cir. 2009), which held that vacatur is appropriate only when "'the arbitral award contradicts an express and unambiguous term of the contract [between the parties] or if the award so far departs from the terms of the agreement that it is not even arguably derived from the contract.'"

Applying these principles, the court held that the panel did not act outside the scope of its authority in entering the final order. In so holding, the court rejected the LMCs' argument that the panel ordered relief that neither party requested and that it exceeded its powers by materially altering Treaty 101 to include a prepayment provision. With respect to the LMCs' first point, the LMCs argued "that Century only sought an order requiring LMC to 'pay or deny' bills within 75 days of receipt." The LMCs argued that they were not given due process as they did not present witnesses or evidence relating to the relief that was awarded with respect to the prepayment provision. The court disagreed and explained that the LMCs confused "the question of whether an *issue* was presented to the arbitrators with the question of whether a *potential remedy* was presented to the arbitrators." (Emphasis in original). The court held that while a panel has no authority to decide an issue that has not been presented to them, there is no rule precluding the panel from issuing a remedy directed to an issue squarely before them. This is especially true considering the broad arbitration language at issue in this case, which directed the arbitrators to interpret the treaty as an "honorable engagement." Furthermore, the court held that the parties did present evidence on this issue and, therefore, rejected LMCs argument that the prepayment provision was not presented before the panel.

The court also held that the prepayment provision was within the authority of the panel. Again citing to the "honorable engagement" clause, the court did not find that the panel materially rewrote the treaty as the arbitration provision directed the arbitrators to refrain from interpreting the contract literally, and to effectuate its general purpose in a reasonable manner. The court held that "the prepayment protocol [was] a legitimate interpretation of the contract's implied expectation that claims would be paid promptly." Even if the court disagreed with the panel's conclusion in this regard, the court held that it had "no authority to override their considered judgment."

The LMCs also argued that once the panel determined that the LMCs' implementation of the RDRs violated Treaty 101, it was improper for the panel to issue any remedy other than what Century asked for or, otherwise, it was required to return the matter to the status quo. In rejecting this argument, the court held:

> Having improperly imposed their terms into the contract, LMCs cannot reasonably complain that the arbitrators, with the mandate of an honorable engagement clause, constructed a remedy in an effort to even the balance of power and ensure that the contract will be performed properly going forward.

The court further recognized that the final order's protocol provided the LMCs with protections, including the panel's endeavor to decide any dispute within three months and an award of interest at a commercial rate on the sum payable to the prevailing party. The court also rejected the LMCs' concern that future arbitration panels would not enforce these protections. The court held that the LMCs could have asked that the panel retain jurisdiction. Since they requested that jurisdiction be terminated, the court held that the LMCs could not now raise a concern with respect to the actions of future panels. Lastly, the court addressed the LMCs' concern "that since this case is a matter of public record, [the court's] decision will be widely read throughout the industry and will 'guide both arbitrators and practitioners regarding the scope of the jurisdiction [a] panel has.'" The court dismissed this concern, reminding the LMCs that it was their choice to bring their petition in federal court.

In reaching its conclusion, the court distinguished *PMA Capital Insurance Company v. Platinum Underwriters Berm., Ltd.*, 659 F. Supp. 2d 631 (E.D. Pa. 2009), *aff'd* 400 Fed. Appx. 654 (3d Cir. 2010), where the district court held that the arbitration panel exceeded its authority by removing a "Deficit Carry Forward Provision" from the reinsurance agreement. In distinguishing *PMA* the trial court noted "the Panel's prepayment mechanism does not violate any explicit provision of the contract itself" and that "the prepayment protocol is a legitimate interpretation of the contract's implied expectation that claims would be promptly." Furthermore, the court found that, unlike *PMA*, the panel in this case provided rationale for its award, namely that it effectuated the general purpose of the parties' agreement.

The scope of the arbitration panels' ability to craft an award to resolve disputes between insurers and reinsurers is central to the arbitration process. The seemingly contradictory decisions found in *PMA* and *Harper Insurance Ltd.* highlight the difficulty that parties face in seeking relief in arbitration. Care must be taken not only in crafting the remedy sought, but also in the panel's work in explaining the remedy awarded. A great dispute in the reinsurance industry is found over whether panels should provide reasoned awards. One of the reasons articulated by the court in *Harper Insurance Ltd.* was the panel's explanation for its decision to require additional obligations on the reinsurer not found in the contract. Certainly, greater clarity in drafting the award formed one basis for the trial court's decision to confirm the arbitration award. Whether the decision will withstand appellate review remains to be seen, though. It seems that the court's attempt to distinguish the decision in *PMA* is superficial. The parties to reinsurance disputes deserve better and more consistent guidance from the courts to allow this private dispute resolution process to achieve its goals.

To discuss any questions you may have regarding the opinion discussed in this Alert!, or how it may apply to your particular circumstances, please contact John D. LaBarbera at 312.382.311 or jlabarbera@cozen.com, or Nicole J. Moody at 312.382.3115 or nmoody@cozen.com.