# REINSURANCE ARBITRATION BASICS

A Practical Guide

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Introduction

Arbitration is any adjudicatory procedure in which a disinterested third party (or panel) hears arguments and reviews evidence provided by the disputants regarding the dispute between them. The arbitrator (or panel) then renders a final, binding decision, which is not subject to court approval or appeal.

When parties to a reinsurance agreement disagree on matters related to their contractual relationship, arbitration is traditionally the forum called for in the contract for the resolution of the dispute.

Reinsurance contracts have specified arbitration as the means to resolve disputes between reinsurers and cedents for well over one hundred years. In an era when there were fewer reinsurers and ceding companies, contractually mandated arbitration was an informal process that enabled the parties to settle disagreements between business persons in a private, collegial manner that preserved highly valued ongoing relationships between reinsurers and their clients. The arbitration panel usually consisted of three financially disinterested active or retired insurance, reinsurance or Lloyd’s executives familiar with the customs and practices of the industry, one of whom served as the umpire. The panel met informally to discuss the issues and reach a binding, practical resolution without lawyers, discovery or, in many cases, a formal hearing.

In the 1990s, as the stakes got higher because of huge losses from asbestos and environmental claims and numbers of insurers and reinsurers went into runoff, the process evolved into a much more formal, quasi-judicial process more closely resembling the litigation that arbitration was originally intended to avoid.

In a typical arbitration now, both sides are represented by legal counsel; there is often extensive discovery involving documented depositions; panels consist of “professional” arbitrators and umpires; there are written briefs and trial-like hearings that frequently involve testimony by fact and expert witnesses and transcripts by court reporters. Modern formalized arbitrations are far more adversarial than their early predecessors, particularly when one or both parties are in runoff and lack the incentive to maintain a continuing trading relationship.

The majority of treaty reinsurance disputes are resolved through arbitration rather than litigation. Some facultative reinsurance certificates also contain arbitration provisions, but this is unusual. This introduction to arbitration is intended to provide a brief overview of current arbitration practices and issues, practical considerations when drafting arbitration clauses and selecting arbitrators, and sources of more in-depth information.

While arbitration is based in the terms of the reinsurance contract itself, parties retain the ability to modify the process or even waive it entirely in favor of litigation, if both sides so agree. In

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1 Professional in this case refers to full-time arbitrators typically in their second career after gaining industry knowledge and expertise.

2 Some facultative reinsurance certificates also contain arbitration provisions, but this is unusual.
the event that a reinsurance contract is silent on how disputes should be resolved, the parties may similarly agree to resolve their dispute through arbitration. Without an arbitration clause, parties electing to submit a dispute to arbitration often memorialize their agreement in a signed, written document issued as a result of an organizational meeting, specifying the terms and conditions they wish to apply to the proceeding.
Arbitration Pluses and Minuses

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<th>Plus</th>
<th>Minus</th>
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<tr>
<td>Designed to be less expensive and quicker than litigation</td>
<td>May not necessarily be cheaper or faster than litigation</td>
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<tr>
<td>Proceedings and results are confidential (subject to litigation)</td>
<td>The award does not establish a precedent for future arbitrations</td>
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<tr>
<td>Decided by industry participants based on custom and practice</td>
<td>Decision may not follow established law</td>
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<tr>
<td>Very limited opportunity for appeal</td>
<td>Very limited opportunity for appeal even if decision is erroneous and/or does not follow established law</td>
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<td>Awards represent pragmatic resolution of the dispute</td>
<td>Perception that arbitrators too often compromise and “split the baby” in the interest of achieving consensus</td>
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Forms of Arbitration

US Arbitrations

Arbitration form and process is dictated (in the absence of mutual agreement to the contrary) by the arbitration clause contained in the reinsurance treaty, or less commonly, facultative certificate. The most common form of arbitration provides for a three person panel of current or retired industry participants with no financial connection to the parties or other interest in the dispute at issue. Each party appoints an arbitrator (“party appointeds”) and the arbitrators together select a neutral umpire. In modern arbitration, potential umpires are usually selected by the parties and their legal counsel, often in consultation with the party appointed arbitrator. Ground rules and schedules for conducting the arbitration are established at an Organizational Meeting between the panel, the parties and their counsels. Parties are usually allowed to communicate with the arbitrator they appointed (known as “ex parte communication”) to obtain guidance on the strengths and weaknesses of the arguments up to a point, established at the Organizational Meeting, when communication ceases. However, arbitrators are generally prohibited by custom from revealing the deliberations between panel members.

Following a discovery process, which may generate motions to the panel regarding relevance of witnesses and issues of privileged information, the panel will review pre-hearing briefs prepared by the attorneys prior to a hearing at which witnesses may be presented and cross examined. Following the hearing, the panel will deliberate and issue its award, which may include interest and costs, although awards of legal fees are rare in US arbitrations.) The decision may be unanimous or may reflect the views of two of the three panel members. The award itself usually consists of a brief, often one sentence, statement. Reasoned awards, explaining the basis of the panel’s decision, are sometimes provided if required by the arbitration clause in the reinsurance contract or at the request of both parties.

Because of concerns over the cost and duration of modern arbitrations, some reinsurance contracts issued in the last ten years call for “expedited” or “streamlined” arbitration, particularly for disputes where the amount at issue falls below a certain threshold. Expedited arbitrations may be decided by a single, neutral arbitrator and often have limited or no discovery, tight time frames, no or few witnesses and a one day hearing or no hearing at all. Various streamlined procedures have been codified by an RAA-sponsored industry task force on arbitration (the U.S. Insurance and Reinsurance Dispute Resolution Procedures), ARIAS³, AIRROC⁴, and other dispute resolution organizations.

In response to perceptions by some cedents and reinsurers that certain arbitrators are biased in favor of the parties that repeatedly appoint them, some recent arbitration clauses specify that all three panel members must be neutral as well disinterested.

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³ The AIDA Reinsurance and Insurance Arbitration Society, ARIAS•U.S. is a not-for-profit corporation that promotes improvement of the insurance and reinsurance arbitration process for the international and domestic markets.

⁴ A US-based non-profit association focusing on the legacy sector of the insurance and reinsurance industries.
Baseball Arbitration, borrowed from a process used by Major League Baseball to resolve salary disputes, precludes arbitrators from making compromise, “split the baby” awards. Both parties state their claims and present their cases. The arbitrators may only choose one claim or the other. While the process is practicable when the recoverable amounts are at issue, as in allocation cases, it is less useful when the parties are contesting whether coverage applies at all or when amounts are widely separated. Baseball arbitration provisions are relatively uncommon in reinsurance contracts.

**UK Arbitrations**

UK reinsurance arbitrations differ from US practice in a number of fundamental ways. All panel members are impartial and independent. Ex parte communication is not permitted. Awards are “reasoned,” providing explanation and justification for the decision and may, in some circumstances, be appealed to the courts for mistakes in applying established law. The UK legal practice of “loser pays” also applies, awarding attorneys’ fees and arbitration expenses to the prevailing party.
Contract Checklist

A partial list of some critical issues to consider when drafting reinsurance contracts containing provisions for arbitration. Although the parties may agree to amend contractual provisions at any time, this often becomes impractical once a dispute arises and the process becomes adversarial.

☑ US arbitration is traditionally based on industry custom and practice. Including an Honorable Engagement Clause, which states that the contract should be interpreted as an “honorable engagement” between the parties, frees the arbitrators from following strict rules of law and procedure.

☑ Should the arbitrators be simply “disinterested”, with no financial ties to the parties or the outcome of the disagreement, or neutral (impartial and unbiased; no current or former relationship)

☑ What are the qualifications for selecting a panel?
  - Some older reinsurance contracts require that arbitrators be active officers of insurance or reinsurance companies. This has proved difficult to fulfill since many companies prohibit or strongly discourage their employees from serving on panels.
  - Arbitration clauses commonly specify that potential arbitrators be active or retired executive officers of insurance or reinsurance companies or underwriters at Lloyd’s. This may lead to disagreement over what constitutes an “executive officer” and also eliminates brokers, non-company lawyers and regulators from serving on panels. Some recent contracts have broadened qualifications to include individuals “familiar with” or “knowledgeable about” reinsurance, generally adding a requirement for a stated number of years of experience.
  - Many modern contracts require panel members to be certified as an arbitrator or umpire by ARIAS. While the benefits of ARIAS certification are noted below, there has been some concern expressed within the reinsurance community that the majority of ARIAS certified arbitrators and umpires have ceding company backgrounds which, some feel, may predispose them in favor of insurers.

☑ Umpire Selection Process
  - In “traditional” US arbitration, where each party appoints its own arbitrator and the two then choose a neutral umpire, selecting the umpire has the potential to determine the final outcome. Because umpire selection is often viewed as critical, the process may be prolonged and contentious. Older contracts utilized coin tosses to determine which name proposed by the parties would become the umpire. Other approaches involve a series of challenges to a list of proposed candidates submitted by each party with the final selection determined by a coin toss if there are no matches. Some older contracts delegate umpire selection to a dispute resolution organization or even the courts. ARIAS and the American Arbitration Association maintain lists of certified
umpires. Many modern arbitration clauses reference the ARIAS umpire selection process that uses a computer program to generate a random list of candidates as a starting point.

☑ A timely resolution is one of the main tenets of arbitration. As the process has become more formalized, the length of arbitrations has increased commensurately. Establishing time frames for each step in the process in the arbitration clause itself may help to keep the process moving efficiently.

☑ Explicitly stating that the arbitration provisions extend to the formation and validity of the reinsurance agreement, rather than solely to its “interpretation,” eliminates problems that may arise when the dispute involves claims for rescission or fraud and when disputes arise from expired or terminated contracts.

☑ When a cedent and multiple reinsurers participating on the same placement disagree on the same issues, including a mechanism for consolidating the arbitration avoids having to adjudicate the disagreement in multiple proceedings.

☑ The Award

- Arbitrators have broad latitude in the scope of the award, which may include indemnity, injunctive relief and pre- and/or post judgment interest. Each party usually pays the cost of its appointed arbitrator and shares the cost of the umpire, court reporter and other hearing expenses equally. Some arbitration clauses specify how costs are to be awarded and may even address awarding attorneys’ fees and punitive damages in unusual circumstances.

- Although most US awards consist of a brief statement, the parties may contractually provide for a reasoned award explaining and justifying the panel’s decision. Some arbitrators are reluctant to serve on panels where reasoned opinions are required and there is some concern within the arbitration community that reasoned awards increase the potential for reconsideration and possible overturn by the courts.

- Arbitration clauses do not stand on their own within a reinsurance agreement. Does other language within the contract, such as Service of Suit and Choice of Law clauses that reference litigation, conflict with the provisions of the arbitration clause?
Choosing the Panel

Panel qualifications are defined by the arbitration clause. This checklist includes some considerations for selecting potential party appointed arbitrators and umpire candidates.5

☑ Does the potential panel member have expertise in the type or line of business covered by the reinsurance agreement? Does the potential panel member’s background match the type of dispute? For example, someone with claims handling experience may be a good match for a dispute involving allocation issues whereas an underwriter may be a better choice for a disagreement involving underwriting guidelines or risk classification.

☑ Is a potential panel member’s experience as an arbitrator or umpire an important consideration? Parties and their counsel are sometimes more comfortable appointing arbitrators who they have worked with before and whose general views on certain broad issues may be known. In other cases, a party may prefer a fresh perspective from someone who is not a full time arbitrator.

☑ Should the panel member be certified by ARIAS? Arbitrators and umpires certified by ARIAS receive ongoing training in the arbitration process and in dealing with the potentially thorny issues that may arise. They also subscribe to the ARIAS Code of Conduct.

☑ Parties or their counsel should be familiar with a potential panel member’s fee schedule before the appointment. Considerations should include whether there is a retainer (non-refundable or refundable if unearned in the event of early settlement or conclusion), specific travel requirements, etc.

☑ The calendars of well-known, highly experienced arbitrators and umpires are often booked a year or more in advance. Availability may be a concern if time is of the essence.

5 Umpire candidates are usually proposed by a party’s legal counsel in consultation with its appointed arbitrator. An umpire should not know which party submitted his or her name. There is no ex parte communication between the parties and the umpire. Party appointed arbitrators should likewise refrain from one-on-one discussions with an umpire candidate or umpire during the appointment process as well as the course of the arbitration.
Organizational Meeting Checklist

Administrative items that should be addressed during the Organizational Meeting.

☑ Although arbitrations are assumed to be private, in the US there is no legal presumption of confidentiality. In the absence of language in the reinsurance contract requiring it, confidentiality agreements may be signed by all parties at the Organizational Meeting.⁶

☑ Hold Harmless agreements in favor of the panel members.

☑ Will there be ex parte communication between the parties and their appointed arbitrators? If yes, at what stage in the arbitration will it cease?

☑ Will there be a reasoned award (unless one has already been specified in the reinsurance agreement)?

☑ Extent and duration of discovery.

☑ Will fact and/or expert witnesses be permitted?

☑ Schedules for each stage of the arbitration.

☑ Arbitrators lack the authority to enforce their award. Will the final award be entered as a judgment in court under the Federal Arbitration Act? Entering the award may jeopardize confidentiality.

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⁶ There are usually some exceptions to confidentiality relating to arbitration awards including: as required by law or judicial proceedings, regulatory or accounting audits, in support of reinsurance or retrocession recoveries, or as otherwise agreed between the parties.
Additional Resources

The RAA provides these references for informational purposes only and does not endorse or recommend any of the products, processes, or services referenced. The RAA is not responsible for the availability or content of any referenced Internet sites, nor does the RAA endorse, warrant, or guarantee the products, services, or information described or offered at these other Internet sites.

AIRROC
E-mail: info@airroc.org
Web Page: www.airroc.org

PO Box 9001
Mount Vernon, New York 10552
Phone: (914) 699-3180
Fax: (914) 699-3264
E-mail: info@arias-us.org
Web Page: www.arias-us.org

American Arbitration Association
Corporate Headquarters 1633 Broadway, 10th Floor
New York, New York 10019
Phone: (212) 716-5800
Fax: (212) 716-5905
E-mail: websitemail@adr.org
Web Page: www.adr.org

American Bar Association: Section of Dispute Resolution
740 15th Street, N.W. Washington, DC 20005-1009
Phone: (202) 662-1680
Fax: (202) 662-1683
E-mail: dispute@abanet.org
Web Page: http://www.abanet.org/dispute/

Reinsurance Association of America
1445 New York Ave. 7th Floor
Washington, D.C. 20005
Phone: (202) 638-3690
Fax: (202) 638-0936
Email: Matthew Wulf, wulf@reinsurance.org
Web Page: www.reinsurance.org