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BRIEFING

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The Federal Insurance Office's Report: Road to Modernization Of Insurance Regulation: Heavy Lifting For The States

On December 13, 2013, the Federal Insurance Office ("FIO") issued its long-awaited report entitled: "How to Modernize and Improve the System of Insurance Regulation in the United States."[1] The Report sets 18 performance goals for the states, while proposing nine federal action points. It is expected that insurance regulation will evolve as a hybrid model, where state and federal oversight play complementary roles.

The FIO was created in response to the financial crisis by the Dodd-Frank Act. The Dodd-Frank Act[2] also established the Financial Stability Oversight Council ("Council"), a new government department that identifies risks and responds to emerging threats to financial stability. The FIO has the following authorities:

1. Monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system.
2. Monitor the extent to which traditionally under-served communities, consumers, minorities, and low and moderate income persons have access to affordable insurance products regarding all lines of insurance, except health insurance.
3. Recommend to the Council that it designate an insurer, including the affiliates of such insurer, as an entity subject to regulation as a nonbank financial company supervised by the Federal Reserve.
4. Assist the Secretary of the Treasury (the "Secretary") in administering the Terrorism Insurance Program established under the Terrorism Risk Insurance Act of 2002.
5. Coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, in the International Association of Insurance Supervisors and assisting the Secretary in negotiating "covered agreements." Covered agreements are defined as bilateral or multilateral agreements regarding prudential measures with respect to the business of insurance or reinsurance that – (A) are entered into between the United States and one or more foreign governments, authorities, or regulator entities; and (B) relate to the recognition of prudential measures with respect to the business of insurance or reinsurance that achieve a level of protection for insurance or reinsurance consumers that are substantially equivalent to the protection achieved under state insurance or reinsurance regulation.[3]
6. Determine whether state insurance measures are preempted by "covered agreements."
7. Consult with the states (including state insurance regulators) regarding insurance matters of national importance and prudential insurance matters of international importance; and
8. Perform such other related duties and authorities as may be assigned to the FIO by the Secretary.

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In July 2013, the Council effectively designated three companies outside of the banking industry—AIG, GE, and Prudential Financial—as "systematically important financial institutions," meaning that these insurers are put under the supervision of the Federal Reserve System and must meet enhanced prudential standards.[4]

The FIO Report is structured in five sections. The first section contains the recommendations for modernizing insurance regulation in the United States, represented in the table below. The additional sections cover the history of insurance regulation in the U.S. (Section II), analysis with regard to the state recommendations on prudential oversight (Section III), analysis with regard to the state recommendations on marketplace oversight (Section IV), and basic principles of regulatory reform (Section V).

The recommendations for modernizing insurance regulation are of two kinds:

1) Recommendations regarding areas that need to be reformed by the states in the near term;
2) Recommendations regarding areas that need direct federal involvement.

The table below lists the 18 areas of reform to be addressed by the states and the nine identified areas of federal involvement.

Table: FIO's Recommendations for Modernizing Insurance Regulation

Areas of Reform for the States	Areas of Federal Involvement in Regulation
CAPITAL ADEQUACY AND SAFETY/SOUNDNESS	
1. Material solvency oversight decisions of a discretionary nature: develop and implement a process that obligates the appropriate state regulators to first obtain the consent of regulators from other states in which the subject insurer operates.	(1) Develop federal standards and oversight for mortgage insurers.
2. Solvency oversight: establish independent, third-party review mechanism for NAIC's Financial Regulation Standards Accreditation Program.	(2) Recommend that Treasury and United States Trade Representative pursue a "covered agreement" for reinsurance collateral requirements based on the NAIC's Credit for Reinsurance Model Law and Regulation.
3. Develop uniform and transparent solvency oversight regime for transfer of risk to reinsurance captives.	(3) FIO to engage in supervisory colleges to monitor financial stability and identify issues in regulation of large national and internationally active insurers.
4. Solvency oversight and capital adequacy regimes to converge to best practices and uniform standards.	(4) Adopt the National Association of Registered Agents and Brokers Reform Act of 2013; its implementation to be monitored by FIO.
5. Move cautiously with implementation of principle-based reserving and condition it on (1) consistent, binding guidelines and (2) attracting supervisory resources and developing uniform guidelines to monitor supervisory review.	(5) FIO to work with agencies, state regulators to develop auto insurance policies for U.S. military enforceable across state lines.
6. Develop corporate governance principles: impose character and fitness expectations on directors and officers.	(6) FIO to work with state regulators to establish pilot programs for rate regulation that seek to maximize number of insurers offering personal lines products.
7. Develop approaches to group supervision.	(7) FIO to study and report on how personal information is used for insurance pricing and coverage.
8. Build toward group supervision by attention to supervisory colleges.	(8) FIO to consult with Tribal leaders to identify alternative to improve accessibility and affordability of insurance on sovereign Native American and Tribal lands.

Areas of Reform for the States	Areas of Federal Involvement in Regulation
REFORM OF INSURER RESOLUTION PRACTICES	
9. (1) Adopt uniform approach to address closing out and netting of qualified contracts with counterparties; (2) develop requirements for transparent financial reporting regarding the administration of a receiver estate.	(9) FIO will continue to monitor state progress on implementation of Subtitle B of Title V of the Dodd-Frank Act, requiring states to simplify the collection of surplus lines taxes, and determine whether federal action may be warranted in the near term.
10. Adopt uniform policyholder recovery rules so that policyholders receive the same maximum benefits from guaranty funds.	
MARKETPLACE REGULATION	
11. Consider whether marital status is an appropriate underwriting or rating consideration.	
12. Improve state-based product approval processes (participation in the Interstate Insurance Product Regulation Commission ("IIPRC") and expanding products subject to approval of the IIPRC).	
13. Adopt the NAIC's Suitability in Annuities Transactions Model Regulation.	
14. Reform market conduct examination and oversight practices.	
15. Monitor impact of different rate regulation regimes on market to best foster competitive markets for personal lines insurance consumers.	
16. Develop standards for use of data for pricing of personal lines insurance.	
17. Extend regulatory oversight to vendors that provide insurance score products to consumers.	
18. Identify, adopt, and implement best practices to mitigate losses from catastrophes.	

The FIO Report points to the inefficiencies of the state-based insurance regulatory system for consumers and insurers, the need for uniformity, and the international dimension of the insurance market in support of its recommendations.

Importantly, at the end of Section I, the FIO Report addresses the fact that many of the state recommendations relate to issues that the states have been addressing, but that progress has been uneven "despite the absence of any dispute about the need for change." The FIO Report states: "As a result, should the states fail to accomplish necessary modernization reforms in the near term, Congress should strongly consider direct federal involvement." The final paragraphs address two options in this regard: the development of federal standards implemented by the states and direct federal regulation. In other words, in the short term, the FIO Report proposes to modernize the U.S. system of insurance regulation through a combination of state action—the bigger part—and federal action. In the long term, additional federal involvement may depend on the success of state reform.

[1] http://www.treasury.gov/press-center/press-releases/Pages/jl2245.aspx; 31 U.S.C. § 313(p): congressional directive.

[2] 31 U.S.C. §§ 313-14.

[3] 31 U.S.C. 313§ r(2).

[4] http://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx.

Sixth Circuit Rules Holder Of Insurance Certificate May Assert Negligence Claim Against Broker For Failure To Obtain Correct Coverage Requested By Named Insured

SUMMARY: In *Cleveland Indians Baseball Co., L.P. v. New Hampshire Insurance Company*, 727 F.3d 633 (6th Cir. 2013), the Sixth Circuit Court of Appeals found that a holder of an insurance certificate could assert a viable negligence claim against the insurance broker that issued the certificate where the broker failed to obtain the correct coverage requested by the named insured. The case expansively interpreted Michigan law to find potential tort liability by the broker, opening up avenues of recovery for additional insureds and insurance certificate holders where the insurance policy at issue does not provide expected coverage due to a mistake by the broker.

National Pastime Sports agreed to produce a "Kids Fun Day" event in conjunction with a Cleveland Indians home game. As part of this undertaking, National Pastime procured a commercial general liability ("CGL") policy through its insurance broker, CSI Insurance Group, under which the Cleveland Indians were named as additional insureds. On the insurance application submitted to the broker, National Pastime checked a box that stated inflatables would be used at the event. The broker then provided the Cleveland Indians with an insurance certificate for the policy.

Once the CGL policy was purchased and the insurance certificate was issued, but before the policy was provided to either National Pastime or the Cleveland Indians, the Fun Day event took place. During the event, two attendees, Douglas Johnson and David Brown, were injured when an inflatable slide collapsed on them. Johnson died nine days later.

National Pastime notified CSI of the accident shortly after it occurred. At that time, National Pastime learned that the CGL policy it had purchased included an "amusement device" exclusion which, among other things, excluded coverage for inflatable slides like the slide involved in the accident. When National Pastime informed the broker that it had checked a box on the policy application noting that inflatables would be used during the event, a CSI employee responded, "Oh, ok. Sorry, I guessed I missed it. I'm so used to quoting up your events I think I hardly look at anything but the dates and the details of the event."

Brown's and Johnson's representatives subsequently sued National Pastime and the Cleveland Indians. The CGL insurer denied coverage of the lawsuit based upon the amusement device exclusion. Coverage lawsuits subsequently ensued between the various parties, including claims brought by the Cleveland Indians against CSI alleging that CSI was negligent in failing to procure the requested insurance coverage for the Fun Day event. The federal district court dismissed the Cleveland Indians' claims on CSI's motion for summary judgment, finding there was no duty owed to the Cleveland Indians by CSI which could give rise to tort liability.

On appeal, the Sixth Circuit reversed the trial court. While the court acknowledged that there "is no Michigan case law directly on the issue of an insurance broker's duty to an additional insured," the court found that there was case law supporting a claim of negligence against CSI in this instance. Specifically, the court noted that in various contexts, Michigan courts have imposed "an independent duty of care" on those who provide professional services "towards third parties where the harm was foreseeable and where the defendant had specific knowledge that its actions might harm a specific third party." Relying on this general proposition, the court found:

> Here, it is reasonably foreseeable that an additional insured such as the Indians will be harmed if an insurance agency or other intermediary fails to procure the intended coverage, just as the primary insured would be. While it is understandable that the law should not allow the insurance broker to be held liable to a virtually limitless class of claimants who are total strangers to the relationship between the insurance agency and the insured, or parties who were unknown to the insurance broker before the filing of a suit, this is not that case.

The court further found that to the extent Michigan law required a "special relationship" between CSI and the Cleveland Indians in order for a tort claim to exist, such a relationship "certainly exists here" since CSI knew the specific purpose of the CGL policy, and CSI sent the Cleveland Indians an insurance certificate naming the team as an additional insured.

Accordingly, the court held that the Cleveland Indians had a viable negligence claim against CSI as "CSI was well aware that the Indians could be harmed if the proper insurance was not procured." The court also found that the Cleveland Indians could assert a claim of negligent misrepresentation against CSI since the Cleveland Indians reasonably relied upon the insurance certificate provided by CSI and believed adequate insurance coverage had been procured for the Fun Day

event. The court held this reliance was reasonable in light of the fact that the insurance policy itself (which contained the "amusement device" exclusion) had not yet been provided to the Cleveland Indians at the time of the accident.

One judge dissented, asserting that the majority opinion was contrary to established Michigan law. The dissent said there was no independent duty owed by CSI to the Cleveland Indians separate and distinct from CSI's contractual duty to procure insurance for National Pastime. Absent such a distinct duty, the dissent said, CSI should not be held liable in tort to the Cleveland Indians. The dissent also found fault with the majority opinion because it could potentially result in a windfall recovery to the Cleveland Indians. "The rule proposed by the majority would permit double recovery, because under the majority's approach CSI could be liable to [National Pastime] for breach of its contract to obtain insurance, and to the Indians for negligence, even though the damages due to each would be the same."

IMPORT OF DECISION: The *Cleveland Indians* case expansively interpreted Michigan tort law to find that an insurance broker can be held liable to third parties with which it did not contract if the harm to such parties was foreseeable by the broker. The holding of the case seems to conflict somewhat with a Michigan Court of Appeals case, *West American Ins. Co. v. Meridian Mutual Ins. Co.*, 230 Mich. App. 305, 583 N.W.2d 548 (1998), in which the court held that insurance certificates only show that an insurance policy has been issued, but cannot be used to prove the specific terms of the policy referenced in the certificate. Because the *Cleveland Indians* case was decided by a federal court, it is not binding on Michigan state courts. It is unclear whether Michigan courts will reject its holding or follow its lead in future broker liability cases. As issuing insurance certificates is a common function of insurance brokers, it remains to be seen if this activity will be the basis for an increase in claims by certificate holders who find out that the policy referenced in the certificate does not provide the coverage the certificate holder expected.

Michigan Federal Court Enjoins Ongoing Arbitration To Allow Party To Raise Issues Concerning Improper Conduct Of Opposing Counsel And Party-Appointed Arbitrator

SUMMARY OF DECISION: In *Star Insurance Company v. National Union Fire Insurance Company of Pittsburgh*, PA, 2013 U.S. Dist. LEXIS 130379 (E. D. Mich. Sept. 12, 2013), a federal trial court in Michigan enjoined an arbitration after the panel issued an interim final award that left open certain damages issues when the cedents alleged counsel for the reinsurer and its arbitrator engaged in impermissible *ex parte* communications and the panel entered orders without the participation of the cedents' arbitrator in order to allow the cedents an opportunity to prove their claims of improper conduct.

Generally, courts have no jurisdiction to review arbitration proceedings unless a final award has been issued. There are few exceptions to this rule, and one of those was at issue in this case. Star Insurance Company, Savers Property & Casualty Insurance Company, Ameritrust Insurance Corporation, and Williamsburg National Insurance Company ("Cedents") and their reinsurer, National Union Fire Insurance Company ("National Union"), entered into a reinsurance treaty covering workers' compensation business that contained an arbitration provision under which disputes were to be submitted to a panel of two party-appointed arbitrators and an umpire not under the control of either party.

The Cedents commenced an arbitration against National Union, and a three member arbitration panel was appointed. During the umpire selection process, it was disclosed that the umpire had a "close friendship" with National Union's arbitrator. The Cedents also contended that National Union's counsel and its arbitrator had participated together on various unrelated panel discussions sponsored by that counsel's law firm during the pendency of the arbitration.

The arbitrators issued a scheduling order that provided *ex parte* communications with panel members were to cease upon the filing of the parties' initial pre-hearing briefs. Following a hearing, the panel issued an Interim Final Award resolving liability but leaving open issues relating to damages. On the day the award was issued, and then on two other occasions within two weeks, National Union's counsel had *ex parte* communications about the Interim Final Award with National Union's arbitrator, as evidenced by entries in counsel's billing records that were submitted to the panel in support of a petition for attorney's fees and costs.

The Interim Final Award required the Cedents to submit additional documentation, which they did. National Union filed a motion to strike the Cedents' submission on the grounds that it was insufficient. The umpire and National Union's arbitrator granted the motion. The Cedents alleged this was done without their arbitrator's knowledge or participation.

The Cedents filed a motion for clarification with the panel and for more time to file replacement submissions. The umpire and National Union's arbitrator, again

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allegedly without the input of the Cedents' arbitrator, granted the request for more time and clarified what documentation was to be submitted.

The Cedents then filed a complaint in state court seeking to vacate, correct and/or modify the panel's Interim Final Award. They also filed an emergency motion with the panel seeking to stay all proceedings. The umpire and National Union's arbitrator denied the motion, with the Cedents' arbitrator dissenting. In his dissent, he stated that both prior orders had been rendered without his participation, input or consultation and "had the effect of disenfranchising me from participation in decisions on very important issues in the arbitration."

After the panel denied their emergency motion, the Cedents filed a motion in their state court action seeking review and appeal of the panel's Interim Final Award. National Union removed the action to federal court.

The Cedents then filed a motion for preliminary injunction seeking to stay the arbitration so they could investigate whether the *ex parte* communications breached the treaty and whether the various relationships between National Union's counsel and its arbitrator and between National Union's arbitrator and the umpire breached the treaty's requirement that the panel be comprised of disinterested arbitrators under the control of no party. The Cedents did not request the court to vacate the Interim Final Award.

In ruling on the motion for preliminary injunction, the district court acknowledged that generally courts have no jurisdiction to review arbitration proceedings until they are final. However, the district court observed that the issue was whether National Union had, through its counsel's *ex parte* communications with National Union's arbitrator and the various relationships described above, breached the provision in the treaty requiring that disputes be decided by a three party panel of disinterested arbitrators who are not under the control of any party. The court further observed that under the Federal Arbitration Act, a court may intervene in ongoing arbitration proceedings if the arbitration agreement is subject to attack under general contract principles. The court concluded that although a court may be generally prohibited from reviewing arbitration proceedings before a final award, it nevertheless has jurisdiction to determine if the arbitration agreement has been breached by a party's and an arbitrator's actions preceding the final award.

The district court examined the elements necessary for the issuance of injunctive relief: (1) whether the Cedents would suffer irreparable harm if an injunction were not granted; (2) whether they were likely to succeed on the merits; (3) whether there was substantial harm to others, including National Union; and (4) whether public policy weighs against injunctive relief.

National Union argued that the Cedents had an adequate remedy at law: money damages. The Cedents responded that the anticipated adverse arbitration award would damage their business reputation and good will. The court agreed this would be irreparable injury.

As to whether the Cedents were likely to succeed on the merits of their claim, the court described the claim as seeking additional time to investigate the relationship between National Union's counsel and its arbitrator and to determine whether that conduct and the relevant circumstances violated the treaty's arbitration clause. The court appeared to be influenced by the fact that National Union "failed to meaningfully address" the alleged *ex parte* communications and, in fact, seemed not to dispute their occurrence. The court said that while courts generally do not have jurisdiction over disputes involving allegations of bias until after an arbitration has concluded, an exception to that rule allows a court to intervene if the agreement is subject to attack under general contract principles. Courts have authority to remove an arbitrator before arbitration proceedings have ended where the arbitrator's relationship to one party is not disclosed or is unanticipated and unintended.

The court found that these factors weighed in favor of injunctive relief and granted the Cedents' motion. Factoring heavily in the district court's decision was the fact of the *ex parte* communications, the close friendship between the umpire and National Union's arbitrator, the relationship between National Union's counsel and its arbitrator (as evidenced by their appearance together on the unrelated panels during the course of the arbitration), and the fact that the Cedents' arbitrator was not involved in two key decisions impacting the Cedents' liability.

The court said the parties entered into a contract that required disinterested officials, not under the control of any party, to serve as arbitrators. The Cedents raised substantial questions going to the heart of this contractual provision. The court held the Cedents' prospects for success on the merits turned on whether National Union violated the terms of the Treaty

through *ex parte* communications with National Union's arbitrator. The court held that the Cedents need only prove the fact of the *ex parte* communications to prevail on the merits of a request to remove a panel member which would in effect vacate the arbitration award.

The court also held the Cedents were likely to prevail on their breach of contract claim for the failure to submit disputes before a three member panel since the Cedents' arbitrator was not involved in two major decisions which impacted whether the Cedents would be liable for over $25 million. The court rejected National Union's argument that the Cedents could not prevail because their arbitrator was copied on emails and the umpire participated in the process. The Cedents' arbitrator said there was no urgency in the decisions which were made while he was on a two day vacation during which National Union's arbitrator and the umpire knew he would have no or limited ability to communicate.

The district court felt that additional time was needed to examine the impact of these factors and, therefore, granted the Cedents' motion for a preliminary injunction. The court said National Union would not suffer any harm if the arbitration were stayed. The court acknowledged the strong federal policy favoring arbitration, but concluded the public's interest in the integrity of the arbitration process and in upholding contracts favored the issuance of an injunction to preserve the status quo.

IMPORT OF DECISION: While courts will generally not entertain allegations of arbitrator bias until after an arbitration has concluded, the court found this case to be an exception. The court was troubled by what had transpired and was very concerned that the integrity of the arbitral process may have been compromised. The court concluded that: (a) the *ex parte* communications between National Union's arbitrator and its counsel; (b) the relationship between those two individuals as well as the one between National Union's arbitrator and the umpire; and (c) the fact that important decisions had been made by only two of the arbitrators without the input of the Cedents' arbitrator were sufficient to warrant enjoining the arbitration to allow the Cedents to have time to present their arguments that the treaty had been violated.

Credit for Reinsurance—The Emergence of Reduced Collateral Requirements

The move towards reduced collateral requirements for alien reinsurers (non-U.S. companies that are not admitted in any U.S. jurisdiction) continues to gather momentum. As most people in the industry know, in 2011 the National Association of Insurance Commissioners ("NAIC") adopted amendments to its credit for reinsurance statutes and regulations to create a system whereby alien reinsurers could get "certified" and become eligible to post reduced collateral in connection with their assumed U.S. business. The amendments marked a rather dramatic shift in policy from what had been the *de facto* default rule that alien reinsurers needed to post 100% collateral in order for U.S. ceding companies to be able to take credit for reinsurance on their financial statements. While several states were quick to adopt the new statutes and regulations, only two states, Florida and New York, implemented the procedures and actually certified reinsurers for reduced collateral. Connecticut and New Jersey began certifying reinsurers in 2013.

One of the main reasons for the slow implementation of the NAIC's amendments was that in order for a state that had adopted these provisions to certify an alien reinsurer, the state first had to qualify a foreign jurisdiction (and more specifically the regulatory body governing insurance companies in that jurisdiction) as meeting certain fundamental regulatory requirements related to the solvency of insurance companies in that jurisdiction. This obstacle has now been overcome with the NAIC's adoption of its *Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions* ("Process") on August 27, 2013, whereby it will serve as a clearing house for granting the regulatory authorities of foreign jurisdictions qualified status.

The NAIC then began an expedited review process and on December 18, 2013 announced that it had granted preliminary qualification to four jurisdictions: the Bermuda Monetary Authority; the German Federal Financial Supervisory Authority; the Swiss Financial Market Supervisory Authority; and the United Kingdom's Prudential Regulation Authority of the Bank of England. The preliminary qualifications became effective January 1, 2014 and help pave the way for several other states to start certifying alien reinsurers for reduced collateral. While the qualification of these jurisdictions is only preliminary at this point, all are expected to receive full qualification in 2014. In addition, other foreign jurisdictions are expected to begin the qualification process.

It has been fairly widely reported that as of the NAIC's adoption of the Process in August 2013, 18 states representing 53% of the written premium in the U.S. have adopted the reduced collateral provisions. There are notable exceptions, including Illinois and Texas. The NAIC is clearly committed to pushing this process along, which should help continue the momentum for this initiative. Things to look for as this process develops include the following:

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- Now that the NAIC has granted preliminary approval to four jurisdictions, how quickly will the states that have adopted these provisions begin to certify reinsurers? Early indications are that the states are ready to move forward. Missouri on January 17, 2014 and Pennsylvania on January 25, 2014 both announced that they have now approved two reinsurers under these procedures.
- Will reciprocity be granted by other jurisdictions to companies once they are certified by one state? The NAIC model provisions include an optional reciprocity provision that a state can defer to another state's certification of a particular reinsurer. There are some indications that a system is being established to co-ordinate this in practice, but it cannot yet be confirmed that such a system is in place.
- How is the reinsurance market impacted in these states? This is the true test of the system and an issue that will be watched closely.
- How quickly will other jurisdictions look to become approved as qualified jurisdictions?
- How quickly will additional states adopt the new reduced collateral provisions? This remains to be seen and will likely be impacted by the above factors and how smoothly the process works in practice.

District Court Refused To Implement Alternative Umpire Selection Procedure Not Provided In Reinsurance Agreements After Reinsurance Dispute Was Transferred From Western District Of Wisconsin To Southern District Of New York

SUMMARY: In *Employers Insurance Company of Wausau v. Arrowood Indemnity Company*, No. 12-cv-08005-LLS (S.D.N.Y. Oct. 25, 2013), a consolidated dispute between a cedent and three of its reinsurers over the reinsurers' obligations to reimburse the cedent for claims, the U.S. District Court for the Southern District of New York refused the cedent's request that the court order the selection of an umpire in a manner not provided for by the reinsurance agreements. Instead, the court determined that the agreements should be enforced, and that the arbitrators already appointed must select an umpire in accordance with the terms of the agreements.

Arrowood Indemnity Company ceded various claims to its reinsurers, Employers Insurance Company of Wausau, Nationwide Mutual Insurance Company, and National Casualty Company ("Reinsurers") under separate reinsurance agreements. When the Reinsurers failed to pay Arrowood's claims, Arrowood initiated arbitration. The agreements provided that the party arbitrators would select the umpire. Following the parties' selection of arbitrators, the parties arrived at an impasse over appointment of an umpire in each dispute. The Reinsurers petitioned the federal court in the Western District of Wisconsin to enforce the agreements by ordering compliance with the agreements' mechanism for selection of umpires.

Arrowood responded that not all of the agreements contained the same umpire selection mechanism. Because the parties were not able to agree on an umpire, Arrowood argued the court should choose an arbitrator from a list of three it had submitted. *See Employers Ins. Co. of Wausau v. Arrowood Indem. Co.*, 2012 U.S. Dist. LEXIS 154140 (W.D. Wisc. Oct. 26, 2012). Arrowood further argued that the case should be dismissed for improper venue citing the forum selection clause in each agreement that provided: "arbitration shall take place in New York, New York unless some other place is mutually agreed upon." The Reinsurers argued that the forum selection clauses were permissive rather than mandatory and therefore did not preclude the case from proceeding outside New York.

The Wisconsin federal court disagreed with the Reinsurers' argument that the action should remain in Wisconsin. The court ruled that the forum selection clauses were mandatory, requiring the dispute to be heard in New York. The court agreed that under the Federal Arbitration Act, 9 U.S.C. § 4, the forum selection clause must be enforced in the context of a petition to compel arbitration, which was to be heard by the court in the forum selected by the parties through the agreements' forum selection clause.

Arrowood also argued that its underlying case for breach of the agreements should not be transferred because it was attempting to enforce the agreements under § 5 of the FAA which does not contain the same venue limitations as does § 4. The court disagreed that some claims could be selected by Arrowood for transfer of venue while others would be decided separately. Accordingly, the court transferred the entire case to the Southern District of New York to consider the umpire selection process as well as Arrowood's underlying claims.

The Southern District of New York considered whether the mechanism for selection of an umpire in the agreements should be enforced or whether the court should apply a different selection approach. Although the reinsurance agreements specified a procedure whereby the appointed arbitrators would select a neutral umpire, Arrowood instead proposed an alternative approach, claiming the method stipulated in the agreements would not lead to appointment of an agreed upon umpire. Arrowood suggested the parties instead each nominate up to eight candidates from which the umpire would be selected after a voir dire style objection process.

However, the Court, acting under authority granted by Section 5 of the Federal Arbitration Act, denied that alternative, ordering that the present arbitrators select an umpire in accordance with the agreements' requirements. Though the court simply entered a two page order without a written opinion, we note that its decision is consistent with the decision of the Northern District of California in *Granite State Insurance Co. v. Clearwater Insurance Co.*, No. C 13-2924 SI, 2013 WL 4482948 (N.D. Cal. Aug. 19, 2013) where, faced with a similar stalemate over arbitrator selection, the court ruled the parties must follow the arbitrator selection process provided by the agreements. Citing to Sections 4 and 5 of the FAA, the district court there held that these sections limit the court's authority to require the parties to arbitrate as agreed or to appoint arbitrators under certain conditions. It also noted that a court may appoint an umpire only where the circumstances render it impossible to follow the parties' arbitration clause dictating the method of selecting an umpire. The ruling by the Southern District of New York in *Arrowood* supports these propositions.

IMPORT OF DECISION: While the FAA empowers courts to appoint arbitrators or umpires if the selection method in the parties' agreement fails, the FAA also clearly says courts are to enforce an agreement's appointment provisions. This decision underscores the point that courts will require parties to follow the approach set out in their contract, even if it may not be ideally tailored to a particular situation.

Virginia Supreme Court Rules Unavailability Of Entity Specified In Contract To Administer Arbitration Does Not Render Arbitration Provision Unenforceable

SUMMARY: In *Schuiling v. Harris*, 286 Va. 187 (2013), the Virginia Supreme Court ruled that a provision in an arbitration clause of an employment agreement stating that any disputes were to be resolved by arbitration administered by a specifically named entity was not unenforceable when the entity was no longer in existence at the time the dispute arose.

William Schuiling hired Samantha Harris to be his full-time, live-in housekeeper. As a condition of employment, Harris signed an arbitration agreement which required all claims, disputes, or controversies arising out of, or related to, her employment to be resolved "exclusively by arbitration administered by the National Arbitration Forum ["NAF"]."

Several years after the contract was entered into, Harris filed suit against Schuiling in Virginia state court alleging multiple torts, statutory violations, and breach of contract. Schuiling filed a motion to enforce arbitration, stating that the NAF was no longer available to administer the arbitration and requesting that the trial court appoint a substitute arbitrator. Harris opposed the motion, arguing that the NAF was exclusively designated as the arbitrator. She contended that the parties' agreement to arbitrate was conditioned on the NAF conducting the arbitration. Since the NAF was unavailable, and since the agreement did not provide for the appointment of a substitute arbitrator, Harris argued the agreement was unenforceable. The trial court agreed. The Virginia Supreme Court granted Schuiling's interlocutory appeal.

The Supreme Court reversed, concluding that the agreement's severability clause required that the term providing that an arbitration was to be administered by the NAF could be severed from the agreement. In addition to the language of the severability clause itself, the court stated that the sole object of the entire agreement was to require arbitration. Since the agreement contained no other provisions that would survive failure of the arbitration requirement, a determination that the NAF's designation was not severable would defeat the entire agreement.

The court also held that the parties were presumed to know that under Virginia law, the trial court was empowered to appoint an arbitrator when the method of arbitrator appointment in the agreement fails or cannot be followed.

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The court stated that nothing in the agreement indicated that the parties contemplated the contingency that the NAF might be unavailable and intended the arbitration requirement itself to terminate if that contingency occurred. The court held that the inclusion of the word "exclusively" indicated nothing more than a designation of the single arbitrator to decide a dispute presuming that arbitrator would be available if called upon.

The court concluded that the severability clause reflected that the parties intended the NAF to be the exclusive arbitrator so long as it was available. If the NAF's unavailability made its appointment unenforceable, however, the designation would be severed. The absence of a provision for the appointment of a substitute arbitrator indicates nothing more than the parties' presumed knowledge that the Virginia Code provided the necessary mechanism for the appointment of an arbitrator.

IMPORT OF DECISION: Although this case does not involve a reinsurance agreement, its holding may be applicable to arbitrations under reinsurance contracts. It is not uncommon for a reinsurance agreement to provide that an arbitrator or umpire is to be selected by an organization specifically named in the agreement. It sometimes occurs that the organization is no longer in existence or may not be available to appoint an arbitrator. Most state arbitration statutes, as well as the Federal Arbitration Act, contain provisions authorizing courts to appoint arbitrators if the method provided in the arbitration agreement fails for any reason. This case is authority for the proposition that if the appointing entity is no longer available to appoint an arbitrator, the parties' agreement to arbitrate remains enforceable, and a court may be requested to make the appointment.

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Philadelphia

Joseph M. Donley
Insurance & Reinsurance Practice Group Leader

Christopher M. Brubaker
William E. Cox
Christopher J. Day
Douglas M. Chapman
Peter B. Kupelian
Carol G. Schley
Karolien M. Vandenberghe

For more information, please contact Joseph M. Donley at jdonley@clarkhill.com, or call 215.640.8500.

To subscribe to *Insurance & Reinsurance Briefing*, please contact Connie Lojewski at 215.640.8543 or clojewski@clarkhill.com.

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