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BRIEFING

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Supreme Court Restricts Applicability of "Exceeded Powers" Basis To Vacate Arbitral Award

SUMMARY: In *Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064 (June 10, 2013), the U.S. Supreme Court ruled that an arbitrator had not "exceeded [his] powers" under § 10(a)(4) of the Federal Arbitration Act ("FAA") in ruling that a contract's arbitration clause required class action claims to be arbitrated.

John Sutter, a pediatrician, entered into a contract with Oxford Health Plans, a health insurance company. He agreed to provide medical care to members of Oxford's network, and Oxford agreed to pay for those services at prescribed rates. When a dispute arose concerning whether Oxford had made the required payments, Sutter filed suit on behalf of himself and a proposed class of other physicians who also had contracts with Oxford. Oxford moved to compel arbitration, relying on the following arbitration clause:

> No civil action concerning any dispute arising under this Agreement shall be instituted before any court, and all such disputes shall be submitted to final and binding arbitration.

The court granted the motion, and the dispute was sent to arbitration. The parties agreed that the arbitrator should decide whether their contract authorized class arbitration, and he ruled that it did. The arbitrator concluded that the arbitration clause obligated the parties to arbitrate the "same universal class of disputes" that it barred the parties from bringing "as civil actions." He held that the intent of the arbitration clause was "to vest in the arbitration process everything that is prohibited from the court process." Since class action is a type of civil action that could be brought in court, the arbitrator concluded it was within the scope of disputes covered by the arbitration clause.

Oxford filed a motion in federal court to vacate the arbitrator's decision on the grounds that he had exceeded his powers under § 10(a)(4) of the FAA. The trial court denied the motion, and the Third Circuit affirmed. The Supreme Court granted *certiorari* to address a split in the federal circuit courts on whether § 10(a)(4) allows a court to vacate an arbitral award in similar circumstances. The Court affirmed the Third Circuit's decision.

The Supreme Court framed the issue for decision as "whether the arbitrator (even arguably) interpreted the parties' contract, not whether he got its meaning right or wrong." The Court began by noting the limited scope of judicial review of an arbitrator's decision, stating that it is not enough to show the arbitrator committed an error, "even a serious error." Because the parties bargained for the arbitrator's construction of their agreement, an arbitral decision, even arguably construing or applying the contract, must stand regardless of a court's view of its merits. A court may overturn an arbitrator's determination only if he acts outside the scope of his contractually delegated authority by issuing an award that simply reflects his own notions of economic justice rather than drawing its essence from the contract.

In this case, the Court found that the arbitrator had focused on the language of the arbitration clause

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in determining what disputes were to be resolved by arbitration and in concluding that class action claims were covered by the agreement to arbitrate. Since the arbitrator construed the contract, the Court ruled that sufficed to show he had not exceeded his powers. Oxford chose arbitration, and it must live with that choice, the Court said.

The Court broadly hinted it thought the arbitrator had incorrectly interpreted the contract in deciding the arbitration clause encompassed class actions. But under § 10(a)(4), the question for a court is not whether the arbitrator construed the parties' contract correctly, but whether he construed it at all. The Court held that § 10(a)(4) permits courts to vacate an arbitral decision only when the arbitrator "strayed from his delegated task of interpreting a contract, not when he performed that task poorly." The Court also said that "convincing a court of an arbitrator's error – even his grave error – is not enough" so long as the arbitrator was arguably construing the contract. "The arbitrator's construction holds, however good, bad, or ugly."

The Court stated it is the arbitrator's construction of the contract which was bargained for, and the potential for an arbitrator to make mistakes is the price for agreeing to arbitration. Courts have no business overruling such constructions simply because their interpretation of the contract is different from the arbitrator's.

It was critically important to the Court's decision that the parties had agreed the arbitrator should decide whether their contract authorized class arbitration. The Court noted it would have faced a different issue if Oxford had argued the availability of class arbitration was not an issue that was covered by the arbitration clause since, the Court said, "gateway" issues, including whether parties have a valid arbitration agreement or whether a certain type of dispute is covered by that agreement, are presumptively for courts to decide.

IMPORT OF DECISION: This decision from the U.S. Supreme Court reinforces the well-known point, in most emphatic and even colorful terms, that it is very difficult to overturn an arbitrator's decision. Even if an arbitrator wrongly construes a contract, an arbitral award will not be vacated on the grounds that the arbitrator "exceeded [his] powers" under § 10(a)(4) of the FAA.

After First Arbitration Award Was Vacated As Irrational Because Arbitrators Ignored Contract Provision And Granted Relief Not Sought By Either Party, Court Confirms Second Award Concluding It Was Rational And Reasonable

SUMMARY: Parties to a reinsurance contract engaged in an arbitration that resulted in an award a federal district court concluded disregarded a key provision of the contract and granted relief neither party had sought. The court vacated the award. The parties then re-arbitrated their dispute. The second arbitration panel (different from the first) issued an award agreeing with one party's interpretation of the agreement and disagreeing with the other's. The parties then applied to the federal court in the Eastern District of Pennsylvania to review the second award. The court confirmed the award, contrasting it with the earlier "irrational" award, because it drew its essence from the contract.

In *Platinum Underwriters Bermuda, Ltd. v. Excalibur Reinsurance Corp.*, Misc. No. 12-70, (E.D. Pa. July 15, 2013), a petition to confirm and a counter-petition to vacate were filed by the parties, asking the court for a second time to review an arbitration award arising from a reinsurance agreement entered into between Excalibur, formerly known as PMA Capital Insurance Company, the reinsured, and Platinum, the reinsurer. The parties disputed the application of the agreement's "experience account" and "deficit carry forward" provisions. The experience account tracked the premium paid by Excalibur to Platinum. As claims came due, the reinsured debited the account. If the account became depleted, the reinsurer was required to pay any remaining obligations from its own funds. The deficit carry forward provision allowed Platinum to "carry forward" to a subsequent year any loss incurred in a prior year by applying funds remaining in the subsequent year's experience account to offset losses from the earlier year. The reinsurance agreement stated that upon commutation, Platinum would relinquish to Excalibur any balance remaining in the experience account less any projected paid loss deficit.

When a disagreement arose over the operation of the agreement's experience account and deficit carry forward provisions, the parties engaged in arbitration. In the first arbitration, the arbitrators issued an award that deleted the deficit carry forward provision from the agreement and ordered Excalibur to immediately pay $6 million to Platinum (relief Platinum had not specifically sought). The arbitrators offered no reasoning or explanation for

their decision. Excalibur's petition to vacate the award was granted by the trial court which held that the award could not rationally be derived from the contract. The Third Circuit affirmed.

The parties then engaged in a second arbitration regarding the operation of the deficit carry forward provision and Platinum's rights to retain certain funds upon commutation. Following a hearing, the arbitration panel issued an award interpreting and applying the deficit carry forward provision and determining the parties' respective rights upon commutation. The award provided that upon commutation, Platinum was entitled to retain 25% of the deficit under an earlier contract before the remainder of the experience account under a later contract was relinquished to Excalibur. This required Excalibur to pay monies to Platinum which then brought an action in the Eastern District of Pennsylvania seeking to confirm the award. Excalibur requested that it be vacated.

The court concluded that the Convention on the Recognition and Enforcement of Foreign Arbitral Awards applied because the award arose from a commercial relationship between a Bermuda citizen (Platinum) and a U.S. citizen (Excalibur). The court considered whether the award should be vacated on the grounds that "the arbitrators exceeded their powers" under 9 U.S.C. § 10(a)(4). Discussing relevant case law, the court noted that judicial review of arbitration awards is extremely deferential and that a court cannot vacate an award simply because it disagrees with the arbitrator's decision. Rather, to do so, the court must conclude there is absolutely no support in the record justifying the award which the court must find to be completely irrational.

The court said that Excalibur challenged one portion of the award on the basis that it was too literal an interpretation of the contract and another portion on the grounds it was not literal enough. The court observed that it could not vacate an award for over or under "literality," but only for irrationality. The court reviewed the arbitrators' decision and concluded they had rationally interpreted the agreement's provisions.

The court then contrasted the two arbitration awards. In the first award, the arbitrators not only eliminated a key contractual provision (the deficit carry forward provision), "they appeared to have conjured their award from the vapors" since neither party had asked the arbitrators to remove that provision or to award Platinum an immediate payment. In the second award, however, the arbitrators accepted the contractual interpretations Platinum urged and rejected those advocated by Excalibur. The arbitrators did not eviscerate the contract, but grounded their decision in the language of the agreement. In short, the court concluded, the second award drew its essence from the contract. Accordingly, the court confirmed the award.

IMPORT OF DECISION: The two decisions evidence the limits of arbitrators' authority, on the one hand, and the restrictions applicable to judicial review of arbitral awards, on the other. As long as arbitrators interpret a contract, their decision will be upheld, even if they reach the wrong conclusion. If, however, arbitrators seek to effectuate their own notion of "rough justice," which has no relationship to any contractual provision, their award may be subject to being vacated.

Sixth Circuit Rules Insurer Not Liable For Insured's Pre-Tender Legal Fees

SUMMARY: In *AMI Entertainment Network, Inc. v. Zurich Am. Ins. Co.*, 2013 FED App. 0504N (6th Cir. 2013), the Sixth Circuit Court of Appeals affirmed the district court's grant of summary judgment in favor of an insurer, holding that where the insured did not notify the insurer about a suit against the insured for 16 months, the insurer was not required to pay defense fees and costs the insured incurred before notice to the insurer because the policy squarely supported the insurer's lack of liability for such fees and costs.

In July 2010, AMI Entertainment Network, Inc. ("AMI") was sued in Michigan state court by RDI Of Michigan, Inc. ("RDI") ("RDI Suit"). RDI alleged that AMI's executives made disparaging remarks in 2008 about RDI's ownership of a license to distribute a video-poker gaming product. Between July 2010 and November 1, 2011, AMI incurred approximately $1,300,000 in defense fees and costs defending itself against the RDI Suit in both state and federal court.

On November 1, 2011, AMI tendered the suit to its liability insurance carrier, Zurich American Insurance Company ("Zurich"), and requested a defense and indemnity. By letter dated December 20, 2011, Zurich agreed to defend on a going-forward basis, but specifically disclaimed liability for fees and costs AMI incurred to defend itself against the RDI Suit prior to November 1, 2011, when the insured provided notice to Zurich ("Pre-Tender Fees").

AMI filed suit against Zurich in May 2012 in the Federal District Court for the Eastern District of Michigan, alleging Zurich's breach of contract for failing to pay the Pre-Tender Fees. The parties filed cross-motions for summary judgment. AMI argued Zurich was liable for these fees because under Michigan law the duty to defend begins when the complaint is filed against the insured and is independent of tender. AMI also contended that before Zurich could disclaim liability for the Pre-Tender Fees based on its lack of notice of the RDI Suit, Zurich was required to establish that it had been prejudiced. In addition, AMI argued that because a conflict of interest arose between AMI and Zurich,

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AMI was entitled to control its own defense, and Zurich was required to pay AMI's defense fees and costs.

Zurich cited to Michigan law that held an insurer has no duty to defend until its insured requests a defense. Zurich also relied on the "voluntary payments" clause in its policy to negate its liability for the Pre-Tender Fees and case law holding that where the insured's breach of the "voluntary payments" clause is at issue, prejudice to the insurer is not relevant. Zurich further argued that no conflict of interest existed until December 2011 when Zurich sent its reservation of rights letter to the insured.

The trial court granted summary judgment to Zurich, holding the carrier had no liability for the Pre-Tender Fees because the duty to defend requires a request by the insured to defend, and AMI did not make that request to Zurich until November 1, 2011. *AMI Entertainment Network, Inc. v. Zurich Am. Ins. Co.*, 2012 U.S. Dist. LEXIS 151543. The court also held the "voluntary payments" clause in the policy further insulated Zurich from liability. In addition, the court held that as a matter of law there was no conflict between Zurich and AMI prior to notice to Zurich.

AMI appealed to the Sixth Circuit. Deciding the appeal without oral argument, the Sixth Circuit affirmed the Eastern District. 2013 FED App. 0504N (6th Cir. 2013). The court said the "appeal presents one question: Must Zurich pay the defense costs AMI incurred before it told Zurich about the underlying litigation? The answer is no, as the district court correctly recognized." *Id.* at *2. The court first addressed Zurich's policy language, which (1) required AMI to notify Zurich "as soon as practicable" in the event of suit against it; (2) prohibited AMI from making "voluntary payments"; and (3) stated that if AMI failed to comply with reporting requirements, Zurich would not need to establish prejudice but would be relieved of all liability with respect to the claim. The court concluded that based on the policy language alone, "[w]hen all is said and done, the language of the policy squarely supports Zurich's decision not to pay for defense expenses incurred before AMI told Zurich about the underlying lawsuit and incurred without Zurich's permission." *Id.* at *3.

The court then turned to the insurer's duty to defend which it said begins under Michigan law upon the filing of a suit. *Id.* The court stated that "[a]n insurer cannot, however, breach that duty before it knows about a lawsuit." *Id.* at *4. The court held: "AMI does not dispute that Zurich did not know about the RDI Suit until November 2011. Before then, Zurich could not have breached any duty to defend, and in the absence of a breach Zurich cannot be liable for AMI's defense costs." *Id.*

Finally, the court addressed AMI's prejudice and conflict of interest arguments. As to prejudice, the court observed that AMI ignored the plain policy language stating Zurich was not required to show prejudice. The court then held that, regardless, Zurich could show prejudice because (1) it was deprived of "the opportunity to manage the litigation efficiently or for that matter settle it"; and (2) AMI's counsel's rates were much higher than Zurich's approved counsel rates, and to require Zurich to pay the higher rates incurred before notice would transform its duty to defend into a duty to reimburse, without affording it the opportunity to control the defense. *Id.* at *6-*7.

The court agreed with Zurich that no conflict of interest could have arisen prior to Zurich's receipt of notice of the RDI Suit. Accordingly, even if AMI had the right to control its defense once a conflict of interest arose, "it had no bearing on Zurich's liability for money AMI spent *before* it notified Zurich. As the district court correctly concluded, AMI alone bears responsibility for those costs." *Id.* at *8.

IMPORT OF DECISION: This decision is important for several reasons. First, it adds to the body of case law holding that a liability insurer is not liable for fees and costs the insured incurs to defend against a suit when those fees and costs are incurred prior to tender or notice of the suit to the carrier. Second, the case is a good example of the applicability of the "voluntary payments" clause in liability policies, which precludes the insured from voluntarily incurring any payments, fees, or other liabilities. Third, the decision provides a good indication of the Sixth Circuit's belief that under Michigan law an insurance carrier's duty to defend arises when suit is filed against its insured.

Coverage Under CGL Policy For Wrongful Eviction May Not Be Available If Claimant Is Corporate Tenant As Opposed To Natural Person

SUMMARY: Coverage B of the standard commercial general liability ("CGL") policy form provides coverage for "personal and advertising injury," which includes claims of wrongful eviction of a "person." What constitutes a "person" is an open issue in the majority of U.S. jurisdictions. The few courts that have dealt with this issue have reached opposing conclusions.

Some courts have held wrongful eviction coverage under CGL policies is limited to claims asserted by natural persons and that claims brought by corporations are not covered. Others have ruled that coverage exists for claims asserted by both natural persons and corporations.

The standard CGL policy form includes the Coverage B insuring agreement which provides coverage for "personal and advertising injury." Typical policy language provides:

> "Personal and advertising injury" means injury, including consequential "bodily injury", arising out of one or more of the following offenses: . . .
>
> c. The wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling or premises that a person occupies, committed by or on behalf of its owner, landlord or lessor. . . .

(This definition of "personal and advertising injury" is referred to in this article as the "wrongful eviction offense.") In a typical claim, an insured property owner or landlord is sued for wrongful eviction by a tenant. If the claimant is a natural person, the claim of a wrongful eviction offense will usually be covered. If the claim is brought by a corporation, however, coverage is less clear. There is little relevant case law, and those decisions that have been rendered are conflicting.

On one side of the issue is *Mirpad, LLC v. California Ins. Guar. Ass'n*, 34 Cal. Rptr. 3d 136 (Cal. Ct. App. 2005), decided under California law. In *Mirpad*, a corporate tenant filed a lawsuit against the insured property manager claiming wrongful eviction from a commercial premises. The property manager tendered the claim under its CGL policy, which provided coverage for claims alleging "wrongful eviction from . . . (a) a room; (b) a dwelling; (c) or premises; that a person occupies by or on behalf of its owner, landlord or lessor." The carrier denied coverage, contending the CGL policy only covered claims for wrongful eviction that were asserted by a tenant who was a natural person, not a corporate entity.

The insured filed a declaratory judgment against the carrier, arguing that, based on the definition of "person" as used in various contexts under state law, a corporation can be a "person," and thus the claim asserted against the insured by the corporate tenant should fall within the wrongful eviction offense. The *Mirpad* court rejected the insured's argument, however, finding that the CGL policy's use of the term "person" clearly referred only to a natural person. In reaching this conclusion, the court recognized that under California law it was required "to glean the meaning of the words [in the policy] *from the context and usage of the words in the contract itself*." *Id.* at 144 (emphasis in original). Reviewing the CGL policy as a whole, the court noted that every reference in the policy to a "person" clearly referred to a natural person, with a corporate entity being separately identified in the policy as an "organization." Accordingly, the court held that the claim for wrongful eviction asserted against the insured was not covered by the CGL policy. "Since the policy only provided 'personal injury' coverage for 'wrongful eviction from . . . [a room, dwelling or premises] that a person occupies . . .' it would seem that such coverage should not extend to the wrongful eviction of 'organizations'. . . ." *Id.* at 144. The *Mirpad* court also found support for its decision based on its conclusion that "the places from which the eviction must take place are places where people live" *i.e.*, a room, dwelling or premises. *Id.*

Three years after *Mirpad* was decided, a contrary result was reached in *Supreme Laundry Service, LLC v. Hartford Cas. Ins. Co.*, 521 F.3d 743 (7th Cir. 2008) (applying Illinois law). The insured in *Supreme Laundry* installed and maintained laundry machines in leased space at condominium and apartment complexes. The insured was sued for wrongful eviction by one of its competitors after the insured replaced the competitor as the lessee of a laundry facility at a condominium complex. The insured tendered the competitor's lawsuit to its CGL carrier for a defense under the wrongful eviction offense section of Coverage B. The insurer denied coverage, claiming the wrongful eviction offense only provided coverage of claims asserted against the insured by a natural person, not a corporate entity.

While the insurer won at the trial court level, the Seventh Circuit reversed. The appeals court held the CGL policy failed to provide a definition for the word "person," and thus, under Illinois law, standard dictionary definitions must be applied to determine the meaning of the word. The court said dictionaries defined the word "person" to include corporate entities and, therefore, held the wrongful eviction offense included claims brought by both natural persons and corporations, "which, at the very least, means that the use of 'person' in the policy is ambiguous." *Id.* at 747. The court further rejected the argument (which was successfully asserted in *Mirpad*) that usage of the term "person" in the CGL policy solely referred to a natural person. While the *Supreme Laundry* court recognized that some provisions of the CGL policy clearly were meant to apply only to a natural person (such as the policy's definition of "bodily injury"), both a natural person and a corporate entity could be wrongfully evicted from the premises. Therefore, "[g]iven that neither 'person' nor 'organization' is defined by the policies, we will not read 'person' in this CGL policy to refer to simply natural persons when it can plausibly apply to a corporate entity, especially where the drafters never expressed any intent that usage of the term was meant only to refer to natural persons." *Id.* at 748.

Since *Mirpad* and *Supreme Laundry* have been decided, a few other courts have addressed the issue of whether "person" as used in the wrongful eviction offense refers only to a natural person or whether it also applies to a

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corporate entity. These decisions have come out on both sides of the issue. *See, e.g., 47 Mamaroneck Ave. Corp. v. Hartford Fire Ins. Co.*, 50 A.D.3d 952 (N.Y. App. Div. 2008) (following *Mirpad*); *Alco Iron & Metal Co. v. American Int'l Specialty Lines Ins. Co.*, 2012 U.S. Dist. LEXIS 166692 (N.D. Cal. 2012) (following *Mirpad*); *City of Glendale v. National Union Fire Ins. Co. of Pittsburgh, PA*, 2013 U.S. Dist. LEXIS 45468 (D. Ariz. 2013) (following *Supreme Laundry*). The issue remains undecided in many jurisdictions.

IMPORT OF ISSUE: Depending on the jurisdiction, insurance carriers may be able to successfully deny coverage of wrongful eviction offense claims brought by corporations against insureds. In a few jurisdictions, that position may not be available since courts have ruled CGL policies *do* cover such claims. In some other jurisdictions, judicial decisions exist supporting a denial of coverage. There is no governing case law, however, in the large majority of jurisdictions. In those states, carriers will need to rely on the case law that precludes coverage of claims brought by corporate claimants to support a denial of coverage.

Court Holds Reinsurance Certificate's Follow-The-Form Clause Obligates Reinsurer To Pay Expense Even Though No Indemnity Payment Made To Insured

SUMMARY: In *ACE Prop. & Cas. Ins. Co. v. Global Reinsurance Corp. of America*, Case No. 11-2838 (E.D. Pa. Mar. 31, 2013), the court ruled a reinsurance certificate's follow-the-form clause required a reinsurer to pay its share of expense even though the reinsured made no indemnity payment to its insured for the associated claims. The court held that since the certificate did not define "loss," the underlying policy's definition of "ultimate net loss" should apply and that under that definition "loss" included expense.

ACE Property & Casualty Insurance Co., as successor to Central National Insurance Company of Omaha ("ACE"), sued Global Reinsurance Corporation of America, as successor to Constitution Reinsurance Corporation ("Global"), for breach of a facultative reinsurance certificate ("Certificate") that reinsured an umbrella liability policy ACE issued to Wylain, Inc. ("Umbrella Policy"). Global raised several defenses, including that the Certificate did not require it to pay defense costs (or expense) associated with claims for which ACE made no indemnity payments.

The pertinent language of the Certificate regarding reinsurance coverage of defense costs or expense provided:

> Upon receipt of a definitive statement of loss, the Reinsurer shall promptly pay its proportion of such loss as set forth in the Declarations. In addition thereto, the Reinsurer shall pay its proportion of expenses . . . incurred by the Company in the investigation . . . in the ratio that the Reinsurer's loss payment bears to the Company's gross loss payment. If there is no loss payment, the Reinsurer shall pay its proportion of such expenses only in respect of business accepted on a contributing excess basis . . . .

The Certificate provided that the reinsurance was on an excess of loss, not a contributing excess, basis.

Global argued that because ACE paid no indemnity for the claims in question, ACE had not paid any "loss" to the insured. Accordingly, Global said, it had no liability to ACE for the defense costs ACE had paid for such claims since the Certificate was not written on a contributing excess basis.

ACE countered that since the Certificate did not define "loss," the court should look to the Umbrella Policy for a definition of that term. The Umbrella Policy did not include a definition of "loss," but did define "ultimate net loss" as follows:

> the total sum which the Insured . . . become[s] obligated to pay by reason of personal injury, property damage or advertising liability claims, either through adjudication or compromise, and **shall also include . . . all sums paid as expenses for . . . lawyers . . ., and for litigation**, settlement, adjustment and investigation of claims and suits which are paid as a consequence of any occurrence covered hereunder . . . .

(Emphasis added). ACE argued that this definition should be used for purposes of defining "loss" under the Certificate and that "loss," therefore, included defense costs.

ACE also contended that the Certificate's "follow-the-form" provision required the reinsurance coverage provided by the Certificate to be concurrent with the coverage of the Umbrella Policy. The Certificate's "follow-the-form" term provided as follows:

> [t]he liability of the Reinsurer . . . shall follow that of the Company and shall be subject in all respects to all the terms and conditions of the Company's policy except when otherwise specifically provided herein or designated as non-concurrent reinsurance in the Declarations.

The Certificate was not designated non-concurrent. Since the Umbrella Policy covered defense, ACE asserted that the Certificate did as well.

The court agreed with ACE and held Global was obligated to pay defense costs under the Certificate even though ACE had not paid any indemnity for the corresponding claims. The court held the follow-the-form clause required the Certificate's coverage to be concurrent with that of the Umbrella Policy. Although the terms "loss" and "ultimate net loss" are not the same, the court nevertheless held that in the absence of a definition of "loss" in the Certificate, under the follow-the-form clause that term should mean the same as "ultimate net loss" in the Umbrella Policy. Since defense costs were included in the definition of "ultimate net loss," such costs were also covered by the Certificate.

IMPORT OF DECISION: A reinsurer's obligation to pay a share of the expense incurred by its cedent is often a hotly contested issue that may involve a substantial amount of money. The resolution of the issue usually depends on the applicable language of the reinsurance contract. Here, the language of the Certificate appeared to support the reinsurer's position that it had no liability for defense since its reinsured had not paid any indemnity loss. The court's decision, however, was driven by its conclusion that the Certificate's follow-the-form clause required the reinsurance coverage under the Certificate to be concurrent with the coverage of the Umbrella Policy. The court relied on the follow-the-form provision to support its ruling that the "ultimate net loss" definition in the Umbrella Policy should be used to define "loss" in the Certificate since "loss" was not defined in the reinsurance agreement.

Sixth and Second Circuits Reach Different Decisions On Whether To Compel Arbitration Of Dispute Under Contract Lacking Arbitration Clause When Related Contract Has Such A Clause

SUMMARY: Two federal courts of appeals reached opposite decisions regarding whether a party may be compelled to arbitrate a dispute arising under a contract without an arbitration clause when that contract was one of several relating to an overall transaction. In the first case, the Sixth Circuit denied arbitration in a dispute involving a service agreement which did not have an arbitration clause, rejecting the argument that an arbitration provision in a related asset purchase agreement was sufficient to require arbitration. Conversely, the Second Circuit ordered parties to arbitrate a dispute brought by one law firm against a co-counsel firm to recover attorney's fees under a joint representation agreement (which did not have an arbitration clause) because a related client agreement (which had such a clause) provided the basis for the firm's claimed entitlement for legal fees.

In *Dental Assocs., P.C. v. American Dental Partners of Michigan, LLC*, No. 12-1008 (6th Cir. Mar. 28, 2013), American Dental Partners, Inc. ("ADPI") provided assets, personnel, and non-clinical services to dentists throughout the United States. Its wholly owned subsidiary, American Dental Partners of Michigan, LLC ("ADPM"), entered into the following contracts with Dental Associates, P.C. ("Associates"), a professional corporation of dentists: (1) an asset purchase agreement ("APA") through which ADPI purchased assets used in Associates' dental practices; and (2) a service agreement under which ADPM provided administrative and other non-clinical services to Associates. The service agreement required Associates to enter into employment agreements with certain of its dentists. ADPM and ADPI were not parties to the employment agreements but were referred to as third party beneficiaries.

The APA and employment agreements both contained broad arbitration clauses. The service agreement contained an arbitration provision limited to a narrow issue not involved in the litigation. The APA and the service agreement each provided that the other agreements were incorporated by reference. The employment agreements did not incorporate the other agreements by reference.

Associates brought an action against ADPI and ADPM, alleging claims of breach of fiduciary duty, breach of contract, tortious interference with contract and/or prospective economic advantage, and unjust enrichment. ADPI and ADPM filed a motion to dismiss and compel arbitration, arguing that the dispute should be arbitrated under the arbitration clauses of the APA and employment agreements. The trial court denied the motion, finding that the parties' dispute could be resolved without reference to the APA or the employment agreements and therefore was not subject to arbitration. ADPI and ADPM appealed.

The Sixth Circuit said that the "critical inquiry in determining whether a dispute falls under an arbitration clause is whether the action can be maintained without reference to the agreement containing the arbitration clause." Where there are multiple contracts between parties, a dispute is arbitrable pursuant to an arbitration clause in a related contract if the clause is part of an umbrella agreement governing the parties' overall relationship.

ADPI and ADPM argued that the APA was an umbrella agreement governing the parties' relationship and that the dispute was thus arbitrable pursuant to the APA. The Sixth Circuit disagreed, holding that the APA only governed the one-time purchase and transfer of assets and did not create the relationship between the parties.

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Rather, the court said, the service agreement defined the parties' ongoing business relationship. The fact that the APA incorporated the service agreement and employment agreements by reference was not dispositive because the service agreement also incorporated the APA and employment agreements by reference.

The court also held that the dispute could be maintained without reference to the APA. Associates' claim of breach of fiduciary duty arose under the service agreement which created that duty. Associates' breach of contract claim related solely to the breach of the service agreement. Furthermore, the service agreement contained its own definitions and could be interpreted without reference to the APA. Lastly, the action could be maintained without reference to the employment agreements.

In *Robinson Brog Leinwand Greene Genovese & Gluck P.C. v. John M. O'Quinn & Assocs., L.L.P.*, No. 12-2915-cv (2d Cir. Apr. 22, 2013), three law firms agreed to jointly represent plaintiffs in a stock fraud case on a contingency fee basis. One of the firms, the O'Quinn firm, agreed to finance the litigation. The other two firms agreed to handle the majority of the legal work. Three documents defined the terms of the representation. A client agreement provided for a 50% contingency fee and stated that all disputes were to be submitted to arbitration. A joint responsibility referral fee letter agreement provided that the three firms would jointly prosecute the litigation and specified how they would share attorney's fees. The third agreement set out the terms of the fee splitting arrangement among the law firms and was signed by the clients.

One of the firms filed suit seeking to recover fees from another firm which sought to dismiss the case on the grounds that the claims were required to be arbitrated. The firm that instituted the action argued that there was no arbitration provision in the joint representation agreement and that its claims were not within the scope of the arbitration clause of the client contingency fee agreement which it did not sign. The trial court granted the motion to dismiss, and the law firm appealed.

The Second Circuit stated that a non-signatory may be bound by an arbitration clause, even without signing the agreement, when it has knowingly accepted the benefits of an agreement with an arbitration clause. The court concluded that only by virtue of all three agreements functioning together was there a basis for generating a potential recovery, and only from such recovery would the firm be paid any attorney's fees. The court said that the client agreement, which established the attorney-client relationship between the plaintiffs and the law firms, was the foundation of these interdependent documents. Without a client to represent, there could be no settlement or recovery and thus no basis for distributing attorney's fees.

The law firm seeking attorney's fees argued that the sole source of its entitlement to a recovery was the joint agreement. The court said, however, that while that agreement apportioned fees among the law firms, it did not contain an independent means of generating the funds from which those fees would be paid. According to the court, the firm could not limit the basis for its claim only to the joint agreement, but necessarily must rely on the client agreement as the basis for the payment of fees to the firms. The court held that the firm could not seek to benefit from the portion of the client agreement that created the pool of funds for payment of attorney's fees without also subjecting itself to the arbitration clause contained in the same agreement.

The firm also argued that even if it were bound by the client agreement's arbitration clause, the dispute fell outside the scope of the clause because its claims were not based directly on the client agreement. The court gave this argument short shrift, holding that under the Federal Arbitration Act, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.

IMPORT OF DECISIONS: If it is intended that all disputes concerning a transaction or series of related transactions are to be arbitrated, lawyers involved in drafting interconnected contracts or documents should include an identical arbitration clause in all documents or at least clearly provide that an arbitration clause is incorporated by reference in all documents. Otherwise, a court may decide that a particular dispute is not subject to arbitration as the Sixth Circuit did in *Dental Associates v. American Dental Partners*.

Eighth Circuit Holds Arbitration Clause In Excess Insurance Policy Is Trumped By Service-Of-Suit Provision In Policy Endorsement And That Dispute Should Be Litigated, Not Arbitrated

SUMMARY: Do your insurance and reinsurance contracts require arbitration of disputes? The answer may not be as clear as you think. A recent decision by the Eighth Circuit Court of Appeals held that, despite terms of an excess insurance policy clearly stating that any dispute shall be resolved by binding arbitration, the service-of-suit provision in a later endorsement overrode the arbitration clause and arbitration was not required.

In *Union Elec. Co. v. Aegis Energy Syndicate 1225*, No. 12-3546, 2013 WL 1688859 (8th Cir. Apr. 19, 2013), the assured, Union Electric, filed suit to recover from its excess insurer, Aegis, for losses sustained in an accident at its hydroelectric power plant in Missouri. The excess policy provided for a three-step process of negotiation, mediation, and arbitration to resolve all disputes. The policy also included a provision stating:

> [a]ny controversy or dispute arising out of or relating to this . . . [policy], or the breach, termination, or validity thereof, which has not been resolved by non-binding means, . . . shall be settled by binding arbitration.

The insurer responded to the lawsuit by moving to compel arbitration under the above arbitration clause.

The policy also contained an endorsement that provided:

> [n]otwithstanding anything contained in the Policy to the contrary, any dispute related to this Insurance or to a CLAIM (including but not limited thereto the interpretation of any provision of the Insurance) shall be governed by and construed in accordance with the laws of the State of Missouri **and each party agree [sic] to submit to the jurisdiction of the Courts of the state of Missouri.** (Emphasis added.)

The assured argued that this service-of-suit language superseded the mandatory arbitration language in the policy and that the dispute could be litigated in Missouri courts. The trial court agreed and the Eighth Circuit affirmed, holding that the case was to be decided in Missouri courts and not in arbitration. Citing to Missouri law, the Eighth Circuit reasoned that endorsements "supplant conflicting general provisions in the main body of a contract" and thus the endorsement's language in which the parties submitted to the jurisdiction of Missouri courts replaced the policy language requiring arbitration.

In so ruling, the court rejected the insurer's arguments that the two provisions should be construed together unless they were in such conflict that they could not be reconciled and that the endorsement complemented the arbitration provision and was meant to give Missouri courts personal jurisdiction over the parties to enforce the arbitration provisions.

In contrast with the *Union Electric v. Aegis* decision, the District Court of New Jersey held in *New Jersey Physicians United Reciprocal Exchange v. ACE Underwriting Agencies, Ltd.*, No. 12-04397, 2013 U.S. Dist. LEXIS 52035 (D.N.J. Apr. 11, 2013) that a service-of-suit provision similar to the one in *Union Electric* could be read in harmony with an arbitration provision and did not limit or undermine the effect of the arbitration clause.

In *New Jersey Physicians v. ACE*, the reinsurer ("ACE") and cedent ("NJ Pure") had entered into a first excess of loss reinsurance agreement in 2004 ("2004 contract") pursuant to which ACE alleged NJ Pure owed $1.9 million for a premium adjustment. The parties also entered into another first excess of loss reinsurance agreement in 2007 ("2007 contract") under which NJ Pure alleged (and ACE did not dispute) it was owed approximately $2.1 million arising from losses and premium owed under that contract.

ACE relied on an offset provision in the 2007 contract to offset what it owed NJ Pure under the 2007 contract by the amount it claimed it was owed under the 2004 contract. NJ Pure filed suit in federal court alleging ACE breached the 2007 contract by failing to pay the entire amount due under that agreement. ACE initiated arbitration under the arbitration provision of the 2007 contract which provided that:

> all disputes or differences arising out of or connected with this Contract . . . shall, upon written request of either party, be submitted to three arbitrators . . . .

ACE moved to dismiss or stay the lawsuit based on this arbitration clause.

The 2007 contract also contained the following service-of-suit provision:

> It is agreed that in the event of the failure of the Reinsurers hereon to pay any amount claimed to be due hereunder, the Reinsurers hereon, at the request of the Reinsured, **will submit to the jurisdiction of a Court of competent jurisdiction within the United States**. (Emphasis added.)

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ACE argued that the service-of-suit provision should be read in harmony with the arbitration clause which should be enforced. Otherwise, ACE said, its effect would be undermined if the lawsuit were to be allowed to continue. The court agreed and stayed the lawsuit and ordered the parties to arbitrate their dispute despite the service-of-suit clause. Relying in part on federal case law providing that service-of-suit clauses do not negate arbitration provisions in the same contract, the court reasoned that the service-of-suit language acts as a forum selection clause and complements the arbitration provision by providing a forum for litigation in the event either party "should need to turn to the courts to compel arbitration or enforce an arbitration award, or [if] the parties opt out of arbitration." These same arguments were rejected by the court in *Union Electric*.

IMPORT OF DECISIONS: Most courts have held that a service-of-suit clause does not negate an arbitration clause in an insurance or reinsurance contract and have interpreted the two provisions to require disputes to be arbitrated. The service-of-suit clause is held to apply to any litigation the parties may engage in, such as suits to compel arbitration or enforce arbitral awards or actions not covered by the arbitration clause. The *New Jersey Physicians v. ACE* decision is consistent with this majority line of cases. In that case, both the service-of-suit and arbitration provisions were in the original policy. The *Union Electric* case may be distinguished on the basis that the service-of-suit provision was in a policy endorsement issued subsequent to the original policy. The Eighth Circuit concluded that the later issued endorsement, which included language that the endorsement applied "[n]otwithstanding anything contained in the Policy to the contrary," supplanted the arbitration clause. The two clauses might still have been read to give meaning to each, as courts generally have done in similar situations. The holding demonstrates that an arbitration clause may not always be enforced as a party intended. If parties to insurance and reinsurance contracts intend that *all* disputes are to be arbitrated, they must clearly so state in their agreements, leaving no ambiguity.

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