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Insurance Practice

Reinsurance Redux

The redux on developments in the law of reinsurance

In This Issue

Southern District of New York Orders Arbitration Panel to Proceed with Umpire Selection

In the Matter of the Arbitration between OneBeacon America Insurance Co. and Swiss Reinsurance America Corp., No. 12-CV-5043 (S.D.N.Y. October 19, 2012).

Finding the Federal Arbitration Act mandates that a provision in a reinsurance agreement establishing a method for umpire selection must be followed, a judge in the United States District Court for the Southern District of New York recently granted an insurer's petition to appoint an arbitration umpire.

Petitioner OneBeacon America Insurance Co. paid out numerous insurance claims arising from asbestos-related bodily injuries, and sought reinsurance from Respondent Swiss Reinsurance America Corp. pursuant to a multi-line reinsurance treaty. Swiss Re refused to reimburse OneBeacon for the paid-out insurance claims so OneBeacon initiated arbitration in Boston, Massachusetts pursuant to the treaty. The arbitration panel ultimately ruled in favor of Swiss Re, and this decision was affirmed by the United States District Court for the District of Massachusetts.

Thereafter, OneBeacon re-submitted its reinsurance claim to Swiss Re, now claiming it was entitled to reimbursement pursuant to a "different ceding methodology." Swiss Re again did not reimburse OneBeacon on this re-submission so OneBeacon initiated a second arbitration proceeding against Swiss Re. During this second proceeding, each party selected its own party-appointed arbitrator pursuant to the treaty. The parties, however, could not agree on an umpire so OneBeacon petitioned the Court pursuant to Section 5 of the FAA to order Swiss Re to participate in the selection of an umpire, or alternatively, appoint an arbitrator itself.

Swiss Re cross-moved to dismiss OneBeacon's petition or to transfer the petition to the District of Massachusetts, arguing that OneBeacon's petition was improper in the Southern District of New York because of the venue limitation provision of Section 4 of the FAA — which limits the location of the compelled arbitration to the district in which the petition was filed — and the treaty's language requiring arbitration to take place in Boston. In the alternative, Swiss Re moved to enjoin the arbitration altogether as duplicative pursuant to the FAA and barred by *res judicata*.

The Court granted OneBeacon's motion and ordered the parties to proceed with choosing an umpire in accordance with the terms of the treaty. Relying on *In re Salomon Inc. Shareholder's Derivative Litig. 91 Civ. 5500 (RRP)*, 68 F.3d 554, 560 (2d Cir. 1995), the Court reasoned that when, like here, there is an agreement between the parties to arbitrate, Section 5 of the FAA requires compliance therewith, and the Court "shall" exercise its appointment authority if a party has failed "to avail" itself of a method of selection provided in the agreement. Under Section 5, the Court continued, there is a "failure to avail" when the arbitration agreement specifies a procedure for selecting an arbitrator, but one of the parties refuses to comply, thereby delaying the arbitration indefinitely, which is "exactly the case here." Because Swiss Re declined to participate in a "dialogue" regarding the selection of the umpire, the Court concluded, it failed "to avail" itself "of the agreed-upon" method" and therefore relief under Section 5 was appropriate. Accordingly, the Court ordered that the parties proceed with umpire selection as set forth in the treaty, which in this case meant that the two party-appointed arbitrators must choose the umpire.

The Court also denied Swiss Re's cross-motion to dismiss OneBeacon's petition or to transfer the petition to the District of Massachusetts. Relying on *ACEquip Ltd. v. Am Eng'g Corp.*, 315 F.3d 151 (2d Cir. 2003), the Court rejected Swiss Re's improper venue argument, stating that while Swiss Re was correct in its assertion that Section 4 of the FAA provided authority to compel arbitration only within the district in which the petition is filed, "Swiss Re has not pointed the Court to, nor has the Court been able to find on its own, any authority that suggests that Section 5 should be read to incorporate Section 4's venue limitation." According to the Court, the

Second Circuit has relied on "the linguistic differences between Sections 4 and 5," as well as the "different consequences that follow from the appointment of an arbitrator [versus] an order compelling arbitration," in holding that a "somewhat less stringent standard governs the court's decision to appoint an arbitrator as opposed to its decision to compel arbitration."

Additionally, the Court also denied Swiss Re's motion to transfer venue to the District of Massachusetts, stating that appointment of an arbitrator is not the same as ordering arbitration and the Court was unwilling to burden a second court with considering the instant petition. Moreover, the Court stated that Swiss Re's argument that it can avoid the arbitration by pressing its *res judicata* defense "is for another day." Lastly, the Court denied Swiss Re's motion to enjoin the arbitration without prejudice to renewal in "an appropriate forum."

REDUX IN CONTEXT:

- When there is an agreement between the parties to arbitrate, under the FAA, the Court "shall" exercise its authority to appoint an arbitrator if aparty has failed "to avail" itself of a method of selection provided in the agreement;
- New York federal courts are unwilling to incorporate the venue limitation of Section 4 of the FAA — concerning the power to *compel* arbitration only within the district in which the petition is filed — to Section 5 of the FAA — concerning the appointment of an arbitrator; and
- New York federal courts hold that under the FAA, a less stringent standard governs the court's decision to appoint an arbitrator as opposed to its decision to compel arbitration

U.S. Supreme Court Vacates Ruling By Oklahoma Supreme Court Preventing the Arbitration of a Dispute Over a Non-Competition Agreement on Federal Arbitration Act Grounds

Nitro-Lift Technologies, LLC v. Eddie Lee Howard, et al., 568 U.S. 500 (2012).

In a per curiam opinion, the U.S. Supreme Court vacated a ruling by the Oklahoma Supreme Court preventing the arbitration of a dispute concerning a non-competition agreement on Federal Arbitration Act grounds, holding that a court may review the enforceability of an arbitration clause itself, but if the clause is valid, the validity of the remainder of the agreement is for the arbitrator to decide.

The underlying dispute arose from a contract between petitioner Nitro-Lift Technologies, LLC and two of its former employees, respondents Eddie Lee Howard and Shane Schneider. Respondents entered into a confidentiality and non-competition agreement with Nitro-Lift containing an arbitration clause, stating, "[a]ny dispute, difference or unresolved question between Nitro-Lift and the Employee . . . shall be settled by arbitration by a single arbitrator" in accordance with the American Arbitration Association.

After working for Nitro-Lift for some time, the respondents each quit and began to work for one of Nitro-Lift's competitors. Claiming respondents breached their non-competition agreements, Nitro-Lift demanded arbitration. Respondents then filed suit in Johnson County, Oklahoma, and requested the court to declare the non-competition agreements null and void and enjoin their enforcement. The Johnson County trial court dismissed the complaint, finding that the arbitration clause was enforceable and therefore an arbitrator, not the court, should decide the parties' dispute. On appeal, declaring its decision rests on adequate and independent state grounds, the Oklahoma Supreme Court held

that the non-competition agreement was void and unenforceable as against Oklahoma's public policy, reasoning that the existence of an arbitration agreement in an employment contract does not prohibit judicial review of the underlying agreement.

Stating that the Oklahoma Supreme Court's ruling improperly disregarded "precedents of the FAA," the U.S. Supreme Court granted certiorari, and vacated the Oklahoma Supreme Court's decision. In support of its holding, the Court stated it is well-settled that when parties commit to arbitrate contractual disputes, it is a "mainstay of the [FAA's] substantive law that attacks on the validity of the contract, as distinct from attacks on the validity of the arbitration clause itself," are to be resolved by the arbitrator in the first instance, not by a federal or state court. Further, the Court stated, because the Oklahoma Supreme Court did not question the validity of the arbitration clause, but at the same time nonetheless assumed the arbitrator's role by declaring the non-competition agreements null and void, it overstepped its bounds by not abiding by the FAA, which in this context is "the supreme Law of the Land." The Court also cited the holding of *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), for the proposition that when state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward and the conflicting rule is displaced by the FAA.

REDUX IN CONTEXT

- The FAA is far-reaching and when a state court categorically prohibits the arbitration of a particular type of claim, the analysis is straightforward and the conflicting rule is displaced by the FAA;
- This decision again affirms the applicability, and enforceability, of agreements to arbitrate disputes; and
- Under the FAA, attacks on the validity of the contract, as distinct from attacks on the validity of the arbitration clause itself, are to be resolved by the arbitrator in the first instance, not by a federal or state court.

Eleventh Circuit Court of Appeals Rules in Class Action That Bank Waived its Right to Compel Arbitration By Failing to Move to Compel Arbitration

Garcia, et al. v. Wachovia Corp., et al., No. 11-16029, 2012 WL 5272942 (11th Cir. October 26, 2012).

Affirming the Southern District of Florida in a multi-district class action, the U.S. Court of Appeals for the Eleventh Circuit held that Defendant Wells Fargo Bank, N.A., and its predecessor, Wachovia Bank, N.A. (collectively, "Wells Fargo") waived the right to compel arbitration of claims brought by customers as putative class action plaintiffs because they failed to move to compel arbitration, and such a failure was not excused on grounds that such a motion would have been futile.

In June 2009, the Judicial Panel on Multidistrict Litigation consolidated the five putative class actions involved in this appeal with dozens of similar cases filed against approximately thirty banks in the Southern District of Florida. With respect to the claims against Wells Fargo, plaintiff account holders alleged that Wells Fargo unlawfully charged them overdraft fees for their checking accounts, which are governed by agreements that provide for arbitration of disputes on an individual basis. The arbitration clause of the Wells Fargo agreement in question stated that either the customer or the "the Bank may require the submission of a dispute to binding arbitration at any reasonable time notwithstanding that a lawsuit or other proceeding has been commenced," but that neither party may consolidate disputes or "include in any arbitration any dispute as a representative or member of a class." The Wachovia customer agreement stated that if either the

customer or the bank requested, "any dispute or claim concerning [the customer's] account or [the customer's] relationship to [Wachovia] will be decided by binding arbitration," and any such arbitration "will be brought individually and not as part of a class action."

Despite being ordered to do so by the district court in late 2009, Wells Fargo did not move to compel arbitration of plaintiffs' claims, opting instead to only join several other banks in filing an omnibus motion to dismiss. The district court denied the motion to dismiss in most respects. In April 2010, the district court offered Wells Fargo a second opportunity to move to compel arbitration but it again did not accept the invitation. Instead, Wells Fargo responded that it declined to elect to arbitrate the disputes.

A year later, following extensive discovery, motion practice and trial preparation, Wells Fargo reversed course and moved to compel arbitration soon after the Supreme Court held in *AT&T Mobility LLC v. Concepcion*, — U.S. —, 131 S. Ct. 1740, 1753 (2011) that the FAA preempts state laws that condition the enforceability of consumer arbitration agreements on the availability of class-wide procedures. Wells Fargo argued that it had not waived its right to compel arbitration because before *Concepcion*, the state laws governing the customer agreements — in this case, California, Florida, Georgia, New Jersey, New Mexico, Oregon, Texas, Virginia, and Washington — foreclosed Wells Fargo from enforcing the agreements to arbitrate on an individual rather than class-wide basis. Further, Wells Fargo argued, before *Concepcion*, those state laws made arbitration provisions that contained class action waivers unenforceable, so its moving to compel would have been futile.

The district court denied Wells Fargo's motion on waiver grounds. In addition, the district court concluded that before the Supreme Court decided *Concepcion*, a motion to compel arbitration by Wells Fargo would not have been futile because Wells Fargo could have argued that the FAA preempted state laws that refused to enforce the arbitration agreements. It also could have argued at least some of the state laws did not prohibit enforcement of the agreements, and it could have severed the class action waiver provision and submitted to class arbitration.

On appeal, the Eleventh Circuit affirmed, ruling that Wells Fargo had waived its right to arbitration because: 1) it acted inconsistent with its arbitration right by failing to move to compel arbitration despite the district court twice inviting it to do so, and 2) it had "substantially invoked" the litigation machinery prior to demanding arbitration. In addition, the Court reasoned that if it would have compelled arbitration, plaintiffs would have suffered substantial prejudice in terms of litigation costs and Wells Fargo would have benefitted from conducting discovery of the plaintiffs, a benefit to which it would not have been entitled during arbitration.

Lastly, the Eleventh Circuit concluded that it would not have been futile for Wells Fargo to argue that the FAA preempts any state laws that purported to make the class-wide arbitration provisions unenforceable. Instead, according to the Court, *Concepcion* established no new law but "merely correctly applied existing law," and Wells Fargo could have argued, but did not, that the FAA preempts state laws that might have made the arbitration provisions unenforceable.

REDUX IN CONTEXT

- Despite the strong policy in favor of arbitration, a party, by its conduct, may waive its right to arbitration; and
- The FAA preempts state laws that condition the enforceability of consumer arbitration agreements on the availability of class-wide procedures.

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