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# Reinsurance Redux ←

The redux on developments in the law of reinsurance

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## Pennsylvania Court Grants Plaintiff's Motion for Summary Judgment and Holds that Terms Not Defined in Reinsurance Certificates are Defined As Set Forth in the Underlying Insurance Policies

*Ace Prop. & Cas. Ins. Co. v. R & Q Reinsurance Co., No. 11081920 (Phila. Ct. Comm. Pl. May 15, 2012).*

On May 15, 2012, the Pennsylvania Court of Common Pleas granted an insurer's motion for summary judgment, holding that the meaning of terms not defined in reinsurance certificates were set forth in the underlying policies for which the reinsurer provided reinsurance. R & Q Reinsurance Company ("R&Q") provided reinsurance under an excess of loss facultative certificate for four Ace Property & Casualty Insurance Company ("Ace") insurance policies. Ace was subsequently sued by insureds alleging asbestos bodily injury under these insurance policies. As a result, the insured under each policy entered into a funding agreement with Ace for payment of their claims. Ace submitted proofs of loss to R&Q under the terms of the facultative certificates. R&Q denied payment claiming that Ace wrongly combined expenses and indemnity to calculate the amount of the attachment point. R&Q argued that under an excess of loss facultative certificate, the meaning of "loss" is limited to indemnity.

Ace argued that R&Q's liability followed the underlying insurance policy, because the meaning of terms was set forth in the underlying policy, not the facultative certificates. The court held that a facultative certificate only determines the meaning of the terms loss, expense, and damage when the facultative

certificate is non-concurrent. Because the parties did not declare the facultative certificates to be non-concurrent, the meaning of the terms was set forth in the underlying insurance policies. The court reasoned that the definition of "loss" included defense and expense costs, in addition to indemnity, because the facultative certificates at issue were "excess of loss." The court noted that R&Q had copies of the underlying insurance policies, or at the very least had access to them. Therefore, the court concluded that R&Q's liability followed Ace's liability in the underlying insurance policies.

### Redux in Context:

- A facultative certificate only defines the terms loss, expense and damage, when the facultative certificate is non-concurrent with the underlying policy; and
- If a facultative certificate does not define the terms loss, expense and damage, the terms may be defined as set forth in the underlying insurance policy.

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## United States Court of Appeals for the Eighth Circuit Affirms Order Compelling Arbitration of a Subcontract Agreement Dispute, in Which Other Portions of the Subcontract Were Held to be Unenforceable

*M. A. Mortenson Co. v. Saunders Concrete Co., Inc., 676 F.3d 1153 (8th Cir. 2012).*

On March 13, 2012, the United States Court of Appeals for the Eighth Circuit affirmed the Minnesota federal district court's decision to enforce an arbitration agreement between a general

contractor and subcontractor that provided for arbitration in a specific forum, for any dispute, at the sole discretion of the contractor. M.A Mortenson Company ("Mortenson") hired

Saunders Concrete Company, Inc. ("Saunders") as its sub-contractor to supply concrete for a wind turbine project in New York. Mortenson alleged that the concrete that Saunders supplied failed to meet specifications and caused Mortenson to incur over \$4.5 million in repair costs. Mortenson filed a demand for arbitration with the American Arbitration Association ("AAA") against Saunders and asserted claims of negligence and breach of contract. In response, Saunders asserted counterclaims, and moved in New York state court for a stay of arbitration.

Before the New York court ruled on Saunders' stay motion, Mortenson filed a motion to compel arbitration under the Federal Arbitration Act ("FAA") in Minnesota pursuant to the arbitration provision of the agreement. The agreement provided that any dispute between Mortenson and Saunders would be decided by arbitration in Minneapolis, Minnesota if Mortenson, in its sole discretion, demanded arbitration. Saunders opposed Mortenson's motion pending in the District of Minnesota, contending that another section of the contract

related to arbitration constituted a "pay-if-paid" provision, in violation of New York lien law.

The District of Minnesota held that the arbitration provision Mortenson sought to enforce was a separate provision that contained a specific agreement to arbitrate. Thus, the provision was severable from the other sections. The court reasoned that the multiple sections in the subcontract agreement between Mortenson and Saunders were used to describe mutually exclusive processes for resolving different disputes, unlike agreements that used multiple sections to outline a unified arbitration process.

### Redux in Context:

- The unenforceability of certain provisions of a contract may not affect the enforceability of a specific agreement to arbitrate; arbitration clauses may be severable from the remainder of the contract.

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## United States District Court Denies Request to Vacate an Arbitration Award Notwithstanding Alleged Nondisclosure by Arbitrator

*Stone v. Bear Stearns & Co., Inc.*, No. 2:11-CV-5118, 2012 WL 1946938 (E.D. Pa. May 29, 2012)

On May 20, 2012, the United States District Court for the Eastern District of Pennsylvania denied a petitioner's request to vacate an arbitration award, holding that an arbitrator's nondisclosure did not render her ineligible to serve as a public arbitrator, and further holding that the petitioner waived his right to challenge the award because he failed to investigate the arbitrators before the commencement of arbitration as diligently as he did after he lost.

Laurence Stone ("Stone") brought an action against Bear Stearns to vacate an arbitration award in favor of Bear Stearns & Co., Inc. ("Bear Stearns"). Stone claimed that Bear Stearns fraudulently induced him to invest \$7.6 million. The arbitration panel unanimously ruled in favor of Bear Stearns. In response,

Stone argued that one of the arbitrator's alleged failure to disclose her husband's position at Wharton Business School and his previous employment at J.P. Morgan warranted vacatur of the arbitration award. Stone alleged that under the FAA, if the arbitrator had disclosed her husband's relationship to the securities industry, she would have been ineligible to serve as a public arbitrator.

Stone first argued that the arbitrator's failure to disclose information creates an impression of possible bias. The Third Circuit has previously held that a party asserting an evident partiality challenge must show that a reasonable person would have concluded that the arbitrator was biased. The Eastern District held that such was not the case here. The arbitrator

tried to disclose her husband's relationship to the securities industry to the Financial Industry Regulatory Authority (FINRA). In addition, the Court concluded that the husband's relationship to the securities industry was too tenuous to affect Stone. Ultimately, the court held that Stone failed to establish circumstances powerfully suggestive of the arbitrator's bias towards Bear Stearns.

Next, Stone alleged that the arbitrator's conduct constituted misbehavior which prejudiced his rights. The District Court dismissed this argument because the standard articulated by the Third Circuit for misbehavior was extremely high. Stone failed to demonstrate how the arbitrator's misconduct was so severe that it denied him a fundamentally fair hearing.

Stone also argued that the arbitrator's connection to the securities industry disqualified her from serving as a public arbitrator, and thus, she exceeded her power by issuing an award in this capacity. The District Court relied on the Third Circuit holding that trivial instances of an arbitrator exceeding his or her authority does not justify vacatur. The Court reasoned that because FINRA classified the arbitrator as eligible to serve, she did not exceed her powers. The Court also noted that because a three-person arbitration panel unanimously denied

Stone's claims, the arbitrator's presence on the panel did not prejudice him.

Lastly, the Court held that even if Stone successfully argued that the arbitration award warranted vacatur, he waived his right to challenge the award by waiting to investigate the arbitrators' biographies until only after the adverse award.

### Redux in Context:

- To successfully assert an evident partiality challenge in an arbitration agreement, a party must show that a reasonable person would conclude that the arbitrator was biased against the party;
- To constitute misbehavior, an arbitrator's misconduct must be so severe that it denies a party a fundamentally fair hearing; and
- Trivial instances do not disqualify a party from serving as an arbitrator when the entity conducting the arbitration has classified the person as an eligible arbitrator.

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## United States Court of Appeals for the Sixth Circuit Affirms District Court's Decision that Defendant Waived its Right to Arbitrate

*Johnson Associates Corp. v. HL Operating Corp.*, 680 F.3d 713 (6th Cir. 2012).

On May 23, 2012, the United States Court of Appeals for the Sixth Circuit affirmed a district court's decision that the defendant waived its right to arbitrate a dispute relating to a sourcing agreement. Johnson Associates Corporation (Johnson) filed suit against HL Operating Corporation ("HL") on December 22, 2009. In its answer, HL did not assert its right to arbitrate. HL participated in judicial settlement conferences, engaged in settlement discussions and exchanged multiple settlement offers for approximately eight months. HL also requested discovery, including depositions. On August 23, 2010, the day before the discovery deadline, HL moved to compel arbitration.

The district court held that HL waived its right to arbitrate because the sourcing agreement contained an arbitration clause, but HL did not raise the issue of arbitration until eight months later. Under existing Sixth Circuit precedent, a party may waive an agreement to arbitrate by taking actions that are completely inconsistent with the right to arbitrate, and causing the plaintiff to be prejudiced by unnecessary delay and expense. In this case, the Court reasoned that HL's behavior showed an intent to litigate. HL failed to assert arbitration as an affirmative defense and participated in litigation for nearly a year. Moreover, the court reasoned that Johnson was preju-

diced by HL's behavior, because of the time and resources invested in litigating the matter.

Furthermore, the court noted that a no-waiver clause in the sourcing agreement did not preclude using the court's standard analysis to determine whether a party has waived its right to arbitration. The court rejected HL's contention that a no-waiver clause justified its motion to compel arbitration. Permitting a no-waiver clause to prevent the court from finding a waiver, would permit parties to waste judicial time and effort. Moreover, granting HL's motion to compel arbitration would allow parties to test the possibility of litigation by delaying the assertion of their right to arbitration until litigation had ended.

### Redux in Context:

- A no-wavier clause does not preclude the Court from applying its standard analysis as to whether a party has waived its right to arbitration.

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