ARIAS U.S.

QUARTERLY

ALSO IN THIS ISSUE

‘Look Through’ Changes to Diversity Jurisdiction Under the FAA

A Boost for Arbitrator Discretion Under Honorable Engagements?

Recent Reinsurance Decisions in Federal Court: Part I

Q2 • 2022

TABLE OF CONTENTS

FEATURES

2 A Farewell to *Bellefonte*
By Patrick McDermott and Syed Ahmad

7 'Look Through' Changes to Diversity Jurisdiction Under the FAA
By Robert M. Hall

10 A Boost for Arbitrator Discretion Under Honorable Engagements?
By Charles H. Barr

18 Recent Reinsurance Decisions in Federal Courts: Part II
By James F. Jorden

ALSO IN THIS ISSUE

1 EDITOR'S LETTER

BACK COVER

BOARD OF DIRECTORS

EDITORIAL POLICY — ARIAS • U.S. welcomes manuscripts of original articles, book reviews, comments, and case notes from our members dealing with current and emerging issues in the field of insurance and reinsurance arbitration and dispute resolution. All contributions must be double-spaced electronic files in Microsoft Word or rich text format, with all references and footnotes numbered consecutively. The text supplied must contain all editorial revisions. Please include a brief biographical statement and a portrait style photograph in electronic form. The page limit for submissions is 5 single-spaced or 10 double-spaced pages. In the case of authors wishing to submit more lengthy articles, the *Quarterly* may require either a summary or an abridged version, which will be published in our hardcopy edition, with the entire article available online. Alternatively, the *Quarterly* may elect to publish as much of the article as can be contained in 5 printed pages, in which case the entire article will also be available on line. Manuscripts should be submitted as email attachments. Material accepted for publication becomes the property of ARIAS • U.S. No compensation is paid for published articles. Opinions and views expressed by the authors are not those of ARIAS•U.S., its Board of Directors, or its Editorial Board, nor should publication be deemed an endorsement of any views or positions contained therein.

COVER ARTWORK: GURZART/ADOBE STOCK

By the time you read this letter, our Spring Conference on Amelia Island will have just occurred. This gives every conference presenter a great opportunity to leverage your fine work into an article for the *Quarterly*. Don't delay—submit an article today.

In this issue of the *Quarterly*, we start with an article on a subject near and dear to almost every reinsurance person's heart—that's right, our old friend *Bellefonte*. Patrick McDermott and Syed Ahmad from Hunton Andrews Kurth LLP present "A Farewell to *Bellefonte*," a tale of a case that shook the reinsurance industry for 31 long years and now has been relegated to the trash heap of history. Is it a fond farewell, or a derisive good riddance?

Next, we have another article from the prolific Robert M. Hall, a member of our *Quarterly* Editorial Committee and head of Hall Arbitrations. In "'Look-Through' Changes to Diversity Jurisdiction Under the Federal Arbitration Act," Bob takes us back to basics to discover how the Federal Arbitration Act works in federal court and how parties may obtain jurisdiction if that is the forum in which they wish

to proceed. Notably, the U.S. Supreme Court recently ruled on a related issue that the "look-through" method used for cases involving compelling arbitration does not apply to provide federal question jurisdiction in cases seeking enforcement of arbitration awards.

Following is an article on a potential judicial expansion of the honorable engagement clause by Charles H. Barr of the Health Sciences Law Group LLC. In "A Boost for Arbitrator Discretion Under Honorable Engagements?" Charles explores two different judicial approaches to interpreting the honorable engagement clause and leaves us to wonder where the courts will go from here.

Our final article comes from James F. Jorden of the Jorden Group, who presents Part II of his follow-up from the Fall 2021 Conference, "Recent Reinsurance Decisions in Federal Court." The article discusses several additional important decisions in the life reinsurance area, including cases on the power of arbitrators and subpoenas and functus officio.

Spring gives us all the opportunity to renew, recharge and reinvigorate our practices, our companies, and our organization--ARIAS·U.S. We hope this issue of the *Quarterly* provides you with a foundation for renewal.

Larry P. Schiffer
Editor

A Farewell to *Bellefonte*

By Patrick McDermott and Syed Ahmad

The Second Circuit recently ended a meandering saga—not unlike those in American novels written by the Lost Generation—ruling that *Bellefonte* is "no longer valid law." Since the last century, commentators have recognized the industry-wide critique of *Bellefonte*, including in articles with Hemingway-inspired titles like "For Whom Does *Bellefonte* Toll? It Tolls for Thee" [1].

We now present a farewell to *Bellefonte*. (Disclaimer: The authors represent Utica Mutual Insurance Company and were involved in the Utica cases discussed in this article.)

The *Bellefonte* Decision

The story begins in the 1980s. Bellefonte Re and other reinsurers sued Aetna Casualty and Surety Co. in federal court in Manhattan. They claimed that the "Reinsurance Accepted" amount in the reinsurance contracts was an overall limit on their liability and, thus, they did not need to pay expenses in addition to that limit.

The reinsurers persuaded the trial court to rule in their favor as a matter of law. In so deciding, the trial court stated it found "no indication in the policies at issue that expenses are to be excluded from the policy limitations" [2].

Up to the Second Circuit the case went. In 1990, that court affirmed, stating that the reinsurance accepted amount was "a cap on all payments under the certificate" [3]. The court rejected the cedent's reliance on a separate provision that obligated the reinsurers to pay their proportion of settlements and, "in addition thereto," their share of expense. It explained that this provision "merely differentiate[d] the obligations for losses and for expenses."

Commentators immediately questioned the decision. An article in the December 1990 issue of *Mealey's Reinsurance Report* asserted that *Bellefonte* raised "two significant questions concerning fundamental principles of reinsurance" [4]. One of those questions was, "Did *Bellefonte* eliminate expenses as a supplemental benefit under a standard form facultative certificate?" The author's answer was a "clear[] ... no."

The *Unigard* Decision

Still, *Bellefonte* gained steam. In a 1993 decision, the Second Circuit addressed Unigard's argument that its reinsurance-accepted amount capped its liability [5]. There the cedent contended that *Bellefonte* did not consider the follow-the-form clause in the reinsurance contracts. The court rejected the cedent's reliance on the follow-the-form provision, pointing out that the clause mandated that the reinsurers' liability was subject to the terms and conditions of the reinsured policy "except as otherwise provided by" the reinsurance contract. The court also found the reinsurance contract "otherwise provided ... for the policy limits."

The court was also unpersuaded by the cedent's reliance on past practices, which included the following: (1) testimony from Unigard's own witness that he understood the reinsurance paid expenses in addition to the reinsurance-accepted amount, (2) Unigard's repeated payment of expenses in addition to the reinsurance-accepted amount, and (3) expert testimony about the "universal understanding" in the reinsurance industry "that whenever the underlying policy owes defense costs in addition to indemnity limits, facultative certificates such as Unigard's reinsure on the same basis" [6]. The Second Circuit ignored all of that because "*Bellefonte's* gloss upon the written agreement is conclusive" [7].

Commentators also pounced on *Unigard*. "Because of the importance of the issue, however, and the fact that industry practice seems to have been to the contrary, *Unigard* may not be the last word on this matter" [8].

The *Allendale v. Excess* Decision

In 1997, a federal district court took *Bellefonte* and *Unigard* a step forward [9]. That court recognized that the reinsurance contracts before it lacked key phrases relied upon by the Second Circuit in *Bellefonte* and *Unigard*, yet it still followed the conclusions in those decisions. To that court, the "underpinning" of those rules was "the parties' assumed intent to give meaning to both the limit clause and the follow-the-fortunes clause." The court concluded that to "fulfill this intent, the reinsurers' duty to follow the settlement must be understood to be capped by the limit clause."

Following *Unigard* and *Allendale*, criticism continued. In this very publication, one author stated that the "understanding in the reinsurance world since time immemorial has been that the reinsurer's share of expense is not charged against its limit of liability—in other words, the expense is in addition to the limit" [10]. Because of that understanding, "[m]any members of the reinsurance community were shocked by *Bellefonte* and *Unigard*" [11].

Other authors recognized that the "*Bellefonte* line of decisions has been criticized as being contrary to the general custom and practice of the industry" [12]. Even pro-reinsurer articles recognized that *Bellefonte* "has been roundly criticized in the reinsurance industry" as "utterly at odds with decades-old custom and practice" [13].

Despite all of that, certain facultative reinsurers reportedly were relying on *Bellefonte* as the rule "from sea to shining sea" [14]. And so the battle between industry custom and practice and the federal courts' rulings continued.

The *Utica v. Munich* Decision

Skirmishes in court were relatively unimportant until 2014, when the issue again reached the Second Circuit in *Utica v. Munich*. There, the tide began to turn against *Bellefonte*.

The trial court had relied on *Bellefonte* and summarily disposed of the case by applying a presumption that the reinsurance-accepted amount was an overall liability cap [15]. The Second Circuit reversed, distinguishing *Bellefonte*. The court recognized that *Bellefonte* turned on a specific provision that made the reinsurance "subject to" the amount of liability set forth in the reinsurance-accepted amount. The reinsurance contract before the Second Circuit in 2014 did not contain any such provision. Thus, the court found that *Bellefonte* did not control. The court also rejected the theory that there was some sort of presumption about

reinsurance limits regardless of reinsurance contract language. Instead, the contract language controlled.

Decisions After *Utica v. Munich*

After *Utica v. Munich*, other courts continued chipping away at the reach of *Bellefonte*. One federal court in New York found a reinsurance contract ambiguous on how the reinsurance-accepted amount applied [16]. As part of its ruling, it noted material differences between the reinsurance agreements before it and those in *Bellefonte*. Instead of applying any presumption, the court ruled based on the contract language before it.

Pennsylvania courts ruled similarly. In 2015, the Pennsylvania Court of Common Pleas denied a reinsurer's summary judgment motion that asked the court to rule that the reinsurance-accepted amount capped the reinsurer's total liability [17]. That court followed the reasoning in the Second Circuit's *Utica* decision. A bench trial followed that summary judgment decision. Based on the evidence at trial, the court ruled that the reinsurance-accepted amount was not a total liability cap and that the reinsurer had to pay expense in addition to that amount, just like the insurer had paid expense in addition to the limit in the reinsured policy [18]. In a lengthy decision, the Superior Court of Pennsylvania affirmed on appeal [19].

Some courts, on the other hand, continued to take an expansive view of *Bellefonte*. In *Utica v. Clearwater*, a federal court found that *Utica v. Munich* did not control and adhered to its prior summary judgment decision, finding that reinsurance-accepted amounts were a total cap on the reinsurer's liability [20].

The *Global v. Century* Decisions

The trial court in *Global v. Century* took a similar position. There, the trial court had granted summary judgment to the reinsurer (Global), finding that the reinsurance-accepted amount was an absolute limit [21]. After that, the Second Circuit issued its decision in *Utica v. Munich*.

The cedent (Century) then moved for reconsideration, which the court denied [22]. While it concluded that *Utica v. Munich* was not a change in the law that would require reconsideration, it still went on to address whether *Utica v. Munich* would change the result. The court found it would not, because the language at issue in *Utica v. Munich* was different.

That ruling spawned a series of appellate decisions resulting in the downfall of *Bellefonte*. In the first, the Second Circuit asked for guidance from New York's highest court, the New York Court of Appeals [23].

In so doing, the Second Circuit cast doubt on *Bellefonte*. It said that Century's argument that *Bellefonte* and *Unigard* were decided wrongly "is not without force." The court explained that it found it "difficult to understand the *Bellefonte* court's conclusion that the reinsurance certificate in that case unambiguously capped the reinsurer's liability for both loss and expenses." The Second Circuit then asked the New York Court of Appeals whether there was "a rule of construction, or a strong presumption, that a per-occurrence liability cap in a reinsurance contract limits the total reinsurance available under the contract to the amount of the cap regardless of whether the underlying policy is understood to cover expenses such as, for instance, defense costs?"

The New York Court of Appeals answered that question "no" [24]. It said no such presumption applied, reminding courts that "[r]ather than adopting a blanket rule, based on policy concerns, the court must look to the language of the policy above all else." The case then went back to the Second Circuit, which in turn sent the matter back to the federal trial court [25].

In subsequent proceedings, the trial court then applied an often cited but rarely applied contract interpretation rule. It held an evidentiary hearing at which it received extrinsic evidence as part of deciding whether the contract was unambiguous or ambiguous [26]. Four experts testified on Century's behalf and two on Global's behalf, and the court spent pages summarizing those experts' testimony.

Then, while interpreting the reinsurance contracts, the court relied upon that expert testimony. For instance, the court found that "the credible testimony from the Century experts confirms that Global's construction [about the "subject to" clause] is incorrect."

The court ultimately concluded that the "plain and unambiguous meaning of the reinsurance contracts is that the dollar amount stated in Item 4

caps Global's obligation to pay losses ... but does not cap Global's obligation to pay expenses ..." It said its interpretation was "based on the language of the policy ... after having read the contract as a whole and with reference to the customs, practices, usages and terminology understood in the reinsurance industry in the 1970s ..."

> "An anomaly to the industry at the time it was decided, it is now an anomaly to the federal courts as well."

The December 2021 *Global v. Century* Decision

Global appealed, and the Second Circuit issued its third opinion in the dispute [27]. The court affirmed—and, like the trial court, it ruled based on both the contract language and extrinsic evidence about custom and practice.

For the contract language, the court found that Global's interpretation—that, like prior interpretations by other courts, the follow-the-form clause was "subordinate" to certain language in the preamble and to the reinsurance-accepted provision—turned the contract language on its head. This was because the follow-the-form provision made the reinsurers' liability "... subject in all respects to all the terms and conditions of the" reinsured policy "except as otherwise specifically provided" in the reinsurance contract. So, the reinsurance-accepted provision was subject to the reinsured policy terms unless the reinsurance contracts stated otherwise. The court concluded that "[n]owhere do the certificates specifically provide[] that the certificates' policy limits are inclusive of defense costs."

The Second Circuit found further support for its conclusion in the evidence about the reinsurance industry custom and practice. After reviewing that evidence, it stated that "Century's evidence of industry custom thus confirms what is apparent from the unambiguous language of the certificates."

In sum, the court found that "the reinsurance certificates' follow-form clauses require Global to pay its proportionate share of Century's defense costs in excess of the certificates' liability limits." It said that it based "this conclusion on the certificates' unambiguous language as well as the testimony of Century's experts confirming that a strong presumption of concurrency prevailed in the reinsurance market at the time the certificates were issued."

The Second Circuit also addressed *Bellefonte*. The court said that the New York Court of Appeals' ruling in the *Century v. Global* dispute "exposed a fundamental conflict between our holdings in *Bellefonte* and *Unigard* and the standard rules of contract interpretation ... applicable to facultative reinsurance contracts." In particular, in *Bellefonte* and *Unigard*, the Second Circuit wrongly "disregard[ed] the precise terminology that the parties used" and instead erroneously "assumed from the outset that the applicable policy limits capped the reinsurers' liability as to both losses and expenses ..." Thus, the court overruled *Bellefonte* and *Unigard* once and for all and found that they were "no longer good law."

So now we say farewell to *Bellefonte*, 31 years after it "shocked" the reinsurance community. An anomaly to the industry at the time it was decided, it is now an anomaly to the federal courts as well. The decision spawned decades of disputes and ultimately resulted in a reminder to all courts that the reinsurance contract language controls, not one-size-fits-all rules applicable to construing all reinsurance contracts.

NOTES

1 See Goldstein, Michael H., "For Whom Does *Bellefonte* Toll? It Tolls for Thee," 9 *MEALEY'S LITIG. REP. REINSURANCE*, no. 7, 1998 (*Bellefonte* "has been roundly criticized in the reinsurance industry."); see also Wilker, P. Jay, and Edward K. Lenci, "For Whom Does *Bellefonte* Toll," 9 *MEALEY'S LITIG. REP. REINSURANCE*, no. 2, 1998.

2 *Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co.*, No. 85 CIV. 2706 (JFK), 1989 WL 106469, at *2 (S.D.N.Y. Sept. 5, 1989).

3 *Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co.*, 903 F.2d 910, 913 (2d Cir. 1990); see also id. at 914 ("Here, the limitation on liability provision capped the reinsurers' liability under the certificates. All other contractual language must be construed in light of that cap.").

4 Cohen, Deborah F. 1990. "The *Bellefonte* Decision and The Follow the Fortunes Doctrine. 1 *MEALEY'S LITIG. REP. REINSURANCE*, no. 15, at 24 (emphasis added).

5 *Unigard Sec. Ins. Co. v. N. River Ins. Co.*, 4 F.3d 1049 (2d Cir. 1993).

6 North River's Brief, *Unigard Sec. Ins. Co. v. N. River Ins. Co.*, No. 91-7534, 1991 WL 11009416, at *36-38 (2d Cir. July 31, 1991).

7 *Unigard*, 4 F.3d at 1071.

8 Brady, Michael J., and Lawrence O. Monin. 1994. "Reinsurance Disputes: Death of the Handshake." 61 *Def. Counsel J*. 529 (October).

9 *Allendale Mut. Ins. Co. v. Excess Ins. Co., Ltd.*, 970 F. Supp. 265, 271 (S.D.N.Y. 1997).

10 See Wollan, Eugene, "Sing a Song of Reinsurance," ARIAS·U.S.. *Quarterly*, 1999, First Quarter Review, at 1.

11 *Id*.

12 Wilker, P. Jay, and Edward K. Lenci. 1998. "Much Ado About Nothing: A Response Regarding *Bellefonte's* Reach." 9 *MEALEY'S LITIG. REP. REINSURANCE* 16, no. 10.

13 Goldstein, Michael H. 1998. "For Whom Does *Bellefonte* Toll? It Tolls for Thee." 9 *MEALEY'S LITIG. REP. REINSURANCE*, no. 7. See also Goldstein, Michael H. 1997. "*Bellefonte* Lives." 8 *MEALEY'S LITIG. REP. REINSURANCE*, no. 10 (citing the "custom and practice of reinsurers providing coverage for expenses in addition to limits where the reinsured policy also covers expenses in addition to limits" and noting that *Bellefonte* "was met by almost universal condemnation and in some quarters ridiculed by insurance and reinsurance claims people").

14 Wilker, P. Jay, and Edward K. Lenci. 1998. "Much Ado About Nothing: A Response Regarding *Bellefonte's* Reach." 9 *MEALEY'S LITIG. REP. REINSURANCE* 16, no. 10.

15 *Utica Mut. Ins. Co. v. Munich Reins. Am., Inc.*, 976 F. Supp. 2d 254, 264 (N.D.N.Y. 2013), vacated and remanded by 594 F. App'x 700 (2d Cir. 2014).

16 *Utica Mut. Ins. Co. v. R & Q Reins. Co.*, No. 6:13-cv-1332 (BKS/ATB), 2015 WL 4254074 (N.D.N.Y. June 4, 2015).

17 *Century Indem. Co. v. OneBeacon Ins. Co.*, No. 02928, 2015 WL 10436083 (Pa. Ct. Com. Pl. Mar. 27, 2015).

18 *Century Indem. Co. v. OneBeacon Ins. Co.*, No. 1207002928, 2016 WL 10100710 (Pa. Ct. Com. Pl. Feb. 23, 2016).

19 *Century Indem. Co. v. OneBeacon Ins. Co.*, 173 A.3d 784 (Pa. Super. Ct. 2017).

20 *Utica Mut. Ins. Co. v. Clearwater Ins. Co.*, No. 6:13-cv-1178 (GLS/TWD), 2015 WL 4496374 (N.D.N.Y. July 23, 2015).

21 *Global Reins. Corp. of Am. v. Century Indem. Co.*, No. 13 Civ. 06577(LGS), 2014 WL 4054260, at *2, *6-7 (S.D.N.Y. Aug. 15, 2014).

22 *Global Reins. Corp. of Am. v. Century Indem. Co.*, 2015 WL 1782206, at *2-3 (S.D.N.Y. 2015).

23 *Global Reins. Corp. of Am. v. Century Indem. Co.*, 843 F.3d 120 (2d Cir. 2016).

24 *Global Reins. Corp. of Am. v. Century Indem. Co.*, 91 N.E.3d 1186 (N.Y. 2017).

25 *Global Reins. Corp. of Am. v. Century Indem. Co.*, 890 F.3d 74, 77 (2d Cir. 2018).

26 *Global Reins. Corp. of Am. v. Century Indem. Co.*, 442 F. Supp. 3d 576, 579, 581-84, 586 (S.D.N.Y. 2020).

27 *Global Reins. Corp. of Am. v. Century Indem. Co.*, 22 F.4th 83, 87, 96-97, 100-03 (2d Cir. 2021).

Patrick McDermott is a counsel in Hunton Andrews Kurth LLP's office in Richmond, Virginia. He advises clients on all aspects of insurance and reinsurance coverage.

Syed Ahmad is a partner in Hunton Andrews Kurth LLP's office in Washington, D.C. He advises clients in connection with reinsurance disputes and matters involving direct insurance policies, including general liability policies, errors and omissions policies, directors and officers (D&O) policies, commercial property policies, and representations and warranty (R&W) insurance.

‘Look Through’ Changes to Diversity Jurisdiction Under the FAA

By Robert M. Hall

When there is a refusal to arbitrate, § 4 of the Federal Arbitration Act (FAA) gives the district court jurisdiction to compel arbitration when there is diversity of parties in the “controversy between the parties ...” This begs the question of how to determine diversity. The answer to this question appeared clear until the Supreme Court handed down *Vaden v. Discover Bank*, 556 U.S. 49 (2009). The purpose of this article is to examine the *Vaden* decision as well as lower court rulings both before and after *Vaden* to determine if it resulted in any change to the rule on diversity.

Pre-*Vaden* Caselaw

Pre-*Vaden* caselaw is represented by *Doctor’s Assocs., Inc. v. Distajo*, 66 F. 3d 438 (2nd Cir. 1995). This case involved disputes between the franchisor of certain Subway sandwich shops and its franchisees, which were subject to arbitration clauses. Franchisees brought state court actions against the franchisor and certain “development agents” who were not parties to the franchise agreements. When the franchisor brought a motion against the franchisees to compel arbitration, the franchisees claimed that the development agents were indispensable parties that destroyed the complete diversity required by § 4 of the FAA.

The court characterized *Doctor's Assocs.* as a "forum-shopping" case [1], ruling for the franchisor. It held that "the 'parties' to which Section (4) of the FAA refers are the parties to the petition to compel" [2]. If it ruled otherwise, the court noted, any party could avoid federal jurisdiction by naming a non-diverse party in a parallel state court action. It further ruled that those who are not parties to the arbitration agreement cannot be indispensable parties.

Supreme Court Ruling on *Vaden v. Discover Bank*

This case arose on the portion of § 4 of the FAA that provides the court with jurisdiction over federal questions. Specifically, the Supreme Court posed the issue as "may a district court exercise jurisdiction over a § 4 petition when the petitioner's complaint rests on state law but an actual or potential counterclaim rests on federal law?" [3] The fact situation involved a state law claim by Discover Bank for past due charges and a counterclaim by the debtor that such charges violated state law. In its motion to compel arbitration under the credit card agreement, Discover Bank alleged that the state law cited in the counterclaim was pre-empted by federal banking law. The Supreme Court accepted certiorari to resolve a split among the circuit courts.

The Court adopted a "look through" approach to the finding of a federal question for purposes of a motion to compel under the FAA:

The text of § 4 drives our conclusion that a federal court should determine its jurisdiction by "looking through" a § 4 petition to the parties' underlying substantive controversy. We reiterate § 4's relevant instruction: When one party seeks arbitration pursuant to a written agreement and the other resists, the proponent of arbitration may petition for an order compelling arbitration in:

"any United States district court which, save for [the arbitration] agreement, would have jurisdiction under title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties" [4].

Observing that the Court's jurisdiction was over the controversy between the parties, the Court ruled that a "look through" approach did not support federal jurisdiction:

We conclude that the parties' actual controversy, here precipitated by Discover's state-court suit for the balance due on [the debtor's] account, is not amenable to federal court adjudication [5].

> "Observing that the Court's jurisdiction was over the controversy between the parties, the Court ruled that a 'look through' approach did not support federal jurisdiction"

Impact of *Vaden* on Subsequent Diversity Cases

Northport Health Services of Arkansas, LLC v. Rutherford, 605 F.3d 483 (8th Cir. 2010), involved state court actions by the representatives of two nursing home residents asserting tort claims against the nursing homes and their administrators. The nursing homes filed federal actions to enforce the arbitration agreements against the representatives. The administrators were not parties to the federal action, but were citizens of the same state as the representatives.

The representatives argued that the inclusion of the administrators in the state court actions destroyed diversity. The district court applied *Vaden* in finding no diversity jurisdiction.

On appeal, the *Northport* court found that *Vaden v. Discover Bank* was a federal question case that did not govern a diversity case and that *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1 (1983), was the proper precedent to follow. The court found there to be diversity jurisdiction, citing to the traditional principle of diversity jurisdiction that it cannot be defeated by a non-diverse party who is not a party to the federal action unless that party is indispensable under Rule 19.

In another case, a fired employee brought a state court action against the store and store manager in *Hermes of Paris, Inc. v. Swain*, 867 F.3d 321 (2nd Cir. 2017). The store sought to enforce an arbitration clause in a federal court action based on diversity between the employee and the store. The court rejected the employee's "look through" argument based on *Vaden v. Discover Bank:*

That argument is simply incorrect. The Supreme Court's decision is Vaden deals with the entirely different question of determining whether a district court has federal question jurisdiction over a petition to compel arbitration (emphasis in the original) [6].

The court compelled the arbitration following its earlier decision in *Doctor's Assocs., Inc. v. Distajo*, 66 F. 3d 438 (2nd Cir. 1995).

ADT, LLC v. Richmond, No. 21-10023, 2021 U.S. App. LEXIS 33431 (5th Cir. Nov. 21, 2021), is a case in which an employee of ADT security systems was spying on security system customers. A customer brought a state court action against ADT and the employee, the latter destroying diversity. ADT filed a federal court action to compel arbitration against the customer, who then argued that the court should "look through" the controversy under *Vaden* to determine that the parties' dispute included a non-diverse party. The court ruled that *Vaden* did not control since "unlike diversity jurisdiction, federal-question jurisdiction turns not on the identity of the parties but on the subject matter of the controversy." The court granted the motion to compel, ruling that diversity is based on the parties to the motion to compel.

Commentary

The upshot of these and similar cases is that *Vaden v. Discover Bank* is a somewhat different gloss on federal question jurisdiction under the FAA. It does not, however, change the holdings of previous caselaw on diversity jurisdiction under the FAA.

NOTES

1 *Doctor's Assocs. Inc. v. Distajo*, 66 F. 3d 438, 411 (2nd Cir. 1995).

2 *Id*. at 445.

3 556 U.S. 49, 53.

4 *Id*. at 62.

5 *Id*. at 66.

6 867 F.3d 321, 325.

Robert M. Hall is a former senior vice president and general counsel of a major reinsurer, a former partner of a leading law firm, an ARIAS-certified arbitrator and umpire, an expert witness and a frequent author whose articles can be found on robertmhalladr.com. He is a member of the editorial board of ARIAS·U.S.

A Boost for Arbitrator Discretion Under Honorable Engagements?

By Charles H. Barr

The "honorable engagement" is a unique and—from the outside looking in, at least—odd creature in the conceptual menagerie of arbitration. Its natural habitat is an arbitration provision in a reinsurance or retrocessional agreement, and it typically directs arbitrators [1] to—

interpret this Agreement as an honorable engagement and not merely as a legal obligation; they are relieved of all judicial formalities and may abstain from following the strict rules of law, and they will make their award with a view to effecting the general purpose of the Agreement in a reasonable manner rather than in accordance with the literal interpretation of the language [2].

The effect of honorable engagement clauses, according to most courts confronted with them, is to grant arbitrators wide discretion to order remedies they deem appropriate [3]. The rubber meets the road, however, when arbitrators order a "creative" remedy that arguably impairs a party's contractual or other legal right.

It has been about 15 years since an article in these pages explored honorable engagements as its central focus [4]. That article explored the tension between vacatur of an award for arbitrators' manifest disregard of law and honorable engagement language that appears to authorize arbitrators to do just that. A few months later, the U.S. Supreme Court held, in *Hall Street Associates, L.L.C. v. Mattell, Inc.* [5], that the grounds enumerated in the Federal Arbitration Act (FAA) for vacatur and modification [6] are exclusive and, therefore, manifest disregard of law, which is not on either list, is not such a ground in and of itself. This holding suggested the possibility that courts reviewing awards under the FAA would afford honorable engagements—and, correlatively, arbitrator discretion

thereunder—freer rein [7].

The U.S. Court of Appeals for the Seventh Circuit may have begun to fulfill that expectation with its August 2021 opinion in *Continental Casualty Co. v. Certain Underwriters at Lloyd's of London* [8]. This article examines that opinion, contrasts its approach with that of earlier district court and Third Circuit opinions in *PMA Capital Ins. Co. v. Platinum Underwriters Bermuda, Ltd.* [9], and briefly reviews other judicial opinions addressing honorable engagement clauses since *Hall Street,* with an eye to how courts balance arbitrators' enhanced remedial discretion under honorable engagements with protection of parties' contractual rights [10].

The *Continental Casualty* Ruling

The arbitration reviewed in *Continental Casualty* arose from reinsurance treaties to cover mass tort and pollution liability. The cedent, on the advice of its third-party administrator, changed the way it calculated its self-insured retention for multi-year losses so as to increase its billings to the reinsurers. The reinsurers demanded arbitration, seeking a declaration of how the policy limits and retentions for five of the cedent's insureds apply to multi-year losses that the cedent had incurred or would incur [11].

The arbitrators found that the cedent's new method of calculating its retention contravened the parties' established course of dealings. That much of their ruling was uncontroversial in the judicial review [12], but the arbitrators went further. They held that the reinsurers had "paid the full amount due" and that the cedent could not rebill them for losses for the five insureds. Upon the cedent's request for clarification of whether this statement covered only past billings or also future billings, the arbitrators held that the reinsurers had "fully and finally discharged their past, present and future obligations" with respect to asbestos claims of three of those insureds [13]. The arbitrators did not explain their reasoning in support of any of these conclusions [14].

The cedent sought vacatur under FAA § 10(a)(4), arguing that (1) the arbitrators lacked a contractual basis for cutting off future billing for asbestos claims, (2) the remedy was punitive, and (3) the arbitrators therefore had exceeded their powers. The district court confirmed the award in its totality. The cedent appealed, and a unanimous Seventh Circuit panel affirmed [15].

Judge Diane P. Woods' opinion for the court, after discussing the deferential standard with which it must review an award that allegedly exceeded the arbitrators' powers [16], identified the issue on appeal as whether the arbitrators had the authority to prohibit the cedent's future billings for asbestos products losses to certain insureds [17]. The court addressed that issue by turning to the honorable engagement clause, noting that it had never before addressed honorable engagement clauses directly. Citing authority from other circuits, it adopted the related principles that honorable engagements are construed generously to give arbitrators wide discretion to order remedies, and that arbitrators under honorable engagements may employ equitable remedies not mentioned in the underlying agreement [18]. Citing its own pre-*Hall Street* authority, the court observed that "'[i]t is commonplace to leave the arbitrators pretty much at large in the formulation of remedies, just as in the formulation of the principles of contract interpretation'" [19].

In applying these principles to the arbitrators' remedy, the court observed that "the Panel members (all, recall, from industry) may have been striving to effectuate the broader purpose of the agreement" [20]. The arbitrators "may have thought" that "implicit in [the reinsurers'] request for resolution of the aggregate billing question was the consequence of a ruling either way"; that "the efficient way to wrap up the case would be to announce where [its ruling] left both sides, for their past, present, and future billings"; and that the cedent's adoption of its third-party administrator's over-aggressive position "might not be a one-time event" [21].

The cedent complained nonetheless that by prohibiting its future billings for asbestos losses of the three insureds, the arbitrators pro tanto "effectively delete[d] the 'basic grant of reinsurance coverage ... for amounts it pays to its underlying insureds'" [22]. The court pointed out that the award precluded future billing only for asbestos claims, not other covered claims [23]. As for the asbestos claims, it responded as follows:

While there are still asbestos exposure cases in the courts, many companies have finally resolved this aspect of their legal exposure. The record does not tell us why the arbitrators deliberately cut off coverage for future

asbestos claims for those companies, but they may have been persuaded that no such claims were likely to come along [24].

The court then reiterated that the arbitrators "had a relatively free hand in deciding how to wrap up the case. And once again, if there were any doubt on that point, the honorable engagement clause should remove it" [25]. It concluded by noting the following:

The arbitrators may have thought that the only way to implement the purpose of the agreement was to preclude all of the asbestos bills for the three named [insureds]. The agreement gave them the power to resolve the case on general principles, not just legal entitlements, and that seems to be what they did [26].

On the basis of this reasoning, the court ruled that "the arbitrators did not stray beyond the boundaries of their authority" [27].

The *PMA Capital Insurance* Ruling

The reinsurance agreement construed in *PMA Capital Insurance* included a "deficit carryforward provision" that "apparently" entitled the reinsurer, when the agreement terminated or upon satisfaction of certain other conditions, to (1) carry forward any reinsurance loss attributable to the cedent's previous agreement with the reinsurer's predecessor and (2) offset that loss against funds to which the cedent would otherwise be entitled at that time [28]. A dispute arose when the cedent contended that the carryforward provision was invalid because the current reinsurer was not a party to the previous agreement. The parties also disputed the amount of loss to be carried forward if the provision were valid, with the cedent at different times asserting loss amounts of zero and slightly over $6 million, and the reinsurer claiming loss of $10.7 million [29]. The reinsurer demanded arbitration, seeking (1) a declaration of how the carryforward amount should be calculated and (2) an order that when that amount was made concrete by future payment of losses, the cedent would be required to pay those funds [30].

> "Had the district and appellate courts in *PMA* been willing to indulge in similar speculation ... the award in that case would have survived judicial review."

The arbitrators' award ordered the cedent to pay the reinsurer $6 million within 30 days and that, upon payment, all references to the "deficit carryforward" would be removed from the reinsurance agreement. As in *Continental Casualty*, the award included no reasoning in support of the decision [31]. The cedent sought vacatur, arguing that the arbitrators exceeded their powers because their award was contrary to the relief sought by the parties and the plain language of their agreement. In the alternative, the cedent sought modification to delay the $6 million "payment" (or, presumably, the offset of same) until the contractually specified conditions to fixing the carryforward amount had occurred. The reinsurer sought confirmation of the award, arguing that the agreement's honorable engagement clause clothed the arbitrators with broad power to order the remedies they deemed appropriate [32].

The district court vacated the award [33]. After acknowledging its deferential scope of review and the generous reading to which the honorable engagement clause was entitled in the context of the arbitrators' remedial discretion [34], the court nonetheless rejected the reinsurer's reliance on that clause to justify the award. It concluded that "[t]he Arbi-

trators evidently found the Deficit Carry Forward Provision to be more trouble than it was worth and simply eliminated it" from the agreement and then ordered the cedent to pay $6 million in "an apparent effort to 'compensate'" the reinsurer for this loss, even though, as the reinsurer conceded, the conditions precedent to that "payment" had not been met [35].

The court reasoned that this conclusion was irrational in three respects. First, the award could not be rationally derived from the parties' agreement because the arbitrators, by eliminating the deficit carryforward provision and the conditions precedent to fixing the carryforward amount, had re-written that agreement, which no court had held to be within the authority conferred by an honorable engagement clause [36]. Second, the award could not be rationally derived from the parties' submissions, since neither party had asked the arbitrators to eliminate the deficit carryforward provision or to order immediate payment of any such deficit [37]. Finally, the award itself was deemed "completely irrational," particularly in light of the arbitrators' failure to explain their reasoning. The deficit carryforward provision and the conditions to fixing the carryforward amount were "essential parts" of the agreement, and no authority "authorizes arbitrators, acting sua sponte, to eliminate material provisions of the contract they are charged with interpreting" [38].

The reinsurer appealed the vacatur, and a unanimous Third Circuit panel, "agree[ing] with the district court in all respects," affirmed in a brief opinion not selected for official publication [39]. The court held that the arbitrators, "by ordering unrequested relief and rewriting material terms of the contract they purported to implement, went beyond the scope of their authority," and that the honorable engagement clause "did not give them authority to reinvent the contract before them, or to order relief no one requested" [40].

Incompatible Approaches

It is difficult to reconcile *Continental Casualty* and *PMA Capital Insurance*. To be sure, the "creative" arbitral remedy in *PMA* used more direct language to impair a clear contractual right, expressly "removing" the reinsurer's right to a future deficit carryforward. Too, the award in that case ironically impaired clear contractual rights of both parties, prospectively depriving the reinsurer of the carryforward benefit and the cedent of the right to defer "payment" (or offset) of the carryforward amount as then valued until the conditions precedent described in the agreement had occurred.

Nonetheless, the conclusion that the remedy in *Continental Casualty* impaired a clear contractual right of the cedent is unavoidable: it lost its right to look to the reinsurer for reimbursement of any asbestos product losses for which it may have to indemnify certain of its insureds in the future. The arbitrators in that case rewrote the parties' agreement pro tanto, just as surely as the arbitrators in *PMA* rewrote the agreement from which they derived their authority [41].

The *Continental Casualty* court expanded the influence of the honorable engagement clause in a manner that should raise eyebrows. Whereas *PMA* expressly stated that the arbitrators' failure to explain their reasoning contributed to the finding that the award was irrational, the same failure in *Continental Casualty* appears to have facilitated confirmation of the award by permitting unbounded judicial speculation about that reasoning. The Seventh Circuit went to considerable lengths to hypothesize "an interpretive route" from the parties' agreement to the award [42]. For example, it hazarded that the arbitrators "may have been persuaded" that no further asbestos claim against the cedent's three insureds "were likely to come along." The court cited no record support for this speculation, and therefore it is reasonable to conclude none existed. Indeed, the court admitted that "[t]he record does not tell us why the arbitrators deliberately cut off coverage for future asbestos claims against those [insureds]."

Had the district and appellate courts in *PMA* been willing to indulge in similar speculation under the auspices of the honorable engagement clause, the award in that case would have survived judicial review. For example, the *PMA* courts could have allowed that the arbitrators "may have been persuaded" that nothing further would occur to affect the eventual carryforward amount attributable to the previous reinsurance agreement, and therefore that "the efficient way to wrap up the case" would be to order payment in an amount that the cedent had at one point valued the carryforward and to dispense with further reference to it [43].

In contrast, the *PMA* court surmised at the outset of its analysis that the arbitrators, with a "rough justice" motivation, prospectively eliminated the carryforward provision they considered "to be more trouble than it was worth" and compensated the disadvantaged party by eliminating the conditions precedent to "payment" of the carryforward amount. Once that characterization was cast in cement, the award was doomed notwithstanding the honorable engagement clause, because no viable interpretive path from the agreement to the award could exist.

Had the *Continental Casualty* court adopted such a jaundiced view of the arbitrators' motivation at the outset of its analysis, the award in that case would similarly have fallen. For example, the court could have concluded that the arbitrators evidently viewed the prospect of future asbestos liability as an unnecessarily complicating factor in the parties' ongoing relationship, such that it was more trouble than it was worth.

Other Honorable Engagement Opinions

While all other officially published post-*Hall Street* opinions involving an honorable engagement confirmed awards, none addressed an arbitral remedy that materially impinged on a clear contractual right. In *First State Insurance Co. v. National Casualty Co.* [44], a First Circuit panel affirmed confirmation of an award that established a payment protocol under reinsurance and retrocessional agreements. Under this protocol, the reinsurer could pay under a reservation of rights if it identified facts giving rise to reasonable doubt regarding coverage, but its payment could not be conditioned on its right to audit the cedent's files [45]. The reinsurer sought vacatur, arguing in part that the arbitrators exceeded their powers because the "reservation of rights procedure," which was "plucked out of thin air and not derived from any contract term," impaired its audit rights [46].

The appellate court, noting that it had not previously addressed the operation and effect of an honorable engagement clause, held that it "empowers arbitrators to grant forms of relief, such as equitable remedies, not explicitly mentioned in the underlying agreement" [47]. The opinion is also significant for its statement that an honorable engagement clause encumbers the already narrow scope of judicial review with "yet a further level of circumscription" [48], whereas the Seventh Circuit in *Continental Casualty* ascribed to the honorable engagement the arguably more modest role of "removing doubt" about the broad scope of arbitral remedial discretion.

When it came to applying these principles to the facts, however, the result in *First State* was unremarkable and did not presage the result in *Continental Casualty*. The First Circuit opinion, characterizing the case as one "easily resolved on the merits" [49], dismissed out of hand the argument that the reservation-of-rights remedy impaired the reinsurer's audit rights. It noted that in the underlying agreements, the reinsurer's audit rights were disconnected from its payment obligations, such that its audit rights did not depend on a reservation of rights [50]. In effect, the court relegated the admittedly extracontractual remedy to the role of an inconsequential gloss that did not interfere with a clear contractual right.

The Third Circuit's opinion in *Century Indemnity Co. v. Certain Underwriters at Lloyd's, London* [51] also does not represent a significant expansion in the operation of an honorable engagement clause. In that case, the clause was invoked to justify not the arbitrators' discretion to craft a remedy but, rather, their discretion in receiving and excluding evidence. The honorable engagement clause, although mentioned by the court, served essentially as a makeweight [52].

Harper Insurance, Ltd. v. Century Indemnity Co. [53] drew an important distinction between an issue and a remedy in the context of arbitral discretion. While "arbitrators have no authority to rule on an issue not submitted to them," there is "no per se rule that it is beyond the authority of the arbitrators to issue a remedy directed to an issue squarely before them unless it was requested by one of the parties" [54]. When the parties agree to an honorable engagement, they forfeit the right to "complain that the arbitrators granted relief that was not specifically requested by either party" [55].

The court thus upheld an award that ordered reinsurers, which had delayed payments by imposing documentation requirements not authorized by agreement, to remit to the cedent within 106 days of billing the undisputed portion plus 75% of the disputed portion, along with their written objections [56]. While this payment protocol was not found in the agreement, it did not violate any specific provision in the

agreement; rather, it effectuated the agreement's "implied expectation that claims would be paid promptly" [57]. The court distinguished *PMA* on that basis, as well as on the basis that the arbitrators in the case before it had explained their rationale [58].

Questions Remain

Among the published judicial decisions after *Hall Street*, *PMA* stands alone in suggesting that arbitrators under an honorable engagement cannot order a remedy that no party requested, but only *Continental Casualty* holds that an honorable engagement clause justified an arbitral remedy that impaired a clear contractual right [59]. It is too soon to know whether the Seventh Circuit's opinion is a harbinger of expanded influence for honorable engagements when arbitrators flex their remedial muscles to "wrap up" a case, or a mere outlier.

> "It is tantalizing to consider whether arbitrators' discretion to disregard 'strict rules of law' under an honorable engagement extends beyond formulation of remedies and includes creation of their own rules of decision to determine parties' rights and liabilities."

The weight of an honorable engagement clause standing alone, however, remains unclear. When all was said and done, the *Continental Casualty* court relegated it to the relatively modest role of "removing doubt" about its decision to uphold the award—thereby implying that it would have reached the same decision without the honorable engagement clause, based on its extremely deferential scope of review under the FAA.

On the other side of the ledger, it is tantalizing to consider whether arbitrators' discretion to disregard "strict rules of law" under an honorable engagement extends beyond formulation of remedies and includes creation of their own rules of decision to determine parties' rights and liabilities [60]. *Continental Casualty* states that arbitrators are left "pretty much at large" with respect not only to remedies but also the principles of contract interpretation. This dictum awaits a future judicial challenge to an award in which the arbitrators choose to push that envelope.

NOTES

1. References to arbitration assume a panel of arbitrators rather than a single arbitrator, but the discussion is equally applicable to both.

2. *Continental Cas. Co. v. Certain*

Underwriters at Lloyds of London, 10 F.4th. 814, 817 (7th Cir. 2021). See also *PMA Capital Ins. Co. v. Platinum Underwriters Bermuda, Ltd.*, 400 Fed.Appx. 654, 654-55 (3rd Cir. 2010) (materially equivalent language); *First State Ins. Co. v. National Cas. Co.*, 781 F.3d 7, 12 (1st Cir. 2015) (similar language); *Century Indem. Co. v. Certain Underwriters at Lloyd's London*, 584 F.3d 513, 550 (3rd Cir. 2009) (similar language); *U.S. Life Ins. Co. v. Superior National Ins. Co.*, 591 F.3d 1167, 1178 n.12 (9th Cir. 2010) (similar language); *Harper Ins. Ltd. v. Century Indem. Co.*, 819 F.Supp.2d 270, 272 (S.D.N.Y. 2011) (similar language); *Starr Indem. & Liab. Co. v. G&G Underwriters, LLC*, --- F.Supp.3d ----, 2021 WL 3500957 (S.D.N.Y. Aug. 9, 2021) (slip opinion) (citing *Banco de Seguros del Estado v. Mut. Marine Office, Inc.*, 344 F.3d 255, 261 (2nd Cir. 2003) (similar language)); *On Time Staffing, LLC v. National Union Fire Ins. Co. of Pittsburgh, PA*, 784 F. Supp.2d 450, 452 (S.D.N.Y. 2011).

3. *Continental Cas.*, 10 F.4th. at 821; *PMA Capital Ins. Co. v. Platinum Underwriters Bermuda, Ltd.*, 659 F.Supp.2d 631, 636 (E.D. Pa. 2009), aff'd 400 Fed.Appx. 654 (3rd Cir. 2010); *First State Ins.*, 781 F.3d at 12 ("empowers arbitrators to grant forms of relief, such as equitable remedies, not explicitly mentioned in underlying agreement"); *Harper Ins., 829 F.Supp.2d at 278*; Starr Indem., 2021 WL 3500957, *2; *On Time Staffing*, 784 F.Supp.3d at 454 ("broad grant of [remedial] authority to arbitration panel"). These cases cite *Banco de Seguros*, 344 F.3d at 261-62, a leading pre-*Hall Street* case on the effect of an honorable engagement, for the proposition that it grants arbitrators wide remedial discretion, including the power to order remedies not expressly authorized by the parties' agreement. But see *Century Indem.*, 584 F.3d at 557-58 (construing honorable engagement clause to grant arbitrators wide discretion in admission and exclusion of evidence).

4. See Natasha C. Lisman, "Honoring the Honorable Engagement Clause in Judicial Review of Arbitral Awards: Should the Honorable Engagement Clause Preclude Any Scrutiny for Manifest Disregard of the Law?" ARIAS·U.S. *Quarterly*, Vol. 14, No. 3 at 11-16 (3rd Quarter, 2007). See also the following articles touching on the honorable engagement concept but not as a central focus: James H. Foster, "Reinsurance Arbitration Clauses through the Looking Glass; Practical Questions Raised by Newer Contract Terms," ARIAS·U.S. *Quarterly*, Vol. 15, No. 3 at 8-11 (3rd Quarter, 2008); Larry P. Schiffer, "Reinsurance Arbitration Clauses: Where the Courts Find Problems," ARIAS·U.S. *Quarterly*, Vol. 16, No. 1 at 30-31 (1st Quarter, 2009); Daniel M. Perry and Aluyah I. Imoisili, "Have Courts Declared Open Season on Reinsurance Arbitrators? Four Recent Court Decisions Present a Case for Reinsurance Arbitration Reform," ARIAS·U.S. *Quarterly*, Vol. 17, No. 3 at 2-5 (3rd Quarter, 2010); Clifford H. Schoenberg and Brian O'Sullivan, "The Application of *Stolt-Nielsen* to the Issue of Arbitral Consolidation," ARIAS·U.S. *Quarterly*, Vol. 18, No. 4 at 7 (4th Quarter, 2011); Fred G. Marziano, "Where Non-lawyers Fit in the Arbitration Process," ARIAS · U.S. *Quarterly*, Vol. 19, No. 2 at 16 (2nd Quarter, 2012).

5. 552 U.S. 576, 584 (2008).

6. 9 U.S.C. §§ 10-11.

7. See Daniel M. Perry and Aluyah I. Imoisili, supra n.4, at 2.

8. 10 F.4th. 814 (7th Cir. 2021).

9. 659 F.Supp.2d 631 (E.D. Pa. 2009), aff'd 400 Fed.Appx. 654 (3rd Cir. 2010).

10. A remedy can impinge upon legal rights other than contractual ones, such as statutory rights. For example, in *Banco de Seguros*, 344 F.3d at 261-62, the court invoked honorable engagement language to uphold the arbitrators' order requiring pre-hearing security, which arguably violated the foreign-state party's right under the Foreign Sovereign Immunities Act, 28 U.S.C. § 1609, to immunity from prejudgment attachment. However, in most judicial reviews of arbitrators' remedial discretion under honorable engagement clauses—including the cases examined in this article—the issue is whether and the extent to which a remedy imposed in arbitration can impair a party's contractual right under the agreement containing that clause.

11. See *Continental Cas.*, 10 F.4th. at 817.

12. The term "judicial review" is used here broadly so as to include any case in which a party asks a court to confirm, modify, or vacate an arbitral award. For a narrower use of the term that does not include such cases, see *Wise v. Wachovia Sec., LLC*, 450 F.3d 265, 269 (7th Cir.), cert. denied, 549 U.S. 1047 (2006).

13. See *id*. at 818.

14. See *id*. at 820.

15. See *id*. at 818-19.

16. See *id*. at 819.

17. *Id*. at 821.

18. *Id*. (citing *Banco de Seguros*, 344 F.3d at 261; *First State Ins.*, 781 F.3 at 12).

19. *Id*. (italics added) (quoting *Baravati v. Josephthal, Lyon & Ross, Inc.*, 28 F.3d 704, 710 (7th Cir. 1994)).

20. *Id*. at 822.

21. *Id*. at 821-22 (italics added).

22. *Id*. at 822.

23. See *id*.

24. *Id*. (italics added).

25. *Id*.

26. *Id*. at 823 (italics added).

27. *Id*.

28. See *PMA Capital Ins.*, 659 F.Supp.2d at 632-34.

29. See *id*. at 634.

30. See *id*. at 638.

31. See *id*. at 634, 635.

32. *Id*. at 634, 636.

33. The district court opinion in *PMA* was discussed in the article by Daniel M. Perry and Aluyah I. Imoisili, supra n.4, at 3-5.

34. See *id*. at 635, 636.

35. *Id*. at 636.

36. See *id*.

37. See *id*. at 637-38.

38. *Id*. at 639; see also id. at 638-39.

39. 400 Fed.Appx. at 654, 656. See also Third Circuit Local Appellate Internal Operating Procedure §§ 5.3, 5.7.

40. 400 Fed.Appx. at 656.

41. *Continental Casualty* does not cite either the appellate or the district court opinion in *PMA*. Perhaps the court did not feel obligated to cite the *PMA* appellate opinion because it was not officially published and therefore not precedential (see Third Circuit IOP §§ 5.3, 5.7), and did not feel obligated to cite the officially published district court opinion because it was "only" a district court opinion. By rule, however, the parties were permitted to cite both *PMA* opinions to the court (see Fed-.R.App.P. 32.1(a)), and it is difficult to imagine that the cedent did not do so.

42. See 10 F.4th. at 823.

43. The reinsurer in *PMA* may have agreed with that proposition. The fact that it sought confirmation of the award despite "removal" of the carryforward provision upon the cedent's payment of $6 million suggests as much.

44. 781 F.3d 7 (1st Cir. 2015).

45. *Id*. at 9-10.

46. *Id*. at 11.

47. *Id*. at 12.

48. *Id*. at 8.

49. *Id*. at 10.

50. See *id*. at 12.

51. 584 F.3d 513 (3rd Cir. 2009).

52. See *id*. at 556-59. See also *U.S. Life Ins. Co. v. Superior National Ins. Co.*, 591 F.3d 1167 (9th Cir. 2010), which affirmed confirmation of an award ordering a reinsurer to disgorge investment income in excess of calculated interest on withheld payments, pay all tendered bills, and pay all future bills within 30 days of billing. See id. at 1172. The court mentioned the honorable engagement clause only in a footnote (id. at 1178 n.12) and not as part of its reasoning, which rested on its deferential scope of review, arbitrators' inherently broad power to fashion appropriate remedies, and the reinsurer's own request to the arbitrators for "such other or further relief as [they] shall deem just and proper." See id. at 1178-80. Accordingly, the case cannot be considered to herald an enhanced role for honorable engagement clauses.

53. 819 F.Supp.2d 270 (S.D.N.Y. 2011).

54. *Id*. at 277.

55. *Id*. at 278.

56. See *id*. at 273.

57. *Id*. at 280.

58. See *id*. See also *Starr Indem. & Liab. Co. v. G&G Underwriters, LLC*, 2021 WL 3500958, *2 (S.D.N.Y. Aug. 9 2021) (slip opinion) (upholding arbitrators' award of attorney's fees to agent for successful claim to recover underwriting commissions; authority under applicable law was mixed on whether indemnity provision permitted fee shifting, and honorable engagement clause was "separate, independent ground" for award); *On Time Staffing, LLC v. National Union Fire Ins. Co. of Pittsburgh, PA,* 784 F.Supp.2d 450, 454 (S.D.N.Y. 2011) (citing *Banco de Seguros*, supra n.2, 344 F.3d at 262) (honorable engagement clause rendered arbitration provision broad rather than narrow, and justified order for pre-hearing security even though not expressly authorized by agreement).

59. A straight line from *Hall Street* to *Continental Casualty* would require that an arbitral remedy that impinges on a party's contractual right be characterized as a manifest disregard of law. That law would presumably be the rule of contract construction that when the parties use unambiguous language in their contract, the tribunal must apply it. See, e.g., *BladeRoom Group Ltd. v. Emerson Electric Co.*, --- F.4th. ----, 2021 WL 6056194, *5 (9th Cir. Dec. 21, 2021). An example of such an approach is *Adventure Motorsports Reinsurance, Ltd. v. Interstate National Dealer Services Inc.*, 356 Ga.App. 236, 240, 846 S.E.2d 115, 119 (2020) (vacating award for manifest disregard under Georgia law because arbitrators ignored express contractual language), rev'd and remanded, --- S.E.2d ----, 2021 WL 5893247 (Ga. Dec. 14, 2021) (referring to honorable engagement clause in factual recitation but not explicitly in analysis). More commonly, an arbitral remedy that impairs a party's contractual right is attacked on the ground that the arbitrators exceeded their powers.

60. See *Elwood Ins. Ltd. v. Onebeacon America Ins. Co.*, 2011 WL 679840, *3 (Mass. Super. Ct., Suffolk Cty. Feb. 9, 2011) (suggesting that honorable engagement clause, which "frees the panel from technical constraints under any body of substantive or procedural law," entitled arbitrators to ignore statute of limitations under law that was otherwise applicable).

Charles H. Barr is of counsel to Health Sciences Law Group LLC. He serves on the Commercial and Consumer Panels of the American Arbitration Association and as a referee for the Wisconsin Supreme Court.

Recent Reinsurance Decisions in Federal Courts: Part II

By James F. Jorden

This article is Part II of the discussion of recent reinsurance decisions that were briefly covered at the ARIAS 2021 Fall Conference panel presentation, "Hot Topics in the Life Insurance Industry." As noted in Part 1 in the Q1 2022 *Quarterly*, the panel's objective was to cover relatively recent case law involving reinsurance disputes that might ultimately have relevance in a reinsurance arbitration setting. The brief discussion below completes the review of those cases and incorporates brief comments on the potential implication of these decisions.

Arbitration Disputes: Enforcement, Panel Summons and Subpoena Powers

In Part 1, I discussed the federal appeals court decision in *Bankers Conseco Life Insurance Co. v. Wilmington Trust* on the scope of fiduciary duties of a non-discretionary trustee. Prior proceedings in an arbitration between Bankers Conseco and Beechwood Re, the reinsurer in that matter, gave rise to a discovery dispute involving the enforcement of an arbitration panel's third-party subpoena. *Washington National Ins. Co. v. OBEX Group LLC*, No. 18 CV 9693 (VB), 2019 WL 266681 (S.D.N.Y. Jan. 18, 2019).

Upon the failure of a third party to comply with the panel's second witness and document subpoena (having already complied with the first), and its representative's failure to appear at a hearing, the panel granted claimants leave to pursue judicial intervention. Bankers then sought compliance with the summonses under 9 U.S.C. § 7, which permits a petition

for enforcement to the federal district court "for the district in which such arbitrators or a majority of them are sitting." OBEX first moved to dismiss the subpoena for lack of subject matter jurisdiction and to quash the subpoenas. The district court summarily denied the OBEX petition and granted the subpoena. OBEX then sought reconsideration, citing three arguments, which were addressed by the district court. The court's analysis appears consistent with the respect typically shown by federal courts enforcing arbitration panel orders.

First, OBEX argued that the parties to the arbitration lacked diversity, thus denying jurisdiction to the court to enforce a subpoena. The court noted that the "controversy actually before the Court" was not the arbitration but the enforcement of a subpoena, and the parties to that dispute actually met the "diversity" requirement.

Second, OBEX argued that Washington National could not meet the "amount in controversy" requirement for federal jurisdiction because the value of the enforcement of the subpoena was clearly less than $75,000. The court rejected that argument, noting that the amount at issue in the primary arbitration was at least $134 million and even if the "documents responsive to the summonses pertain to only a fraction of that sum," the amount in controversy requirement would be met.

Third, OBEX argued that the panel was not authorized to issue non-party summonses in different districts (the arbitration panel had previously issued a summons for a party in the Eastern District of Pennsylvania). The court concluded that "nothing in Section 7 requires an arbitration panel to sit in only one location."

As in the review of prior decisions, the court's analysis and conclusions here reflect the general deference provided by federal courts to arbitration panel action on both substantive and procedural issues.

Functus Officio: The Standards and Issues in the Second Circuit

The Second Circuit, in *General Re Life Corp. v. Lincoln National Life Ins. Co.*, 909 F.3d 544 (2nd Cir. 2018), joined the Third, Fifth, Sixth, Seventh and Ninth Circuits in recognizing an exception to the rule of functus officio in arbitration proceedings if the arbitral award "fails to address a contingency that later arises or when the award is susceptible to more than one interpretation." In preparing for our Fall Conference presentation, my fellow panelists and I thought that, although the *General Re* decision has no doubt been previously addressed, it would be good to review the critical issues addressed by the Second Circuit and particularly its endorsement of the exception for "ambiguity" in addressing whether a panel review and amendment to a previously issued order is "functus officio."

The dispute involved the unwinding of a YRT reinsurance agreement between General Re and Lincoln. The agreement permitted General Re to increase premiums based on changes in "anticipated mortality" and a corresponding allowance to Lincoln to "recapture" its life insurance policies rather than pay increased premiums. General Re chose to increase premiums, and Lincoln elected to arbitrate the rate on the basis that the "anticipated mortality" test had not been met. The panel, addressing that issue, eventually concluded that the increase was permissible, and Lincoln elected to recapture the policies.

A dispute arose over the language in the award regarding the premium payments made by Lincoln in advance of the recapture date and the corresponding obligation of General Re to pay death benefits after the recapture date. General Re argued it was entitled to the premiums paid prior to the recapture date and obligated only to pay death benefits for deaths prior to that date. Lincoln objected and sought the panel's review and resolution.

General Re objected, arguing that the award was clear and no clarification was needed. General Re argued the panel's award entitled it to retain the "unearned" advance premiums paid before the date of recapture, but it was not responsible for reinsured claims paid after the date of recapture. Lincoln's position was that General Re was required to refund all "unearned" premiums and cover claims on all deaths prior to the date of recapture.

The panel agreed to review the dispute and issued a "clarification" that was not entirely consistent with either Lincoln's or General Re's position. The panel concluded that the award should be read to provide that General Re would retain the "unearned" premiums but be responsible for death benefits "for claims for which it retains premiums." General Re then petitioned the District Court for the District of Connecticut to con-

firm the original award (prior to the clarification), and Lincoln filed a cross petition to confirm the panel's award as clarified. The district court granted Lincoln's petition. General Re then appealed to the Second Circuit, arguing, in part, that the arbitration panel exceeded its authority to issue the clarification because the panel was "functus officio."

The Second Circuit rejected General Re's functus officio argument, noting that it was joining the Third, Fifth, Sixth, Seventh and Ninth Circuits in recognizing an exception to functus officio where an award "is susceptible to more than one interpretation." The court explained that the exception it was endorsing was consistent with an existing exception in the Second Circuit that "when asked to confirm an ambiguous award, the district court should instead remand to the arbitrators for clarification." The court then specified the three conditions that would need to be satisfied to support an exception to the functus officio doctrine: (1) the final award is ambiguous; (2) the clarification merely clarifies the award rather than substantially modifying it; and (3) the clarification comports with the parties' intent as set forth in the agreement that gave rise to the arbitration.

On the first requirement, the court concluded that "while perhaps not dispositive, the arbitrators' finding of ambiguity is due deference." As to the second issue, the court concluded that the final award was consistent with underlying agreement between the parties and therefore consistent with the original award. Finally, the court found that the premium payments by Lincoln were those called for under the original agreement between the parties.

Under the Second Circuit's analysis, the concept of functus officio is effectively inapplicable to limiting or denying an arbitration panel's authority to review or revisit its award, so long as the parties dispute one portion of its meaning. Indeed, where a party can raise a reasonable doubt as to the interpretation of an award, functus officio will not likely prevent further review and decision by the panel. It appears that federal courts are loathe to re-litigate the core principles of an issue when the arbitration panel's analysis and decision can be characterized (or effectively argued) as "ambiguous."

James F. Jorden recently retired as co-chairman of the Faegre Drinker law firm's 150-member Insurance Industry Group. Prior thereto, he was the founder and chairman of the Jorden Burt law firm for more than 30 years, representing insurers and reinsurers in national litigation and arbitration matters.

UPCOMING EVENTS

Fall Conference

November 3-4, 2022
New York Hilton, Midtown

Calling All Authors

The *Quarterly* is seeking article submissions for upcoming issues. Don't let your thought leadership languish. Leverage your blogs, client alerts and internal memos into an article for the *Quarterly*. ARIAS Committee articles and updates are needed as well. Don't delay. See your name in print in 2022 and 2023.

You can access the submission form and information on the ARIAS website under Publications at:

https://www.arias-us.org/wp-content/uploads/2021/02/ARIAS-Quarterly-Article-Submission-Form-2021.pdf

BOARD OF DIRECTORS

CHAIRPERSON
Cynthia R. Koehler
AIG
1700 Broadway, 33rd Floor
New York, NY 10019
617-330-4324
cindy.koehler@aig.com

PRESIDENT
Alysa Wakin
Odyssey Reinsurance Company
300 First Stamford Place, 7th Floor
Stamford, CT 0690
203-977-6074
awakin@odysseyre.com

VICE PRESIDENT
Marc Abrams
Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.
666 Third Avenue
New York, NY 10017
212-692-6775
mlabrams@mintz.com

VICE PRESIDENT
Joshua Schwartz
Chubb
436 Walnut Street
Philadelphia, PA 19106
215-640-2107
joshua.schwartz@chubb.com

TREASURER
Peter Gentile
7976 Cranes Pointe Way
West Palm Beach FL. 33412
203-246-6091
pagentile@optonline.net

Stacey Schwartz
Swiss Re
175 King Street
Armonk, NY 10504
914-828-8193
stacey_schwartz@swissre.com

Beth Levene
Transatlantic Reinsurance Co.
One Liberty Plaza 165 Broadway, 17th Floor
New York, NY 10006
212-365-2090
blevene@transre.com

Sarah Gordon
Steptoe & Johnson LLP
1330 Connecticut Avenue, NW
Washington, DC 20036
202-429-8005
sgordon@steptoe.com

Steve Schwartz
Chaffetz Lindsey LLP
1700 Broadway, 33rd Floor
New York, NY 10019
212-257-6940
s.schwartz@chaffetzlindsey.com

Seema Misra
Arch Insurance Group, Inc.
Harborside 3
210 Hudson Street, Suite 300
Jersey City, NJ 07311
212-458-6350
smisra@archinsurance.com

Jonathan Rosen
Arbitration, Mediation and Expert Witness Services
1133 Broadway, Suite 600
New York, NY 10010
646-330-5128
jonrosen55@aol.com

CHAIRMAN EMERITUS
T. Richard Kennedy*

DIRECTORS EMERITI
Charles M. Foss
Mark S. Gurevitz
Charles W. Havens, III
Ronald A. Jacks*
Susan E. Mack
Robert M. Mangino*
Edmond F. Rondepierre*
Daniel E. Schmidt, IV
**deceased*

ADMINISTRATION
Jonathan Gilad
Corporate Secretary/Ex officio
7918 Jones Branch Drive, Suite 300
McLean, VA 22102
703-506-3260
jgilad@arias-us.org

EDITORIAL BOARD
EDITOR
Larry P. Schiffer
larry.schiffer@schifferlc.com

ASSOCIATE EDITORS
Robin Dusek
robin.dusek@saul.com

Mark S. Gurevitz
gurevitz@aol.com

Andrew Poplinger
andrew.poplinger@ChaffetzLindsey.com

Teresa Snider
tsnider@porterwright.com

Robert M. Hall
bob@robertmhall.com

MANAGING EDITOR
Michela Rynczak
mrynczak@arias-us.org

INTERNATIONAL EDITORS
Adrian Mecz
adrian.mecz@nortonrosefulbright.com

Jonathan Sacher
jonathan.sacher@blplaw.com

ARIAS•U.S.
7918 Jones Branch Drive, Suite 300
McLean, VA 22102
Phone: 703-574-4087
Fax: 703-506-3266
info@arias-us.org
www.arias-us.org

©2020 ARIAS•U.S. The contents of this publication may not be reproduced, in whole or in part, without written permission of ARIAS•U.S. Requests for permission to reproduce or republish material from the ARIAS•U.S. Quarterly should be addressed to Sara Meier, Executive Director, at the contact details noted above.

The ARIAS•U.S. Quarterly (ISSN 7132-698X) is published 4 times a year by ARIAS•U.S.

7918 Jones Branch Drive,
Suite 300, McLean, VA 22102.

AIDA Reinsurance & Insurance Arbitration Society
7918 Jones Branch Dr.
Suite 300 • McLean, VA 22102
Phone: 703-506-3260 • Fax: 703-506-3266
Email: info@arias-us.org