THE POWERS THAT BE:

A SUMMARY SURVEY OF THE SCOPE AND LIMITS OF AN ARBITRATOR’S AUTHORITY AND PRE-HEARING SECURITY IN INSURANCE AND REINSURANCE DISPUTES

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INTRODUCTION

Most parties to reinsurance contracts agree in advance to resolve their disputes by means of private arbitration. Once proceedings begin, two procedural issues predominate: the parameters of the arbitrators’ power to control the proceedings and direct the outcome, and requirements that the putative debtor deposit security for its obligations as a pre-condition to defending its position. This paper provides a general introduction to the topics and case law relating to the (i) the scope of arbitrator authority generally, and (ii) pre-hearing security in insurance and reinsurance disputes. A comprehensive discussion of the issues is beyond the scope of this paper. Counsel should endeavor to master these areas of law prior to counseling clients or litigating these issues on behalf of their clients.

I. A PRIMER ON THE SCOPE OF ARBITRATOR AUTHORITY

A. An Arbitrator’s Authority to Hear Issues

The scope of the arbitrator’s authority is determined from the parties’ reinsurance contract and applicable law. A vast majority of reinsurance contracts contain arbitration clauses describing what disputes the parties agree to resolve in arbitration. Significantly, any doubts as to the arbitrability of an issue or issues will be decided in favor of arbitration. Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 80 (2002); Green Tree Financial Corp. – Alabama v. Randolph, 531 U.S. 79, 81 (2000); Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University, 489 U.S. 468, 469 (1989); Moses H. Cone Hosp., 460 U.S. at 24-25; accord Nat’l Am. Ins. Co. v. SCOR Reinsurance Co., 362 F.3d 1288 (10th Cir. 2004).

There are many variations of arbitration clause language. Classic examples of relevant language is provided herewith in footnote 1. The purpose of the arbitration clause is to identify what will create a right to demand arbitration. That is to say, there must be some “dispute” or “difference of opinion” to establish the right. See, e.g., Hartford Accident & Indemnity Co. v.

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1 Example 1 (only portion of clause quoted, emphasis added):

As a condition precedent to any right of action hereunder, in the event of any dispute or difference of opinion hereafter arising with respect to this Contract, it is hereby mutually agreed that such dispute or difference of opinion shall be submitted to arbitration.

Example 2 (only portion of clause quoted, emphasis added):

As a condition precedent to any right of action hereunder, any dispute arising out of this Agreement shall be submitted to the decision of the board of arbitration composed of two arbiters and an umpire, meeting in New York City, New York, unless otherwise agreed.

Example 3 (only portion of clause quoted, emphasis added):

Any dispute or claim arising out of or relating to this Agreement, including its formation and validity, shall be referred to arbitration.
Swiss Reinsurance America Corp., 246 F.3d 219, 226 (2d Cir. 2001) (“The district court erred by narrowly construing the arbitration clauses. . . . The language merely requires ‘any difference’ to trigger arbitration.”) The scope of the dispute is then generally described perhaps relating to “the interpretation of this agreement;” “transactions relating to this contract;” disputes “arising under;” “arising out of or relating to;” or to “all matters relating to the interpretation or performance of this contract.”)

When faced with an issue concerning the scope of the arbitrator’s authority, what does all this mean? Put simply, some language leads to broader scope of authority than other language. The language primarily considered the broadest in the industry includes phrases such as “all disputes.” When such language is incorporated into an arbitration clause, courts recognize the wide breadth of authority retained by the arbitrator to oversee a dispute. The authority is essentially over any matter of contention relating to the parties’ contract. Of course, matters of dispute not involving the contract in which the arbitration clause appears are not arbitrable, unless otherwise agreed to by the parties.

Although it may seem a philosophical or semantic exercise, some courts have looked to and interpreted language otherwise appearing equivalent in nature. For example, some courts have noted that “arising out of” may be broader in nature than “arising under.” See St. Paul Fire Marine Ins. Co. v. Employers Reinsurance Corp., 919 F. Supp. 133, 136 (S.D.N.Y. 1996) (“[B]oth the Supreme Court and the Second Circuit have taken an increasingly broad view of such phrases as ‘arising under’ and ‘arising out of’ in arbitration agreements . . .”); but see Medtronic AVE Inc. v. Cordis Corp., 100 Fed. Appx. 865 (3d Cir. 2004) (Treating “arising under” and “arising out of” as equivalent); accord Telecom Italia, SpA v. Wholesale Telecom Corp., 248 F.3d 1109, 1115 (11th Cir. 2001). Other cases have made further comparisons. See, e.g., Selma Medical Center, Inc. v. Manayan, 733 So.2d 382, 385 (Ala. 1999) (clause containing “any dispute [that] shall arise concerning any aspect of this Agreement” broader than the phrase “arising out of.”)

Ultimately, debate concerning the arbitration clauses turns upon whether the clauses are “broad” in scope or “narrow” in scope. The greater the breadth, the greater the scope of the arbitrator’s authority to decide issues and craft remedies. Again, any doubts are decided in favor of arbitrability. In addressing broad language in the arbitration provision of a reinsurance contract, and summarizing the law in its circuit, the Second Circuit recently held:

In summary, Hartford Accident and other decisions within this Circuit show that the arbitration clause in the present case is a broad one that must be held to encompass a claim of fraudulent inducement of the contract in general. There is no controlling authority for ACE’s contention that the prefatory phrase operates to limit the scope of arbitration. [ ] The remainder of the clause – “if any dispute shall arise between the parties hereto with reference

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Most arbitration clauses describe the duty of the arbitrator as an “honorable engagement rather than merely a legal obligation.” Further, arbitration clauses generally declare that the arbitrators are “relieved from all judicial formalities and may abstain from the strict rules of law.”
to the interpretation of this Agreement or their rights with respect to any transaction involved, whether such dispute arises before or after termination of this Agreement” – uses the broad phrase “any dispute”; the general phrase “with respect to”; . . . the broad, open ended phrase “any transaction involved”; and the temporally non-limiting phrase, “whether such dispute arises before or after termination of this Agreement.” The clause adds that the disputes “with reference to the interpretation of this Agreement” are also subject to arbitration. Thus, both this Circuit’s case law and the plain meaning of the arbitration clause suggest that the clause should be construed as broad in scope.

Ace Capital Re Overseas Ltd. v. Central United Life Ins., 307 F.3d 24, 33-34 (2d Cir. 2002).

See also:

•  Id. (quoting Louis Dreyfus Negoce S.A. v. Blystad Shipping & Trading Inc., 252 F.3d 218, 225(2d Cir. 2001) (“Moreover, ‘[w]hen parties use expansive language in drafting an arbitration clause, presumably they intend all issues that ‘touch matters’ within the main agreement to be arbitrated, while the intended scope of a narrow arbitration clause is obviously more.’’”);

•  Continental Ins. Co. v. Allianz Ins. Co., 52 Fed. Appx. 557, 559 (2d Cir. 2002) (Arbitration clause which was a “prototypical broad arbitration provision” contained in reinsurance and assumption agreement between insurer and reinsurer survived the cancellation of the agreement);

•  Burlington Ins. Co. v. Trygg-Hansa Ins. Co. AB, 9 Fed. Appx. 196 (4th Cir. 2001) (Parent company was subject to arbitration provision in agreement of its subsidiary notwithstanding that it was not a party to the agreement.);

•  Nissan Fire & Marine Ins. Co., Ltd. v. Fortress Re, Inc., No. 02 CV 00054, 2002 WL 737789 (M.D.N.C. 2002) (broad arbitration clause containing language “with reference to the interpretation of this Agreement or the rights of either party with respect to any transaction under this Agreement”);

•  Christian Mut. Life Ins. Co. v. Penn Mut. Life Ins. Co., 163 F. Supp. 2d 260, 262 (S.D.N.Y. 2001) (“First and foremost, an alleged failure to fulfill an expressly-stated provision of the Agreement whether characterized as a ‘condition precedent’ or otherwise, is itself a ‘dispute or difference between the parties with respect to this Agreement, and therefore entirely within the scope of what the parties expressly agreed to arbitrate.’”);

•  Quackenbush v. Allstate Ins. Co., 121 F.3d 1372, 1380 (9th Cir. 1997) (treaty clauses requiring arbitration of “any dispute with respect to any transaction” required arbitration of whether reinsurer was entitled to offset treaty obligations
owed to Insurance Commissioner as trustee with debts owed by reinsureds under other contracts);

- *Michigan Mut. Ins. Co. v. Unigard Security Ins. Co.*, 44 F.3d 826, 831 (9th Cir. 1995) (“The quota share contract provides for the parties to submit ‘any’ dispute to arbitration, and contains no limitation on the kinds of relief the arbitration panel may award.”);

- *Sweet Dreams Unlimited, Inc. v. Dial-A-Mattress Int’l, Ltd.*, 1 F.3d 639, (7th Cir. 1993) (“We find . . . that ‘arising out of’ reaches all disputes having their origin or genesis in the contract, whether or not they implicate interpretation of the contract per se.”); and

- *Phoenix Mut. Life Ins. Co. v. North American Co. for Life & Health Ins.*, 661 F. Supp. 751, 754 (N.D. Ill. 1987) (Describing as broad clause providing for “[a]ll disputes and differences upon which an amicable understanding cannot be reached are to be decided by arbitration,” but holding that clause did no expand to arbitrating issue of law firm representation.)

Obviously, the scope of an arbitrator’s authority is important and must be clearly understood. Therefore, the first thing any party or counsel should do when a dispute is on the horizon or actually present is closely analyze the relevant arbitration clause to ascertain the arbitrability of issues. In fact, parties should think about this long before, at the time the contract is executed. Parties should be aware of the authority third parties (*i.e.*, arbitration panels) will have to resolve their disputes, and confirm their comfort with the provisions. It may be that parties are comfortable with leaving all “business” dispute issues to a panel of industry experts but would rather have a fraudulent inducement claim litigated in a public forum. However, if parties are convinced that arbitration is the best forum for all dispute resolution, in most cases the clause should be unequivocal and broad. While it is possible to agree to arbitrate some issues or categories of disputes, there is substantial risk that a lengthy and costly dispute may take place on the scope of arbitrability alone at a later time.

**B. Specific Aspects of Arbitrator Authority**

Once the arbitrators are impaneled and the issues identified, certain specific authority, beyond their general ability to hear claims in arbitration, may be at issue. Below is a sample:

1. **Ordering Confidentiality**

There is no set rule of arbitrator authority in the United States to order confidentiality of proceedings. While there are various state statutes that provide for the confidentiality of

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3 Compare, authority cited *supra*, with, *e.g.*, *Gerling Global Reinsurance Co. v. ACE Prop. & Cas. Ins. Co.*, 42 Fed. Appx. 522, 523-24 (2d Cir. 2002) (Holding that an arbitration clause was narrow where it only applied to “irreconcilable differences of opinion.”); *see also Cummings v. Fed Ex Ground Package Sys.*, 404 F.3d 1258, 1262 (10th Cir. 2005) (Discussing a narrow arbitration clause, and refusing to compel arbitration where the intent of the parties was clearly to limit the arbitrable issues).
arbitration proceedings, a general rule has yet to be codified. To the extent the parties’ contract has adopted confidentiality provisions, or adopted rules which mandate confidentiality, the arbitration is properly ordered confidential. Absent such language, the parties may agree prior to the hearing or at the organizational meeting. But what if they don’t agree?

Under ad hoc procedures under the guise of the Federal Arbitration Act (“FAA”), it is concededly the industry custom for hearings to be confidential (generally by agreement). Absent specific contractual authority or agreement of the parties, panels tend to impose confidentiality on the basis that it is implicitly within their authority. While there is no established precedent to conclusively condemn or condone this approach, there are arguments for and against it.

On the one hand it can be argued: (i) confidentiality is the custom in the industry; (ii) if the parties did not want it they could have so expressed their intent in their reinsurance contract; (iii) confidentiality is an inducement to choosing arbitration generally as there is an expectation of privacy, and (iv) as a tribunal overseeing the dispute the panel has “inherent authority” to impose confidentiality much like a protective order.

On the other hand, parties may argue: (i) if the FAA permitted confidentiality, Congress would have clearly expressed that authority; (ii) arbitrator authority is a creature of contract and since there is no agreement on the issue, there is no authority; and (iii) the parties’ intentions are clearly expressed by not including a confidentiality clause in the contract. Further, a party may argue that “inherent” in such a practice is the potential abuse that may arise there from. Some companies have sought confidentiality in arbitrations to allow them to make inconsistent arguments in different cases, or to make the identical argument in repeated similar cases in the hope of succeeding in at least some matters. If there is no confidentiality, this could not occur.

Obviously, compelling arguments can be made for and against the arbitrators’ authority. The best way to avoid any such problems, however, is to address the issue in the contract. The parties need only provide a simple expression of confidentiality (or no confidentiality) in the reinsurance contract’s arbitration clause. The parties may also incorporate institutional rules, such as those of ARIAS-U.S., which provide that “[t]he confidentiality of arbitration proceedings should be memorialized in either an agreement by the parties and the Panel, or an order entered by the Panel, setting forth the terms and scope of the confidentiality.”

Ultimately, the few keystrokes made to specifically include or exclude confidentiality may save parties tens of thousands of dollars of litigation expenses relating to such a collateral issue.

2. Subpoenas / Third-Party Discovery

Parties often employ subpoenas executed by a panel majority to obtain discovery from a third-party. That practice is now in doubt in light of *Hay Group, Inc. v. E.B.S. Acquisition Corp.*, 360 F.3d 404, 407 (3d Cir. 2004). Although not a reinsurance dispute, the court in *Hay Group* held that in disputes governed by the Federal Arbitration Act, if a party wants to discover non-party documents, it must seek a panel subpoena requesting that the non-party representatives

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appear before the arbitrators at a hearing with the documents requested. The issue (as well as the issue of depositions), however, is not settled among the courts:

See:

- *Legion Ins. Co. v. John Hancock Mut. Life Ins. Co.*, 33 Fed. Appx. 26 (3d Cir. 2002) (unpublished) (Recognizing that FAA authorizes third party discovery, but holding that the court lacked the authority to enforce a third party subpoena outside the court’s geographical reach);

- *Security Life Ins. Co. v. Duncanson & Holt, Inc.*, 228 F.3d 865, 870-71 (8th Cir. 2000) (“We thus hold that implicit in an arbitration panel’s power to subpoena relevant documents for production at a hearing is the power to order production of relevant documents for review by a party prior to the hearing.”);

- *COMSAT Corp. v. NSF*, 190 F.3d 269, 276 (4th Cir. 1999) (finding FAA generally does not permit pre-hearing discovery subpoena, but suggesting arbitration panel may subpoena party for pre-hearing discovery “under unusual circumstances” and “upon a showing of special need or hardship.”);


- *Meadows Indemnity Co., Ltd. v. Nutmeg Insurance Co.*, 157 F.R.D. 42, 45 (M.D. Tenn. 1994) (“The power of the panel to compel production of documents from third-parties for the purposes of a hearing implicitly authorizes the lesser power to compel such documents for arbitration purposes prior to a hearing.”); and

- *Stanton v. Paine Webber Jackson & Curtis, Inc.*, 685 F. Supp. 1241, 1242-43 (S.D. Fla. 1988) (“Furthermore, the court finds that under the Arbitration Act, the arbitrators may order and conduct such discovery as they find necessary. . . . Plaintiff’s contention that § 7 of the Arbitration Act only permits the arbitrators to compel witnesses at the hearing, and prohibits pre-hearing appearances, is unfounded.”).

3. Summary Disposition

Summary disposition is developing into an acceptable procedural remedy in reinsurance arbitration. Essentially, summary disposition is similar to a motion to dismiss, motion for judgment on the pleadings, or a motion for summary judgment in a court proceeding. A selected procedure may involve the parties submitting a matter to the panel on the briefs, or based on oral argument alone with reference to relevant documents, or seeking resolution of a dispute following some form of abbreviated hearing. Often times the non-movant will object, claiming the panel has no authority to award summary disposition as the panel may only issue an award following a full evidentiary hearing. With the growing number of such awards, objections are
less frequently being sustained. So long as the procedure is fundamentally fair, arbitration panels generally have wide latitude in deciding the best method by which to decide a dispute, and may have specific authority pursuant to institutional rules incorporated into the arbitration clause. The following few cases relate to summary disposition in arbitration:

See:

• *Sphere Drake Ins. Ltd. v. All Am. Life Ins. Co.*, No. 01 C 5226, 2004 WL 442640 (N.D. Ill. 2004) (confirming panel order granting motion for judgment on the pleadings), *aff’d*, 103 Fed. Appx. 39 (7th Cir. 2004) (adopting the District Court’s reasoning);

• *Sheldon v. Vermonty*, 269 F.3d 1202, 1207 (10th Cir. 2001) (in NASD dispute confirming dismissal of claim and holding that “if a party’s claims are facially deficient and the party therefore has no relevant or material evidence to present at an evidentiary hearing, the arbitration panel has full authority to dismiss the claims without permitting discovery or holding an evidentiary hearing.”); and

• *Warren v. Tacher*, 114 F. Supp. 2d 600, 602 (W.D. Ky. 2000) (in NASD dispute confirming dismissal of claim and holding that party was “not entitled to full blown discovery when it would not change the outcome and the claim could be decided on a pre-hearing motion.”)

But see:

• *International Union, United Mine Workers v. Marrowbone Dev. Co.*, 232 F.3d 383 (4th Cir. 2000) (vacating award of summary disposition where claimant should have been permitted to submit evidence of material facts in dispute);

• *Prudential Sec. Inc. v. Dalton*, 929 F. Supp. 1411, 1417 (N.D. Okla. 1996) (in NASD dispute recognizing authority to dismiss deficient claims; however, panel exceeded authority and should have heard pertinent evidence in light of issues in dispute).

4. Sanctions

Arbitration panels are often loathe to impose sanctions against a party and/or counsel. However, given the burgeoning load of disputes arising in reinsurance, inevitably some misbehavior occurs. It is critical that a panel maintain adequate control over a dispute and take necessary steps when appropriate, either *sua sponte*, or at the request of a party. So long as the parties’ agreement does not preclude sanctions, the arbitration panel is generally free to issue an appropriate remedial order. The following cases provide examples of the arbitrators’ authority or limits:
See:

• *Norfolk & Western Ry. Co. v. Transportation Comm. Int’l Union*, 17 F.3d 696, 701-02 (4th Cir. 1994) (arbitration panel permitted to draw adverse inference from party’s refusal to produce documents);

• *Polin v. Kellwood Co.*, 103 F. Supp. 2d 238, 264-65 (S.D.N.Y. 2000) (panel award affirmed where final award awarded defendant half its expenses, including attorney’s fees, for outrageous conduct); and

• *Konkar Maritime Enterprises, S.A. v. Compagnie Belge D’Affretement*, 668 F. Supp. 267, 274 (S.D.N.Y. 1987) (not improper for panel to consider failure to comply with interim escrow order in assessing 85% of costs against party and noting that “[a]rbitration panels routinely assess 100% of the costs against one party.”)

But see:

• *Certain Underwriters at Lloyd’s v. Argonaut Ins. Co.*, 264 F. Supp. 2d 926, 944 (N.D. Cal. 1995) (imposition of fine of $10,000 per day “akin to civil contempt” and exceeded panel’s authority).

5. Awarding Punitive Damages

In *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52, 59-64 (1995), the United States Supreme Court held that arbitrators have the authority to award punitive damages unless the parties expressly agree otherwise. Depending on the applicability of particular organizational rules (e.g. AAA), the ruling may not apply as there may be a presumption that no punitive damages may be awarded absent express agreement. In short, however, where the FAA applies and no rules are otherwise adopted, parties must explicitly state the intention to exclude punitive damages, even where an applicable choice of law provision excludes such damages. *See id.* at 62 (“At most the choice-of-law clause introduces an ambiguity into an arbitration agreement that would otherwise allow punitive damages awards.”)

See also:

• *Stark v. Sandberg, Phoenix & Von Gontard, P.C.*, 381 F.3d 793, 802-03, (8th Cir. 2004) (affirming punitive damages award although waived in arbitration clause);

• *Sec. Ins. Co. of Hartford v. TIG Ins. Co.*, 360 F.3d 322, 326-27 (2d Cir. 2004) (Availability of punitive damages from arbitration panel usually depends on choice of law provision in treaty of contract.)

But see:

6. Awarding Attorney Fees

As a rule, unless permitted otherwise by statute, if the parties put the issue of attorney fees before the panel, the panel is free to make such an award. Thus, while the parties are free to agree to the shifting of fees in their arbitration clause, they may otherwise place the issue before the panel by their conduct in expressly raising the issue.

See:

- *Spector v. Torenburg*, 852 F. Supp. 201, 210 (S.D.N.Y. 1994) (party against which award was made agreed to authority by making request for attorney fees in arbitration demand and including request in post-hearing brief);

- *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056, 1064-65 (9th Cir. 1991) (confirming award of attorney’s fees based on bad faith during proceedings).

But see:


7. Awarding Interest

Panels have broad authority to reach equitable resolutions. It is widely practiced and accepted in reinsurance arbitration that panels have the authority to award appropriate interest. See, e.g., EUGENE WOLLAN, HANDBOOK OF REINSURANCE LAW, § 8.05[c] at 8-17 (2003 Supp.) (“The panel has authority to, in keeping with its very wide discretion, award costs, interest, and even (although it is rarely done) counsel fees.”); see also ROBERT W. HAMMESFAHR & SCOTT. W. WRIGHT, THE LAW OF REINSURANCE CLAIMS, § 12.7 (1994) (“An arbitration panel has the power to award pre-award and post-award interest. . . . Arbitration panels have broad authority to issue an award within the scope of the arbitration agreement, and the power to award interest has been upheld.”)

C. Conclusion

It is fair to say that there are three overriding questions an arbitrator should keep in mind when overseeing a matter in arbitration: (i) does the arbitrator have specific authority to act based on the parties’ agreement? (ii) If not, is the authority implied from the parties’ agreement? (iii) Is the decision or remedy fundamentally fair in light of the dispute? These simple inquiries go far in assisting an arbitrator who is not otherwise constrained by specific rules of law. In most cases, equitable decisions issued by arbitrations panels will not be disturbed in furtherance of the strong public policy in favor of arbitration.
II. A PRIMER ON PRE-HEARING SECURITY

A. Background

In 1949 the National Association of Insurance Commissioners (“NAIC”) adopted the Uniform Unauthorized Insurers Process Act (“Model Act”). Its purpose was described:

[t]o subject certain insurers to the jurisdictions of courts of this state in suits by or on behalf of beneficiaries under insurance contracts. The legislature declares that it is a subject of concern that many residents of this state hold policies of insurance issued or delivered in this state by insurers while not authorized to do business in this state, thus presenting to these residents the often insuperable obstacle of resorting to distant forums for the purpose of asserting legal rights under these policies.

The Model Act was written in the general terms, using “unauthorized insurer” rather than specifically referencing reinsurers or reinsurance. Further, the Model Act does not reference arbitration. In order to protect citizens of a state, the Model Act provides:

Before any unauthorized foreign or alien insurer shall file or cause to be filed any pleading in any action, suit or proceeding instituted against it, the unauthorized insurer shall deposit with the clerk of the court in which the action, suit or proceeding is pending, cash or securities or file with the clerk of the court a bond with good and sufficient securities, to be approved by the court, in an amount to be fixed by the court sufficient to secure the payment of any final judgment which may be rendered in the action; or procure a certificate of authority to transact the business of insurance in this state.

Most states have since adopted some form of legislation requiring unlicensed foreign and alien insurers to post security for the amount of any potential judgment before the insurer may

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5 National Association of Insurance Commissioners, 4 MODEL INSURANCE LAWS, REGULATIONS AND GUIDELINES 860-2 (1948).
6 Id. at § 1.
7 Id. at § 3.A.
8 A “foreign” insurer is an insurer from another state in the United States.
9 An “alien” insurer is an insurer from another country.
defend the action. The trend in American courts is to apply the legislation broadly to insurers, reinsurers and retrocessionaires in court litigation and arbitration. This is critical for foreign and alien reinsurers. Further, courts permit arbitration panels broad authority to fashion security measures where the authority may said to derive from the language of the parties’ contract. As a result of the requirements for posting security, large sums of money may stand idle which otherwise would be have been available for some economic advantage. Few arguments have been successful in avoiding the application of state legislation or broad contractual language. The courts are uniform in rejecting constitutional and other challenges by respondents, and generally protect the extensive authority of arbitration panels to order security.

B. Legislation & Case Law in Selected States

1. New York

Federal and state cases interpreting New York law have provided substantial guidance on pre-hearing security in the busiest insurance and reinsurance locale in the country.

a. Section 1213

New York’s pre-hearing security legislation, in relevant part, provides:

Before any unauthorized foreign or alien insurer files any pleading in any proceeding against it, it shall either:

(A) deposit with the clerk of the court in which the proceeding is pending, cash or securities or file with such clerk a bond with good and sufficient sureties, to be approved by the court, in an amount to be fixed by the court sufficient to secure payment of any final judgment which may be rendered in the proceeding, but the court may in its discretion make an order dispensing with such deposit or

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bond if the superintendent certifies to it that such insurer maintains within the state funds or securities in trust or otherwise sufficient and available to satisfy any final judgment which may be entered in the proceeding, or

(B) procure a license to do an insurance business in this state.\(^1\)

Section 1213 is broad in scope. It applies to situations where a foreign insurer issued a policy to a resident of the state, as well as to an entity that is licensed to conduct business in New York. Thus, companies that are incorporated in other states but are licensed in New York may assert the protections of § 1213.

Further, the statute, unlike other state versions, grants the court discretion to recognize the existence of trust funds or securities otherwise available so that the insurer/reinsurer may address security issues through large trusts – as is Lloyd’s practice. Several cases have applied and interpreted § 1213.

b. Cases of Note

The first in a line of several state and federal decisions (addressing § 1213 and/or contractual authority to award pre-hearing security) is *Morgan v. American Risk Mgt., Inc.*, No. 89 Civ. 2999, 1990 WL 106837 (S.D.N.Y. 1990) (Roberts, Mag. J).\(^2\) In *Morgan*, Delta America Re’s receiver sued retrocessionaires seeking to rescind their reinsurance contracts. The retrocessionaires opposed the statutory security requirement arguing that: (i) it did not apply to reinsurance, (ii) the receiver was not a resident of New York and could not invoke § 1213’s protections, and (iii) the statute only applied to “coverage claims.” *Id.* at *3-4. The court rejected each argument in turn. First, the court noted that “[w]hile a reinsurance treaty is arguably not a ‘policy of insurance’ or even a ‘contract of insurance,’ the contention that the legislature did not intend § 1213 to apply to reinsurance must be rejected in light of the express language of § 1101(b)(2)(g) [addressing the placement of reinsurance with alien or foreign reinsurer].”

As to the claim that the receiver could not invoke § 1213, the statute specifically extended to “residents of this state or to corporations authorized to do business therein.” *Id.* at *6 (citing § 1213(b)(1)(A)). Significantly, the court ruled that it is the transaction from which that lawsuit arose that determines the court’s jurisdiction under § 1213(b)(1), not the status of the plaintiff or movant at the time litigation is filed. *Id.* at *7. The court then rejected the argument that the statute applied only to coverage actions. Any defense, no matter the merits, had no relevance to the security requirement of § 1213. The court explained that the statute applied

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\(^1\) NY Ins. Law § 1213(c)(1)(A-B).

broadly and set out the only pertinent defense to the security requirement – that the unauthorized foreign or alien reinsurer did not engage in the activities listed in § 1213(b). *Id.* at *8.

Finally, in addressing the amount of security, the court reasoned that the “security should be for the amount that plaintiff would win as monetary damages….” *Id.* However, “estimates” of liability could not be secured, and thus the receiver’s submission for security for estimated cases reserves and IBNR was rejected. *Id.*


In *Curiale v. Adra Ins. Co., Ltd*, 88 N.Y.2d 268, 667 N.E.2d 313 (1996), the NY Insurance Commissioner, as liquidator, sued an insolvent insurer’s reinsurer for amounts allegedly due under certain reinsurance treaties. When the alien reinsurer sought to answer without posting security pursuant to § 1213, the trial court granted the liquidator’s motion for default. The reinsurer argued that it did not have sufficient assets to post the security and that the court’s default was a violation of due process. In rejecting the reinsurer’s arguments, the court noted the important purposes served by §1213, and found the reinsurer’s argument unpersuasive:

> Appellant’s interest can be identified as the ability of an alien insurer . . . to contest its liability on insurance policies issued in New York State without ensuring that funds for the risks it has agreed to cover are available in New York State. Thus, appellant would encourage alien insurers, with little or no assets in New York, to conduct a large volume of insurance business in this State at the expense of licensed insurers who must limit their risk to a percentage of their surplus, and maintain certain reserves and deposits. [ ] Taken to its logical conclusion, appellant’s position would eviscerate the Legislature’s policy, as embodied in the insurance policies issued here. Such a result is not required by notions of procedural due process, especially since the ability to

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conduct insurance business free from legitimate government regulation is not a constitutionally protected property or liberty interest.


In British Int’l Ins. Co. Ltd. v. Seguros La Republica, 212 F.3d 138 (2d Cir. 2000), a reinsurer appealed the district court’s striking of its answer and entry of default judgment. The reinsurer argued that § 1213 did not apply to reinsurance, and that the statute effected a pre-judgment attachment in violation of due process. The Second Circuit rejected these arguments. With respect to § 1213, the court cited to Morgan as properly interpreting New York law. As to the due process challenge, the court noted the state’s significant interest in “ensuring that businesses in the heavily regulated insurance industry have sufficient funds within the state where they conduct business.” Id. at 143. Relying on Curiale, the court further rejected the due process challenge to § 1213:

First, in terms of the private interest involved, § 1213’s security requirement, as discussed above, does deprive a foreign insurer of a significant property interest that implicates due process concerns. However, the insurer has an alternative means available to protect its property: it will be excused from the requirement if it obtains a license to do an insurance business in New York. [ ] Thus, in reality the security requirement is simply a means of avoiding state licensing requirements, a right an insurer does not have. . . . Second, there is little risk of an erroneous deprivation of an insurer’s property rights and there are significant additional procedural safeguards. Unlike most prejudgment security statutes, § 1213 is not “available at the plaintiff’s option, without any notice to the defendant,” but is a “regulatory requirement imposed on all unlicensed foreign and alien insurers” and mandates court
supervision before an insurer may be required to post preanswer security.” [ ] Thus, all insurers subject to § 1213(c) are “provided with notice and an opportunity to be heard before being subjected to the preanswer security requirement.”

212 F.3d at 143 (citations omitted); see also Cragwood Managers, LLC v. Reliance Ins. Co., 132 F. Supp. 2d 285, 287-89 (S.D.N.Y. 2001) (confirming panel’s interim award of pre-hearing security); British Ins. Co. of Cayman v. Water St. Ins. Co., 93 F. Supp. 2d 506, 516 (S.D.N.Y. 2000) (“Courts in this Circuit have firmly established the principle that arbitrators operating pursuant to such provisions have the authority to order interim relief in order to prevent their final award from becoming meaningless.”)

Interestingly, the New York Court of Appeals has even gone so far as to require security pursuant to § 1213 when a defendant is moving to dismiss the complaint. Levin v. Intercontinental Cas. Ins. Co., 95 N.Y.2d 523, 528-29 (2000). There, the highest court in the state rejected the argument that the motion to dismiss was not a “pleading” subject to security. The court focused on the fact that the legislature had already bothered to carve out certain motions as being exempt from the security requirement — e.g. motions to set aside service. The noticeable absence of the motion to dismiss was evidence that the legislature did not intend to excuse it from the security requirement. Id. at 527-28. The court rationalized its inference by pointing out that if no bond were required with a motion to dismiss, a foreign carrier would be able to “wage extensive, costly motion practice,” without actually answering the complaint, and, if unsuccessful, it could sit back and accept a default judgment without any in-state collateral. Id. at 528.

Most recently, the Second Circuit in Banco De Seguros Del Estado v. Mutual Marine Office, Inc., 344 F.3d 255, 262-63 (2d Cir. 2003) made the following remarks when rejecting a reinsurer’s argument that a panel “exceeded their powers” in violation of the FAA:

14 When challenging a pre-hearing security award issued by an arbitration panel, litigants seek review of the interim “final order” pursuant to § 10 of the FAA. 9 U.S.C.A. § 10. Pursuant to § 10, litigants may seek to vacate an award for the following reasons:

1. the award was procured by corruption, fraud or undue means;
2. evident partiality or corruption of an arbitrator;
3. arbitrator misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence material to controversy, or any other misbehavior resulting in prejudice; or
4. the arbitrators exceeded their powers, or so imperfectly executed them such that a mutual, final and definite award upon the subject was not issued.

Furthermore there are “common law” grounds for challenging an award, such as “manifest disregard of the law,” see, e.g., Wallace v. Buttar, 378 F.3d 182, 189 (2d Cir. 2004), or public policy, see, e.g., Commercial Union Ins. Co. v. Lines, 378 F.3d 204, 208-09 (2d Cir. 2004).
It is not the role of the courts to undermine the comprehensive grant of authority to arbitrators by prohibiting an arbitral security award that ensures a meaningful final award. . . . There is little doubt that the parties expected the Panel to rule on the issue of pre-hearing security. It was listed as an agenda item for the Organizational Meeting with the Panel; it was fully briefed and was orally debated by both parties.

It is not without significance that the arbitrators were “relieved of all judicial formalities and may abstain from following the strict rules of law,” and that the agreements do not preclude the posting of security, and, indeed, contain a clause requiring Banco to post a Letter of Credit. We can hardly conclude that the posting of pre-hearing security represented the Panels’ “own brand of justice.”

2. Illinois

   a. Insurance Code Section 123

   Illinois passed § 123, containing, in part, the following provision:

   Before any authorized foreign or alien company shall file or cause to be filed any pleading in any action or proceeding, including any arbitration, instituted against it, such unauthorized company shall either (1) deposit with the clerk of the court in which such action or proceeding is pending or with the clerk of the court in the jurisdiction in which the arbitration is pending cash or securities or file with such clerk a bond with good and sufficient securities, to be approved by the court, in an amount to be fixed by the court sufficient to secure the payment of any final judgment which may be rendered in such action, proceeding or arbitration; or (2) where the unauthorized company continues to transact business of insurance by issuing new contracts of insurance or reinsurance, procure a certificate of authority to transact the business of insurance in this state.

   The Illinois legislature took care to avoid certain confusion in the statute. First, § 123 expressly applies to arbitration proceedings. Second, avoiding arguments that arose in New York litigation, the Illinois statute specifically makes reference to reinsurers as subject to the security requirements. Third, like the New York statute, the Illinois statute by its terms includes corporations authorized to do business in the state. See id. (“The Legislature declares that it is a

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15 The court further held that the order of pre-hearing security was not made in manifest disregard of the law, nor contrary to public policy or fundamental fairness. 344 F.3d at 263-64.

subject of concern that many residents of this State or corporations authorized to do business in this State, thus presenting to such residents or corporations authorized to do business in this State the often insuperable obstacle to resorting to distant forums for the purpose of asserting legal rights under such policies.”) Unlike New York, however, a court does not have the discretion to excuse the posting requirement in recognition of a trust fund. Courts do have the authority, on the other hand, to stay the security requirement and permit an unauthorized insurer or reinsurer to comply with the requirements of § 123.

b. Cases of Note

In International Ins. Co. v. Caja Nacional De Ahorro Y Seguro, No. 00 C 6703, 2001 WL 322005 (N.D. Ill. 2001), cedent International Insurance Company (“IIC”) petitioned for confirmation of an arbitration award ordered by default when the reinsurer, Caja Nacional (“Caja”) failed to appear. When Caja answered the petition and asserted affirmative defenses before the court, IIC moved to strike the response arguing Caja failed to post security prior to filing the answer as required by 215 ILCS 5/213(5). Caja argued that as an instrumentality of a foreign government, it is exempt and not required to post security pursuant to the Foreign Sovereign Immunities Act, 28 U.S.C. 1600 et seq. (“FSIA”). The court held that by answering the petition and filing defenses, Caja essentially was seeking to set aside the award, and pursuant to the Convention of the Recognition and Enforcement of Foreign Arbitration Awards, was not immune from the posting requirements of the Illinois Insurance Code. Caja, 2001 WL 322005, at *2. Consequently, the court struck Caja’s answer and affirmative defenses and ordered it to post security in the amount of $4.7 million prior to filing an answer and affirmative defenses. Id. at *3-4.

The Seventh Circuit Court of Appeals affirmed the district court’s decision, first finding that Caja had waived its immunity, International Ins. Co. v. Caja Nacional De Ahorro Y Seguro, 293 F.3d 392, 399-400 (7th Cir. 2002), and second in upholding the district court’s discretion:

Both the New York Convention and the Panama Convention clearly indicate that district courts have discretion to impose prejudgment security as they deem proper. [] However, under Illinois law it is less clear as to whether courts have such discretion. The statute’s language provides that the court shall order the posting of security ‘in an amount to be fixed by the court sufficient to secure the payment of any final judgment. ’ 215 ILCS 5/123(5). While we have found no published Illinois cases interpreting this

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17 Article VI of the New York Convention permits a court to order adequate security if an application for setting aside of suspension of the award is made. Id. at *2. Importantly, for alien reinsurers, where immunity from security requirements is not waived and proof of agency by a foreign government is demonstrated, the protections of the FSIA are afforded. See Moore v. Aegon Reinsurance Co., 196 A.D.2d 250, 261-62, 608 N.Y.S.2d 166, 174 (App. Div. 1994).

18 For purposes of judicial economy, the court nevertheless proceeded to strike many of the affirmative defenses put forth in the answer Caja previously filed, including substantive defenses that should have been presented to an arbitration panel. Id. at *3-4.
statute, its plain language arguably gives courts discretion in fashioning security.

*Id.* at 401. Given Caja’s track record in the case, the court held that pre-judgment security was proper under any circumstance. *Id.*; see also *Sphere Drake Ins. Ltd. v. All Amer. Life Ins. Co.* No. 99 C 4573, 2003 WL 22953336 (N.D. Ill. 2003) (“The Seventh Circuit has held that the security provision of § 123(5) is not mandatory, but instead subject to the discretion of the court. The court has discretion to fashion suitable security.”)

In a case based not on the Illinois Insurance Code, but solely on the parties’ reinsurance contract, the Seventh Circuit Court of Appeals in *Yasuda Fire & Marine Ins. Co. v. Continental Cas. Co.*, 37 F.3d 345, 348 (7th Cir. 1994), confirmed a panel’s order mandating that a reinsurer post a letter of credit as security during arbitration. On appeal, Yusada asserted that (i) the arbitrators exceeded their authority under the pertinent reinsurance contracts, (ii) the arbitrators security award was excessive; and (iii) it was denied due process with respect to the security award. The court rejected all of Yusada’s arguments.

First, after reviewing the relevant reinsurance contract the court held that the arbitration panel had the authority to require pre-hearing security:

While no provision of the agreement explicitly provides that the arbitrator may require Yasuda to post a letter of credit as interim relief pending final arbitration, no article of the agreement precludes that sort of remedy. In fact, as mentioned above, Yasuda and CNA contemplated that letters of credit were appropriate instruments of security in this transaction. The arbitration panel has acted merely to preserve CNA’s stake in the controversy. If the panel were not to order the letter of credit, and Yasuda were to exhaust its reserves, the impact of the arbitration, indeed the meaning of the entire agreement between CNA and Yasuda, would be in serious doubt. To this extent the arbitration panel acted consistently with the agreement in an even broader sense: to protect the bargain giving rise to the dispute. . . .

Furthermore, we would be remiss if we did not emphasize how important a wide range of remedies is to successful arbitration. Although parties to arbitration agreements may not always articulate specific remedies, that does not mean remedies are not available. If an enumeration of remedies were necessary, in many

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19 The court initially held that the interim order mandating the LOC was an “award” within the meaning of the Federal Arbitration Act, 9 U.S.C. § 10, and the district court’s order “final” within the meaning of 9 U.S.C. § 16. *Yasuda Fire & Marine Ins. Co. v. Continental Cas. Co.*, 37 F.3d 345, 348 (7th Cir. 1994).

20 The court separately noted, however, the general proposition that an arbitration panel exceeds its authority if it fashions an award that is explicitly excluded by the parties’ contract. *Id.* at 351.
cases the arbitrator would be powerless to impose any remedy, and that would not be correct. Since the arbitrator derives all his powers from the agreement, the agreement must implicitly grant him remedial powers when there is no explicit grant.

Id. at 351. With respect to Yasuda’s argument that the security order was excessive, the court again found that the arbitration panel’s decision drew “its essence” from the contract. Id. at 351 (“Again, this court can reverse the arbitration panel only if the basis for the arbitration panel’s decision to grant the award does not draw its essence from the agreement between the parties.”)

The amount the panel required for security was in the amount CNA claimed was collectible from Yasuda. When Yasuda sought argument over the calculation, the panel rejected the contentions at the organizational meeting on the basis that Yasuda’s claims went to the ultimate issues which the parties were not then prepared to address. The panel determined that requiring security in the amount claimed during the meantime was therefore appropriate and consistent with the terms of the parties’ contract. The court agreed, not wishing to “question the arbitration panel’s interpretation of the agreement.” Id. at 352.

Finally, Yusada argued that the parties’ agreement required an evidentiary hearing prior to such an interim award. The relevant terms of the arbitration clause provided that the panel “shall issue its decision . . . based upon a hearing at which evidence may be introduced without following strict rules of evidence but in which cross examination and rebuttal shall be allowed.” Id. (quoting agreement) The court rejected this argument as well, explaining that the parties had some opportunity to present evidence by submitting written materials and arguing to the panel at the organizational meeting. Although the panel “squelched” further argument by Yasuda, the panel did not exceed its powers. As the court explained, the “panel acted within the essence of the agreement, making certain that the arbitration process would resolve the dispute the way the parties intended.” Id. The court further explained that the arbitration panel in this case has met the fundamental fairness standard:

Each party had notice of the preliminary hearing, had the opportunity to submit written arguments and exhibits, and had an opportunity to be heard. That the arbitration panel refused to hear detailed arguments regarding the amount of the letter of credit does not frustrate the organizational meeting’s fairness; on the contrary, the arbitration panel’s insistence that the parties argue essentially the same issue only after discovery, when both sides will be more thoroughly prepared, likely has enhanced the fullness and fairness of the ultimate arbitration.

Id. at 353.
3. California
   
a. Section 1620

Perhaps one of the more progressive statutes in the nation is that of California:

(b) In any such action, suit or proceeding arising out of any such contract of insurance, the court may require the insurer to file a bond, in an amount sufficient to secure the payment of any final judgment which may be rendered unless one or more of the following is applicable:

1. The insurer makes a showing satisfactory to the court that it maintains in a state of the United States funds or securities in trust or otherwise, sufficient and available to satisfy any such final judgment and that it will pay the judgment without requiring suit to be brought thereon in the state where the securities or funds are located.

2. At the time the insurer files any pleading in any action, suit, or proceeding instituted against it, the insurer is listed as an eligible surplus line insurer in accordance with subdivision (f) of Section 1765.1, unless by the facts presented to the court there is created a reasonable doubt as to the present ability of the insurer to satisfy any final judgment in the action, suit, or proceeding. Upon request of a party or the court, the unauthorized foreign or alien insurer or reinsurer shall provide the court and the party requesting the bond with copies of documents relating to the financial condition of the insurer, including, but not limited to, copies of the insurer’s most recent annual statement and audited financial report and, where applicable, a certified copy of the trust agreement.

3. With respect to a contract of reinsurance issued in accordance with Section 1760.5, the reinsurer has complied with the provisions of this code necessary to permit the ceding insurer to take credit on its financial statement for the reinsurance as set forth in Section 922.4 or 922.5.

Section 1620(b) makes broad reference for application to “any action, suit or proceeding,” and thereby suggests possible application in an arbitration setting, as in Illinois. The statute is written with discretionary language, i.e., “the court may require the insurer to file a bond. . . .” Id. Further, the insurer has the opportunity to employ assets in trust (or other securities), even if the trust or securities are located outside the state. Id. at § 1620(b)(2). Unlike

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21 CA Ins. Code § 1620.
most other states, California permits a reinsurer to rely upon its compliance with the state’s credit for reinsurance laws. The result is a more efficient use of funds by a reinsurer who will not be required to meet obligations both under the state credit for reinsurance laws and the pre-hearing security laws.

b. Cases of Note

In a California case not based on the California statute, *Pacific Reins. Mgt. Corp. v Ohio Reins. Corp.*, 935 F.2d 1019 (9th Cir. 1991), the court addressed pool members’ arguments that the arbitration panel exceeded its authority and that the amount ordered in security for the benefit of a pool manager was excessive. The court rejected the pool members’ arguments. The court found that the management agreement gave the panel wide latitude and the order to pool members to place an amount in escrow for a possible final award did not exceed the authority granted by the contract. With evidence to support the claimed amount due, and no evidence of the panel’s misbehavior or manifest disregard of law, the court would not disturb the arbitration panel’s interim order. *Id.* at 1026; see also *Certain Underwriters at Lloyd’s v. Argonaut Ins. Co.*, 264 F. Supp. 2d 926, 937 (N.D. Cal. 1995) (“There is no question that an arbitration panel has the authority to require escrow to serve as security for an ultimate award. . . . That authority may be either derived from the arbitration agreement or implicitly from the panel’s power to ensure the parties receive the benefit of their bargain.”); *Insco Ltd. v. Meadows Indem. Co., Ltd.*, No. 90 2935, 1993 WL 328376 (N.D. Cal. 1993) (confirming panel’s interim award of pre-hearing security.).

4. Other Cases of Note

In a case litigated in Ohio and involving the Ohio statute, a federal district court upheld the pre-hearing security requirement. *See International Surplus Lines Ins. Co. v. Certain Under. at Lloyd’s*, 868 F. Supp. 923 (S. D. Ohio 1994.) Lloyds argued that it should not be required to post security due to the existence of certain large trust funds in New York established for the benefit of policyholders in the United States. The court rejected this argument as the statute did not contain any exemptions for trusts maintained by an entity. *Id.* at 927. However, relying on Ohio precedent and the *Morgan* decision, the court limited the amount of security the reinsurer must post:

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22 The agreement provided:

> [I]f any dispute shall arise between the Manager and the Company with reference to the interpretation of this Agreement or their rights with respect to any transaction involved . . . such dispute . . . shall be submitted to three arbitrators. . . . The arbitrators shall interpret this Agreement as an honorable engagement and not as merely a legal obligation; they are relieved of all judicial formalities and may abstain from following the strict rules of law, and they shall make their award with a view to effecting the general purpose of this Agreement in a reasonable manner rather than in accordance with a literal interpretation of the language.

935 F.3d at 1025.
As the Supreme Court of Ohio stated in *Sickel v. Excess Ins. Co. of America*, 136 Ohio St. 49, 23 N.E.2d 839 (1939), “the reinsurer cannot be called upon to part with its money until the reinsured has in reality paid a loss.” Accordingly, the Court finds that the Defendants in this action are required to post a bond pursuant to Section 3901.18 only to the extent that such losses have been billed and paid by the Plaintiff and only to the extent that the Plaintiff provides the Court with evidence in support of the above.

Id. at 928 (citing *Morgan*, 1990 WL 106837); see also *Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 90 F. Supp. 2d 893, 901 (S.D. Ohio 2000), aff’d, 278 F.3d 621 (2002) (“According to Home, the unanimous Panel decisions with respect to ordering pre-hearing security were in excess of the Panel’s power and in disregard of the law and evidence. This Court summarily dismisses such argument.”).

In *Recyclers Ins. Group, Ltd. v. Insurance Co. of N. Am.*, No. 91-503, 150662 (E.D. Pa. 1992), the district court ruled that a panel did not have authority to order security based on the language of the parties’ contract. The case arose in the district court after the reinsurer filed for arbitration, the cedent demanded security and the panel ordered the reinsurer to provide a letter of credit or other acceptable collateral. In seeking to vacate the interim ruling, Recyclers argued, among other things, that the panel exceeded its authority because the reinsurance contract did not empower the panel to require security before asserting a claim in the arbitration. *Id.* at *3. The court agreed, reasoning that while the contract required Recyclers to post security, “nowhere in the Agreement, whether in the arbitration clause or elsewhere, is it stated that the arbitration panel has the authority to require a party to post security as a condition to having its claims resolved by the panel or while the claims are being arbitrated.” *Id.* at *5. Furthermore, the court held that the agreement required a hearing on the merits prior to any award. Thus, the award was vacated. *Id.*

The Recyclers decision is of dubious precedential value, having been largely rejected by a sister court in *Meadows Indem. Co. Ltd. v. Arkrweight Mut. Ins. Co.*, No. 88-0600, 1996 WL 557513 (E.D. Pa. 1996). In Meadows, a reinsurer challenged a panel’s authority to order security after the request was made for security in an organizational meeting (based on “industry rumors” of the reinsurer’s weakened financial condition) and an audit provided certain information requested by the panel. After the panel ordered the reinsurer to post an LOC (and to increase security already provided), the parties filed simultaneous motions to confirm and vacate. The court noted that the contract neither expressly authorized the panel to impose pre-hearing security measures nor prevented the panel from doing so. *Id.* at *4. Nor did the contract enumerate specific remedies that the arbitrators could impose. *Id.* In rejecting the Recyclers decision, the court explained:

[T]he more appropriate rule is that an arbitration award ordering a party to post security before the panel will consider the merits may rationally derive such an award from a contract that does not expressly provide that it may impose such an award. . . . This rule is especially appropriate in this case. The Treaty does not specify
any remedies and the provisions governing the arbitrator’s powers are broad.

Id. at *7.

5. Foreign Enforcement Problems? / Curiale Rejected In Bermuda

It is an obvious truism that American courts may freely enforce the statutes of their jurisdictions and mandate pre-hearing security. For example, numerous decisions demonstrate that courts will strike responsive pleadings and enter default judgments. What will occur, however, after a default is entered against an alien insurer as in Curiale? There is no guarantee that foreign jurisdictions will enforce the judgments predicated on nothing other than lack of security. Indeed, the Supreme Court of Bermuda found that the judgment in Curiale violated basic principles of natural justice:

So I turn to the substantive question, namely whether the New York proceedings leading to the judgment upon which the plaintiff sues were conducted in a manner which was contrary to the English idea of substantial justice. In my judgment it is contrary to substantial justice or Natural Justice to require a defendant to put up security as a condition of defending which it cannot meet. I think that is a common law principle of general application which can be discerned in the case law governing the limited range of circumstances in which a defendant under our system can be required to post security.

The effect is that the defendant was deprived of his opportunity of defending, and the plaintiff now seeks to enforce a judgment which the defendant was not allowed to contest on the merits. I think that is contrary to Natural Justice.


This is but one example of how a foreign court may view an award entered pursuant to the strict provisions of American pre-hearing security statutes. Parties must therefore consider what risks to incur in pursuit of a judgment in an American court. Is a default due to lack of security, while available under various statutes, a desirable remedy? Despite the attempt of the legislature to provide a mechanism to ensure a collectable judgment, the safe approach may be to simply forego rights to security and litigate an issue on the merits. The alternative to litigation may be the hollow victory of a statutory default that has no ultimate enforceability against an alien company in foreign jurisdictions.

23 The court further distinguished the Recycler’s case on the basis that there was no provision for a hearing prior to an award of security, and in any event a hearing had taken place. Id. at *7.

24 The court also found that the attempted enforcement of the American judgment in Bermuda violated public policy as the plaintiff was in violation of an injunction previously issued by Bermuda courts.
C. Conclusion

Based on the discussion above, panels may find the following inquiries important prior to addressing an interim award for pre-hearing security: (i) Has a party requested security? (ii) What does the parties’ agreement provide? (e.g., does it require security for the cedent to claim statutory credit for the reinsurance)? (iii) Does the panel have authority to issue security pursuant to the agreement’s express terms? (iv) If not by its express terms, is the authority implicit as discussed by case law? (v) Does the jurisdiction in which the panel is sitting have an applicable statute (applying to reinsurance as well as arbitration)? (vi) Has the movant made some effort to substantiate the amount due? (e.g., by proving amounts of covered paid loss and expense) (vii) Have the parties been given adequate notice and a fair opportunity to be heard on the issue? (viii) What is the financial condition of the non-movant? Following this brief checklist will assist in reaching a proper result when faced with a demand for pre-hearing security. With authority, either explicit or implied, a panel should permit an opportunity for a hearing, and based on arguments early in the process, take steps necessary to ensure the integrity of the arbitration process.