Reinsurance Arbitration: Practical Considerations in the Legal Context

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In both insurance and reinsurance contracts arbitration continues to be a very popular means of dispute resolution. The vast majority of London market reinsurance treaties, whether proportional or non-proportional provide for disputes to be resolved by London arbitration. The Arbitration Act 1996 was intended to streamline and refine the process, but has it achieved its objectives? Is arbitration the most appropriate route to dispute resolution? Let us look at the other options first:

Informal discussion

Of course, the most sensible way of minimising the risk of dispute is to ensure the clearest contract wording and the most sensible way of resolving any dispute is for the parties to discuss the issues arising as frankly and calmly as possible and reach a shared view on the appropriate outcome after considering each other's positions. In the "good old days", the principle of "utmost good faith" was not so severely tested as it has been in recent times. Differences of view were undoubtedly resolved in a number of cases in a relatively informal and perhaps broad-brush way.

Certainly, in an ideal world, there would be no need for lawyers' involvement. Unfortunately, however, parties can have very different views as to what they intended and/or understood when they entered into the contract originally, particularly if payment of an unexpectedly large sum of money is sought. It is also possible that one party to a contract (most likely the paying party) may not wish to resolve a dispute in the most efficient, speedy way. Delay is a frequently used tool to minimise payments and therefore there must be in place a robust strategy to ensure that the parties to the contract comply with all their obligations.

ADR / Mediation

In recent times, mediation has become a much talked about process for seeking to resolve differences of view. Indeed, the Court now requires parties to consider the mediation route as a possible means of removing issues from the Court's processes. The Judge will ask the parties if they have utilised ADR and may stay Court proceedings while ADR is attempted (Civil Procedure Rules Part 24.6) Of course, where a party is determined to thwart the ADR process, then more formal proceedings will be inevitable, but there is now considerable vulnerability, particularly in relation to costs, where a party is determinedly uncooperative.

Mediation is a significantly less formal procedure than arbitration or court proceedings and the parties can agree to pursue mediation in the original contract or subsequently once a disagreement has arisen. In reality, mediation will work best if the parties are both ready and willing "to play the game", and if that condition applies, mediation can be a significantly cheaper short-cut. It can be tailored to the particular needs of the parties who can establish their own timescales, rules of evidence and can dispense with disclosure and witness statements. One of its greatest benefits is that the parties' respective arguments can be fully understood and agreed at a relatively early stage so that cost savings can arise. More creative solutions to the dispute can often be worked out in mediation proceedings, commercial relationships can be preserved or perhaps even improved and mediation proceedings are, of course, private and confidential.

The incorporation of an ADR procedure within the original contract will be the best way of seeking to ensure that it will be followed in the event of a disagreement. It will be important to draft the clause as precisely as possible and to make proper use of the ADR mechanism a condition precedent to bringing formal proceedings. Reference can also be made to a standard mediation provider, perhaps by the use of their standard form. Despite the potential benefits, however, the enthusiasm for mediation in reinsurance cases is still relatively limited.

Court action

In situations where ADR is unsuccessful or inappropriate for whatever reason and no arbitration process has been prescribed in the original contract or subsequently agreed, the only recourse is likely to be to the Courts. For reasons discussed, there are situations when notwithstanding the presence of an arbitration clause, it may be appropriate to launch court proceedings without using other dispute resolution routes. Points relating to the relative pros and cons of court or arbitration action are discussed in the sections that follow from the perspective of arbitration, but with the introduction of the Civil Procedure Rules, instigated by Lord Justice Woolf, some of the perceived disadvantages of the Court procedure have been reduced and, therefore, the decision to recommend arbitration may be less clear. With the alternatives in mind, the strengths and weaknesses of the arbitration process can be considered.

The history of arbitration

As previously noted, arbitration has been a popular procedure adopted to resolve disagreements in the reinsurance industry, as in other commercial contracts for

many years. English legislation relating to arbitration dates back to the Seventeenth Century when the Arbitration Act 1698 was passed. English arbitration law has developed at various stages over the interim period. By the Arbitration Act 1889, the Courts were given power to enforce arbitration agreements as well as additional powers to support the arbitral process. The Arbitration Act 1950 consolidated earlier legislation, but neither it nor further Acts of 1975 and 1979 were comprehensive and exhaustive in terms of arbitration law and practice. As a result of a full review, it was decided that the UNCITRAL Model Law in its full form, should not be adopted in England and that a new statute should be enacted.

The Arbitration Act 1996

The latest arbitration act was intended to be a comprehensive statute or code setting out how an arbitration under English law should be conducted. "The object of arbitration is" stated in the Act to be "to obtain the fair resolution of disputes by an impartial tribunal without unnecessary delay or expense" (section 1(a) of the 1996 Act). The general duties of the tribunal and the parties to pursue that objective are specifically set out. An important element of the Act is its reinforcement of the supremacy of the arbitration agreement and the fact that the role of the Court is limited to those occasions when it is obvious that even the arbitral process needs assistance or that there has been or there is likely to be a clear denial of justice. Arbitration proceedings should therefore, be less formal and more practical than Court proceedings. In particular, under the Act, arbitrators have the power to be proactive and take greater initiative in arbitration proceedings. Where appropriate, they may move away from the traditional adversarial approach and adopt a more inquisitorial one. An inquisitorial approach should certainly encourage flexibility, informality and speed. The parties should be free to agree how their disputes are to be resolved, subject only to such safeguards as are necessary in the public interest.

In practice, despite the intention to achieve informality, arbitrators in reinsurance proceedings still generally utilise formal documentation in a similar form to that required in Court proceedings. The proceedings themselves are often conducted in a rather rigid, formal way which closely mirrors proceedings in Court. It appears that many practitioners are reluctant to adopt a freer approach and from a practical point of view, if one party and/or members of the Tribunal are determined to maintain such formalities, then it is very difficult for the other to ignore and avoid them.

The start of the process

It is not infrequently the case that difficulty is experienced in tracking down a wording for a reinsurance contract. Historically, there may well not have been a reference in the slip to arbitration, but often when a wording was finalised, an arbitration clause would be included. It has been confirmed by the Courts, however, that without specific reference, an arbitration clause cannot be taken to have been agreed. In *Cigna Life Insurance Company of Europe SA NU v Intercaser SA de Seguros y Reaseguros [2001]*, Intercaser sought to rely on the wording of an underlying contract which contained an arbitration clause, as being incorporated. The Court held that an agreement to arbitrate was personal to the parties and collateral to the main obligations and, on the facts in this case, that agreement had not been incorporated. In situations where the position is uncertain, and no acknowledgement can be obtained from the other parties to the dispute, then the safest route (unless there are issues in relation to possible time bar) will probably be to pursue the claim through the Courts. But a clear statement up-front of the parties' intentions would avoid such difficulties.

Although parties may enter into an agreement to follow the arbitration route after a dispute has arisen, it is relatively unusual. The most common route to arbitration is by reference to a particular clause contained in the original contract. Historically, the range of clauses used was immense and there were often practical difficulties in following them. Greater standardisation can now be found, however, and more recent wordings have attempted to deal with the difficulties that had been identified. Clauses and procedures are now set by various organisations such as ARIAS, the London Centre for Dispute Resolution, the Chartered Institute of Arbitrators and LIRMA/ILU (now IUA).

Aside from the advantages that have been achieved in careful consideration of the operation of these clauses, an arbitration clause which is in standard form has a further advantage in that it can be incorporated into the short form agreement (the slip) by a very short reference to the standard form, the law to be applied and where an arbitration should take place. Making clear at the outset where the arbitration should take place and what law should apply will obviously save potentially expensive arguments in difficult jurisdictions.

The first step in pursuit of the aim that a dispute should be referred to arbitration in line with an existing contractual term will be the issue and service of a notice by which the arbitration process is begun. It is essential that the identity of the parties and the details of the specific contract involved are clearly stated. If sums due arise

under difficult contracts, it is essential to be clear on individual balances due under each separate contract by layer and year. Obviously this can be a difficult process of clarification where there are numerous contracts, spanning many years with reinsurers, perhaps when there is a Pool, having changed status and perhaps participating in a variety of ways. In relation to contracts already in place, whatever the form of arbitration agreement that was incorporated, there is little scope for correcting any inadequacies, unless agreement can be reached with the other party.

The appointment of arbitrators

Under the provisions of older clauses, there was scope for considerable confusion and difficulty at even this early stage. The notice referred to above will normally propose an individual to be considered by the other party as a "sole arbitrator". The choice of candidate can be not at all straightforward. One clear advantage of the arbitration process is that the parties are usually able to choose arbitrators with technical expertise in the issues arising. Inevitably, there is a shortage of suitable candidate arbitrators to deal with the many disputes now needing resolution. The problem is often worsened, by the restrictive wording that has been used in some contracts such that it can be very difficult to find a candidate who fulfils the qualification criteria. To ensure a broader pool of potential arbitrators modern wordings might use phrases such as:

> "with not less than 10 years' experience of insurance or reinsurance within the industry or as lawyers or other professional advisers serving the industry".

Generally it will be difficult to obtain the services of anyone who is still active in the sense of having a full time involvement with an insurance or reinsurance company simply because of the heavy demand on time that such a role imposes.

The problem is of course exacerbated by the usual need for two and often three appointments to be made in order for the Tribunal to be fully constituted, although the appointment of one member of the Tribunal in the role of legal Umpire or a third arbitrator can produce benefits in ensuring that legal issues are properly regarded.

The difficulties of delay

As discussed above, the process for actually getting the arbitration underway can take some time, but probably no more than court action.

Once the arbitrators have been validly appointed, it is usual for directions for the conduct of the arbitration to be given, probably at a first or preliminary hearing. In

theory this should be able to be dealt with swiftly, but in reality it can often be difficult to get three busy panel members and parties' legal advisers together so that the often heralded advantage of speed in arbitration over Court proceedings is not so clear.

Under the Act arbitrators have wide discretion, provided they "act fairly and impartially as between the parties, giving each party a reasonable opportunity of putting his case and dealing with that of his opponent and adopt ... the procedures suitable to the circumstances ... avoiding unnecessary delay or expense." (Section 33).

Section 34 prescribes a model procedure to be followed unless the parties agree to a variation such as those prescribed by ARIAS.

There is scope for the arbitration process to be "fast tracked" if the parties agree. There are, however, some obvious obstacles: first and foremost, in many cases one party will not wish to speed up the process once the dispute has arisen. From experience, this often seems to work in favour of a party who chooses to prevaricate since arbitrators will often be even more reluctant than a Judge to prevent a party from "having his day in court" and will give considerable leeway where directions are not complied with.

The basis of decision making – an 'honourable engagement'

Under previous legislation, arbitrators were bound to follow applicable law. In *Home & Overseas Insurance Co v Mentor Insurance Company (UK) Limited* [1989] 1 Lloyds Rep 473, the Court of Appeal accepted that the arbitrators could validly disregard strict rules of construction in looking at the words used, but was divided on the question of whether arbitrators could legitimately be authorised to go further and disregard words used, and disregard other rules of law in reaching a reasonable result. If a clause were to go that far, it would risk being struck out on the grounds of uncertainty.

A significant contributor to the fact that arbitrations have historically been more lengthy, formal and legalistic than was originally intended was the requirement before the 1996 Act, that English law must be applied correctly, failing which an award might be appealed to, and overturned by, the courts.

Accordingly, notwithstanding the original intentions of the parties and the frequent presence of an "equity" or "honourable engagement" clause in the original contract, legal considerations had to be prioritised and have led to arbitrations mirroring the court process. This trend has undoubtedly been encouraged as a result of the

appointed umpire on the panel often being a former member of the judiciary or a QC. It is perhaps inevitable that individuals from this background will control and perhaps dominate the proceedings with the effect that the proceedings will become difficult for the party-nominated arbitrators to redirect. The ultimate result is that the outcome of the process does not reflect market practice or the original deal between the parties.

In an effort to empower arbitrators to give clearer recognition to the intention of the 'honourable engagement' clause, the 1996 Act sought to give back the freedom to "decide the dispute ... if the parties so agree, in accordance with such other considerations as are agreed between them or determined by the tribunal" (section 46 1(b)) and thereby effectively exclude the right to appeal on a point of law. This provision only affects arbitration agreements which came into affect after 31 January 1997.

As is so often the case, however, every silver lining has a cloud. The potential uncertainty which may derive from seeking to second guess how a tribunal will react to an issue if they are to be freed from the constraints of legal interpretation may well be more disadvantageous from a business point of view than the effect of the stricter approach that has had to be followed until now. In reality, arbitration tribunals, which include a legal person, still tend to follow legal analysis closely, but there is more scope for alternative argument.

From another perspective, the giving of a reasoned award can encourage an overly legalistic approach. Section 52 requires that reasons for an award be given, but the parties are free to override this requirement. The result of doing so should be to reduce the legal elements and formalities of the arbitration. This would seem to be more in line with what was originally intended by agreeing to pursue the arbitration, but it is a significant change from the pre-1996 position.

Challenging awards

The importance of maintaining the general position that an arbitration award should be final and binding is clear. The position was given support in the Arbitration Act 1996 and the Courts will now allow a challenge only in very clear circumstances.

In two recent examples *(Brandeis (Brokers) Ltd v Black & Others [2001] and Petroships Pte Ltd v Petec Trading and Investment Corp of Vietnam & Others [2001])* the Courts considered challenges based on allegations of serious irregularity and that the arbitration had failed to give full reasons. In both cases, the circumstances were carefully analysed.

Other aspects changed by the 1996 Act

(a) Summary Judgment

The position under previous legislation was that if the Claimant believed that the Respondent had no defence to the claim, he could pursue an application for summary judgment in the Courts. It has been suggested that Section 34 of the Act is wide enough to allow arbitrators to adopt something akin to the summary judgment procedure, at least where a cedant is faced with a "can't pay, won't pay" reinsurer. However, were arbitrators to consider exercising their discretion under this section, they would need to bear in mind their overriding obligation to allow each party a reasonable opportunity to put its case, which may cause difficulties in practice.

Conversely, the route of summary judgment in court where a party really had no valid defence to a claim has been blocked. Previously, the court might retain jurisdiction in a case where the defendant could not show a reasonable ground of defence and allow the Claimant to enter summary judgment. Although in *Hayter v Nelson* [1990], Saville J held that the existing dispute was not necessarily determined by a finding that one party's argument was right, the court now will only retain jurisdiction if it is satisfied that the arbitration agreement is null and void, inoperative or incapable of being performed (section 9(4)).

Where *bona fide* disputes arise, it may well be possible to negotiate a change in the form of the arbitration clause to enable resolution of a dispute or part of a dispute in a streamlined way since it is in both parties' interests to save costs and inconvenience. Where a debtor reinsurer is determined to do all possible, frequently by doing nothing at all, to slow down the recovery process, the lack of any debt recovery fast-track process is a serious omission, however.

(b) Security for Costs

Under section 38(3) of the Act is the possibility of requiring a Claimant to provide security for the Respondent's costs of the arbitration. This is a power of the arbitration panel so not requiring a party to apply to court as was formerly the case. However, the ground most commonly used historically to support an application for security for costs – that the Claimant is incorporated or managed outside the UK – is not available under the Act. Accordingly, it is now more difficult to obtain security for costs than previously. It appears that the Respondent will need to show an inability or unwillingness on the part of the Claimant to satisfy a costs award against him. (e.g. insolvency or run-off situation). If an Order is made but not complied with the tribunal may dismiss the relevant claim (section 38(6)).

(c) Interest

Arbitrators now have a wider power to award compound interest. This arises under section 49 of the Act. Arbitrators may award compound interest where reinsurers fail to pay.

(d) Consolidation

Section 35 of the Act permits consolidation of the arbitral proceedings or the holding of concurrent hearings, but only with the agreement of the parties. The inability to consolidate has often been an issue particularly where similar issues are being pursued against either a number of contracting reinsurers and/or the broker (s) involved in the transaction.

So is arbitration best?

Confidentiality is often heralded of as an advantage of arbitral proceedings.

In The Eastern Saga [1984] 2 Lloyds Report 373, Mr Justice Leggatt said

> *"the concept of private arbitration derives simply from the fact that the parties have agreed to submit to arbitration particular disputes arising between them and only between them. It is implicit in this that strangers should be precluded from the hearing and conduct of the arbitration."*

The involvement of "experts" on the tribunal itself, together with the intended confidentiality has lead to the common view that arbitration proceedings can be better controlled and will result in a "cosier" resolution of a dispute than in Court. The fact that a confidential arbitration award will have no presidential value can, depending upon the circumstances, be either a considerable advantage or a considerable disadvantage. The prospect of issuing separate arbitration notices against a raft of parties with no prospect of consolidation is generally not appealing to a Claimant, however.

In *Hassneh Insurance Company of Israel v Mew* [1993] disclosure of an award against reinsurers was sanctioned on the basis that it was "reasonably necessary" for the reinsured in order for him to establish his course of action against brokers in Court action, but that was clearly a very special circumstance.

In the reinsurance market the restraints of confidentiality are often considerably eroded in practice so that an award can have a commercially persuasive value in other disputes with similar facts. Confidentiality can also be lost, of course, where issues to do with the conduct of the arbitration have to be referred to the Court.

Whether at the stage of drafting an arbitration clause or in the arbitration procedure

itself, the aim and motto, consistent with the 1996 Act, must be: keep it simple, but make sure that the procedure works by anticipating, so far as possible, the difficulties that can arise. By so doing, perhaps arbitration will achieve a speedier and more effective outcome than in the Courts.

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