The Truth Behind the Myth: Discovery in Reinsurance Arbitrations

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Larry P. Schiffer
Dewey & LeBoeuf LLP
125 West 55th Street
New York, New York 10019
212-424-8086
Larry.schiffer@dl.com
www.dl.com

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Introduction

In the last decade, discovery requests and disputes concerning discovery in reinsurance arbitrations have increased exponentially. Obviously, with escalating discovery requests and disputes come rising costs. The discovery explosion is often cited by practitioners and commentators as one of the most important factors inciting dissatisfaction among some with the current state of reinsurance arbitration. In many, if not most, cases the claim that arbitration is a lower cost alternative to litigation is no longer true. This disturbing result, caused in part by increased discovery and discovery disputes, however, is not inevitable. The stakeholders in reinsurance arbitration have the power to alter the trend toward increasing discovery and cost.

This paper will explore several facets of discovery in reinsurance arbitration. First, it will provide a general review of discovery in arbitration, including the statutory foundation for discovery in arbitration and describe several arbitration organizations' rules regarding discovery. Next, the paper will identify and briefly discuss how the stakeholders in reinsurance arbitration can slow the trend of increasing discovery. After providing this general background, the paper will explore the changing contours of discovery in three areas of specific applicability to reinsurance disputes: third-party discovery, international discovery, and e-discovery. Finally, the paper will propose several initiatives that stakeholders can undertake to effectively curtail rising discovery requests in reinsurance arbitration.

The Foundations of Discovery in Arbitration

The increase in discovery in reinsurance arbitrations is interesting because, unlike in litigation, discovery in arbitration is neither constitutionally nor statutorily guaranteed in most jurisdictions. The Federal Arbitration Act ("FAA"), the act authorizing arbitration as the judicially-favored dispute resolution mechanism when provided for in contracts, is silent on the issue of discovery. While section 7 of the FAA authorizes some investigatory power for the arbitrators, it does not, as we will explore later, clearly provide broad powers for the pre-hearing phase of the proceedings. 9 U.S.C. § 7 (2006).

Most state arbitration laws, similarly, do not guarantee discovery for parties in arbitration. The Uniform Arbitration Act, which has been adopted by thirty-six states, grants arbitrators the authority to permit discovery. *See* UNIF. ARBITRATION ACT § 17 (2000). It states that arbitrators "may permit such discovery as the arbitrator decides is appropriate in the circumstances . . . ." This permissive language leaves the scope and content of discovery to the sole discretion of the arbitrators. Ostensibly, a panel of arbitrators could decide not to permit any discovery. The New York Arbitration Act omits any mention of discovery, suggesting that there is no right to discovery in arbitration in the state of New York. *See* N.Y. C.L.P.R. 7505 (Consol. 2007).

Unlike most states, California grants parties a right to discovery in certain situations. Section 1283.05 of California's Civil Procedure Code explicitly grants a right to discovery in arbitration "as if the subject matter of the arbitration were pending before a superior court of this state . . . ." Cal. Civ. Proc. Code § 1283.05 (Deering 2007). Unless a contract specifically elects to apply section 1283.05, however, the right only applies to "every agreement to arbitrate any dispute, controversy, or issue arising out of

or resulting from any injury to, or death of, a person caused by the wrongful act or neglect of another." Because reinsurance disputes may not fall into that category, it can be presumed that in California there is no right to discovery in reinsurance arbitrations unless it is specifically provided for in an agreement.

Putting it simply then, there is no absolute right to discovery in a reinsurance arbitration that can be derived from the FAA and most state arbitration laws. Because there is no statutory right to discovery, the scope and content of discovery depends on the wording of the arbitration clause in the reinsurance agreement and, for the most part, the discretion and tolerance of the arbitration panel.

With neither statutes nor arbitration rules adequately defining the scope of discovery in reinsurance arbitration, only specific procedures written into arbitration clauses can control discovery in a particular dispute. Unfortunately, few contracts have more than a boilerplate arbitration clause. Even fewer contracts contain clauses outlining tailored arbitration procedures and discovery controls. Despite the efficacy of outlining discovery desires, few parties have taken the time and expense to draft specific procedures.

Typically, discovery is left to the sole discretion of the arbitration panel. This results in a wide disparity in the scope and nature of discovery among arbitration panels. Arbitration panels often will allow document discovery and depositions, but some will limit the number of depositions and the scope of the document requests. On the other hand, some panels will allow the parties to engage in broad discovery with few limitations. Because of this variance, parties often are unable to forecast dispute resolution costs at the commencement of the arbitration with any degree of accuracy.

Stemming the Tide of Discovery

The stakeholders in the reinsurance arbitration process, and others with an interest in the process, each have a vested interest in reducing the costs associated with unnecessary discovery. Arbitrators, contracting parties, arbitration organizations, courts, Congress, and state legislatures all can assist in reducing the amount of discovery in reinsurance arbitrations. Although each stakeholder may be able to limit discovery, actions taken by any stakeholder may have unique drawbacks. Understanding the relative benefits and drawbacks of these actions is essential for creating a cohesive strategy to reduce unnecessary discovery.

The Arbitrators

First and foremost, arbitrators may use their broad discretion to limit discovery. Experienced arbitrators have a good sense of how much discovery is required to unearth the facts surrounding the dispute, and can limit fishing expeditions and frolics and detours. Although this solution's simplicity is appealing, it apparently has proven to be insufficient.

Reinsurance disputes are increasingly complicated and the amounts involved are significant. As the complexity of disputes grows, the amount of discovery needed often grows correspondingly. If arbitrators are consistently basing their decisions about the amount of discovery allowed on previous disputes, they might systematically underestimate the amount of discovery needed in newer, more complex arbitrations. While most parties do not want unnecessary discovery, few parties want an insufficient amount of discovery. Reaching the correct balance remains paramount.

Another factor is the hesitancy of many arbitrators to deny discovery requests made by the parties, particularly if the lawyers have agreed upon a discovery plan and schedule. Many arbitrators take a wait-and-see approach to discovery, allowing the parties to seek broad discovery so as not to limit any parties' desire to present evidence to the panel. Some arbitrators have expressed concern about limiting discovery for fear of those limitations becoming grounds for applications to the court to vacate the arbitration award.

Leaving the scope of discovery solely in the hands of the arbitrators has not, to date, significantly decreased the scope and variance in discovery costs across disputes. Because it is reasonable to assume that preferences for discovery vary by arbitrator, the amount of discovery may still vary significantly from arbitration to arbitration. With considerable variation in the amount of discovery, action by arbitrators alone is an insufficient solution to the problem of excessive discovery.

The Parties

The contracting parties have substantial power to limit the amount of discovery. As mentioned above, contracting parties can specify whether they want discovery and how much discovery they desire. Writing discovery limitations into arbitration clauses would allow parties to foresee their dispute resolution costs and contract accordingly. Again, this is another straightforward solution with some noticeable limitations.

Few reinsurance contracts contain more than a boilerplate arbitration clause. Drafting a more specific clause may be difficult and expensive. At the time of contracting, parties lack information about the nature of any potential future disputes. Both parties may agree that simple disputes require little discovery, while complicated

disputes require substantial discovery. Despite this agreement, the parties are unlikely to be able to specify the desired amount of discovery for every contingency. Even if this were possible, it would be economically prohibitive.

Instead of defining the desired amount of discovery for each potential dispute, contracting parties may create a procedure that minimizes the amount of discovery while maximizing the probability that sufficient evidence will be available to the arbitrators to reach the best result. Solving this difficult optimization problem will likely require clever drafting and significant expense.

Arbitration Organizations

The agreement to arbitrate may define the scope of discovery by requiring that the arbitration be conducted under the rules or guidelines set forth by independent organizations such as the Reinsurance Dispute Resolution Task Force, the American Arbitration Association, ARIAS-US, United Nations Commission on International Trade Law ("UNCITRAL"), or the International Chamber of Commerce ("ICC"). Industry rules, however, do not guarantee a minimum or maximum level of discovery. ARIAS-US guidelines state that "[t]he panel has considerable discretion to limit the amount and type of discovery available . . . ." Similarly, the rules disseminated by the International Institute for Conflict Prevention and Resolution state that "[t]he Tribunal may require and facilitate such discovery as it shall determine is appropriate . . . ." The Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes basically leaves it to the arbitration panel to decide the scope of discovery ("The Panel shall address the following: . . . The extent to which depositions and other discovery will be allowed and the date by which they must be completed . . . . " Rule 10.7(e)). Other rules are even less

clear. The ICC Rules of Arbitration, for example, state: "The Arbitral Tribunal shall proceed within as short a time as possible to establish the facts of a case by all appropriate means." Not one commonly used set of arbitration rules clearly specifies the scope or extent of discovery.

Arbitration organizations certainly can better define the entitlement to and amount of discovery in their rules. Although drafting these new rules would be costly and time-consuming, it would be less costly than if each group of contracting parties created their own procedures. Once an organization promulgates the new rules, hundreds of contracts can use them. These economies of scale, however, mean that the rules are less transaction-specific than rules drafted by the parties. Also, as with the contracting parties, arbitration organizations must balance the desire for lower costs without sacrificing accurate outcomes. Of course, parties have to agree in their arbitration clauses, or subsequently, to abide by a specific organization's rules. This has yet to happen on any uniform or consistent basis.

The Judicial System

Courts, too, can limit discovery in arbitration by narrowly interpreting the statutes that authorize arbitration. If a court determines that these statutes do not endow arbitrators with broad subpoena powers, a possibility this paper will explore below, wide-ranging non-party discovery will not be feasible. This tactic, however, would also decrease the desirability of arbitration as an alternative mode of dispute resolution if parties fear that arbitrators lack sufficient power to obtain all relevant evidence. Additionally, because the courts created the restrictions, parties would be unable to

contract around these limitations if they foresaw that a particular contract might require unusually large amounts of discovery.

Lawmakers

Finally, the federal and state legislatures can curtail discovery. Congress can amend the FAA to better define the power of arbitrators and rights to discovery. Similarly, states could alter their arbitration-authorizing statutes to reflect the desire to maintain arbitration as a lower-cost alternative to litigation. These legislatures would contend with the same optimization problem as would the other stakeholders. As with the courts, the legislatures must recognize that their decisions would have significant consequences for arbitration's usefulness because parties would be unable to contract around the statutory boundaries.

Special Discovery Topics of Reinsurance Arbitration

The nature of the reinsurance industry creates unique challenges for discovery in arbitration proceedings. Most notably, problems arise regarding third-party and international discovery. Depending on the jurisdiction of the arbitration and the location of the third party, parties may be unable to obtain pertinent information. Without this information, arbitration may prove an ineffective mode of dispute resolution for reinsurance disputes where this information is necessary. Additionally, e-discovery threatens to overwhelm parties with irrelevant information and greatly increase the costs of arbitration. Fortunately, careful drafting by legislatures, industry organizations, and parties can resolve these issues and maintain arbitration's status as a cost-effective dispute resolution method for the reinsurance industry.

Third-Party Discovery

In reinsurance disputes, important information often resides with parties not directly involved in the dispute. These third parties could be independent claims handlers, reinsurance intermediaries, managing agents, or retrocessionaires. Because these parties are by definition non-parties to the reinsurance contract, they generally are not bound by clauses requiring cooperation in arbitration proceedings. If a third party refuses to voluntarily produce documents or appear for a deposition, the information may be obtained only with the use of a subpoena. Recent case law, however, is divided on the authority of arbitrators to compel the production of documents or appearance by an individual for testimony.

The sentence, "The arbitrators . . . may summon in writing any person to attend before them or any of them as a witness and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case," 9 U.S.C. § 7 (2006), is at the center of the debate. Some courts, notably the Eighth Circuit, have held that this statement grants the arbitrators broad discovery authority. Others have held that arbitrators have no power to subpoena third-parties in the discovery phase of a proceeding, while some have taken an intermediate position.

The Eighth Circuit has liberally interpreted Section 7 as authorizing the use of subpoenas in discovery. In *Security Life Insurance Co. v. Duncanson & Holt, Inc.*, 228 F.3d 865 (8th Cir. 2000), the court granted arbitrators broad authority to subpoena relevant documents. Although it admitted that "[§ 7] does not . . . explicitly authorize the arbitration panel to require the production of documents for inspection by a party," the court suggested that making relevant information available furthers, rather than hinders,

an efficient resolution to the dispute. *Security Life*, 228 F.3d at 870. Additionally, the court held "that implicit in an arbitration panel's power to subpoena relevant documents for production at a hearing is the power to order the production of relevant documents for review by a party prior to the hearing." *Security Life*, 228 F.3d at 870-71.

This power, however, may not be unlimited. In dicta, the court stated that the third party's involvement as a party to the contract underlying the dispute is important, suggesting that arbitrators may be unable to subpoena less involved third parties in the pre-hearing phase. Despite this potential limitation, the ultimate result of *Security Life* is that arbitrators in the Eighth Circuit have broad subpoena powers.

Since the Eighth Circuit decided *Security Life*, other cases within the Circuit have followed this logic. Notably, in *SchlumbergerSema, Inc. v. Xcel Energy, Inc.*, the District Court of Minnesota acknowledged that Section 7 explicitly applies only to the production of documents at a hearing, stating, "the Eighth Circuit has held that implicit in this section is 'the power to order the production of relevant documents for review by a party prior to the hearing.'" No. 02-4304, 2004 U.S. Dist. LEXIS 389, at *3 (D. Minn. Jan. 9, 2004) (quoting *Security Life*, 228 F.3d at 870).

Courts in other circuits, however, have been reluctant to accept the Eighth Circuit's liberal interpretation of Section 7. In *Hay Group, Inc. v. E.B.S. Acquisition Corp*, 360 F.3d 404 (3rd Cir. 2004), the Third Circuit flatly rejected the Eighth Circuit's interpretation in favor of a strict construction of the statute. Then-judge Alito's opinion states, "[The language of § 7] speaks unambiguously to the issue before us." The opinion then analyzes the wording of Section 7 and concludes that arbitrators only have the power to compel individuals to bring documents with them to a hearing, rather than have a

courier deliver them for a pre-hearing investigation. *Hay* Group, 360 F.3d at 407. The Third Circuit acknowledged the Eighth Circuit's conflicting decision in *Security Life*, but then stated, "We disagree with this power-by-implication analysis." For now, it seems that the Third and Eighth circuits are in open disagreement about the scope of an arbitrator's subpoena powers.

Many of the other circuits have taken an intermediate approach, such as requiring that a party show a special need for the information. In *Comstat Corp. v. National Science Foundation*, 190 F.3d 269 (4th Cir. 1999), the Fourth Circuit determined that arbitrators may only subpoena third parties for the pre-hearing production of documents if there is a special need for the information. Unfortunately, this special need goes undefined. Nonetheless, the result is clear – in the Fourth Circuit, arbitrators have a restricted ability to subpoena documents held by third parties in discovery.

The courts are also divided as to whether arbitrators can compel third parties to appear for depositions. In *Integrity Insurance Co. v. American Centennial Insurance Co.*, 885 F. Supp. 69 (S.D.N.Y. 1995), the District Court weighed the benefits of the deposition against the burden on the third party. Ultimately, the court found that arbitrators do not have the power to subpoena individuals for appearance at a deposition. *Integrity*, 885 F. Supp. at 73. Similarly, the court in *Atmel Corp. v. LM Ericsson Telefon*, 371 F. Supp. 2d 402 (S.D.N.Y. 2005), reasoned that compelling a third party to appear at a deposition and a hearing was too burdensome on that outside party. The Southern District of Florida, however, also weighed the benefits to the proceedings against the burdens on the third party and reached the opposite conclusion. *Stanton v. Paine Webber Jackson & Curtis, Inc.*, 685 F. Supp. 1241 (S.D. Fla. 1988).

Again, some decisions took an intermediate position. In *Stolt-Nielsen Transp. Group, Inc. v. Celanese AG*, 430 F.3d 567 (2nd Cir. 2005), for example, the Second Circuit upheld subpoenas requiring a third party to appear prior to the final hearing. Although the court recognized the limits of the arbitrators' authority to compel third parties to appear for depositions, the court reasoned that this subpoena was allowable because arbitrators were present, the arbitrators ruled on objections, and the testimony became part of the record. For these reasons, the court likened this to providing testimony in a hearing, rather than a deposition, even though it was not the final hearing.

Finally, there are questions as to the geographic range of an arbitrator's subpoena power. The Northern District of Illinois interpreted Section 7's words "any person" as meaning that there were no territorial limits on the arbitrators' authority. *Amgen Inc. v. Kidney Center,* 879 F. Supp. 878 (N.D. Ill. 1995). In the unpublished opinion issued in *Legion Insurance Co. v. John Hancock Mutual Life Insurance Co.*, 33 Fed. Appx. 26 (3rd Cir. 2002), the Third Circuit reasoned that Rule 45 of the Federal Rules of Civil Procedure governs the enforcement of subpoenas. Because Rule 45 places a territorial limit of 100 miles on a subpoena, arbitrators also may only subpoena third parties within 100 miles of where the deposition would take place. As with the other issues related to the discovery of information held by third parties, there is much ambiguity.

With uncertainty as to an arbitrator's subpoena powers, parties may be unwilling to include arbitration clauses in their agreements because they believe that arbitration is an ineffective tool for resolving disputes. Although parties wish to streamline discovery and reduce the costs of arbitration, they also demand that the procedure be capable of producing a just outcome. If parties cannot obtain critical information during discovery

to prepare for arbitration, they may opt for to litigation, knowing that, although expensive, litigation will allow for full access to the needed information.

Legislatures, however, have the power to retain arbitration's reputation as a cost-effective tool for resolving disputes. Most helpfully, Congress could expand or clarify Section 7. If Congress expanded an arbitration panel's jurisdiction to ensure that parties had access to relevant information during the early phases of arbitration, parties would no longer fear that arbitration would ineffectively resolve the dispute.

Although this broad statutory authority would ensure that arbitration is efficient, the authority to subpoena could undermine arbitration's cost-effectiveness. To control costs, industry organizations and parties must create effective mechanisms to efficiently reduce discovery. When adopting new rules, industry organizations should carefully curtail arbitrators' subpoena powers, but expressly allow these provisions to be modified in individual contracts. By having reduced discovery as the default rule while allowing for modification, these rules would keep discovery costs low in all disputes, except those where the parties intended to provide for greater discovery. This would allow for optimal flexibility in the amount of discovery, but would likely reduce the average amount of discovery in arbitration proceedings.

International Discovery

Discovery in reinsurance arbitration is often further complicated by third-parties residing outside the United States. When information resides outside the country, domestic, foreign, and international law all affect the ability of arbitrators to compel action by the third-party.

To date, no domestic law addresses the issue of international discovery in arbitration. With no international-specific law, the same muddied precedent applies to international third-party discovery as to domestic third-party discovery. Most problematically, in jurisdictions that have geographically restricted an arbitrator's subpoena power, all international third-party discovery is effectively barred.

The laws of the country in which the non-party resides also affect the ability of United States arbitrators to compel the production of documents or appearance at a deposition. The Hague Convention, which governs the taking of evidence abroad in civil or commercial matters, does not apply to arbitration proceedings. Because the Hague Convention does not apply, arbitrators cannot use the letters rogatory process to compel the testimony of a witness or the production of documents in discovery.

Fortunately, arbitration laws in the United Kingdom do allow judges to assist in foreign arbitration. The Evidence Act of 1975 creates a process for handling requests from a foreign "court or tribunal." For many years, there was considerable debate as to whether a foreign arbitration panel was a tribunal under this law. The English Parliament clarified the matter with the passage of the English Arbitration Act of 1996. Under the 1996 Act, English courts may assist in foreign arbitration proceedings. The Act does, however, grant courts discretion to deny requests. Occasionally, the courts have exercised this discretion and denied requests for assistance.

Bermuda law, however, does not allow its courts to assist in foreign arbitrations. The Evidence Act of 1905 authorizes Bermuda courts to assist in obtaining evidence in Bermuda when the request comes from "a court or tribunal . . . exercising jurisdiction similar to that of the [Bermuda] Supreme Court in a territory or country outside

Bermuda." Because an arbitration panel does not have a similar jurisdiction to the highest court in a country, the Evidence Act of 1905 does not authorize Bermuda courts to assist United States arbitration panels in their evidence gathering.

Additionally, Bermuda's arbitration statutes do not authorize assisting foreign arbitration panels. The Arbitration Act of 1986 does not expressly prohibit assisting in foreign arbitrations, but the Act applies only to arbitration proceedings located in Bermuda. Also, the Bermuda International Conciliation and Arbitration Act of 1993 does not confer this jurisdiction on the Bermuda courts. The 1993 Act incorporates the UNCITRAL Model Law on International Commercial Arbitration, which the United Nations Commission on International Trade Law Working Group stated is limited to international arbitrations taking place in the state. U.N. Comm. on Int'l Trade L. Working Group, Fifth Working Group Report, (A/CN 9/246 paras. 90-91). Because no statute authorizes Bermuda courts to assist in foreign arbitration proceedings, arbitrators will be unable to compel third parties in Bermuda to produce documents or appear for depositions for discovery in reinsurance arbitrations.

As with domestic third-party discovery, problems obtaining information from international third parties threaten the effectiveness of arbitration. Unlike with the domestic dilemma, Congress cannot resolve the issue with a short statutory amendment. Instead, legislation in each country would have to confer jurisdiction on the local courts to assist in foreign arbitration. Additionally, this issue may require new international agreements. Perhaps a more effective mode for increasing access to important information is to encourage reinsurers to include provisions in their contracts with these third parties that require the disclosure of certain pieces of information in the event of

arbitration. Admittedly, a third party may be reluctant to agree to such a clause. Because this may be the most certain way to obtain this information, parties may be willing to provide valuable consideration for this unconventional provision.

E-Discovery

E-discovery also threatens the efficiency of reinsurance arbitration. Unlike the problems of obtaining the relevant information that complicate third-party discovery, e-discovery threatens to overwhelm parties with excessive quantities of unneeded information. To date, reinsurance arbitration has largely avoided the problems of e-discovery that plague much litigation. There are no reported cases regarding e-discovery in reinsurance arbitration, and few mentioning e-discovery in any arbitration proceedings.

Similarly, there are no statutory guidelines or rules for e-discovery in arbitration. Without guidance from the courts or legislatures, arbitrators must use their discretion to curtail excessive e-discovery requests. Although the reliance on the discretion of the arbitrators has proven successful to date, the industry organizations and contracting parties may want to better define the acceptable scope and manner of e-discovery. A concrete statement on e-discovery in reinsurance arbitration will reduce the variance in e-discovery across disputes.

Conclusion

Currently, arbitrators' discretion is the primary limiting factor of discovery in reinsurance arbitration. As mentioned earlier, the varying tolerances of arbitrators for discovery lead to uncertainty in discovery costs, which makes arbitration less appealing. Although the courts in several jurisdictions have reduced arbitration discovery with their strict interpretation of Section 7 of the FAA, this too is problematic. Rather than simply

reduce the costs of arbitration, these decisions threaten to reduce the effectiveness and usefulness of arbitration. A better solution would be for Congress to clarify the ability of arbitrators to compel third parties to produce documents or appear for depositions and then let industry organizations and parties tailor the cost-control mechanisms. Similarly, industry organizations and parties must vigilantly control e-discovery to prevent it from flooding arbitration proceedings with unneeded information. To effectuate all of this, however, contracting parties must realize the usefulness of industry rules and incorporate those, or other tailored procedural rules, into their arbitration clauses.

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