Article

Interim Security: A Powerful Tool for Protecting the Integrity of Reinsurance Arbitrations

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As reinsurance practitioners know, parties to reinsurance arbitrations are with increasing frequency requesting panels to issue interim awards requiring adverse parties to post prehearing security. The purpose of prehearing security is to maintain the financial status quo in order to ensure that any eventual award does not become meaningless because the assets of the adverse party have been dissipated elsewhere. Courts have consistently recognized arbitrators' authority to issue interim orders of security in the absence of a contractual provision expressly precluding it, and have routinely upheld such orders where a colorable justification for the award exists. Despite the clear recognition of a panel's broad authority to require security, some arbitrators have on occasion been reluctant to require security unless the movant demonstrates that its adversary already suffers from a deteriorated financial position or has through its past conduct raised questions about its compliance with a panel's ultimate award. The problem with such an approach is that it might be too late — ordering security only after compliance with a final award is in question frustrates the purpose of security.

To better preserve the meaning of any ultimate award, this article suggests that arbitrators should exercise their clear authority to order interim security before the collectability of the ultimate award has already become an issue. Ordering security where the possibility exists that any final award could be rendered meaningless serves to better protect the integrity of the arbitration process by preventing the dissipation of assets. This approach can be particularly valuable in these uncertain economic times.

Arbitrators' broad authority to require interim security

There is no question that arbitrators have broad power to order interim security, as recently reaffirmed by the Southern District of New York in *CE International Resources Holdings LLC v. S.A. Minerals Ltd. Partnership*, No. 12 Civ. 8087 (S.D.N.Y. Dec. 10, 2012) (upholding interim security award where parties' agreement indirectly granted arbitrator such authority). In *CE International*, a sole arbitrator issued an interim award ordering respondents to post $10 million in security. The petitioner sought to confirm and enforce the award in court, arguing that the parties' agreement authorized arbitrators to award interim security under the agreed-upon rules, which provided that "the tribunal may take whatever interim measures it deems necessary, including injunctive relief and measures for the protection or conservation of property…[including]…an interim award, and…may require security…."

Respondents argued that the parties' adoption of those rules did not support a finding that the arbitrator acted within his powers in ordering security because the agreement was to be construed and enforced in accordance with New York law, under which prejudgment security is not allowed. The Southern District rejected respondents' argument, stating:

> It lay with the parties to confer on the arbitrator whatever powers they wished. Having adopted rules that allowed the arbitrator to award interim security, Respondents are bound by their bargain. Nothing about enforcing an order rendered in accordance with the procedures to which the parties agreed offends either New York law or New York public policy.

CE International at 6. The court held that by consenting to rules authorizing arbitrators to order interim security the parties had consented to such authority even in the absence of an explicit grant of that

specific authority in their contract. *Id*. at 7. The court focused on the broad authority of the arbitrator, and — significantly — did not consider whether the arbitrator had required a showing that respondents *already* suffered from a dire financial position or had *already* endangered compliance with any eventual award. The arbitrator's authority to order security was sufficient reason for the court to confirm the interim arbitral award, because "the public policy favoring the enforcement of arbitration agreements and the confirmation of arbitral awards trumps any other." *Id*. at 9.[1]

In reaching its conclusion, the court in *CE International* relied on the often cited opinion in *Banco de Seguros del Estado v. Mutual Marine Office, Inc.*, 344 F.3d 255 (2d Cir. 2003). There, the Second Circuit held that arbitrators had the authority to require that the reinsurer post prehearing security. *Id.* at 262. The reinsurer argued that the panel had exceeded its authority, manifestly disregarded the law, and violated public policy and principles of fundamental fairness. The court rejected each of the reinsurer's arguments and enforced the terms of the parties' contract, which granted arbitrators broad authority and required the posting of a letter of credit. In determining whether the security award should be upheld, the court in *Banco de Seguros* did not consider whether the panel had required a showing that the reinsurer already suffered serious financial troubles or already had engaged in conduct placing the eventual award in danger. Rather, the court focused on whether the arbitrators had the power to reach the issue of security under the arbitration agreement, "not whether the arbitrators correctly decided that issue." *Id.* In affirming the confirmation of the panel's interim award, the Second Circuit explained that it was "not the role of the courts to undermine the comprehensive grant of authority to arbitrators by prohibiting an arbitral security measure that ensures a meaningful final award." *Id.* (internal citations omitted). The court held that the panel had the power to order security because the arbitration agreement did not preclude such a remedy. *Id.* at 262-263.[2]

Interim security has been ordered as long as there is a "specter" that any final award could be rendered "meaningless"

Courts have recognized that the purpose of interim security is to ensure that any eventual award does not become "meaningless." *See*, *e.g.*, *Banco de Seguros*, 344 F.3d at 262; *British Ins. Co. of Cayman v. Water Street Ins. Co.*, 93 F. Supp. 2d 506, 516 (S.D.N.Y. 2000) (confirming panel's interim award requiring security where "specter" was raised that any final award could be rendered "meaningless"); *Nw. Nat'l Ins. Co. v. Generali Mexico Compania de Seguros, S.A.*, No. 00 Civ. 1135, 2000 WL 520638, at *11 at n.13 (S.D.N.Y. May 1, 2000) (holding that arbitrators have authority to order interim relief in order to prevent final award from becoming meaningless); *Rakower v. Aker*, No. 98 Cir. 2652, 1998 WL 432092, at *3-4 (E.D.N.Y. May 27, 1998) (confirming arbitrator's award of temporary equitable relief to prevent final award from being meaningless); *Yasuda Fire & Marine Ins. Co. of Eur., Ltd v. Cont'l Cas. Co.*, 37 F.3d 345 (7th Cir. 1994) (affirming interim security order to prevent final award from becoming meaningless); *Pac. Reins. Mgmt. Corp. v. Ohio Reins. Corp.*, 935 F.2d 1019 (9th Cir. 1991) (same).[3]

Interim security's primary goal is therefore to prevent a Pyrrhic victory that leaves the prevailing party unable to collect on the resulting award. *See*, *e.g.*, *id.* This purpose is likely to be frustrated if the panel requires a movant to demonstrate that the award has *already* been placed in doubt or rendered meaningless before security is ordered. Requiring a showing that the adverse party *already* is insolvent or in run-off or has *already* diverted or expended funds elsewhere does not ensure a meaningful final award, because it may well mean that the assets are not going to be available to satisfy the award; it will be too late to order security if the assets have already been dissipated or diverted.

Ordering security where a specter is raised that the final award could be rendered meaningless serves to better protect the integrity of the arbitration process by preventing the dissipation of assets before it is too late. In *British Ins. Co. of Cayman v. Water Street*, *supra*, a dispute arising under a facultative reinsurance contract, British Insurance requested that Water Street provide prehearing security to ensure that any recovery awarded to British Insurance would be available. British Insurance proffered evidence of Water Street's financial instability, regulatory troubles, and possible future liquidation proceedings. *Id.*

at 511. Water Street maintained that "no exigent circumstance or equitable basis" justified an order of security. The panel rejected Water Street's arguments and ordered it to provide $1.7 million in security. Water Street challenged the security award in court on grounds of manifest disregard of the law, arbitrator misconduct, evident partiality, and certain underlying defenses. The court rejected Water Street's arguments, saying that they overlooked the "essence of arbitration…to provide a speedy and inexpensive determination." *Id.* at 514 (citations omitted). Recognizing the purpose of interim relief to ensure a meaningful award, the court found that evidence of Water Street's "maneuvers" raised the "specter" that any final award could be rendered "meaningless" and that a "colorable justification" for the interim award existed. *Id.* at 516. The court accordingly confirmed the interim award and directed that security be provided as directed by the panel. Had the panel waited until Water Street underwent liquidation or insolvency proceedings, any final award would likely have been rendered meaningless. As *British Ins. Co. of Cayman v. Water Street* recognizes, ordering security when a threat to compliance with a final award is present better protects the integrity of the arbitration process and is well within a panel's authority. *Id.*[4]

Courts have consistently upheld arbitrators' interim awards of security

Courts are "reluctant to vacate interim arbitration orders aimed at preserving the ability of the parties to pay final awards that result from arbitration proceedings" and have afforded great deference to arbitration panels on these issues. *Great E. Secs., Inc. v. Goldendale Invs., Ltd.*, 2006 WL 3851159, at * 2 (S.D.N.Y. Dec. 20, 2006) (denying petitioner's request to vacate interim order requiring petitioner to place disputed amount into escrow account pending conclusion of arbitration). *See also Hynix Semiconductor, Inc. v. Rambus, Inc.*, 2010 WL 3719086 (N.D. Cal. Sept. 17, 2010) (denying motion to reconsider order requiring $250 million bond); *Knox v. Palestinian Liberation Org.*, 2009 WL 1591404 (S.D.N.Y. Mar. 26, 2009) (requiring posting of $120 million in security); *Everest Nat'l Ins. Co. v. Sutton*, 321 Fed. App. 192 (3d Cir. 2009) (requiring $70 million in security); *Int'l Ins. Co. v. Caja Nacional de Ahorro y Seguro*, 293 F.3d 392 (7th Cir. June 7, 2002) (affirming prejudgment security order against reinsurer); *Konkar Mar. Enter., S.A. v. Compagnie Belge D'Affertement*, 668 F. Supp. 267 (S.D.N.Y. 1987) (affirming panel's authority to require sums be placed into interest-bearing escrow account for benefit of prevailing party as determined in final award); *E. Asiatic Co., Ltd. v. Transamerican Steamship Corp.*, 1988 A.M.C. 1086, 1089 (S.D.N.Y. 1987) (confirming interim order directing party to deposit money into interest-bearing escrow account pending arbitrator's final determination); *Southern Seas Navigation Ltd. v. Petroleos Mexicanos*, 606 F. Supp. 692, 694 (S.D.N.Y. 1985) (confirming interim arbitration award); *Sperry Int'l Trade, Inc. v. Israel*, 689 F.2d 301, (2d Cir. 1982) (affirming arbitrators' order requiring proceeds of disputed $15 million letter of credit be placed in escrow).[5]

This trend in favor of interim security reflects the strong public policy favoring the enforcement of arbitration agreements and the confirmation of arbitral awards. Arbitrators can take guidance from recent court opinions reaffirming their power to order interim security and increase their willingness to order interim security to protect the meaning and effect of any ultimate arbitration award when there is a possibility that the final award could be rendered meaningless.[6] This approach will strengthen the integrity of the arbitration process.[7]

Practical Considerations

The facts of each particular case will of course play a critical role in an arbitration panel's decision as to whether there is a sufficient prospect of noncompliance with the final award to warrant an order of interim security. Parties to reinsurance disputes should be vigilant in identifying any indication that an adversary's compliance with a final award may be at risk from the time a dispute is anticipated and, under certain circumstances, may need to be prepared to request security along with the demand for arbitration or in connection with the organizational meeting.

These are among some of the factors that may weigh in favor of requiring security:

- financial instability or distress
- threats of insolvency
- bankruptcy discussions
- contemplated winding down of operations
- regulatory problems potentially affecting ability to conduct business
- questionable financial or geographic maneuvers
- diversion of significant funds to related or offshore entities
- reluctance or failure to provide assurances of financial viability
- ongoing breach of obligations under reinsurance agreements
- repeated failure to make payments due
- failure to respond to demand for arbitration
- unexpected corporate changes occurring privately during or just prior to dispute or proceedings
- failure to comply with prior orders in arbitration
- other conduct or conditions raising doubts about compliance with any ultimate award

Whether any of these factors constitutes a ground for security will depend on the particulars of each dispute. Arbitrators should not, however, require a showing that the award has already been placed in doubt before ordering security. Instead, they can require security where a "specter" is raised that any final award could be rendered "meaningless."[8]

Conclusion

With the recent downturn in the world economy, requests for prehearing security in reinsurance arbitrations have increased. Requiring a showing that the adverse party *already* suffers from a dilapidated financial condition or has *already* engaged in conduct that endangers collectability likely means that any eventual award has *already* become meaningless. The better approach is for an arbitration panel to require security when the possibility is raised that the panel's eventual award will be rendered meaningless. The steadfast recognition by courts of arbitrators' authority to order interim security – which reflects the strong public policy favoring the enforcement of arbitration agreements and confirmation of arbitral awards – means that an arbitration panel's order of interim security is likely to be upheld if challenged in court. Arbitrators' clear authority to require security therefore represents a powerful tool for protecting the integrity of reinsurance arbitrations in these uncertain economic times, and panels need not hesitate to exercise that authority when there exists a doubt concerning a party's compliance with a final award.

ENDNOTES

[1] *CE International* reaffirmed that the standards for security that may be required in court are not required in arbitration, confirming the interim award "even though, had the underlying action been brought in this court or in the New York State Supreme Court, no such interim security could have been ordered." *CE International*, No. 12 Civ. 8087 at 7. The court recognized that arbitrators may be "presumptively free from principles of substantive law" and "in the arbitral context, there is a strong countervailing policy of enforcing arbitral awards in accordance with their terms, as long as the arbitrators have not exceeded their powers." Id. at 8 (citing cases).

[2] Other courts have also consistently held that arbitrators are authorized to order interim security. *See, e.g., Certain Underwriters at Lloyd's London v. Argonaut Ins. Co*., No. C-03-1100 EMC, 2003 U.S. Dist. LEXIS 8796 (N.D. Cal. May 13, 2003) (holding that contract "implicitly empowered" panel to "formulate appropriate relief" including interim payments); *Meadows Indem. Co. Ltd. v. Arkwright Mut. Ins. Co*., 1996 WL 557513 (E.D. Pa. Sept. 30, 1996) (ordering prehearing security where contract granted arbitrators broad powers without precluding remedies but did not specify security as authorized remedy); *Yasuda Fire & Marine Ins. Co. of Eur., Ltd v. Cont'l Cas. Co*., 37 F.3d 345 (7th Cir. 1994) (affirming interim order requiring security where arbitration clause did not explicitly authorize it but did contain broad grant of authority and did not preclude security); *Pac. Reins. Mgmt. Corp. v. Ohio Reins. Corp*., 935 F.2d 1019 (9th Cir. 1991) (upholding panel's pre-hearing security order where arbitration clause relieved arbitrators of following judicial formalities and strict rules of law).

[3] *See also Atlas Assurance Co. of Am. v. Am. Centennial Ins. Co*., 1991 WL 4741 (S.D.N.Y. Jan. 16, 1991) (confirming arbitrators' interim order placing disputed amounts in interest-bearing escrow account); *Compania Chilena de Navegacion Interoceanica, S.A. v. Norton Lilly & Co*., 652 F. Supp. 1512 (S.D.N.Y. 1987) (confirming interim order directing party to post bond); David Martowski, *Ordering Security From An Arbitrator's Perspective*, The Arbitrator, Vol. 42, No. 1, at 6, April 2011.

[4] In a different context, a New York state court recently recognized that CPLR 7502(c) permits provisional relief in aid of arbitration, such as pre-award attachments, where a later award would be "rendered ineffectual" without provisional relief. *See Sojitz Corp. v. Prithvi Info. Solutions, Ltd*., 26 Misc. 3d 670, 891 N.Y.S.2d 622 (N.Y. Sup. Ct. N.Y. C. 2009) (confirming creditor's attachment of debtor's assets as security for potential award of panel). Courts also have held that in situations where there is a risk that assets will be dissipated or diverted before judgment, a party can be required to furnish security. *See, e.g., H.I.G. Capital Mgmt. Inc. v. Ligator*, 233 A.D.2d 270, 650 N.Y.S.2d 124 (N.Y. App. Div. 1996) (the "uncontrolled disposal of respondents' assets, which may have rendered arbitration award ineffectual, presented risk of irreparable harm"); *Palm Beach Realty Co. v. Harry J. Kangieser, Inc*., 36 Misc. 2d 1058, 233 N.Y.S.2d 641 (N.Y. Sup. Ct. 1962) (requiring party to post security to avoid dissipation of assets).

[5] Courts have consistently held interim security awards reviewable and enforceable prior to the entry of a final award. *See, e.g, Banco de Seguros, supra*; *CE International, supra; British Ins. Co. of Cayman v. Water Street Ins. Co., supra*.; *Metallgesellschaft A.G. v. M/V Capitan Constante*, 790 F.2d 280, 283 (2d Cir. 1986); *Southern Seas Navigation, supra*.

[6] Requiring security as a matter of course already occurs in disputes involving foreign or unauthorized reinsurers. *See, e.g*, N.Y. Ins. L. §1213(c)(1)(A) (McKinney) (requiring unauthorized insurers and reinsurers to post pre-answer security); Conn. Gen. Stat. § 38a-27(a) (requiring unauthorized insurer to post security "to secure the payment of any final judgment which may be rendered in the action or proceeding"); *Travelers Indem. Co., v. Excalibur Reins. Corp*., Case 3:12-cv1793-RNC (D. Conn. December 24, 2012) (motion for order requiring reinsurer post pre-answer security); *British Int'l Ins. Co. Ltd. v. Seguros la Republica*, S.A., 212 F.3d 138 (2nd Cir. 2000) (holding that New York's pre-answer security statute applied to reinsurance and required reinsurer to post security); *Skandia Am. Reins. Corp. v. Caja Nacional de Ahorro y Seguros*, 1997 WL 278054 (S.D.N.Y. May 23, 1997) (applying pre-answer security statute to unlicensed reinsurer seeking to avoid compliance with the panel's order); Am. *Centennial Ins. Co. v. Seguros la Republica*, S.A., 1992 WL 162770 (S.D.N.Y. June 22, 1992) (applying New York's pre-answer security statute to reinsurance); *Nw. Nat'l Ins. Co. v. Kansa Gen. Ins. Co*., No 92 Civ. 7422 (LJF), 1992 WL 367085 (S.D.N.Y. Nov. 25, 1992). *See also* Robert M. Hall, Pre-Answer *Security and Reinsurance Arbitrations*, 12-18 Mealey's Litig. Rep. Reinsurance 10 (2002) (analyzing pre-answer security statutes and case law).

[7] Commentators have noted that arbitrators' powers to enforce interim awards may be limited. *See, e.g*., Ronald S. Gass, *Panel Exceeded Powers by Imposing $10,000/Day Sanction for Party's Noncompliance with Interim Security Order*, ARIAS•U.S. Q., 3Q 2003 at 28. The general willingness of courts to confirm interim security awards, however, may be sufficiently coercive to support the practice. Moreover, parties may voluntarily comply to avoid the costs of

unsuccessful motions to vacate or to avoid alienating the panel or risking an adverse inference on the merits. *See, e.g.*, Peter Skoufalos, *Having Arbitrators Order the Posting Of Security And Other Interim Measures*, The Arbitrator, Vol. 42, No. 1, at 2, April 2011.

[8] Another benefit of interim orders of security may be that they are likely to foster early dispute resolution in certain cases. For instance, faced with an order requiring security as well as the willingness of courts to confirm such an order, a party facing significant exposure may be compelled to perform a full and frank evaluation of the claim's merit sooner than it might otherwise. This is likely to encourage early settlement talks and may lead to more swift and less costly resolution of certain disputes, thereby advancing one of the traditional advantages and goals of arbitration.