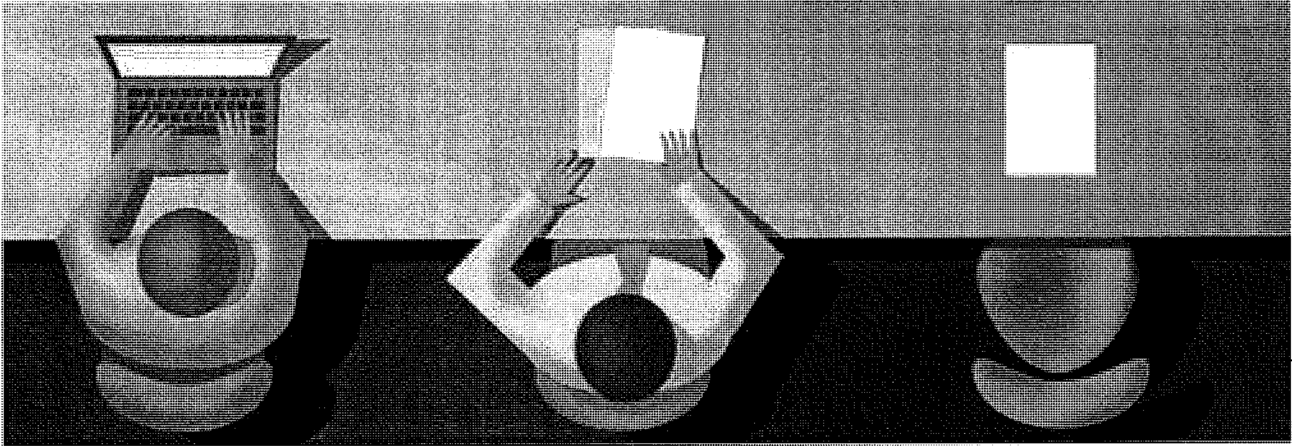
Resign, Replace, Resume

Daryn E. Rush, Thomas E. Klemm

Recent Decisions on Arbitration Panel Vacancies



Courts have looked at panel vacancies that occur through unforeseen events, such as the death of an arbitrator, differently from resignations.

As a general rule, subject to important exceptions, most courts have held that when a member of an arbitration panel dies or becomes too ill to proceed, the arbitration must start over from the beginning before a new arbitration panel. Courts have held that this is the only fair outcome because requiring a party to name a replacement arbitrator could put that party at an unfair disadvantage. A replacement arbitrator, for example, could be joining the proceeding late in the game and face a steep learning curve or other disadvantages. Generally, the courts have rejected the "start over" rule in the context of arbitrator resignations due to concerns that parties and arbitrators might use resignations to manipulate the process. If the "start over" rule applied in the resignation context, a party might be tempted to ask its arbitrator to resign in order to delay the proceedings or to get a fresh start in an arbitration that is not going well, a so called "strategic" resignation. While by no means commonplace, such tactics, unfortunately, have been known to occur in reinsurance arbitrations. Thus, courts have rejected the "start over" rule in the case of resignations due to the concern that such resignations might, in fact, be "strategic." No doubt, courts recognize that distinguishing "non-strategic" resignations, such as an arbitrator resigning due to concerns about partiality or workload, from "strategic" resignations would in many cases be difficult, if not impossible, and would require a very fact intensive inquiry. Three recent decisions reflect judicial concern over whether a party can replace an arbitrator and the circumstances that should be evaluated to avoid manipulation.

> *... courts have rejected the "start over" rule in the case of resignations due to the concern that such resignations might, in fact, be "strategic."*

The Second Circuit decision in *Ins. Co. of N. Am. v. Public Serv. Mut. Ins. Co.*, 609 F.3d 122 (2d Cir. 2010) ("*INA*") establishes a baseline analysis by dealing with the resignation of a panel member due to serious illness. Notably, in this case, the court did not compel the parties to start over with a new panel. After the panel had granted summary judgment to the cedent, Public Service Mutual Insurance Company (hereinafter PSMIC), but before a motion for reconsideration could be heard by the panel, the arbitrator that had been appointed by INA (the reinsurer) resigned, stating he could not effectively continue his service to the parties. The parties and the remaining panel members could not agree on how to proceed. INA wanted a new panel. PSMIC wanted INA or a court to appoint a replacement arbitrator. The Second Circuit held that the general rule applicable when an arbitrator dies (i.e., starting over) does not apply when an arbitrator resigns. Instead, the arbitration process must proceed with a replacement arbitrator without starting over. The key to the court's decision was the threat of manipulation. The court held: "applying a broad rule requiring that a new panel be convened to vacancies occasioned by resignations would open the door to significant potential for manipulation."[1] While such potential for abuse is "not present in the case of an arbitrator's death" it is very real in

Resign, Replace, Resume (continued)

cases regarding resignations.[2] Although the court emphasized that there was no allegation of manipulation present, and in fact one could label this a "non-strategic" resignation, the court feared that "it would be tempting for a party to pressure its party-appointed arbitrator, implicitly or explicitly, to resign following an adverse ruling so that it could get another shot at winning before a new panel."[3]

> *...the arbitration process must proceed with a replacement arbitrator without starting over.*

These concerns outweighed any counter-arguments, including any argument regarding prejudice to the party that lost its arbitrator. As the court held:

> given the potential for manipulation and the waste inevitably occasioned by convening a new arbitral panel, we find that this potential unfairness is not sufficiently strong to require application of the ["general"] rule to resignations.[4]

In the INA case, in fact, the Court directed that the original arbitrator, who had recovered during the appeal, be reappointed. When he refused the appointment, INA was directed to choose a replacement. While only a handful of other courts have dealt with the matter, they have produced rulings consistent with the Second Circuit's decision in *INA*.[5]

The Special Problem of "Strategic" Resignations

As discussed above, central to the decision in *INA* was the risk that a party-appointed arbitrator, at the request of the party or at his own behest, might resign from a panel as a tactical maneuver in an effort to force a new arbitration. The *INA* rule — that with such resignations the arbitration process does not start over but simply continues with a single replacement arbitrator — was specifically crafted to avoid the potential for abuse and manipulation.

> *Even under this rule, however, there remains the potential for manipulation of the process through strategic resignations.*

Even under this rule, however, there remains the potential for manipulation of the process through strategic resignations. Strategic resignations might be attempted in order to delay the proceedings, to replace an ineffective arbitrator or to change the dynamics of the panel. Arbitrations are often fluid proceedings, and they can veer in directions not anticipated by the parties at the start. In such circumstances, it may become apparent that a particular arbitrator was not the best choice. The secondary challenge that arises in the context of arbitrator resignations is a challenge to whether the arbitrator should be allowed to resign at all or whether the party who appointed the arbitrator loses its right to select a replacement.

Although such strategic resignations have almost certainly occurred, until very recently there were no court decisions discussing such circumstances. Interestingly, however, in 2011, two separate courts dealt with this very issue. Not surprisingly, these courts focused on the same issues that other courts have considered when addressing other arbitrator vacancies (i.e., death and "non-strategic" resignations): the prejudice to the party who lost their party-appointed arbitrator and the potential for abuse and/or manipulation. While both courts ultimately allowed the resignations to occur, one court did so hesitantly and only based on the unique facts present in that case, suggesting that in other situations such resignations might not be allowed.

1. Northwestern National

In *Northwestern National Ins. Co. v. Insco, Ltd.*, 2011 U.S. Dist. LEXIS 50789 (S.D.N.Y. May 12, 2011) ("*Northwestern National*"), Insco Ltd. ("Insco") requested that all members of a three-person arbitration panel resign due to alleged conflicts of interest. Insco's party's arbitrator resigned. The other two members did not. Thereafter, Insco contacted the umpire and the opposing party, Northwestern National, "reiterating that it sought a new panel and informing [Northwestern National] that Insco would select an additional party-appointed arbitrator." Northwestern National then filed a petition requesting "judicial appointment of an ARIAS-certified arbitrator to replace Insco's arbitrator."[6] When Insco later named a specific replacement arbitrator (who was ARIAS certified), Northwestern National objected.

The court allowed Insco to name a replacement arbitrator. Citing *INA*, the court acknowledged the general rule that resignation of a party arbitrator does not require the arbitration to start over. Although the court recognized that the arbitrator had been specifically asked to resign, the court nonetheless allowed a replacement. The court reasoned: "[t]he replacement of one arbitrator during arbitration does not create the same incentive for manipulation as would allowing for the arbitration to begin anew with a fresh panel."[7] Thus, the court did not appear to consider the threat of manipulation or abuse caused by a potentially strategic resignation to be significant. It held: "[e]ven if a party pressured its party arbitrator to resign and replaced him or her with an arbitrator more likely to rule in its favor, it could not affect the rulings of the other two arbitrators."[8]

2. IRB

The Southern District of New York dealt with the "strategic" resignation issue in late 2011. The court ultimately allowed the resignation but only after expressing concerns regarding the practice and noting that a few key facts existed to minimize the potential for abuse and waste. In *IRB v. Nat'l Indem. Co.*, 2011 U.S. Dist. LEXIS 136640 (S.D.N.Y. Nov. 29, 2011) ("*IRB*"), under a complicated set of facts, National Indemnity Company ("NICO") asked its party-appointed arbitrator to resign from a panel two years after the arbitrator was

Resign, Replace, Resume (continued)

nominated. The arbitrator complied and resigned, and NICO sought to nominate a replacement. IRB-Brasil Resseguros S.A. ("IRB") objected to the new appointment and filed a petition requesting, *inter alia*, that the court prohibit NICO from changing its party-appointed arbitrator or, alternatively, to permit IRB to choose NICO's arbitrator.

The court allowed NICO to choose its own replacement arbitrator. Its analysis begins by acknowledging that courts have held (perhaps universally) that the party whose arbitrator resigns is free to select a replacement arbitrator. The court concluded that this was the only fair outcome holding that "[t]o deny [party] the party-appointed arbitrator of its choice would... deprive it of a basic expectation in entering the arbitration agreement" and "[t]he fact that the arbitration agreement is silent on a specific method for replacing arbitrators does not, by itself, vitiate [party's] entitlement to this right."[9]

In this case, however, the court expressed concern that the original arbitrator was specifically *asked* to resign and stated that it was "hesitant to ratify NICO's choice of [replacement arbitrator] given that NICO directly solicited the resignation of its original selection."[10] It went on to explain that while the "risk of manipulation" was less in the resignation context because (unlike the death context) the arbitration does not start all over, the court was "wary of creating an unfettered right to alter the composition of an arbitration panel" as "[s]uch a right would enable parties to endlessly delay the arbitration process."[11] The court further explained "such a rule would inject an intolerable level of uncertainty into the arbitration system."[12]

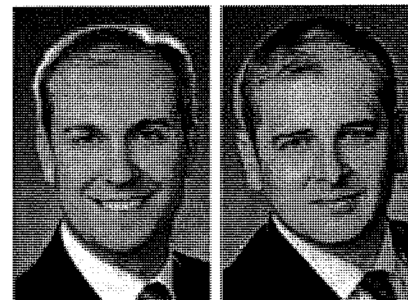
> *... the court expressed concern that the original arbitrator was specifically asked to resign ...*

But, despite such concerns, the court allowed the replacement arbitrator to serve on the panel due to "two reasons specific to the facts" of the case.[13] First, the arbitration had not proceeded very far — indeed, the whole panel had not yet been constituted. The relatively undeveloped status of the proceeding minimized the risk of delay and the likelihood of prejudice to the opposing party. Second, the replacement arbitrator was serving on another arbitration between the same parties. The court noted that inasmuch as IRB had requested that the two arbitrations be consolidated, having the same arbitrator on both panels "would only seem to bolster" IRB's request for consolidation.[14] In other words, the court implied that NICO's replacement would probably benefit IRB.

Conclusion: Proceed with Care

The court decisions above highlight the competing public policy considerations courts evaluate when confronting issues regarding "strategic" resignations. The *Northwestern National* court focused on the right of a party to proceed with the arbitrator of its choice and concluded that the risk of abuse or manipulation was minimal.[15] The *IRB* court focused on the threat of abuse and manipulation that "strategic" resignations caused but also closely examined mitigating facts that reduced these threats and the potential prejudice to the opposing party.

These cases appear to establish a fairly clear rule that parties will generally be permitted to replace party-appointed arbitrators — even when the proceeding is already underway. The cautionary language in the *IRB* case, however, suggests that there are likely circumstances in which a court would not allow an arbitrator to be replaced. As evidenced by the *Northwestern National* decision, the mere fact that a resignation occurs at the specific behest of the party is not necessarily considered a manipulative act such that the resignation will not be allowed. Prejudice is the key, and it must be considered from both sides. ●



Daryn E. Rush is a Director at Gibbons, PC and is part of the firm's Business & Commercial Litigation Group. Thomas E. Klemm is an Associate in the same group. They can be reached at drush@gibbonslaw.com and tklemm@gibbonslaw.com.

Notes

1 *Id.* at 130.
2 *Id.*
3 *Id.*
4 *Id.*
5 *WellPoint, Inc. v. John Hancock Life Ins. Co.*, 576 F.3d 643, 646-47 (7th Cir. 2009); *Nat'l Am. Ins. Co. v. Transam. Occidental Life Ins. Co.*, 328 F.3d 462, 465-66 (8th Cir. 2003).
6 *Id.* at *5.
7 *Id.* at *12.
8 *Id.*
9 *See IRB*, 2011 U.S. Dist. LEXIS 136640, at *11-12 (noting opposing party could cite to no cases in which "a court has displaced a party's selection of a replacement arbitrator after that party's initial choice has resigned.") citing *Northwestern National*, 2011 U.S. Dist. LEXIS 50789, at *7 ("[N]either this Court nor either party has found any case where a court selected a replacement party arbitrator that differed from the one selected by the party.")
10 *Id.*
11 *Id.* at *12-13.
12 *Id.* at *13.
13 *Id.*
14 *Id.* at *13-14.
15 While never citing the case, the court's decision is very similar to *Wellpoint Health Networks, Inc. v. John Hancock Life Ins. Co.*, 547 F. Supp. 2d 899 (N.D. Ill. 2008). Here, the court made a very similar decision regarding "strategic" resignations with the court stressing the need for a party to freely select and choose the arbitrator it wants in an arbitration.