

September 8, 2010

Third Circuit Confirms That Parties Cannot Opt Out Of Federal Arbitration Act Vacatur Standards Absent Clear Intent

On August 18, 2010, in the matter of *Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania, in his official capacity as the statutory liquidator of Legion Insurance Company, et al. v. The Underwriting Members of Syndicate 53 at Lloyds for the 1998 Year of Account*, Nos. 09-1921, 09-2989 & 09-2991, the Third Circuit affirmed the judgment of the District Court for the Middle District of Pennsylvania confirming July 2008 arbitration awards which rescinded three of four reinsurance treaties entered into between the parties. The Underwriting Members of Lloyd's Syndicate 53 for the 1998 Year of Account ("Syndicate 53") were represented by Chadbourne & Parke LLP in the underlying arbitration and subsequent litigation, and David Raim of Chadbourne argued the case before the Court of Appeals.

Factual Background

In September 2006, Legion and Villanova Insurance Companies, both in liquidation and collectively referred to herein as "Legion," demanded arbitration against Syndicate 53 pursuant to four separate reinsurance treaties entered into between the parties in 1998. During the arbitration hearing in June 2008, Legion asked the arbitration panel to award it the full amount of all unpaid billings submitted under the reinsurance treaties plus interest. Syndicate 53 argued that the reinsurance treaties should be rescinded based on eight separate legal theories, including material misrepresentation and non-disclosure prior to contract formation and material breach of the duty of utmost good faith and other contractual duties after contract inception.

After a nine day arbitration hearing in June 2008, the arbitration panel issued "unreasoned" awards in favor of Syndicate 53 rescinding three of the four treaties, while leaving the Syndicate's obligations in place on the fourth treaty.

Cross Motions to Vacate and Confirm the Arbitration Award

On August 6, 2008, Legion filed a motion in state court to the portions of the awards which rescinded the three treaties. Shortly thereafter, Syndicate 53 removed the case to federal district court pursuant to the removal provision of the Convention on the Recognition of Foreign Arbitral Awards, 9 U.S.C. § 205 (the "Convention") -- as there was no diversity between the parties -- and also filed a motion to confirm the award under the Convention. On September 29, 2009, Legion filed a motion to remand the matter back to state court. Legion argued that the parties had selected the Pennsylvania Uniform Arbitration Act ("PUAA") to govern the arbitration and hence, the parties had opted out of the Federal Arbitration Act ("FAA") in its entirety thereby depriving the District Court of subject matter jurisdiction. Legion's argument was based on a sentence in the treaties' arbitration article which provided "[e]xcept as hereinabove provided, the arbitration shall be in accordance with the rules and procedures established by the Uniform Arbitration Act as enacted in Pennsylvania." Additionally, Legion alleged that this same

language constituted an opt-out of the FAA vacatur standards in favor of the PUAA standards which, according to Legion, provide broader grounds for vacatur than the FAA standards.

The Decision of the District Court

The District Court denied Legion’s motion to remand “easily conclude[ing] that it had jurisdiction over the case pursuant to § 205 because the case related to an arbitration award falling under the Convention.” The District Court also held that review of the award was governed by the vacatur standards of the FAA and the Convention, rather than the PUAA, and confirmed the award.

The Decision of the Third Circuit

In its August 18, 2010 decision, the Third Circuit initially examined Legion’s argument that the District Court did not have jurisdiction and therefore, that the Syndicate’s removal of the matter was improper. Legion argued that the reference to the PUAA in the arbitration clause of the treaties demonstrated a clear intent by the parties to “opt out” of the FAA in its entirety, including Chapter 2 of the FAA which is the Convention’s implementing legislation, thereby depriving the District Court of jurisdiction. The Third Circuit disagreed, holding that while the FAA allows parties to choose to have an arbitration governed by state law arbitration standards, they cannot “opt-out” of the FAA in its entirety. Specifically, the court explained “while parties may opt out of the FAA’s default rules, they cannot ‘opt-out’ of FAA coverage in its entirety because it is the FAA itself that authorizes parties to choose different rules in the first place.” The court went on to explain that “[t]hough parties may not opt out of (and are governed by) the FAA, it is still possible to waive specifically the right of removal under 9 U.S.C. § 205.” However, in this case the court determined that the reference to the PUAA in the arbitration clause did not constitute “clear and unambiguous” waiver of the right to removal. In fact, the court held, the service of suit clause in the treaties expressly preserved the right to removal. Accordingly, the court affirmed the District Court’s denial of the motion to remand.

The court then examined Legion’s argument that the standards of vacatur enumerated under the PUAA, rather than the FAA, governed the motion to vacate. Initially, the court held that in an arbitration covered by the Convention but conducted in the U.S. and enforced in a U.S. court, the losing party could move to vacate under the vacatur standards of both the FAA and the Convention (this point was not contested by either party). Then, noting that the domestic FAA allows parties to agree to apply state law standards in lieu of the FAA default rules, the court explained that in order to choose state law standards, the law requires the “parties to express a ‘clear intent’ to apply state law vacatur standards instead of those of the FAA.” Citing from its decision in *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287 (3d Cir. 2001), the court explained:

We must, therefore, decide which error is worse: wrongly concluding that parties intended to opt out, or wrongly concluding that they did not. In light of the FAA’s history, we believe that the former is worse than the latter.

The court then rejected Legion’s argument in this case, holding that the reference to the PUAA in the relevant treaties’ arbitration article fell short of the “clear intent” standard enumerated in *Roadway*. In so holding, the court accepted Syndicate 53’s argument that the PUAA has provisions dealing with both the procedures governing the conduct of the arbitration and other provisions dealing with the enforcement of awards, and that the language of the treaties strongly implied that the parties were choosing only to have the PUAA govern the conduct of the arbitration. Moreover, as noted by the court, the service of suit clause

in the treaties does address judicial enforcement of arbitral awards and makes no mention of the PUA. Therefore, the court concluded:

In the face of the reasonable inferences that (1) the arbitration provisions were concerned solely with the conduct of the arbitration itself, and (2) the service-of-suit provision was concerned with judicial enforcement of any arbitration decision, we believe that the parties did not have a “clear intent” to apply the PUA vacatur standards in lieu of the FAA standards.

Once the court determined that FAA vacatur standards applied, the court then addressed Legion’s argument that the award should still be vacated under the FAA on the ground that the arbitrators exceeded their powers. According to Legion, because the underwriter of the treaties did not personally recall the underwriting negotiations, any award rescinding the treaties was completely “irrational” and must be vacated. The court disagreed that the award was completely irrational and could not be supported on any theory of relief. Rather, according to the court, Legion’s arguments expressed discontent with the “weighing of the evidence by the arbitration panel” and such discontent, the court ruled, does not constitute grounds for vacatur. Accordingly, the court affirmed the District Court’s confirmation of the arbitration award.

The three judge panel ruled by a 3-0 vote on the jurisdiction issue, while the vote was 2-1 on whether the PUA or FAA vacatur standards applied.

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