UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

NATIONAL CASUALTY COMPANY, Plaintiff, -v- MUTUAL MARINE OFFICE, INC., PACIFIC MUTUAL MARINE OFFICE, INC., MUTUAL INLAND MARINE OFFICE, INC., MUTUAL MARINE OFFICE OF THE MIDWEST, INC., UTICA MUTUAL INSURANCE COMPANY, EMPLOYERS MUTUAL CASUALTY COMPANY, MERCHANTS MUTUAL INSURANCE COMPANY, THE LUMBER MUTUAL FIRE INSURANCE COMPANY OF BOSTON, MASSACHUSSETTS, THE MUTUAL FIRE MARINE AND INLAND INSURANCE COMPANY, ARKWRIGHT BOSTON INSURANCE COMPANY n/k/a COFACE NORTH AMERICA INSURANCE COMPANY, ARKWRIGHT BOSTON MANUFACTURERS MUTUAL INSURANCE COMPANY, n/k/a COFACE NORTH AMERICA INSURANCE COMPANY, NEW YORK MARINE INSURANCE COMPANY, NEW YORK MARINE AND GENERAL INSURANCE COMPANY, THE PENNSYLVANIA NATIONAL MUTUAL CASUALTY INSURANCE COMPANY, Defendants.		08 CV 8062 (PGG) (ECF Case)

MEMORANDUM OF LAW IN SUPPORT OF MOTION TO STAY OR DISMISS, COMPEL ARBITRATON AND APPOINT AN ARBITRATOR

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MEMORANDUM OF LAW IN SUPPORT OF MOTION TO STAY OR DISMISS, COMPEL ARBITRATON AND APPOINT AN ARBITRATOR

Mutual Marine Office, Inc., Pacific Mutual Marine Office, Inc. Mutual Inland Marine Office, Inc., and Mutual Marine Office of the Midwest, Inc. on behalf of themselves and the insurance companies for which they act as managers and agents, including the other named defendants, (collectively, "MMO"), respectfully submit this memorandum of law in support of their motion under FRCP 12(b)(1) and 12(b)(6): (i) to dismiss the complaint of National Casualty

Company ("NCC"), or stay this action in favor of arbitration, pursuant to 9 U.S.C. § 3; (ii) to compel arbitration; and (iii) to appoint an arbitrator pursuant to 9 U.S.C. § 5. This memorandum is accompanied by the October 16, 2008 Declaration of Daniel Hargraves (the "Hargraves Dec.").

PRELIMINARY STATEMENT

NCC's Complaint, seeking declaratory relief interpreting the parties' reinsurance treaties, seeks to litigate disputes plainly subject to the broad arbitration clauses contained in those treaties. The arbitration clauses require the arbitration of "any dispute [that] shall arise between the REASSURED and the REINSURERS with reference to the interpretation of this Agreement or [the Parties'] rights with respect to any transaction involved ...." NCC's Complaint asks the Court to thwart the arbitration MMO commenced by finding unwritten service and pleading requirements in the parties' contracts. That dispute falls within the ambit of the parties' arbitration agreements and MMO requests that the Court dismiss or stay this action and compel arbitration.

Although NCC has nominally appointed an arbitrator, it has refused to agree on the appointment of an umpire, frustrating the establishment of an arbitration panel as contemplated by the parties' agreements. Accordingly, MMO respectfully requests that the Court appoint the third arbitrator itself, pursuant to 9 U.S.C. § 5, to resolve the deadlock.

STATEMENT OF FACTS

From 1977 through 1981, NCC reinsured MMO on two reinsurance treaties, the Marine Liabilities Excess of Loss Reinsurance Agreement (the "Marine Liabilities Treaty") and the First Marine Excess of Loss Reinsurance Agreement (the "1st XL") (collectively, the "Treaties"). After NCC ceased paying losses due under the Treaties, on August 12, 2008, MMO

initiated an arbitration against NCC. A copy of MMO's arbitration demand (the "Arbitration Demand") is attached as Exh. C to the Hargraves Dec. The Arbitration Demand indicates that the arbitration is necessary because of NCC's failure to pay balances due under the Treaties and failure to post security for reserves:

> MMO demands arbitration and seeks a hearing to resolve disputes with National Casualty that arise from the interpretation of the reinsurance contracts and the parties' rights with respect to transactions involved, including National Casualty's wrongful failure to pay balances due MMO pursuant to the Treaties and to seek security for reserves in the form of a Letter of Credit.

Id. at 1.

The Arbitration Demand further recites the then current balance due of $240,450 on the Treaties:

> MMO seeks an award: (i) ordering National Casualty to pay balances due under the Treaties currently in the amount of $240,450.00, together with interest thereon; (ii) declaring that National Casualty is liable for all claims submitted by MMO to National Casualty under the Treaties; (iii) declaring that National Casualty will continue to be liable for losses under the Treaties; (iv) ordering National Casualty to procure and maintain a Letter of Credit in an amount sufficient to secure all outstanding loss reserves and incurred but not reported loss reserves; (v) attorneys fees; and (vi) such additional damages and relief deemed appropriate, including costs and expenses as may be awarded by the arbitrators. MMO reserves the right to alter or expand its claims for relief during the course of the arbitration, including the right to seek punitive damages.

Id. at 2.

The Arbitration Demand also required NCC to appoint its arbitrator within thirty days (id.), in accordance with the arbitration clause of the Treaties, which also calls for the parties to present their cases to the arbitration panel within thirty days of the appointment of the arbitrators:

> If either party refuses or neglects to appoint an arbitrator within thirty days after receipt of written notice from the other party request it to do so, the requesting party may nominate two arbitrators who shall choose the third. Each party shall submit its case to the arbitrators within thirty days of the appointment of the arbitrators.

See Hargraves Dec., Exh. A at ¶ 32.

MMO served the Arbitration Demand on NCC directly, addressing it to Mr. Mark Kareken, Esq., NCC's in house counsel, who was responsible for handling the dispute between MMO and NCC. See Hargraves Dec. at Exh. E. Guy Carpenter, although originally named as the intermediary under the Treaties, has had no such involvement for several years. Instead, MMO and NCC have dealt with each other directly. See Hargraves Dec. at ¶ 7.

Instead of responding to the Arbitration Demand, and proceeding with the arbitration in accordance with the parties' contracts, NCC commenced an action in this court. NCC's Complaint is perverse. Although it recognizes that the broad arbitration provision in the parties' Treaties requires arbitration of "any dispute [that] shall arise between the REASSURED and the REINSURERS with reference to the interpretation of this Agreement or their rights with respect to any transaction involved, (see Hargraves Dec., Exh. A at ¶ 32), the Complaint nonetheless asks the Court to interpret the parties' contracts, and provide declaratory relief with respect to the content and service requirements of an arbitration demand under the Treaties. See , id. at ¶¶ 49-54.

Although NCC named an arbitrator, Mr. Spiro Bantis, it instructed him not to proceed with the arbitration. Indeed, NCC's counsel's September 22, 2008 letter acknowledged as much:

> We note your stated expectation that the party appointed arbitrators proceed with the umpire selection process. We respectfully disagree. National Casualty does not believe that the arbitration has

> been commenced and it commenced and filed the lawsuit to have that issue resolved. National Casualty named Mr. Bantis solely for the purpose of preventing an adverse selection of its arbitrator pending the outcome of the litigation.

See Hargraves Dec., Exh. E at 1.

As a result of NCC's recalcitrance, the arbitration has been stalled since August 12, 2008, the date it commenced.

ARGUMENT

I.

THE COURT SHOULD DISMISS OR STAY THIS ACTION AND COMPEL ARBITRATION

The Court should dismiss or stay this action and require NCC to arbitrate the claims its asserts in the Complaint. The declaratory relief requested by NCC falls squarely within the ambit of the parties' broad arbitration agreement.

1. The Court Should Dismiss or Stay This Action in Favor of Arbitration

Section 2 of The Federal Arbitration Act, entitled "Validity, irrevocability, and enforcement of agreements to arbitrate," provides that:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2.

Section 3, entitled "Stay of proceedings where issue therein referable to arbitration," provides that:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 3.

In such a circumstance:

> . . . a district court must stay proceedings if satisfied that the parties have agreed in writing to arbitrate an issue or issues underlying the district court proceeding. The FAA leaves no discretion with the district court in the matter . . . Furthermore, we are mindful of the Supreme Court's admonition that while "the FAA does not require parties to arbitrate when they have not agreed to do so," we must construe "any doubts concerning the scope of arbitrable issues . . . in favor of arbitration.

McMahan Securities Co. L.P. v. Forum Capital Markets L.P., 35 F.3d 82, 85-86 (2nd Cir. 1994) (internal citations omitted).

In determining whether a dispute falls within the scope of the parties' agreement to arbitrate, a court should first classify the particular clause as either broad or narrow. Louis Dreyfus Negoce S.A. v. Blystad Shipping & Trading Inc., 252 F.3d 218 (2nd Cir. 2001):

> No fixed rules govern the determination of an arbitration clause's scope; while very expansive language will generally suggest a broad arbitration clause, see, e.g., Collins, 58 F.3d at 18 ("Any claim or controversy arising out of or relating to this agreement shall be settled by arbitration."), we have also found broad clauses when examining phrasing slightly more limited, see, e.g., Abram Landau Real Estate v. Bevona, 123 F.3d 69, 71 (2d Cir.1997) ("Contract Arbitrator shall have the power to decide all differences arising between the parties to this agreement as to interpretation, application or performance of any part of this agreement.").

Dreyfus Negoce S.A., 252 F.3d at 225. Where the arbitration clause is broad, "there arises a presumption of arbitrability." Id. at 224.

It is well-established that the arbitration clauses at issue -- which require arbitration of "any dispute [that] shall arise between the REASSURED and the REINSURERS with reference to the interpretation of this Agreement or their rights with respect to any transaction involved ...." are broad clauses. They require arbitration of NCC's claims that the Treaties allow it to ignore any Arbitration Demand not served through Guy Carpenter or not itemizing the underlying losses at issue. See ACE Capital Re Overseas Ltd. v. Central United Life Ins. Co., 307 F.3d 24 (2nd Cir. 2002) (broad arbitration clause requires arbitration of claim of fraud in the inducement); Hartford Acc. And Indem. Co. v. Swiss Reinsurance America Corp., 246 F.3d 219 (2nd Cir. 2001) (broad clause triggers the rule that an "order to arbitrate a particular claim should not be denied unless it can be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute"); National Union Fire Insurance Co. v. Belco Petroleum Corp., 88 F.3d 129, 131 (2d Cir. 1996) (requiring arbitration of affirmative defense because "the preclusive effect of a prior, related arbitration between the parties must be determined by the arbitrator in the current arbitration, rather than by the court.").

These Second Circuit cases are in accord with the rationale underpinning Green Tree Financial Corp. v. Bazzle, 539 U.S. 444 (2003) and Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79 (2002), requiring arbitration of all claims and defenses, once the gateway matter of showing the existence of an agreement to arbitrate:

> The phrase "question of arbitrability" has a limited scope, applicable in the kind of narrow circumstance where contracting parties would likely have expected a court to have decided the gateway matter. But the phrase is not applicable in other kinds of

> general circumstance where parties would likely expect that an arbitrator would decide the question –" 'procedural' questions which grow out of the dispute and bear on its final disposition," and "allegation[s] of waiver, delay, or a like defense to arbitrability.

537 U.S. at 79-80 (emphasis supplied). Here, NCC's attempt to conjure a service or pleading defense to the Arbitration Demand does not implicate a gateway matter. First, NCC does not contend the parties lack a valid arbitration agreement. Second, the broad scope of the arbitration agreements clearly covers the declaratory relief sought by NCC.

The Belco case is emblematic. There, Belco argued that National Union Fire Insurance Company, having lost a prior arbitration, was precluded from starting a second arbitration four-and-a-half years later seeking the return of a portion of the amount it paid under the prior award. Belco commenced a declaratory judgment action in the United States Court for the Southern District of Texas seeking a declaration that the second arbitration was barred by *res judicata*. Id. at 131-32. National Union sought to compel arbitration.

The insured argued to the trial court that the issue of the insurer's claim to proceeds under the Seahawk Policy had already been decided in the initial arbitration and that "the preclusive effect of the prior arbitration award had to be determined by the court and not by the arbitrator in the pending arbitration." Id. The District Court held, however, that "under federal law the arbitrator, not the court, should decide the issue." Nat'l Union Fire Ins. Co. v. Belco Petro. Corp., No. 94 Civ. 5205 (TPG), 1995 U.S. Dist. LEXIS 14056, *6 (S.D.N.Y. Sept. 28, 1995) (emphasis added).

In affirming, the Second Circuit held that the insured's "claim of preclusion is a legal defense" and, therefore, "it is itself a component of the dispute on

the merits." 88 F.3d at 135-36 (emphasis added). The Court observed that the arbitration clause at issue, which required arbitration of "all disputes which may arise under or in connection with the" policy in dispute, was broad enough to encompass a dispute regarding the preclusive effect of a prior arbitration. Id. at 133. The Court noted that preclusion is "as much related to the merits as such affirmative defenses as a time limit in the arbitration agreement or laches, which are assigned to an arbitrator under a broad arbitration clause." Id. at 136 (citing Conticommodity Servs., Inc. v. Phillip & Lion, 613 F.2d 1222, 1226 (2d Cir. 1980), 613 (time limitation in arbitration agreement), and Trafalgar Shipping Co. v. Int'l Milling Co., 401 F.2d 568, 571-72 (2d Cir. 1968) (laches)). See also North River Insurance Co. v. Allstate Insurance Co., 866 F. Supp. 123 (S.D.N.Y. 1994) (holding that the issue-preclusive effect of a prior arbitration award is a defense to be heard and decided by the currently empanelled arbitrators):

> When one party to a dispute seeks to stay the other party's demand for arbitration by raising various defenses to arbitration before a district court, there is a considerable temptation for the court to pass on the validity of such defenses rather than to refer their resolution to an arbitrator. Determining the merits of such defenses may often appear to be a simple task that should not be delayed or deferred, and judges are, by training and temperament, prepared to decide the issue that come before them.
>
> These reactions, while understandable, are at odds with the policy considerations embodied in the Federal Arbitration Act, which favor the enforcement of arbitration agreements.

Id. at 129-30 (quoting Conticommodity Servs., Inc. v. Phillip & Lion, 613 F.2d 1222, 1224 (2d Cir. 1980)).

Nothing about NCC's complaint suggests that Belco does not control here. NCC's assertions that the Arbitration Demand is subject to unwritten service and pleading requirements is a legal defense subject to the parties' arbitration agreements and to be decided by the arbitration panel, just as Belco's defense of *res judicata* was a legal defense for the arbitration panel, not the court, to decide.

2. The Court Should Compel Arbitration

Whether the Court chooses to stay or dismiss this proceeding, it should also issue an order compelling NCC to arbitrate its defenses in the arbitration proceeding commenced on August 12, 2008.

Section 4 of the FAA provides:

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court . . . for an order directing that such arbitration proceed in the manner provided for in such agreement. . . . The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.

This "statutory language is straightforward." Conticommodity Servs., Inc. v. Phillip & Lion, 613 F.2d 1222, 1224 (2d Cir. 1980).

II.

THE COURT SHOULD APPOINT THE THIRD ARBITRATOR

The arbitration provisions agreed to by the parties provide that any dispute shall be "referred to three arbitrators, one to be chosen by each party and the third by the two so chosen." Although NCC appointed an arbitrator, it has refused to allow its appointed arbitrator to

proceed with the selection of the third arbitrator. As such, this Court should appoint the third arbitrator.

Section 5 of the Federal Arbitration Act, entitled "Appointment of arbitrators or umpire," provides:

> If in the agreement provision be made for a method of naming or appointing an arbitrator or arbitrators or an umpire, such method shall be followed; but if no method be provided therein, or if a method be provided and any party thereto shall fail to avail himself of such method, or if for any other reason there shall be a lapse in the naming of an arbitrator or arbitrators or umpire, or in filling a vacancy, then upon the application of either party to the controversy the court shall designate and appoint an arbitrator or arbitrators or umpire, as the case may require, who shall act under said agreement with the same force and effect as if he or they had been specifically named therein; and unless otherwise provided in the agreement the arbitration shall be by a single arbitrator.

The instant case is similar to CAE Industries, Ltd. v. Aerospace Holdings Company, 741 F. Supp. 388 (S.D.N.Y. 1989), in which plaintiffs sought to compel arbitration in connection with their claims arising from the purchase of a business from the defendants. The defendants resisted arbitration and, as a result, failed to agree on an arbitrator. Accordingly, the plaintiffs also sought to have an independent auditor appointed as arbitrator by the court. 741 F. Supp. at 393. The court agreed to do so, noting:

> ... 9 U.S.C. Section 5 authorizes this court to appoint an arbitrator which it will do pursuant to an order accompanying this opinion. Defendants have offered no explanation other than that which has been set forth above [i.e., their reasons for resisting arbitration in the first place] for their refusal to cooperate with plaintiffs in naming an independent auditor. The court finds that defendants' claims with respect to arbitration have been wholly frivolous and that the parties should be directed to arbitration.

741 F. Supp. at 393 (citations omitted).

MMO proposes that the Court appoint either James P. White, Howard McCormack or Clive Becker-Jones, each with extensive arbitration experience, as a third arbitrator in this arbitration. Copies of their resumes are attached as Exhibits F, G and H to the Hargraves Dec. Pursuant to its power under 9 U.S.C. § 5, the Court may properly designate an umpire from the identified candidates. See Astra Footwear Indus. v. Harwyn Int'l, Inc., 442 F. Supp. 907, 911 (N.D.N.Y. 1978). This Court should grant MMO's application for appointment of a third arbitrator to resolve the lengthy stalemate in the selection process and allow the arbitration to proceed. See Home Ins. Co. v. Banco de Seguros del Estado (Uru.), 98 Civ. 6022 (KMW), 1999 U.S. Dist. LEXIS 22479, at 1-2 (S.D.N.Y.) ("where the arbitration agreement is silent on the appointment of a replacement arbitrator, it was within the authority conferred by the [Federal Arbitration] Act for the court to appoint to the panel [one party's] new nominee [] to replace its original nominee") (internal quotations omitted) (citing Trade & Transp. v. Natural Petro. Charterers, 931 F.2d 191, 195-96 (2d Cir. 1991).

New York law similarly authorizes the Court's appointment of the third arbitrator. Section 7504 of the CPLR, entitled "Court Appointment of Arbitrators," provides:

> If the arbitration agreement does not provide for a method of appointment of an arbitrator, or if the agreed method fails or for any reason is not followed, or if an arbitrator fails to act and his successor has not been appointed, the court, on application of a party, shall appoint an arbitrator.[1]

The statute "insures that an arbitration will not abort merely because the one of the parties, or one of the arbitrators appointed by the parties, refuses to proceed. In any such situation, either party may make an application to have the court appoint an arbitrator." Vincent

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[1] New York law is applicable in situations where, as here, the Court's diversity jurisdiction has been invoked. See Hargraves Dec., Exh. A at ¶ 13. See Progressive Cas. Ins. Co. v. C.A. Reaseguradora Nacional, 991 F.2d 42, 46 & n. 6 (2d Cir. 1993) (where Federal Arbitration Act invoked via diversity jurisdiction, New York law controlled, unless preempted).

C. Alexander, "Practice Commentaries," 7B McKinney's Consolidated Laws of New York, CPLR § 7504 at 672 (1998). Clearly, the purpose of CPLR § 7504 is to allow the Court to break an impasse in the selection process and move the arbitration forward.

Pursuant to the laws of the State of New York, once the agreed upon method for appointment failed or for any reason was not followed, this Court may designate an arbitrator upon application. See Lassiter v. CNA Ins. Co., 195 A.D.2d 362, 600 N.Y.S.2d 59 (N.Y. App.Div. 1993); see also Koppel v. Koppel, 52 A.D.2d 676, 678, 382 N.Y.S.2d 143 (N.Y. App. Div. 1976) ("If the method for appointment fails, the court has ample authority to appoint arbitrators on proper application."). The Treaties at issue provide for arbitration before a panel of three arbitrators, one to be chosen by each party and the third by the two so chosen. See Hargraves Dec., Exh. A at ¶ 32. Although both party-nominated arbitrators have been chosen, NCC has refused to proceed with umpire selection. NCC's refusal has occasioned a failure of the contractual appointment method that requires the intervention of this Court.

Accordingly, the Court should appoint either James P. White, Howard McCormack or Clive Becker-Jones as the third arbitrator in this arbitration.

CONCLUSION

For the foregoing reasons and those set forth in the accompanying Declaration of Daniel Hargaves, MMO respectfully requests that its motion under FRCP 12(b)(1) and 12(b)(6): (i) to dismiss the complaint of National Casualty Company, or stay this action in favor of arbitration, pursuant to 9 U.S.C. § 3; (ii) to compel arbitration; and (iii) to appoint an arbitrator pursuant to 9 U.S.C. § 5 be granted in its entirety.

Dated: New York, New York
October 16, 2008

Daniel Hargraves
Andrew Costigan

HARGRAVES McCONNELL & COSTIGAN, P.C.
420 Lexington Avenue
New York, New York 10170
Tel. No.: 212-218-8760

Counsel for Defendants