

1 UNITED STATES DISTRICT COURT
2 EASTERN DISTRICT OF WASHINGTON

3
4 LYNN OLSEN, dba OLSEN AGRIPRISES;
5 CARR FARMS, LLC, a Washington
6 Limited Liability Company,

7 Plaintiffs,

8 v.

9 UNITED STATES OF AMERICA, through
10 UNITED STATES DEPARTMENT OF
11 AGRICULTURE AND FEDERAL CROP
12 INSURANCE CORP.,

13 Defendant.

No. CV-06-5020-FVS

SUMMARY JUDGMENT ORDER

14 **THIS MATTER** came before the Court for oral argument on the
15 parties' cross motions for summary judgment. John G. Schultz appeared
16 on behalf of the Plaintiffs. Rolf H. Tangvald appeared on behalf of
17 the Defendant.

18 The Plaintiffs, Lynn Olsen and Carr Farms, LLC ("Carr"), brought
19 this action to enforce two arbitration awards against the Federal Crop
20 Insurance Corporation ("FCIC"), a division of the United States
21 Department of Agriculture ("DOA"). The Court finds that the FCIC did
22 not agree to submit to arbitration, being neither a party to the crop
23 insurance policies at issue nor otherwise in privity of contract with
24 the Plaintiffs. Given the dispute between the parties concerning the
25 existence of an arbitration agreement, the arbitrators did not have
26 jurisdiction to preside over the disputes between the parties. The
arbitrators also proceeded to arbitrate the disputes in violation of a

1 valid court order. The Defendant's motion for summary judgment will
2 accordingly be granted, the Plaintiffs' denied, and the arbitration
3 awards vacated.

4 **BACKGROUND**

5 **REGULATORY FRAMEWORK**

6 Since 1996, the FCIC has acted primarily¹ as a reinsurer of crop
7 insurance policies issued by private insurance companies. The FCIC
8 enters into cooperative financial agreements with private insurance
9 companies referred to as "Standard Reinsurance Agreements" ("SRAs").
10 In this capacity, the FCIC establishes the terms and conditions of the
11 insurance policies and subsidizes insurance rates. 7 U.S.C. §§ 1508;
12 1502(b)(2). The FCIC's reinsurance program is administered by the Risk
13 Management Agency ("RMA"). 7 U.S.C. § 6933.

14 Subpart J of the FCIC's regulations governs appeals of "adverse
15 decisions made by personnel of the [FCIC] with respect to . . .
16 contracts of insurance of private insurance companies and reinsured by
17 the FCIC." 7 C.F.R. § 400.91. An "adverse decision" is broadly
18 defined as, "a decision by an employee or Director of the Agency that
19 is adverse to the participant." 7 C.F.R. § 400.90. Subpart J
20 provides that a participant may only seek judicial review of an
21 adverse determination after exhausting the available administrative
22 remedies.² 7 C.F.R. § 400.96(c). Section 400.96(c) further provides,

24 ¹In addition to reinsuring the policies of private insurers,
25 the FCIC offers insurance directly through local offices of the
DOA. 7 U.S.C. § 1508(a); 7 C.F.R. § 457.2(b).

26 ²This Court has previously ruled that the Plaintiffs were
not required to exhaust their administrative remedies prior to
seeking review of the Agency's refusal to comply with the
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1 "Nothing in this section can be construed to create privity of
2 contract between the Agency and a participant." *Id.*

3 **FACTUAL BACKGROUND**

4 The Plaintiffs owned and grew crops in 2001 and 2002. They
5 purchased crop insurance policies called Adjusted Gross Revenue Pilot
6 Insurance Policies ("the Policies") from American Growers Insurance
7 Company ("AGIC"). AGIC entered into SRAs with the FCIC that were
8 effective for 2001 and 2002. Pursuant to the Federal Crop Insurance
9 Act, 7 U.S.C. §§ 1501 *et seq.*, FCIC thereby became a reinsurer of the
10 Plaintiffs' policies. The Policies specifically provide,

11 "Throughout this policy, "you" and "your" refer to the named
12 insured shown on the accepted application and "we," "us," and
"our" refer to the insurance company providing insurance.

13 Declaration of William J. Murphy, October 10, 2007 ("Murphy Decl.")
14 Ex. 1 at 1. The Policies indicate that, if AGIC could not pay a
15 claim, the FCIC would pay the claim "in accordance with the provisions
16 of this policy." Mem. Of Authorities In Supp. Of Mot. To Stay Civil
17 Proceedings, Att. 1 ¶ 13. The Policies further provide,

18 If you and we fail to agree on any factual determination,
19 you may seek resolution of the disagreement. The
20 disagreement will be resolved in accordance with the rules
21 of the America Arbitration Association. Failure to agree
with any factual determination made by the FCIC must be
resolved through the FCIC appeal provisions published at 7
CFR Part 11.

22 *Id.*

23 In 2001 and 2002, the Plaintiffs sought to recover under the
24 Policies for crop losses allegedly incurred in 2001 and 2002. Neither

25
26 arbitration awards. This conclusion was based on a statutory
exception to the exhaustion requirement for questions of a purely
legal nature. (Ct. Rec. 38.)

1 Plaintiff could reach an agreement with AGIC concerning the amount due
2 and both filed demands for arbitration in August of 2004.

3 On February 28, 2005, the State of Nebraska liquidated
4 AGIC. Declaration of Donald A. Brittenham, October 10, 2007
5 ("Brittenham Decl.") Ex. 5. The Order of Liquidation provides, "No
6 action in law or in equity or in arbitration, whether in this state or
7 elsewhere, may be brought against AGIC or its liquidator, nor shall
8 any existing actions be maintained or further presented after issuance
9 of this Order of Liquidation." *Id.* ¶ 14. The FCIC notified the
10 Plaintiffs of the liquidation and advised them that the FCIC would
11 review their claims. Affidavit of John G. Schultz, April 26, 2007
12 ("Schultz Aff.") Ex. 5 at 63-64.

13 On June 16, 2005, John R. Zeimantz, the arbitrator appointed by
14 the AAA for the Carr proceeding, issued an order indicating that the
15 arbitration would proceed as scheduled. Schultz Aff. Ex. 6 at 72-73.
16 Mr. Brittenham responded by letter on behalf of the FCIC. Brittenham
17 Decl. Ex. 6 at 130-31. This communication explained that the
18 arbitrator did not have jurisdiction over the FCIC, the FCIC had never
19 agreed to participate in arbitration, and the FCIC had not waived its
20 sovereign immunity. *Id.* at 20. Mr. Brittenham wrote to Mr. Zeimantz
21 again on August 30 and reiterated that the FCIC did not recognize the
22 AAA's jurisdiction. Brittenham Decl. Ex. 6 at 130-31.

23 On July 11, 2005, James Wagner, the arbitrator appointed by the
24 AAA for the Olsen proceeding, substituted the FCIC for AGIC. Schultz
25 Decl. Ex. 13 at 192-94. Mr. Brittenham again responded for the FCIC
26 by letter, explaining that the arbitrator did not have jurisdiction
over the FCIC, the FCIC had never agreed to participate in

1 arbitration, and the FCIC had not waived its sovereign immunity.
2 Brittenham Decl. Ex. 7.

3 On September 20, 2005, Mr. Zeimantz held an evidentiary hearing
4 in the Carr case. Brittenham Decl. Ex. 8. On October 17, 2005, he
5 awarded Carr \$ 2,969,341. *Id.* On August 22, 2005, Mr. Wagner held an
6 evidentiary hearing in the Olsen case. Brittenham Ex. 9. On
7 September 15, 2005, he awarded Olsen \$477,114 for the 2001 crop year
8 and \$2,608,699 for the 2002 crop year. *Id.* The arbitration awards
9 are the subject of the present litigation.

10 **DISCUSSION**

11 **I. THE ARBITRATION CLAUSE IS NOT BINDING ON THE FCIC**

12 **A. The FCIC Is Not a Party to the Arbitration Agreement**

13 "It is axiomatic that '[a]rbitration is a matter of contract and
14 a party cannot be required to submit any dispute which he has not
15 agreed so to submit.'" *Sanford v. Member Works, Inc.*, 483 F.3d 956,
16 962 (9th Cir. 2007) (quoting *AT&T Tech., Inc. v. Commc'n Workers of*
17 *Am.*, 475 U.S. 643, 648, 106 S. Ct. 1415, 89 L. Ed. 2d 648 (1986)).
18 Consequently, only disputes that the parties have agreed to submit to
19 arbitration may be so submitted. *First Options v. Kaplan*, 514 U.S.
20 938, 943, 115 S. Ct. 1920, 1924, 131 L. Ed. 2d 985, 992 (1995).
21 Issues concerning the existence of a contract or the existence of an
22 agreement to arbitrate are for the district court to decide. *Sanford*,
23 483 F.3d at 962. In ruling on such issues, the courts generally
24 "should apply ordinary state-law principles that govern the formation
25 of contracts." *Kaplan*, 514 U.S. at 944, 115 S. Ct. at 1924, 131 L.
26 Ed. 2d at 993 (1995).

Applying these principles, the Court finds that the FCIC was a
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1 party to neither the Policies nor the arbitration agreements they
2 contain. As the Defendant has argued, the Policies' preambles
3 indicate that AGIC and the insured are the only parties to the
4 contract. While the FCIC is mentioned as a reinsurer, the FCIC's role
5 and responsibilities are set forth in full in the SRA. Thus, the
6 Policies governed only the relationship between the Plaintiffs and
7 AGIC; the FCIC's obligations as a reinsurer are governed by the SRA.

8 The Plaintiffs argue that the Policy held the FCIC out as a party
9 by representing that the FCIC would "assume all obligations or unpaid
10 losses" if AGIC was unable to fulfill its obligations. However, the
11 Plaintiffs cite no caselaw in support of the proposition that such a
12 statement raises issues of equitable estoppel. In addition, the
13 analytical basis for this argument is insufficiently developed to be
14 persuasive.

15 More importantly, there is no evidence before the Court that the
16 FCIC ever agreed to arbitration. Even if the FCIC could be considered
17 a party to the Policies, Paragraph 13(a) indicates that the
18 arbitration agreement was not meant to bind the FCIC. Paragraph 13(a)
19 explains that factual disagreements between the insured and AGIC will
20 be resolved through arbitration. It further explains that factual
21 disagreements between the insured and the FCIC must be resolved
22 through the administrative process. As the Plaintiffs have remarked,
23 Paragraph 13(a) does not specify the procedures that will govern in
24 the event that, as in this case, AGIC becomes insolvent after a
25 factual dispute has arisen. However, the distinction Paragraph 13(a)
26 draws between the procedures that will govern disputes involving AGIC
and the procedures that will govern disputes involving the FCIC

1 indicates that the FCIC did not agree to enter into arbitration.

2 **B. The FCIC Is Not In Privity of Contract With the Plaintiffs**

3 **1. Privity in general**

4 The Defendant argues that the Plaintiffs lack standing to sue the
5 FCIC because they are not in privity of contract with the FCIC. While
6 the Court agrees that the Plaintiffs lack privity of contract with the
7 FCIC, the Court is not persuaded that the Plaintiffs necessarily lack
8 standing to bring suit. It is true that, as a general rule, "there is
9 no privity of contract that would enable the original insured to bring
10 an action against the reinsurer." *Litho Color, Inc. v. Pacific*
11 *Employer's Ins. Co.*, 98 Wn. App. 286, 301-02, 991 P.2d 638, 646 (Wash.
12 Ct. App. 1999). However, the general rule has its exceptions and the
13 Defendant has not justified its assertion that the general rule
14 applies in this case.

15 Moreover, the Plaintiffs have argued that the relationship
16 between themselves and the FCIC can not be properly qualified as
17 "reinsurance" for the purposes of state law. The Court, therefore,
18 declines to rule on the question of standing in this instance.

19 The Defendant is correct that neither the Policies nor the SRA
20 establish a contractual relationship between the Plaintiffs and the
21 FCIC. The Plaintiffs entered into an agreement with AGIC and AGIC
22 entered into an agreement, the SRA, with the FCIC. Section 400.96
23 negates the Plaintiffs' contention that the Policy and the SRA
24 established privity of contract. This provision indicates, "Nothing
25 in this section can be construed to create privity of contract between
26 the Agency and a participant." 7 C.F.R. § 400.96(c). Reading this
statement in context, it is clear that the act of filing a lawsuit

1 pursuant to the FCIC's regulations does not, by itself, create
2 privity. It would not be necessary for the regulation to address the
3 effect of a lawsuit on privity if, as the Plaintiffs argue, privity
4 existed solely by virtue of the FCIC's role as reinsurer.

5 The Plaintiffs contention that Subpart J is inapplicable to the
6 present action is unavailing. The Plaintiffs are correct that Subpart
7 J would not apply to an appeal of AGIC's determinations. However, as
8 this Court's Order Denying Motion to Stay, Ct. Rec. 38, made clear,
9 the Plaintiffs' action before this Court is not an appeal of AGIC's
10 factual findings. Rather, it is a challenge to the FCIC's refusal to
11 recognize the arbitration awards. Given Subpart J's broad definition
12 of "adverse action," Subpart J applies to the present litigation.

13 **2. Substituted insurance versus reinsurance**

14 As a general rule, "reinsurance" properly refers to the
15 relationship that exists when one insurance company, the reinsurer,
16 agrees to indemnify another insurance company, the insurer, against a
17 portion of the losses that the insurer may incur in connection with a
18 policy. 14 Eric Mills Holmes & L. Anthony Sutton, Appleman on
19 Insurance § 109.1 (2d Ed. 1999.) When a so-called reinsurer assumes
20 direct liability to the policy holder, the relationship is properly
21 characterized as "substituted insurance" rather than reinsurance. *Id.*

22 The Plaintiffs argue that the FCIC is in privity of contract with
23 the Plaintiffs because the FCIC provided substitute insurance rather
24 than reinsurance. However, federal law preempts the application of
25 this principle to the present situation. The FCIC's regulations
26 preempt state and local law to the extent that they conflict with the

1 statute and regulations governing the FCIC. 7 U.S.C. § 1506(1).³
2 Likewise, inconsistent state and local laws are inapplicable to the
3 contracts of the FCIC. *Id.*; 7 C.F.R. § 400.352(a). The federal
4 regulations governing the FCIC refer to "reinsurance," rather than
5 "substituted insurance." Section 400.96 also indicates that, however
6 the relationship between a participant and the FCIC might be
7 described, the mere existence of that relationship does not create
8 privity of contract between an insured and the FCIC. The creation of
9 privity via state contract or insurance law would be inconsistent with
10 these regulations. Consequently, federal law prohibits the inference
11 that the FCIC provided substitute insurance.

12 13 **II. THE ARBITRATION AWARDS MUST BE VACATED**

14 **A. The Arbitrators Lacked Jurisdiction**

15 The Federal Arbitration Act ("FAA" or "the Act") acknowledges the
16 validity of arbitration agreements and establishes a liberal federal
17 policy in favor of their enforcement. *Lozano v. AT&T Wireless Servs.*,
18 504 F.3d 718, 725 (9th Cir. 2007) (citing *Moses H. Cone Mem. Hosp. v.*
19 *Mercury Constr. Corp.*, 460 U.S. 1, 24, 103 S. Ct. 927, 74 L. Ed. 2d
20 765 (1983)). Consistent with this policy, the Act authorizes the

21 ³ 7 U.S.C. § 1506(1) provides,
22

23 The Corporation may enter into and carry out contracts
24 or agreements, and issue regulations, necessary in the
25 conduct of its business, as determined by the Board. State
26 and local laws or rules shall not apply to contracts,
agreements, or regulations of the Corporation or the parties
thereto to the extent that such contracts, agreements, or
regulations provide that such laws or rules shall not apply,
or to the extent that such laws or rules are inconsistent
with such contracts, agreements, or regulations.

1 parties to an arbitration agreement to petition the district court to
2 compel arbitration in appropriate circumstances. 9 U.S.C. § 4. The
3 court must direct the parties to arbitrate the dispute as set forth in
4 their agreement "upon being satisfied that the making of the agreement
5 for arbitration or the failure to comply therewith is not in issue."

6 *Id.* If, however, "the making of the arbitration agreement or the
7 failure, neglect, or refusal to perform the same be in issue, the
8 court shall proceed summarily to the trial thereof." *Id.*

9 An arbitrator's authority to adjudicate a dispute is derived
10 solely from the agreement of the parties. *Three Valleys Municipal*
11 *Water Dist. v. E.F. Hutton & Co.*, 925 F.2d 1136, 1140-41 (9th Cir.
12 1991). He or she "has no independent source of jurisdiction apart
13 from the consent of the parties." *I.S. Joseph Co. v. Michigan Sugar*
14 *Co.*, 803 F.2d 396, 399 (9th Cir. 1986). Consequently, the question of
15 whether a particular party entered into a contract containing an
16 arbitration agreement "must first be determined by the court as a
17 prerequisite to the arbitrator's taking jurisdiction." *Id.*; *Sanford*,
18 483 F.3d at 962. Similarly, challenges to the validity of an
19 agreement to arbitrate must be resolved by a court. *Buckeye Check*
20 *Cashing, Inc. v. Cardegna*, 546 U.S. 440, 444, 126 S. Ct. 1204, 1208,
21 163 L. Ed. 2d 1038, 1043 (2005). In contrast, the validity of a
22 contract that contains an arbitration clause is a question for the
23 arbitrator. *Buckeye*, 546 U.S. at 449, 126 S. Ct. at 1210, 163 L. Ed.
24 2d at 1046.

25 The Court holds that the arbitrators did not have jurisdiction to
26 determine the effectiveness of the arbitration agreement against the
FCIC. As explained above, an arbitrator's jurisdiction is premised on
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1 the agreement of two or more parties to arbitrate a dispute. Both the
2 Ninth Circuit and the FAA indicate that a court must decide whether
3 such an agreement exists in the first instance. An arbitrator does
4 not have the authority to decide this issue for him or herself. Here,
5 the arbitrators assumed jurisdiction and proceeded to arbitrate the
6 disputes without the benefit of a court decision. The arbitration
7 awards are therefore invalid and will be vacated.

8 **B. The Arbitrators Proceeded with Arbitration In Violation of**
9 **State Law**

10 The Nebraska court's Order of Liquidation expressly prohibited
11 the continuation of any arbitration proceeding that had been
12 previously brought against AGIC. Contrary to the Plaintiffs'
13 contention, this order was not preempted by federal law. As the
14 Defendant has argued, the Act and the FCIC's regulations only preempt
15 state law to the extent that it is inconsistent with federal law.
16 Here, the SRA provides for the immediate transfer of the crop
17 insurance policies to the FCIC in the event that AGIC is "unable to
18 fulfill [its] obligations" to any policyholder by reason of a
19 directive or order duly issued by . . . any court of law having
20 competent jurisdiction." The SRA thus not only contemplates that a
21 state court order might impair AGIC's ability to meet its obligations,
22 such an order is a prerequisite to the SRA's effectiveness. Given the
23 validity of the Nebraska court's order, this Court is persuaded that
24 the Plaintiffs and the arbitrators proceeded to arbitration in
25 violation of a valid court order.

26 **C. The Defendant Did Not Waive Its Objection to Arbitration**

It is well established that a party who has voluntarily

1 participated in arbitration waives any challenge he or she may have
2 had to the arbitrator's authority. See *Nagrampa v. MailCoups, Inc.*,
3 469 F.3d 1257, 1279 (9th Cir. 2006) (citing cases). However, when a
4 party "forcefully objected to arbitrability at the outset of the
5 dispute, never withdrew that objection, and did not proceed to
6 arbitration on the merits of the contract claim," waiver does not
7 occur. *Id.* at 1280.

8 The Court finds that the FCIC did not waive its challenges to the
9 arbitrators' authority. The FCIC's letters to Mr. Zeimantz and Mr.
10 Wagner clearly state that the FCIC does not recognize the AAA's
11 jurisdiction over the cases and "will not be bound by any future award
12 in this case." Brittenham Decl. Ex. 6; Brittenham Decl. Ex. 7. The
13 letters further advised the arbitrators that the FCIC would not
14 participate in arbitration. While the letters do mention the legal
15 basis for the FCIC's refusal to arbitrate, neither amounts to a
16 substantive legal argument that could be considered an appearance.
17 Each letter is less than two pages in length and neither relies upon
18 legal citations. The letters are intended to inform the arbitrators
19 of the FCIC's position and create a record of its objections. They do
20 not rise to the level of involvement that the Ninth Circuit has found
21 to constitute waiver. See *Nagrampa*, 469 F.3d at 1279 (citing cases).
22 The Court being fully advised,

23 **IT IS HEREBY ORDERED,**

24 1. The Defendant's Motion For Summary Judgment, and,
25 Alternatively to Vacate Arbitration Awards, **Ct. Rec. 43**, is **GRANTED**.

26 2. The Plaintiffs' Motion For Summary Judgment, **Ct. Rec. 13**, is
DENIED.

3. The arbitration award of October 17, 2005 in the amount of two million, nine hundred sixty-nine thousand, three hundred and forty-one dollars (\$2,969,341) that Mr. Zeimantz awarded to Carr, American Arbitration Association, 75 430 Y 00351 04 DEAR, is **VACATED**.

4. The arbitration award of September 15, 2005, in the amount of four hundred seventy-seven thousand one hundred and fourteen dollars (\$477,114) for the 2001 crop year and two million six hundred eighty thousand six hundred sixty-nine dollars (\$2,608,669) for the 2002 crop year that Mr. Wagner awarded to Mr. Olsen, American Arbitration Association, Commercial Arbitration Tribunal, 75 430 Y 00340 04 DEAR, is **VACATED**

5. The District Court Executive shall **ENTER JUDGMENT** in favor of the Defendant.

IT IS SO ORDERED. The District Court Executive is hereby directed to enter this order, furnish copies to counsel, and **CLOSE THE FILE.**

DATED this 10th day of March, 2008.

s/ Fred Van Sickle
 Fred Van Sickle
 United States District Judge