UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

RELIASTAR LIFE INSURANCE COMPANY OF NEW YORK, Petitioner, v. EMC NATIONAL LIFE COMPANY, F/k/a/ National Travelers Life Company, Respondent.	)	06 CV 10186 (LAK)

PETITIONER RLNY'S MEMORANDUM OF LAW IN RESPONSE TO EMC'S MOTION TO VACATE ARBITRATION AWARD

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I. INTRODUCTION

This matter concerns competing motions relating to an award issued in an arbitration between ReliaStar Life Insurance Company of New York ("RLNY") and EMC National Life Company, successor in interest to National Travelers Life Company ("NTL"). Finding bad faith on the part of NTL, a three person arbitration panel (the "Panel") ordered it to pay RLNY's fees and costs. RLNY seeks to confirm that award. NTL seeks to vacate the award of fees and costs, contending that the Panel did not have authority to render that portion of the award.

The arbitration clauses in the underlying agreements show that the parties clearly and unequivocally vested the Panel with authority to determine its own jurisdiction. The Panel's determination that it had jurisdiction to render an award of fees and costs was correct. It certainly had a colorable basis, which is all that is required. The Panel's finding that an award of fees and costs was warranted due to NTL's bad faith conduct is amply supported by the record. There are no grounds to vacate. Therefore, the award must be confirmed.

II. FACTS

A. Procedural History

This proceeding is the culmination of a long, unnecessary and needlessly drawn out dispute between two insurance companies: NTL and RLNY. On or about January 1, 1998, NTL and RLNY entered into two coinsurance agreements, one for in-force business and one for new business. (the "Agreements") (O'Bryan Aff., Exs. 1, 2) Under the Agreements, NTL agreed to assume 95% of the risks

under a block of individual cancer insurance policies (the "block") that RLNY sold to the public. The Agreements also called for NTL and RLNY to share responsibility for managing the block: RLNY sold the policies and administered the block; NTL adjusted and paid the claims and provided actuarial and other support for the block, including premium rate analysis and product design.[1] The Agreements provided for termination in the event of a material breach that was not timely cured. (O'Bryan Aff., Exs. 1, 2 at § 7.5)

1. NTL Seeks to Avoid the Consequences of Its Failure to Meet its Contractual Responsibilities

By mid-2002, NTL understood that the block of cancer policies would lose a very substantial amount of money due to the fact that the cancer policies provided unlimited coverage for radiotherapy and chemotherapy treatments in an environment where the cost of such treatments had been skyrocketing and the premiums originally charged had become woefully inadequate. (O'Bryan Aff., Ex. 3) Most insurers had long ago capped such benefits and applied to state regulators for rate increases. (O'Bryan Aff., Exs. 4, 5 (Hearing Tr: 1955:3-1961:8)) NTL, which had been experiencing financial difficulties on its own major medical and cancer business, (O'Bryan Aff., Exs. 6 (Hearing Tr: 565:4-25), 7 (Hearing Tr:

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[1] NTL's support was crucial to the parties' business arrangement. Indeed, RLNY sought to partner with NTL because RLNY was new to the cancer insurance business and NTL had expertise in this niche market. (O'Bryan Aff., Exs. 9 (Hearing Tr: 829:17-831:5), 10 (Hearing Tr: 1363:16-1364:1, 1365:14-1366:6)) In addition, the block's performance required careful attention because the parties could not automatically raise premium rates on the product. Instead, they had to request permission from state insurance regulators in order to do so, which at times could be a long process, and RLNY would encounter increasing difficulty if the block required a series of increases. (O'Bryan Aff., Ex. 52 (Rebuttal Expert Report, Ex. 375); Ex. 53 (Hearing Tr: 1951:3-1953:13); Ex. 54 (Hearing Tr: 1974:18-1977:23). Additionally, developing and implementing a new product could also be a time consuming process. (O'Bryan Aff., Ex. 55 (Hearing Tr: 2196:18-2199:22))

864:10-865:16)) had done neither for the block until it was too late. (*Id.*, Ex. 8 (Hearing Tr: 2056:19-2057:3))

When NTL realized the dire consequences of its inaction, it embarked upon a dishonest scheme to allow it to escape those consequences and leave RLNY saddled with the losses. On October 14, 2002, NTL sent RLNY a letter termed "Notice of Default, Notice of Right to Cure Default, and Notice of Intent to Terminate." (O'Bryan Aff., Ex. 11) In the letter, NTL claimed that RLNY had materially breached the Agreements in numerous ways, and stated that if RLNY failed to cure the alleged breaches by November 11, 2002, NTL would terminate the Agreements effective November 30, 2002. (*Id.*)

RLNY denied NTL's allegations and advised NTL that the notice of default was deficient in that it did not specify the nature of the material breaches or the actions necessary to cure them as required by the Agreements. (O'Bryan Aff., Ex. 12) RLNY nevertheless tried to address each of NTL's complaints individually and described the actions RLNY was taking in response. (*Id.*)

On November 14, 2002, NTL informed RLNY that it did not consider the breaches to be cured -- without addressing any of RLNY's cures in any way -- and stated that, in NTL's view, the Agreements would terminate on November 30, 2002. (*Id.*, Ex. 13) RLNY quickly responded that NTL's attempted termination was in bad faith and that RLNY considered the Agreements still in force. (*Id.*, Ex. 14) On January 1, 2003 NTL stopped indemnifying RLNY for losses on the block. (*Id.*, Exs. 15 (NTL Statement of Claim at 9), 16 (RLNY Counterdemand, at 8), 17

(Hearing Tr: 1430:14-31:3); 18 (Chadick Expert Report Ex. 5)) The parties thereafter tried to negotiate a terminal accounting to settle their dispute.

2. The Parties Arbitrate

On November 18, 2004, NTL advised RLNY that it did not wish to negotiate further and demanded arbitration. In its demand, NTL sought a declaration that it had no further coverage obligations to RLNY and owed RLNY no money for any past or future losses on the block. (*Id.*, Ex. 15 (NTL Statement of Claim at 10-11)) RLNY responded that the Agreements had not been legally terminated and that NTL remained on the risk for the block. (O'Bryan Aff., Ex. 16 (RLNY Counterdemand at 9-11)) RLNY alleged that NTL had caused the very losses it was seeking to avoid in the arbitration by failing to provide proper actuarial services, including premium rate analysis and product design, as called for under the Agreements. (O'Bryan Aff., Ex. 16 (RLNY Counterdemand at 9-11))

Throughout the arbitration proceedings, RLNY alleged that NTL's refusal to acknowledge and abide by its obligations under the Agreements was in bad faith, and also that NTL had initiated and was conducting the arbitration in bad faith. (O'Bryan Aff., Exs. 16 (RLNY Counterdemand at 10), 19 (RLNY Post-Hearing Brief at 30-36)) RLNY asked the Panel to award damages, including fees and costs, to compensate RLNY for the injury caused both by NTL's bad faith denial of its obligations and its bad faith arbitration tactics. (O'Bryan Aff., Ex. 16 (RLNY Counterdemand at 10))

3. The Awards

After extensive discovery over a 12-month period, a hearing took place before the Panel during the weeks of May 8 and 15, 2006, followed by post-hearing briefing. On August 4, 2006, a unanimous Panel issued an interim award in RLNY's favor that declared that the Agreements remained in force and ordered NTL to pay to RLNY $21,960,692 plus interest in payment for NTL's full 95% share of losses from January 1, 2003 through April 30, 2006. (O'Bryan Aff., Ex. 20 (August 4, 2006 Award)). The Panel also ordered NTL to abide by its reinsurance obligations from April 30, 2006 onward, in accordance with the Agreements. A majority of the Panel further ordered NTL to reimburse RLNY for its attorney and arbitrator fees and arbitration costs incurred during the arbitration, and ordered the parties to meet and confer and submit further papers to the Panel on the proper amount.

NTL paid RLNY the $21,960,692 plus interest. Thereafter, in September 2006, NTL and RLNY entered into an agreement whereby the parties agreed to terminate the Agreements and resolve all outstanding issues between the parties except for the Panel's award of RLNY's fees and costs, which NTL indicated it intended to challenge. Pursuant to this agreement, on September 25, 2006, NTL paid RLNY an additional $4,250,000. (Dennis Decl., Ex 1)

After further briefing on the fees and costs issue, on October 20, 2006 the Panel entered a final award that, *inter alia*, ordered NTL to compensate RLNY for its arbitrator and attorney fees in the amount of $3,169,496 and arbitration costs in the amount of $691,903.71, with interest to accrue on both until payment.

(O'Bryan Aff., Ex. 21 (Final Award)) The Panel expressly stated that it was awarding fees and costs because it had determined that NTL had not acted in good faith. (O'Bryan Aff., Ex. 21 (Final Award))

4. NTL Moves to Vacate

On October 20, 2006, RLNY filed a motion before this Court to confirm the final award in its entirety.[2] On November 2, 2006, NTL filed a motion to vacate solely that portion of the final award relating to fees and costs.

In its Motion and accompanying Memorandum in Support, NTL makes only one argument -- that the Panel did not have authority to award RLNY its fees and costs. NTL does not argue that the Panel's finding of bad faith by NTL is incorrect, nor does NTL take issue with the amount of the fees and costs awarded by the Panel. Consequently, these two findings by the Panel -- that NTL's conduct was in bad faith, and that the amount of fees and costs to which RLNY is entitled is $3,169,496 and $691,903.71, respectively (plus interest) -- are not before this Court. The only question that this Court must answer is whether the Panel had the authority to award fees and costs.

B. The Agreements

1. The Arbitration Clauses

Both Agreements contained the following broad arbitration clause:

> In the event of ***any disputes or differences*** arising hereafter between the parties with reference to any transaction under or ***relating in any way to this Agreement*** as to which agreement

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[2] The only money award in the final award is the award of fee and costs, which is the subject of the competing motions to confirm and vacate. The rest of the final award simply recounts NTL's prior payments pursuant to the interim award and the major terms of the September 2006 agreement between the parties, which neither NTL nor RLNY wishes to disturb.

> between the parties hereto cannot be reached, the same shall be decided by arbitration. ***The arbitrators shall decide any dispute or difference. ...***

(O'Bryan Aff., Exs. 1, 2 at § 10.1, emphasis added) The Agreements also confirm NTL's agreement that an arbitration panel has jurisdiction over ***all*** disputes between the parties: "Reinsurer [NTL] agrees to comply with all requirements necessary to give the arbitration panel jurisdiction over ***any issues*** arising out of this Agreement." (*Id.* at §10.5, emphasis added.)

The Agreements state that "the laws of the State of New York and to the extent applicable, the Federal Arbitration Act, shall govern the interpretation and application of this Agreement" and that, in rendering its decision, "[t]he arbitrators shall consider customary and standard practices in the life or health reinsurance business, as applicable to the dispute." (O'Bryan Aff., Exs. 1, 2 at §§ 10.4 and 10.2) The Agreements further set forth the usual general procedure for the payment of arbitration-related expenses in reinsurance context, stating that "[e]ach party shall bear the expense of its own arbitrator . . . and related outside attorneys' fees, and shall jointly and equally bear with the other party the expenses of the third arbitrator."[3] (*Id.* at § 10.3)

2. The Duty to Defend Clauses

As noted above, the Agreements required NTL to perform many significant functions for proper management of the block, including actuarial services,

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[3] Contrary to NTL's claim (NTL brief at 8), the Agreements do not make specific reference to the payment of "costs."

premium rate analysis, product design[4] and even claims adjustment and payment. (O'Bryan Aff., Exs. 1, 2 at §§ 5.1-5.3) Because NTL was responsible for these activities, which were crucial to the success of the block, the Agreements required NTL to defend RLNY against any actions arising out of NTL's failure to properly perform these tasks:

> Reinsurer [NTL] will provide a defense for Company [RLNY] in respect to any actions arising out of Reinsurer's performance of the administrative and claims management functions[5] described hereunder and will indemnify and hold Company harmless from legal actions against the Company in respect to the Reinsured Policies.

(*Id.* at § 5.8(a).) New York law extends a contractual duty to defend to disputes between an insurer and insured where the insurer seeks to evade coverage in bad faith. (See infra, pp. 17-20) As demonstrated below, NTL's duty to defend RLNY provides further support for the Panel's award of fees and costs. (*Id.*)

C. The Panel's Determination of NTL's Bad Faith and Consequent Award of Fees and Costs

In its Final Award, the Panel explained that it was awarding fees and costs[6] "because it views the conduct of [NTL] as lacking good faith." (O'Bryan Aff., Ex. 21 (Final Award)) In making this finding, the Panel relied on nine days of live testimony, deposition testimony, and extensive briefing by the parties. (O'Bryan

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4 Product design was addressed in the coinsurance agreement for "new business." (O'Bryan Aff., Ex. 2 at § 5.1(b))

5 The duty of the Reinsurer is defined in the Agreements to include "premium rate analysis and actuarial services." (*Id.* at § 5.1.)

6 The fees awarded by the Panel comprised the amount of attorney and arbitrator fees RLNY had incurred from the beginning of the arbitration through the interim award. The costs awarded comprised arbitration expenses incurred by RLNY for court reporters, experts, witnesses, travel, courier and photocopying services. (O'Bryan Aff., Ex. 22 (RLNY's Response to NTL's Proposal Regarding Fees and Costs) at 11-12)

Aff., Ex. 20 (August 4, 2006 Award), 21 (Final Award)) The finding of bad faith was amply supported by the record. The Panel heard the following evidence and witnessed the following conduct:

- The reason that the block had become loss-making was NTL's failure to provide proper actuarial and premium rate analysis and product design support, as required under the Agreements. (O'Bryan Aff., Ex. 23 (RLNY Post-Hearing Brief at 4-8); Ex. 24 (Cabe Chadick Expert Report Executive Summary))

- After learning of these losses, NTL tried to escape its contractual obligations by fabricating a reason to terminate the Agreements and thereby deny RLNY the coverage for which it had contracted.[7] (O'Bryan Aff., Ex. 25 (RLNY Post-Hearing Brief at 8-30))

- NTL did so because NTL was in financial difficulties and trying to merge with another insurer, and thus needed to rid itself of the loss-making block of business.[8] (O'Bryan Aff., Exs. 11, 13, 19 at 32-35)

- NTL refused to cooperate in good faith with RLNY to cure the alleged breaches, despite an explicit contractual obligation to do so. (O'Bryan Aff., Exs. 1, 2 at § 7.5; Ex. 26 (Hearing Tr. 183:19-187))

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[7] NTL failed to persuade the Panel that any of its own claimed "breaches" were material. For the sake of brevity, RLNY directs this Court's attention to RLNY's post-hearing brief, Ex. 25 at 8-30 for a full recitation of the evidence regarding NTL's claims.

[8] NTL's first proposed merger partner called off negotiations in August 2002 after learning about the losses on the block. (O'Bryan Aff., Ex. 27 (Hearing Tr: at 887:2-888:10))

- NTL never followed up on RLNY's offers to cure and even refused to share with RLNY a list of cures of the alleged breaches that NTL's own audit staff had drafted. (O'Bryan Aff., Ex. 26 (Hearing Tr: at 183:19-184:19))

- Melvin Rambo, NTL's president at the time the purported termination occurred, wrote a memo to a prospective merger partner (EMC) during the cure period, promising that he was "shutting down" the cancer block of business. (O'Bryan Aff., Ex. 28 at EMCNL-08195 – EMCNL-08196)

- At the hearing Rambo testified to a purported desire to work with RLNY in good faith to cure the alleged breaches and thus not terminate the Agreements. Yet he could not explain his statements during the cure period about his intent to shut down the block. (*Id.*, Ex. 29 (Hearing Tr: 899:9-11))

- NTL refused to cooperate on a cure for the alleged breaches because it decided that the risk of staying on the loss-making block was greater than the risk of terminating the Agreements. (As one senior executive at NTL testified, "What's the risk to NTL. Which risk is greater; taking the risk to maintain the agreement and, perhaps, really lose our shirts, or terminate the agreement?") (O'Bryan Aff., Ex. 30, Pearl Dep. Tr. at 157:20-24.)

- NTL continued to pursue claims at the hearing that its own witnesses admitted were frivolous.[9] (*See, e.g.*, Ex. 25 at 18-19)

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[9] During the course of discovery, certain of NTL's claimed "material breaches" were proved to involve very small dollar amounts (particularly in comparison to the size of the block as a whole). Such claims were properly dealt with under the "errors and omissions clause" in the Agreements, and RLNY agreed to reimburse NTL for the amounts. (O'Bryan Aff., Ex. 25, pp. 18-19 and Ex. 1 and 2, § 3.3) NTL nonetheless insisted on introducing testimony at

- NTL asked the Panel to award it premium it purportedly had lost on the cancer policies due to RLNY mistakes, (O'Bryan Aff., Ex. 35 (NTL Opening Brief at 53)) only to have the person who performed the damages calculations admit on the witness stand that his calculations were wrong and that NTL, even under its own theory of recovery, was not entitled to the damages it was seeking. (O'Bryan Aff., Ex. 36 (Hearing Tr: 451:8-478:15))

- Key NTL witnesses, including its former president and its actuary for the block, changed their testimony multiple times. (O'Bryan Aff., Ex 37 (Hearing Tr: 808:10-813:5), Ex. 38 (Hearing Tr: 870:8-871:14), Ex. 25 at 23, n.33; Ex. 39 (Hearing Tr: 955:17-957:10), Ex. 40 (Hearing Tr: 900:23-902:20), Ex. 41 (938:18-939:5); Ex. 23 (RLNY Post-Hearing Brief at 5, n.7); Ex. 42 (Johnson Dep. Tr. at 75:19-76:6, 78:1-79:16); Ex. 43 (Johnson Dep. Tr. at 114:16-115:17); Ex. 44 (Johnson Dep. Tr. at 341:22-344:4); Ex. 45 (Johnson Dep. Tr. at 370:24-371:13); Ex. 46 (Hearing Tr: 508:7-11); Ex. 47 (Hearing Tr: 605:14-606:7).

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the arbitration hearing regarding a claim that RLNY improperly waived a 90 day waiting period, for which NTL was entitled to $200 (*Id.*, Ex. 31 (Hearing Tr: 345:25-347:9)), and a claim regarding waived premium for an account, for which NTL was entitled to $702.35 (O'Bryan Aff., Ex. 32 (Hearing Tr. 218:12-22)). NTL also introduced evidence regarding a claim that RLNY "improperly" waived a 30-day waiting period, even though NTL's marketing director had agreed to doing so for certain types of business. (O'Bryan Aff., Ex. 33 (Hearing Tr: 928:2-932:20)) When confronted, even NTL's witness had to agree that this claim was not a material breach. (O'Bryan Aff. Ex. 33 (Hearing Tr: 932:16-20)). Were those frivolous claims not enough, NTL introduced evidence regarding errors that had occurred *after* NTL had sent its notice of termination as evidence of purported "material breaches." (O'Bryan Aff. Ex. 34 (Hearing Tr: 336-338)) NTL's own witness admitted that those claims were not bases upon which NTL purported to terminate the Agreements. (O'Bryan Aff. Ex. 34 (Hearing Tr: 336-338))

- NTL improperly destroyed relevant documents and e-mails after the arbitration commenced and, in fact, never instructed its employees to maintain relevant documents despite a clear legal obligation to do so. (O'Bryan Aff., Ex 48 (Rambo Dep. Tr. at 425:1-11); Ex. 49 (Hearing Tr: 834:25-835:6); Ex. 50 (Hanson Dep. Tr. at 379:13-19); Ex. 51 (Unkrich Dep. Tr. at 240:3-5))

In short, the evidence demonstrated that NTL caused the losses on the block, sought to terminate the Agreements on pretext, and refused to cooperate on a cure for the alleged "material" breaches, all in an attempt to rid itself of the loss making block and secure a merger. It then made frivolous and patently false claims in the arbitration that caused unnecessary delay and needless increase in the costs of an arbitration that never should have been brought in the first place. After reviewing this evidence, the Panel quite properly concluded that NTL had acted in bad faith, and awarded RLNY the expenses it had incurred in connection with NTL's bad faith actions.

III. ARGUMENT

A. The Courts Must Review the Arbitration Panel's Actions under a Highly Deferential Standard of Review

The scope of review on motions to vacate under the FAA is extremely narrow. Absent a showing of fraud on the part of the arbitrators, "courts must grant an arbitration panel's decision great deference." *Wallace v. Scotti*, 378 F.3d 182, 189 (2d Cir. 2004). Any "barely colorable" basis in the record is enough to confirm an award. *Banco de Seguros v. Mutual Marine Office*, 344 F.3d 255, 260 (2d Cir. 2003). A reviewing district court will not reweigh the evidence, as errors in law or

fact do not merit vacation of an award. *Major League Baseball Players Assoc. v. Garvey*, 532 U.S. 504, 509, 121 S. Ct. 1724, 1728 (2001) (quoting *United Paperworkers v. Misco, Inc.*, 484 U.S. 29 (1987) ("[T]he arbitrators 'improvident, even silly, fact finding' does not provide a basis for a reviewing court to refuse to enforce the award."); *Wallace*, 378 F.3d at 190 ("A federal court cannot vacate an arbitral award merely because it is convinced that the arbitration panel made the wrong call on the law."). This great judicial deference applies to arbitration panels' interpretations of contracts. *Misco*, 484 U.S. at 38.

Where the parties have agreed to submit the question of arbitrability itself to arbitration, "the court's standard for reviewing the arbitrator's decision about *that* matter should not differ from the standard courts apply when they review any other matter that parties have agreed to arbitrate. That is to say, the court should give considerable leeway to the arbitrator, setting aside his or her decision only in certain narrow circumstances." *First Options of Chicago v. Kaplan*, 514 U.S. 938, 942, 943, 115 S. Ct. 1920, 1923 (1995) (internal citations omitted, emphasis in original).

B. The Panel Clearly and Unmistakably Had Authority to Decide Whether to Award Fees and Costs

Under New York contract law, broad arbitration provisions that submit "any issues arising out of an agreement" to arbitration indicate that the parties intended all questions of arbitrability be submitted to the arbitrator. *Painewebber v. Bybyk*, 81 F.3d 1193 (2d Cir. 1996). In *Bybyk*, Painewebber moved to stay permanently an arbitration initiated by customers on the grounds that the relief sought in the arbitration (which included a request for attorney fees) was not allowed by the

governing customer agreement and thus the arbitrator had no jurisdiction to hear the claims. The customer agreement contained the following all encompassing provision: "Any and all controversies . . . concerning any account, transaction, dispute or the construction, performance, or breach of this or any other agreement . . . shall be determined by arbitration . . . ." The Court ruled that this broad language "clearly and unmistakably" indicated that the parties intended for the arbitrator to entertain all issues arising out of the agreement, including his authority to award the relief requested. *Id.* at 1199. *See also Surgutneftegaz v. Harvard*, 167 Fed Appx 266, 2006 U.S. App. LEXIS 3846 at *3 (2d Cir. 2006) (holding that broad terms in an arbitration clause stating that "any controversy, claim or cause of action . . . arising out of or relating to [the agreement] . . . shall be finally settled by arbitration . . . ." "plainly evince[s] an intent to have the question of arbitrability decided by an arbitrator").

These same broad arbitration terms are present here. The Agreements direct that "***any*** disputes or differences . . . ***relating in any way*** to this Agreement . . . shall be decided by arbitration. Three arbitrators shall decide any dispute or difference." (O'Bryan Aff., Exs. 1, 2 at § 10.1 (emphases added)) This clause clearly and unmistakably granted the Panel authority to decide issues of arbitrability, as it closely tracks the arbitration clause in *Bybek*. In addition, the Agreements contain further language that makes the grant of jurisdiction to the arbitrators even more clear. In § 10.5 NTL expressly agrees "to comply with all requirements necessary to give the arbitration panel jurisdiction over ***any issues*** arising out of this Agreement." (O'Bryan Aff., Exs. 1, 2 at §10.5 (emphasis added))

The parties' use of "any" in both arbitration clauses without a qualifier as to jurisdiction is clear and unmistakable evidence that the parties intended the Panel to have authority to rule on ***all*** issues related to the Agreements, including arbitrability of ***any*** issue and including whether it was appropriate for the Panel to award fees and costs.

Section 10.3 of the Agreements, which states that each side shall bear its own fees, is not to the contrary. This clause merely sets forth the usual practice in reinsurance arbitrations that generally each party pays its own arbitration expenses and shares umpire expenses, consistent with the American Rule. *See, e.g.*, Eugene Wollan, *Handbook of Reinsurance Law*, Aspen Publishers, 2003 Supplement at § 8.05 ("Most clauses stipulate that each party will be responsible for the fee of its own arbitrator and half of the umpire's charges . . . . The panel has the authority, in keeping with its very wide discretion, to award costs, interest, and even (although it is rarely done) counsel fees."). The Agreements further mandate that "the arbitrators consider customary and standard practices in the life and health reinsurance business, as applicable to the dispute." (*Id.*, Exs. 1, 2 at § 10.2) Under reinsurance custom and practice, clauses such as § 10.3 do not divest an arbitration panel of jurisdiction to award fees.[10] Moreover, notwithstanding NTL's false claims to the contrary, the Agreements contains absolutely no bar to the awarding of costs as arbitration "costs" are nowhere mentioned. As a general matter, tribunals are free to award costs to the winning party even in the absence

[10] Section 10.3 serves an important purpose: Arbitrators need not be and often are not attorneys, and thus may not be familiar with the American Rule on fees and costs. Section 10.3 apprises the arbitrators of the rule. It does not preclude them from applying any exceptions to that rule should they determine that circumstances so warrant.

of bad faith. *See, e.g.*, 28 U.S.C. § 1920 (Taxation of Costs). The Panel correctly did so here.

Section 10.3 is not, as NTL contends, a mandate that the Panel under no circumstances may consider awarding fees to a party in appropriate circumstances. It would have been easy for the parties to modify the arbitration clause to read: "The arbitrators shall decide any dispute or difference *but may not award attorneys fees and costs*." The fact that NTL and RLNY did not do so indicates that § 10.3 simply directs the parties to follow the American Rule. It makes no restriction on the Panel's ability to enforce exceptions to that Rule.

Although NTL claims that the language of § 10.3 constitutes a bar to the award of fees and costs, any dispute over the interpretation of that section clearly, unequivocally and unmistakably was within the province of the Panel to decide. Their decision is entitled to very substantial deference from this Court, and can only be overturned if there is "no colorable basis" to support it. As demonstrated below, there is ample basis in the record to support the Panel's decision to award both fees and costs.

C. The Panel's Finding that a Fee Award is Merited Should not be Disturbed

In order to overturn the Panel's findings on the merits, NTL must prove that there is no colorable basis in the record to support the findings, which it cannot do. As noted above, NTL falsely alleged "material breaches" against RLNY and refused to work with RLNY to cure the alleged breaches in an attempt to evade its contractual obligations and secure a merger. It then brought and maintained arbitration claims that it knew were frivolous and needlessly prolonged an

arbitration that it should not have brought in the first place. Such conduct constitutes more than a colorable basis to support the Panel's finding of bad faith.

1. The Panel Properly Awarded RLNY Its Fees and Costs Because NTL Denied RLNY Coverage in Bad Faith

In its attempt to set aside the fees and costs award against it, NTL contends that the Panel misapplied New York law on bad faith denial of coverage. As demonstrated above, "[a] federal court cannot vacate an arbitral award merely because it is convinced that the arbitration panel made the wrong call on the law." *Wallace*, 378 F.3d at 190. That said, the Panel was well within its rights to determine that New York law allowed it to award fees and costs based on NTL's bad faith denial of its obligations under the Agreements.

Under New York law, where an insurer initiates litigation with its insured in a bad faith attempt to evade its coverage obligations, and the insurer owes the insured a contractual duty to defend third party actions, a court may award the insured the fees it incurred defending itself and establishing coverage. *Mighty Midgets v. Centennial Ins. Co.*, 47 N.Y.2d 12, 21 (1979), 389 N.E.2d 1080, 1085 (N.Y.). Here, it is undisputed that (1) NTL initiated the arbitration to avoid its coverage obligations under the Agreements; and (2) one of the principal issues in the arbitration was NTL's performance of its actuarial services and premium rate analysis.[11] (O'Bryan Aff., Ex. 16 at 9-11; Ex. 24) It is also undisputed that NTL owed RLNY a contractual duty to defend actions relating to NTL's actuarial

[11] The fact that the arbitration involved other matters in addition to NTL's failure to perform its actuarial and premium rate duties does not affect NTL's duty to defend. Under New York law, if ***any*** claims in an action are subject to a duty to defend, then the duty to defend extends to the entire action. *Massena v. Healthcare Underwriters Mut. Ins.*, 98 N.Y.2d 435, 443-44 (2002), 779 N.E.2d 167, 170 (N.Y.).

services and premium rate analysis.[12] Finally, the Panel found that NTL's denial of coverage was in bad faith. The elements of the *Mighty Midgets* exception were satisfied, and RLNY was entitled to a fees award. In any event, as demonstrated above, the Panel's finding that the elements were satisfied was certainly supported by colorable evidence, and thus should be upheld.

It likewise was reasonable for the Panel to reject NTL's argument that *Mighty Midgets* does not apply. Although NTL's argues that, unlike in *Mighty Midgets*, it owed RLNY no contractual duty to defend (NTL brief at 10), NTL is wrong. As noted above, § 5.8 of the Agreements imposes a duty on NTL to defend RLNY for actions arising out of NTL's performance of its actuarial responsibilities, which were at issue in the arbitration.

NTL's reliance on dicta in an unreported case, *Folksamerica v. Republic Insur. Co.*, 2004 WL 2423539 (S.D.N.Y. 2004), to claim that the *Mighty Midgets* rule should not apply in the reinsurance context is equally misplaced. *Folksamerica* held that the *Mighty Midgets* exception did not apply because the reinsurance agreements at issue did not contain a duty to defend. *Id.* at *4. Furthermore, as demonstrated above, the Agreements were no ordinary reinsurance contracts, but rather imposed substantial duties on NTL for

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[12] The fact that the duty to defend may have been directed at third party actions against the insured is not relevant. New York law extends the duty to defend to instances where the insurer forces the insured to defend itself in a denial of coverage action brought by the insurer in bad faith. *U.S. Underwriters Ins. Co. v. City Club Hotel*, 3 N.Y.3d 592, 597 (2004), 822 N.E.2d 777 (N.Y. 2004) ("An insurer's duty to defend an insured extends to the defense of any action arising out of the occurrence, including a defense against an insurer's declaratory judgment action.")

management of the underlying business, including a duty to defend. Thus, it was reasonable for the Panel to conclude that *Folksamerica* is not relevant here.[13]

Regardless whether this Court agrees with the Panel's application of the *Mighty Midgets* doctrine, it may not overturn the Panel's interpretation of New York law even if the court believes that interpretation was incorrect. *Wallace*, 378 F.3d at 190. There was a colorable basis to support the Panel's application of the *Mighty Midgets* exception to the American Rule in this case. The Panel's award thus may not be disturbed.

2. NTL Arbitrated in Bad Faith

NTL's bad faith conduct in relation to the arbitration provides an alternative basis for the Panel's award of fees and costs. Under the FAA, the Panel had inherent authority to award fees and costs as a sanction against a party for arbitrating in bad faith. *Chambers v. Nasco*, 501 U.S. 32, 45-46, 111 S. Ct. 2123, 2133 (1991) ("[A] court may assess attorney's fees when a party has 'acted in bad faith, vexatiously, wantonly, or for oppressive reasons.'"); *Todd Shipyards v. Cunard Lines*, 943 F.2d 1056, 1063 (9th Cir. 1992) (applying New York law and the FAA) ("In light of the broad power of arbitrators to fashion appropriate remedies and the accepted 'bad faith conduct' exception to the American Rule, we hold that it was within the power of the arbitration panel in this case to award attorneys' fees."); *Marshall & Co. v. Duke*, 114 F.3d 188, 190 (11th Cir. 1997) ("A]rbitrators have the power to award attorney's fees pursuant to the 'bad faith' exception to the

[13] NTL's reliance on *Employers Mutual Cas. v. Key Pharmaceuticals*, 871 F. Supp. 657, 674 (S.D.N.Y. 1994) is similarly misplaced. In that case, the court found the *Mighty Midgets* exception inapplicable because the underlying insurance agreement did not contain a duty to defend. As noted previously, the Agreements here do contain such a duty.

American Rule that each party bears its own attorney's fees."). In light of NTL's bad faith arbitration tactics summarized above, the Panel certainly had more than a colorable basis for sanctioning NTL with an award of fees and costs to RLNY. Therefore, the Panel's award must stand as rendered.[14]

D. Even if the Court Reviews the Panel's Jurisdiction to Award Fees and Costs *De Novo,* It Should Find Jurisdiction and Thus Confirm the Award

Even if this Court were to review the arbitrability of fees and costs *de novo*, it should find that the Panel had jurisdiction to make the fees and costs award, and therefore uphold the award.[15] Under the FAA, where an agreement contains an arbitration clause, there is a presumption that all issues arising out of the agreement are arbitrable. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 626, 105 S. Ct. 3346, 3353 (1985) (quoting *Moses H. Cone Memorial Hosp. v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983)) ("[Q]uestions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration. . . . The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract

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[14] NTL argued to the Panel but not to this Court that New York law prohibited the award of fees where the underlying agreement contains a provision stating that each side should bear its own fees, citing *CBA Industries v. Circulation Management*, 578 N.Y.S.2d 234, 245 (2d Dept. 1992). As NTL apparently now recognizes, *CBA Industries* is inapplicable to the present dispute because there the state court applied New York procedure (the New York Arbitration Act). Here, the FAA governs pursuant to the express terms of the Agreements and NTL's submission to this Court (O'Bryan Aff., Exs. 1, 2 § 10.4; NTL brief at 8).

[15] Even if this Court reviews the arbitrability issue *de novo*, it must still afford the Panel's other legal and factual findings -- that NTL acted in bad faith and that, under the American Rule, this bad faith merited an award of fees and costs -- great deference. *AT&T Tech. v. Communications Workers of America*, 475 U.S. 643, 649-50, 106 S. Ct. 1415, 1419 (1986).

language itself or an allegation of waiver, delay, or a like defense to arbitrability."). As noted above, the Agreements state that any issues arising out of the Agreements "shall be decided by arbitration." Clearly, both a party's request for damages as a result of a counter-party's bad faith conduct under the Agreements and the interpretation of contract language like § 10.3 are issues related to the Agreements. The explicit language of the Agreements coupled with the federal policy construing arbitration clauses broadly gave the Panel jurisdiction to award fees and costs.

Furthermore, as noted above, the parties' selection of New York substantive law and federal procedural law gave the Panel two legal bases to award fees and costs: bad faith denial of coverage (*Mighty Midgets*, 389 N.E.2d at 1085) and bad faith arbitration tactics (*Todd Shipyards*, 943 F.2d at 1063). Therefore, a colorable basis exists to support the Panel's award.

Although § 10.3 is not phrased in proscriptive terms, NTL nonetheless argues that it removes the power of arbitrators to award fees -- no matter what the circumstances. If NTL's interpretation of this language were correct, either party would have a free rein to misbehave without any ability of the Panel to provide a remedy for the bad faith conduct. This cannot be the intent of § 10.3. Such a rule would encourage parties with a losing case to flout their ethical obligations with impunity and conduct an arbitration in bad faith, *e.g.*, by destroying damaging documents and prolonging proceedings with frivolous arguments and delay tactics. Just as a federal judge would never construe a contract to strip the court of its inherent equitable and Rule 11 power to control his or her forum by disciplining

misbehaving parties, this Court should not construe § 10.3 to strip the Panel of the power to manage matters before it.

Reading § 10.3 together with New York insurance law and the FAA, it is clear that the American Rule on fees applies to the arbitration, including the well-settled exceptions that allow for fee awards in cases of bad faith denial of coverage and bad faith litigation tactics. Therefore, under either the deferential or *de novo* standards of review, the Panel's finding that it had jurisdiction to award fees and costs should not be disturbed.

IV. CONCLUSION

The parties agreed to submit ***all*** issues relating to the Agreements to arbitration, including the interpretation of § 10.3 and the question of whether to award fees and costs. Thus, the Panel's construction of the Agreements and decision that it had jurisdiction to award fees and costs is entitled to substantial deference. The Panel's finding that NTL acted in bad faith meriting an award of fees and costs – whether under the bad faith denial of coverage doctrine, the Panel's inherent equitable power to control its proceedings, or both – was amply supported by colorable evidence in the record and should be upheld. As there are no grounds to vacate any portion of the Final Award, that Award should be confirmed pursuant to 9 U.S.C. § 9.

Respectfully submitted,

ReliaStar Life Insurance Company
of New York

One of its attorneys