

Spring 1992

Corcoran v. Ardra: The Impact of Insolvency on International Reinsurance Arbitration, 25 J. Marshall L. Rev. 527 (1992)

John S. Diaconis

Follow this and additional works at: <https://repository.law.uic.edu/lawreview>



Part of the [Bankruptcy Law Commons](#), [Dispute Resolution and Arbitration Commons](#), [International Law Commons](#), and the [International Trade Law Commons](#)

Recommended Citation

John S. Diaconis, Corcoran v. Ardra: The Impact of Insolvency on International Reinsurance Arbitration, 25 J. Marshall L. Rev. 527 (1992)

<https://repository.law.uic.edu/lawreview/vol25/iss3/3>

This Article is brought to you for free and open access by UIC Law Open Access Repository. It has been accepted for inclusion in UIC Law Review by an authorized administrator of UIC Law Open Access Repository. For more information, please contact repository@jmls.edu.

CORCORAN v. ARDRA:* THE IMPACT OF INSOLVENCY ON INTERNATIONAL REINSURANCE ARBITRATION

JOHN S. DIACONIS**

The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards¹ (the "Convention") facilitates the enforcement and recognition of international arbitration agreements and awards.² Congress has implemented the Convention in the United States through legislation³ which requires parties to abide by their agreements to arbitrate. Recognizing the importance of utilizing arbitral agreements in the international context, the courts have enforced the legislation.⁴

The business of insurance⁵ and reinsurance⁶ is international.

* *Corcoran v. Ardra Ins. Co.*, 567 N.E.2d 969 (N.Y. 1990), *cert. denied*, 111 S. Ct. 2260 (1991).

** Member, N.Y. Bar. Mr. Diaconis is a partner in the New York law firm of Wilson, Elser, Moskowitz, Edelman & Dicker. He was counsel for the majority of the reinsurers in *Corcoran v. AIG Multi-Line Syndicate, Inc.*, 539 N.Y.S.2d 630 (N.Y. App. Div. 1989). The views expressed in this article represent those of the author and should not be attributed to his firm or any of its clients.

1. Convention on the Recognition and Enforcement of Foreign Arbitral Awards (opened for signature June 10, 1958, 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 3) (1958) (effective December 29, 1970).

2. Generally speaking, there are three bodies of statutory law applicable to arbitration in the United States. In addition to the Convention, the United States Arbitration Act ("USAA") and the various state laws are applicable to an arbitration. Chapter 2 of the USAA, which contains the enabling legislation in the United States for implementation of the Convention, governs international arbitration. Chapter 1 of the USAA would also apply to an international arbitration to the extent that it does not conflict with the Convention as implemented by Chapter 2. State arbitration laws also apply to international arbitration to the extent that they do not conflict with Chapters 1 and 2, respectively. See John S. Diaconis, *International Arbitration: Subpoena Powers of Arbitrators in New York*, 200 N.Y.L.J. No. 68, Oct. 6, 1988, at 5.

3. 9 U.S.C. §§ 201-208 (1988).

4. *Scherk v. Alberto Culver Co.*, 417 U.S. 506, 510 (1974); *Cooper v. Ateliers De La Motobecane*, 442 N.E.2d 1239 (N.Y. 1982).

5. Insurance is defined as a contract where one party undertakes for consideration to compensate another for a loss to a specific matter caused by specific perils. BLACK'S LAW DICTIONARY 721 (5th ed. 1979).

6. Reinsurance is a transaction whereby a reinsurer, for consideration, agrees to indemnify a reinsured for all or part of a loss which the reinsured may sustain under a policy or policies of insurance which have been issued by the reinsured to an original insured. R.L. CARTER, REINSURANCE 7 (1979); see also, *People ex. rel. Continental Ins. Co. v. Miller*, 70 N.E. 10, 12 (N.Y. 1904) (reinsurance is a "contract by which one insurer insures the risks of another"); KLAUS GERATHEWOHL, REINSURANCE-PRINCIPLES AND PRACTICE, Ch. 24 (1980); HENRY

The activities of insurance and reinsurance corporations often take place in different countries.⁷ American insurance companies often insure risks abroad,⁸ and foreign insurance and reinsurance companies cover risks located in the United States.⁹

The preferred method of dispute resolution in the international reinsurance community is arbitration; it is considered quicker, less costly, and more flexible than litigation.¹⁰ The insurer or reinsurer doing business on an international basis, like other international merchants, prefers arbitration to litigation in local state courts

T. KRAMER, THE NATURE OF REINSURANCE IN REINSURANCE 4 (Robert W. Strain ed., 1980) (hereinafter KRAMER) (reinsurance is "an insurance contract"); N. David Thompson, *Critical Issues of the Eighties: How Trends In Reinsurance Will Affect Legal, Legislative, and Regulatory Actions*, 16 FORUM 1038, 1039 (1981); KRAMER, SUGGESTED REINSURANCE GLOSSARY 661-62 (1987). There are two kinds of reinsurance. One is facultative, and the other is a treaty. Facultative reinsurance involves the reinsurance of all or part of a policy of insurance written by the reinsured. Treaty reinsurance involves the reinsurance of a particular class or classes of business written by the reinsured. *Calvert Fire Ins. Co. v. Uniguard Mut. Ins. Co.*, 526 F. Supp. 623, 626 n.5 (Neb. 1980). The basic purpose of reinsurance is to spread risk of loss and increase the capacity of insurance companies to underwrite or accept new risks. Retrocessional coverage denominates the coverage provided to a reinsurer by another reinsurance company thereby further spreading risk of loss.

7. The United States insurance and reinsurance industries rely heavily on foreign reinsurance to spread risk of loss. The reinsurance industry in the United States is dependant on foreign reinsurance in general, and the London market in particular, for volume and the underwriting of difficult classes of business. In fact, foreign reinsurers underwrite between 25% to 30% of reinsurance in the United States. Carolyn Aldred, *U.S. Leans on Europe, Reinsurer Says*, BUS. REINS., May 8, 1988, at 14; Marian Freedman, *Reinsurers and Insurers are Two Peas From Different Pods*, BEST'S INS. MGMT. REP.: PROP./CAS. INS. ED., Apr. 1988, at 116.

8. See *Belco Petroleum Corp. v. AIG Oil Rig., Inc.*, 565 N.Y.S.2d 776, 781 (N.Y. App. Div. 1991) (involving insurance of oil and gas operations in Peru).

9. See *American Marine Ins. Group v. Price Forbes Ltd.*, 560 N.Y.S.2d 638, 639 (N.Y. App. Div. 1990) (reinsurance of New York based insurer by Bermuda based company and retrocessional coverage afforded by Lloyd's and British companies).

10. One commentator has said that "reinsurance participants 'abhor' litigation of their disputes and prefer arbitration not only for traditional reasons (cost, expediency, confidentiality, etc.), but also because of their fear of 'bad law.'" John M. Sheffey, *Reinsurance Intermediaries: Their Relationship to Reinsured and Reinsurer*, 16 FORUM 922 (1981). Significantly, a number of recent conflicting decisions have caused additional concern in the industry due to a perceived uncertainty involved in litigation. *Compare Travelers Ins. Co. v. Buffalo Reins. Co.*, 735 F. Supp. 492, 498 (S.D.N.Y.) (reinsurer need not show prejudice to prevail on late notice defense), *vacated in part*, 739 F. Supp. 209 (S.D.N.Y. 1990) (question of late notice depends on industry custom and practice) *with Uniguard v. North River Ins. Co.*, 766 F. Supp. 566 (S.D.N.Y. 1990) (question of late notice depends on industry custom and practice), (reinsurer must show prejudice to prevail on late notice defense) *question certified*, 949 F.2d 630 (2d Cir. 1991) and *Christiana Gen. Ins. Co. of N.Y. v. Great Am. Ins. Co.*, 745 F. Supp. 150, 159 (S.D.N.Y. 1990), *appeal docketed*, No. 91-7912 (2d Cir. Sept. 23, 1991).

which are perceived to be less hospitable to foreign entities.¹¹ There has been a dramatic increase in the number of reinsurance disputes, and consequently, there has been a significant increase in international reinsurance arbitrations.

The McCarran-Ferguson Act¹² gives the states broad power to regulate the business of insurance.¹³ In discharging these powers, the states have promulgated extensive legislation to deal with the

11. See Steven C. Nelson, *Alternatives to Litigation of International Disputes*, 23 INT'L LAW. 187 (1989). However, it should be noted that the insurance industry has also recently expressed frustration that arbitration has become expensive and complex with the result of becoming increasingly similar to litigation. Roger Scotton, *Hostility is Increasing in Reinsurance Disputes*, BUS. INS., (Nov. 20, 1989) at 85-86. In fact, a federal jurist in New York expressed displeasure at arbitration in 1983:

Once hailed as boon to the commercial world, the experience of this Court in recent years raised serious questions whether the high hopes of prompt disposition by the arbitral process have been realized. Arbitration is not a one-way street. It has its drawbacks as well as advantages. In calendar calls in recent years, attorneys seek extensive adjournments of pending cases solely based upon unexplained delays before arbitrators or failure to appoint arbitrators.

Bell Canada v. ITT Telecomm. Corp., 563 F. Supp. 636, 641-42 (S.D.N.Y. 1983).

12. 15 U.S.C. §§ 1011-1015 (1988). The McCarran-Ferguson Act embodies a clear congressional mandate "that regulation of the insurance industry be left to the several states." *Levy v. Lewis*, 635 F.2d 960, 963 (2d Cir. 1980). The Act provides that the states shall regulate and tax the business of insurance. 15 U.S.C. § 1011 (1988). Under the Act, no Act of Congress shall be construed to interfere with state regulation unless the intent to preempt is express. *Id.* The McCarran Act was enacted nine months after the Supreme Court's decision in *United States v. South-E. Underwriters Assoc.*, 322 U.S. 533 (1944). In that case, the Court reversed the prior rule enunciated in *Paul v. Virginia*, 75 U.S. (8 Wall.) 168, 183 (1868), that the business of insurance was not interstate commerce under the Commerce Clause. In *South-Eastern Underwriters*, the Court held that the business of insurance constituted interstate commerce, thereby reversing the lower court's dismissal of an indictment for rate fixing under the Sherman Act on the ground that the business of insurance was not interstate commerce and thus not within Congress' power to regulate. *Id.*

In response to concerns raised by insurers, legislatures and commissioners, Congress enacted the McCarran-Ferguson Act in 1915. The House Report states that it was "not the intention of Congress . . . to clothe the states with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to . . . *South-E. Underwriters* . . ." H.R. REP. NO. 193, 64th Cong., 1st Sess., reprinted in, 1945 U.S.C.C.A.N. 670, 671. Congress intended to regulate "insurance by the States, subject always to the limitation Act laid out in controlling decisions of the Supreme Court." *Id.*

13. Specifically, the McCarran Act as codified provides: "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purposes of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance. . . ." 15 U.S.C. § 1012(b) (1988).

The first part of § 1012(b) provides that federal legislation does not preempt state insurance law unless the intention to do so is indicated by specific inference. *Id.* The second part of the statute provides that federal anti-trust legislation is applicable to insurance to the extent that state law does not regulate the business. *Id.* This provision limits the powers given to the state under the first part of the statute. Section 1012(b) of the Act provides a hiatus until June 30, 1948 so as to allow states the opportunity to enact legislation as permitted by

business of insurance in general and the insolvency of insurance and reinsurance corporations in particular.¹⁴ The insolvency legislation promulgated by the states furnishes a comprehensive method for winding up an insolvent company's affairs.¹⁵ It often vests exclusive jurisdiction over liquidations in a state court proceeding.¹⁶ In these proceedings state insurance commissioners, often referred to as "liquidators," proceed on behalf of the insolvent insurance or reinsurance corporation to marshal assets and settle claims against the estate for the benefit of policyholders, stockholders and creditors.¹⁷

the laws exemption. *Id.* State laws were thus promulgated to regulate various aspects of the business.

Section 1013(a) of the Act provides a hiatus until June 30, 1948 before the Sherman, Clayton, Federal Trade Commission or Robinson-Patman Act will apply to the business of insurance. 15 U.S.C. § 1013(a) (1988).

Section 1013(a) provides that the McCarran Act shall not be deemed to render the Sherman Act inapplicable to an "agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation." *Id.* In *Barry v. Saint Paul Fire & Marine Ins. Co.*, 438 U.S. 531 (1978), the Supreme Court broadened the scope of the term boycott.

Section 1014 provides that the National Labor Relations Fair Labor Standards Act and the Merchant Marine Act are applicable to the insurance business. 15 U.S.C. § 1014 (1988). Section 1014 provides that Alaska, Hawaii, Puerto Rico, Guam and the District of Columbia are in the definition of "state." 15 U.S.C. § 1015 (1988).

14. See generally 19 J. APPLEMAN, *INSURANCE LAW AND PRACTICE* §§ 10621-10720 (1982); David J. Howard, *Uncle Sam Versus The Insurance Commissioners: A Multi Level Approach To Defining The "Business of Insurance" Under The McCarran-Ferguson Act*, 25 WILLAMETTE L. REV. 1 (1989); Regulation of Reinsurance, Past, Present and Future - The Politics of Insolvency, 11 INS. LITIG. RPT. 222 (1989). T. Darrington Semple Jr. & Robert M. Hall, *The Reinsurer's Liability In the Event Of The Insolvency Of A Ceding Property And Casualty Insurer*, 21 TORT & INS. L. J. 407 (1986).

15. See, e.g., KY. REV. STAT. ANN. §§ 304.33-440.45 (Baldwin 1978); N.Y. INS. LAW §§ 7401-7409 (McKinney 1992).

16. HOWARD, *supra* note 14, at 13. For example Article 74 of the New York Insurance Law empowers the liquidator "subject to the direction of the [New York Supreme Court] to undertake to liquidate the insolvent company." N.Y. INS. LAW. § 7409(c) (McKinney 1992). The provisions of Article 74 are considered to be "exclusive in their operation and furnish a complete procedure for the protection of the rights of all parties interested." *Knickerbocker Agency, Inc. v. Holz*, 149 N.E.2d 885, 889 (N.Y. 1958).

17. In the landmark reinsurance case of *Fidelity & Deposit Co. of Md. v. Pink*, 302 U.S. 224 (1937), the Supreme Court held that a reinsurer could avoid liability to the liquidator of an insolvent reinsured for reimbursement of a claim on the ground that the liquidator had made no actual payment of the loss to the original insured and thus no loss had occurred under the reinsurance agreement. Typically, in the liquidation situation, losses are rarely, if ever, paid in full while the liquidator nevertheless endeavors to collect funds from all available debtors of the estate.

Thus, in response to *Pink*, state legislatures enacted laws which prevented insurance companies from obtaining a credit on their financial statements for reinsurance unless such reinsurance was payable to the liquidator notwithstanding an insolvency. N.Y. INS. LAW § 1308 (McKinney 1992). These statutes required, in essence, the inclusion of the so-called standard "insolvency clause" in reinsurance contracts. The insolvency clause provides that the reinsured

Insurance and reinsurance corporation insolvencies have increased in the past ten years.¹⁸ In 1980, there were only four property and casualty insurer insolvencies, and five life and health insolvencies.¹⁹ In 1989, there were 23 property and casualty insurer insolvencies, and 43 life and health insurer insolvencies.²⁰

The increase in arbitration, coupled with the recent increase in the number of insolvencies, has resulted in a conflict between the reinsurers' right or desire to arbitrate and a state liquidator's right to resolve an insurance company's insolvency in state court. More specifically, if a reinsurer has a dispute with an insolvent insurance or reinsurance company,²¹ it may be precluded from arbitration by virtue of state liquidation laws.

This dilution of the right to arbitrate is a matter of some importance to the industry, in view of the historical desire to avoid formal, judicial dispute resolution. It also presents an interesting question as to application of the Convention to an insurance insolvency situation. In *Corcoran v. Ardra Ins. Co.*,²² the New York Court of Appeals held that a dispute between a liquidator and a foreign reinsurance corporation was within an exception to the Convention because the arbitration clause was incapable of being performed due to the insolvency and, thus, the dispute was not capable of settlement by arbitration.²³ While the court in *Ardra* rec-

cannot avoid a contractual obligation to reimburse simply due to the insolvency of the reinsured. Based on the insolvency clause, the liquidators routinely pursue the estate's creditors in state court. For a discussion of the origin of the statutory insolvency clause, see *Skandia Am. Reins. Corp. v. Schenck*, 441 F. Supp. 715, 725 (S.D.N.Y. 1977).

18. In a recent Congressional Report, it was noted that "[t]he parallels between the present situation in the insurance industry and the early stages of the savings and loan debacle are both obvious and deeply disturbing." Letter from John D. Dingell, chairman, Committee On Energy and Commerce (Feb. 7, 1990) (letter to Committee citing Failed Promises, Insurance Company Insolvencies, A Report By the Subcommittee On Oversight and Investigations Of The Committee On Energy And Commerce).

These failures have also given rise to a debate as to whether federal regulation of the industry is necessary. Cf. Michael Bradford, *Iowa's Hager Blasts Federal Regulation*, BUS. INS., Oct. 3, 1988, at 43.

19. Leonard Sloane, *Questions Are Intensifying About Insurance Safety Net*, N.Y. TIMES, Nov. 3, 1990, at 50; see also Eric N. Berg, *Insurers Tangled In Bitter Debates Over Regulation*, N.Y. TIMES, Nov. 1, 1990, at 1; Stacy Adler, *Insolvency Toll Likely To Grow: Regulator*, BUS. INS., Nov. 20, 1989, at 97; Adrienne Locke, *Business Insurance Report Assesses Cause of Insolvencies*, BUS. INS., Aug. 28, 1989, at 61.

20. *Id.*

21. As noted in the discussion at *supra* note 18, the reinsurer's liability under a reinsurance contract is not affected by the reinsured's insolvency. *Globe Nat'l Fire Ins. Co. v. American Bonding & Cas. Co.*, 217 N.W. 268, 278 (Iowa 1928).

22. 567 N.E.2d 969, *aff'd*, 565 N.E.2d 969 (N.Y. 1990), *cert. denied*, 111 S.Ct. 2260 (1991).

23. *Id.*

ognized the strong policy concerns of international comity, which clearly militate in favor of arbitration, it nevertheless deferred to the state interest in maintaining control over liquidation proceedings.

This article will discuss the decision in *Ardra*. Part I will discuss early arbitration law and Chapter 1 of the United States Arbitration Act (the "USAA"). Part II will discuss implementation and application of the Convention in the United States in accordance with Chapter 2 of the USAA, plus certain exceptions to *arbitrability* thereunder. Part III will discuss case law prior to *Ardra* which dealt with arbitration in a liquidation situation. Part IV will discuss and analyze the decision of the New York Court of Appeals in *Ardra*. Finally, the Conclusion will discuss the author's views about the effect of *Ardra* on international reinsurance arbitration.

I. EARLY ARBITRATION LAW AND THE UNITED STATES ARBITRATION ACT

A. *Early Arbitration Law*

The enforcement of arbitral agreements and awards was not traditionally favored by the British common law.²⁴ This view, which was firmly imbedded in British precedent, was based on the theory that arbitration agreements improperly ousted courts of jurisdiction.

The British theory of arbitration was adopted by American courts. Thus, the early history of American arbitration law is marked by judicial suspicion of both the need for arbitration as well as the competence of arbitrators.²⁵ The courts were of the view that agreements to arbitrate future disputes were revocable and

24. For a discussion of the historical development of early arbitration law, see, e.g., William Catron Jones, *History of Commercial Arbitration In England and The United States: A Summary View*, reprinted in, THOMAS M. DOMKE, INTERNATIONAL TRADE ARBITRATION 127 (1958); FRANCES A. KELLOR, AMERICAN ARBITRATION, ITS HISTORY, FUNCTIONS AND ACHIEVEMENTS (1948); Paul L. Sayre, *Development of Commercial Arbitration Law*, 37 YALE L.J. 595 (1928).

25. See *The Atlanten*, 252 U.S. 313, 315 (1920). In *The Atlanten*, Justice Holmes affirmed the lower court's decision written by Judge Learned Hand in the district court and in the Court of Appeals by Judge Hough that a dispute between a steamship owner and charterers for the former's refusal to proceed with a voyage from Pensacola, Florida to Scandinavia was not arbitrable. *Id.* at 316.

The arbitration clause broadly provided that if any dispute arises it should be settled by arbitration. *Id.* at 315. The steamship owner refused to proceed with the voyage at the agreed freight due to "increased war risk and other difficulties." *Id.* at 314. The charterer brought suit, and the owner sought to arbitrate. *Id.* The lower courts held that the owner repudiated the contract and, therefore, the arbitration clause did not apply. *Id.* at 315. Justice Holmes wrote that the owner had not repudiated the contract in toto as he assumed the con-

unenforceable.²⁶

B. United States Arbitration Act

In 1925, Congress passed the United States Arbitration Act²⁷ which legislatively overturned judicial reluctance to enforce arbitration agreements.²⁸ The USAA established that agreements to arbitrate were on the same footing as other contracts.²⁹ Under the USAA, arbitration agreements were no longer construed to be "invalid, revocable or unenforceable."³⁰ Thus, the USAA set forth a new policy which favored the enforcement of arbitration agreements, thereby greatly expanding their utility in the commercial context.³¹

The USAA was applicable to arbitral agreements involving interstate commerce, foreign commerce and maritime contracts. The legislation implemented by Congress under the USAA provided for the enforcement of arbitration agreements,³² a stay of litigation

tract was binding and set a limit of liability, but that the owner simply refused to proceed with the voyage. *Id.*

According to Justice Holmes, this was not a "dispute" within the ambit of the arbitration clause. *Id.* The court was of the view that the arbitration clause referred to disputes where the parties were performing the contract, but not to a dispute where the substance of the contract was repudiated, citing to Lord Haldane's opinion in *Jureidini v. National British & Irish Millers Ins. Co.*, App. Cas. 499, 505 (1915). While the court in *The Atlanten* did not consider the general question of the weight to be afforded to an arbitration clause, it nevertheless appears to have taken pains to narrowly construe the scope of the clause.

Today, the repudiation of a contract in a manner similar to the steamship owner's repudiation would clearly not render an arbitration clause void under the doctrine of separability, unless, of course, the arbitration clause itself was procured through fraud. *Prima Paint Corp. v. Floor & Conklin Mfg. Co.*, 388 U.S. 395, 402-04 (1967). Additionally, given the current rule that doubts must be resolved in favor of arbitrability, it is apparent that, today, the broad clause in *The Atlanten* would be construed so as to encompass the dispute in that case.

26. *United States Asphalt Ref. Co. v. Trinidad Lake Petroleum Co.*, 222 F. Supp. 1006, 1012 (S.D.N.Y. 1915); see Sayre, *supra* note 24, at 1 for a discussion of *United States Asphalt* and activities following that decision by the New York Chamber of Commerce and other organizations to further the possibilities for use of arbitration.

27. 9 U.S.C. §§ 1-14 (1988) (ch. 1 of the USAA).

28. Congress was apparently of the view that legislation was necessary to overturn the existent precedent, even though there had been some judicial relaxation of arbitral suspicion. H.R. REP. NO. 96, 68th Cong., 1st Sess. (1924).

29. In addition to the desire to enforce contractual undertakings, Congress took into account the expense and delay inherent in the litigation process. *Id.* at 2.

30. *Robert Lawrence & Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 407 (2d Cir. 1959).

31. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983).

32. 9 U.S.C. § 4 (1988).

pending the conclusion of an arbitration proceeding,³³ and enforcement of the resultant arbitral award by a court of law.³⁴

While the USAA was a watershed for proponents of arbitration, it nevertheless applied only to a limited number of arbitration situations.³⁵ Specifically, the USAA did not serve as a basis for subject matter jurisdiction in federal court. Thus, to seek judicial enforcement in federal court, a plaintiff had to show either: diversity of citizenship and the requisite amount in controversy; or, a federal question which consequently limited use of the statute to those cases within federal subject matter jurisdiction.³⁶ The USAA also could not compel arbitration abroad, which also limited its usefulness in the international context.³⁷

Thus, while the USAA had, and continues to have,³⁸ a positive impact on arbitration, efforts continued to broaden the ability of commercial entities to arbitrate. During the 1940's and 1950's, there were attempts to enforce arbitration clauses in international trade and commerce through bilateral treaties.³⁹ The bilateral approach proved to be slow; there was delay inherent in negotiations and subsequent ratification of the individual treaties. The bilateral approach also did not result in uniform treaties, but in variant terms dependent upon the subject negotiations between particular contracting parties.⁴⁰ This uncertainty could not have been comforting to the business community at large; however, it was not long before efforts to provide for greater uniformity proved to be fruitful.

II. THE CONVENTION

A. Implementation

The Convention was negotiated in 1958 when forty-five nations met in New York under the auspices of the United Nations to resolve uncertainties in the laws applicable to international arbitra-

33. 9 U.S.C. § 3 (1988).

34. 9 U.S.C. § 9 (1988).

35. 9 U.S.C. § 1 (1988). The Act, as noted, applied to arbitral agreements involving maritime contracts and contracts involving commerce, except for grounds which exist at law or equity for revocation of the agreement. *Id.*

36. *Krauss Bros. Lumber Co. v. Louis Bossert & Son*, 62 F.2d 1004, 1006 (2d Cir. 1933).

37. *Midlands Tar Distillers, Inc. v. M. T. Lotos*, 362 F. Supp. 1311, 1315 (S.D.N.Y. 1973).

38. See *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, *reh'g denied*, 419 U.S. 885 (1974) (claims under Securities Exchange Act of 1934 arising out of purported breach of contract held arbitrable).

39. For a discussion of arbitration before implementation of the Convention, see e.g., Leonard v. Quigley, *Accession By The United States To The United Nations Convention On The Recognition and Enforcement of Foreign Arbitral Awards*, 70 YALE L.J. 1049 (1961).

40. *Id.* at 1054.

tion.⁴¹ The signatories to the Convention agreed to enforce arbitral agreements and awards with respect to international commercial matters. The United States attended the Convention, but did not sign the Treaty until twelve years later.

On October 4, 1968, the United States Senate consented to ratification of the Convention. Subsequently, on July 31, 1970, the Convention was implemented by Congress. The United States acceded to the Convention on September 30, 1970, and on December 29, 1970, the Convention became the law of the land after the instrument of accession was filed. The goal of Congress in implementing the Convention was to encourage the recognition of international arbitral agreements and to unify the standards under which such agreements and awards were enforced.⁴² Eighty-one countries have become parties to the Convention.⁴³

The Convention is enforced in the United States in accordance with Chapter 2 of the USAA.⁴⁴ The enactment of Chapter 2 demonstrates a very firm commitment by Congress to eliminate prior judicial reluctance to enforce arbitration agreements, particularly in the context of international commercial transactions.⁴⁵

Section 201⁴⁶ provides that the Convention shall be enforced in accordance with Chapter 2 of the USAA. Section 202⁴⁷ provides that the terms of the Convention shall apply to an arbitration agreement or award arising out of a legal relationship, whether contractual or not, which is considered commercial. To fall within Section 202, the relationship must involve property located abroad, envisage performance or enforcement abroad, or have some other reasonable relationship with one or more foreign states.

Section 203⁴⁸ provides that an action under the terms of the Convention is deemed to arise under the laws and treaties of the United States. Under that section, the district courts of the United States shall have original jurisdiction without regard to the amount in controversy.

41. John P. McMahon, *Implementation of the United Nations Convention On Foreign Arbitral Awards In The United States*, 2 J. MAR. L. & COM. 735 (1971).

42. See H.R. No. 1181, 91st Cong., 1st Sess. 2 (1978).

43. Jack Garvey & Totton Heffelfinger, *Towards Federalizing U.S. International Commercial Arbitration*, 25 INT'L LAW. 209, 214 n.27 (1991).

44. 9 U.S.C. §§ 201-207 (1988). Thus, Congress implemented the convention by amending or adding to the Federal Arbitration Act or, as we have referred to it, the USAA.

45. *McCreary Tire & Rubber Co. v. Ceat S.p.A.*, 501 F.2d 1032, 1037 (3d Cir. 1974).

46. 9 U.S.C. § 201 (1988).

47. 9 U.S.C. § 202 (1988).

48. 9 U.S.C. § 203 (1988).

Section 204⁴⁹ provides that, for purposes of venue, an action under the Convention may be brought in any district court in which, save for the arbitration agreement, an action between the parties could be brought. Additionally, under Section 204, venue is proper in a district court which embraces the place designated in the agreement as the place of arbitration when that place is in the United States.

Section 205⁵⁰ provides that, when the subject matter of an action in a state court pertains to an arbitration agreement or award within the Convention, the defendant may, at any time before trial, remove such action to a district court embracing the place where the action is pending.

Section 206⁵¹ provides that a court with jurisdiction under Chapter 2 may direct that arbitration be held in accordance with the agreement at any place therein provided whether within or outside of the United States.⁵² The court may also appoint arbitrators in accordance with the arbitration agreement.⁵³

Section 207⁵⁴ provides that, within three years after rendition of an arbitral award falling within the Convention, a party may apply to the appropriate court for an order confirming the award. The award must be confirmed unless the court finds one of the grounds for refusal of enforcement or recognition⁵⁵ contained in the Convention. Section 208 provides that Chapter 1 applies to arbitrations brought under Chapter 2 where there is no conflict between them.⁵⁶

49. 9 U.S.C. § 204 (1988).

50. 9 U.S.C. § 205 (1988).

51. 9 U.S.C. § 206 (1988).

52. The ability to order arbitration outside the United States under § 206 of Ch. 2 of the USAA is broader than the power under Ch. 1. *Sedco, Inc. v. Petroleos Mexicanos Mexican Nat'l Oil Co. (Pemex)*, 767 F.2d 1140, 1146 (5th Cir. 1985).

53. Section 206 had been construed so as to permit the appointment of arbitrators to preside over arbitrations outside of the United States. *MCMAHON*, *supra* note 41, at 757.

54. 9 U.S.C. § 207 (1988).

55. It should be noted that a number of states have recently enacted statutes governing international arbitration, including California, Florida, Hawaii and Texas. For a discussion of state international arbitration laws, see, e.g., William P. Mills, III, Note, *State International Arbitration Statutes And The U.S. Arbitration Act: Unifying The Availability of Interim Relief*, 13 *FORDHAM L. REVIEW* 604 (1989). It is the author's view, shared by others, that state international arbitration laws might add to inconsistent application of arbitration rules in the international context. See Garvey & Heffelfinger, *supra* note 43, at 215.

56. 9 U.S.C. § 208 (1988).

B. Application

1. Four Part Test of Arbitrability

In determining whether a controversy falls within the Convention, the courts apply a four part test.⁵⁷ The first part is whether there is an agreement in writing to arbitrate the subject of the dispute; the second is whether the agreement provides for arbitration in the territory of a signatory to the Convention. The third is whether the agreement arises out of a legal relationship, whether contractual or not, which is considered commercial. The fourth is whether a party to the agreement is not an American citizen, or whether the commercial relationship has some reasonable relation with one or more foreign states.⁵⁸

In the context of reinsurance, the first, second and fourth questions are usually answered in the affirmative. Reinsurance agreements are usually in writing, often involve foreign entities, and may call for arbitration in the territory of a signatory to the Convention. The third question, i.e., whether the legal relationship is commercial in nature, is somewhat more difficult to resolve.

2. Commercial Relationship Limitation

The United States, in acceding to the Convention, restricted applicability thereof "to differences arising out of legal relationships, whether contractual or not, which are considered as commercial under the national law of the United States."⁵⁹ Section 202, as noted, also contains this limitation. None of the provisions in Chapter 2, however, define the term "commercial relationship."⁶⁰

It is well settled that the business of insurance is commercial in nature, and that a dispute between an insolvent insurer and another company — at least prior to liquidation — is arbitrable where there is an arbitration agreement.⁶¹ The question in the context of insol-

57. *Ledee v. Ceramiche Ragno*, 684 F.2d 184, 186-87 (1st Cir. 1982).

58. *Id.*

59. The Convention, *supra* note 1. This reservation is in accord with Article I(3) which provides:

When signing, ratifying or acceding to this Convention, or notifying extension under Article X hereof, any State may on the basis of reciprocity declare that it will apply the Convention to the recognition and enforcement of awards only in the territory of another Contracting State. It may also declare that it will apply the Convention only to differences arising out of legal relationships, whether contractual or not, which are considered as commercial under the national law of the State making such declaration.

60. Indeed, the Convention itself was also criticized due to the varying definitions of commercial relationship which might arise in a given country. *McMahon*, *supra* note 41, at 743.

61. *United States v. South-Eastern Underwriters Ass'n*, 332 U.S. 533 (1944) (this case was superseded by statute, as stated in *Western & Southern Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648 (1981)); *Hart v. Orion Ins. Co.*, 453

veny is the effect of a subsequent liquidation on the commercial relationship between the two original contracting entities. Does insolvency transform the commercial relationship of these entities into something else when the liquidator becomes involved?⁶² The author's view, as discussed below, is that insolvency does not nullify the relationship which originally existed between the parties.

If the four part test is satisfied, a court must refer the matter to arbitration unless an exception to arbitration under the Convention is applicable.

C. *Exceptions to Arbitration Under the Convention*

1. *Article II: Exceptions to Recognition of Agreement*

Article II⁶³ of the Convention enumerates certain grounds on which the court may base a refusal to recognize or enforce an arbitral agreement. Only two provisions contained in Article II are applicable to an insolvency situation. First, Article II(1) provides that an arbitration agreement shall be recognized if it concerns "subject matter capable of settlement by arbitration."⁶⁴ Second, Article II(3) provides that an arbitration agreement is enforceable unless the court finds the agreement itself "null and void, inoperative or incapable of being performed."⁶⁵ The Convention does not specify what law governs the determination of these issues.⁶⁶

F.2d 1358 (10th Cir. 1971); NECA Ins. Ltd. v. National Union Fire Ins. Co., 595 F. Supp. 955 (S.D.N.Y. 1984).

62. These questions will be discussed more fully *infra* at text accompanying note 133.

63. Article II of the Convention provides as follows:

Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration. . . .

The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this Article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed.

The Convention, *supra* note 1.

64. *Id.*

65. *Id.*

66. One commentator stated as follows: "As nothing is said in the Article about the governing law to determine the validity of the arbitration agreement, it may be assumed that courts will make such determination on the basis of their own law, including the applicable conflict rules." Paolo Contini, *International Commercial Arbitration, The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 8 AM. J. COMP. L. 283, 296 (1959). Indeed, as discussed *infra* at text accompanying notes 119-22, the determination of the applicable law in construing the validity of the agreement is a critical inquiry.

It can be argued that the declaration of insolvency renders the subject matter of the liquidator's dispute incapable of settlement by arbitration. It also can be argued that placement of the insolvent under the exclusive jurisdiction of the liquidation court renders the arbitral agreement null and void, inoperative, or incapable of being performed. These arguments are based on state law insolvency provisions which basically vest the state liquidation court with exclusive jurisdiction over the affairs of an insolvent insurer.⁶⁷

2. Article V: Exceptions to Enforcement of Award

Article V⁶⁸ of the Convention enumerates the grounds on which a court may refuse to confirm an arbitral award. Section 207 incorporates Article V of the Convention.⁶⁹ Examined below are the grounds for refusal to confirm an arbitration agreement that are applicable to an insolvency situation.

67. See *supra* note 16 for a discussion of the provision of the New York Insurance law applicable to insurance insolvency.

68. Article V provides in part as follows: Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:

- (a) The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or
- (b) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or. . . .

Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

- (a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or
- (b) The recognition or enforcement of the award would be contrary to the public policy of that country.

The Convention, *supra* note 1.

69. Section 207 provides as follows:

Award of Arbitrators; Confirmation; Jurisdiction; Proceeding. Within three years after an arbitral award falling under the Convention is made, any party to the arbitration may apply to any court having jurisdiction under this chapter . . . for an order confirming the award as against any other party to the arbitration. The Court shall confirm the award unless it finds one of the grounds for refusal or deferral of recognition or enforcement of the award specified in the said Convention.

9 U.S.C. § 207 (1988).

a. Article V(1)(a)

The Convention provides in Article V (1)(a) that recognition of an award may be refused if the parties "were, under the law applicable to them, under some incapacity." The issue here is whether the incapacity relates to the time of the agreement or the time of the arbitration proceeding.⁷⁰

It has been argued that this exception refers to a party's capacity at the time of the arbitration itself.⁷¹ One commentator has stated:

Although this exception, on its face, seems to refer to the parties' capacity at the time the arbitration agreement was made, rather than to their capacity at the time of the arbitration proceedings, the background of the provision suggests that the drafters were concerned with ensuring that both parties be properly represented during arbitration proceeding; therefore, the provision refers to the parties' capacity at the time of arbitration.⁷²

Under this interpretation, a court might give weight to the apparent intention of the drafters in ensuring that all parties are properly represented *at the time* of the arbitration.

It has also been suggested that the wording of this exception suggests a court may refuse enforcement based on the status (capacity) of the parties, regardless of whether they are afforded representation.⁷³

There is, nevertheless, an argument that the incapacity relates back to the time of the contract, and thus, the intervening liquidation does not effect the party's capacity.⁷⁴

b. Articles V(1)(c), 2(a) and 2(b)

The Convention also provides in Article V(1)(c) that recognition and enforcement of an arbitral award may be refused if the "award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration." In contrast to Article V(1)(a), which turns on the status of the party, it appears that Article V(2)(a) applies to the nature of the dispute itself.

70. See generally Jay. L. Westbrook, *The Coming Encounter: International Arbitration and Bankruptcy*, 67 MINN. L. REV. 595, 614-16 (1983).

71. *Id.* at 614.

72. *Id.* This commentator acknowledges, however, that Article V(1)(a) might refer back to the validity of the agreement itself since there is a reference to Article II which pertains to the agreement and not the resultant award. *Id.* at 614 n. 73. It is also noteworthy that the word "were" is used in Article V(1)(a), which suggests a reference to a point in time before the arbitration hearing.

73. *Id.* at 614; CONTINI, *supra* note 66, at 300-01.

74. *Corcoran v. AIG Multi-Line, Inc.*, 539 N.Y.S.2d 630, 636 (N.Y. Sup. Ct. 1989), *rev'd*, 562 N.Y.S.2d 933 (N.Y. App. Div. 1990).

Article V(2)(a) sets forth another ground for non-recognition of the award. This exception is applicable where the claim is not capable of settlement by arbitration under the domestic law of the enforcing state. It appears that Article V(2)(a) also applies to the nature of the dispute itself.

Finally, Article V(2)(b) broadly excepts enforcement of awards that are contrary to the public policy of the enforcing state. This exception is construed narrowly and must contravene the "state's most basic notions of morality and justice."⁷⁵ Courts have thus rejected the public policy defense in a variety of circumstances, including where a U.S. company argued that it abandoned a construction project in Egypt after severance of diplomatic relations between the U.S. and Egypt in 1967,⁷⁶ where an award based on testimony which contradicted prior testimony was alleged to be contrary to principles of justice,⁷⁷ and where an award was allegedly obtained under fraudulent circumstances.⁷⁸

III. CASE LAW

The leading case in New York with respect to the arbitrability of disputes with insolvent insurance companies was *Knickerbocker Agency, Inc. v. Holz*.⁷⁹ In that case, the Superintendent of Insurance, as liquidator of Preferred Accident Insurance Company, brought an action in New York State Supreme Court against Knickerbocker to recover \$5,818.35 in purported unearned commissions under a canceled liability.⁸⁰ Knickerbocker filed an answer, which contained a defense that the matter should be arbitrated.⁸¹ Knickerbocker then instituted a special proceeding demanding that the Superintendent show cause why the court should not compel arbitration of the dispute.⁸² The Superintendent argued that liquidation of Knickerbocker precluded arbitration.⁸³

The lower court ordered arbitration to proceed and stayed the

75. *Parsons & Whittemore Overseas Co. v. Societe Gen. de L'Industrie du Papier*, 508 F.2d 969, 974 (2d Cir. 1974); *La Societe Nationale Pour La Rechercheine Prod., Le Transp., La Transformation et La Commercialisation Des Hydrocarbures v. Shaheen Natural Resources Co.*, 585 F. Supp. 57 (S.D.N.Y. 1983), *aff'd*, 733 F.2d 260 (2d Cir.), *cert. denied*, 469 U.S. 883 (1984).

76. *Parsons & Whittemore Overseas Co.*, 508 F.2d at 974.

77. *Waterside Ocean Navigation Co. v. International Navigation, Ltd.*, 737 F.2d 150 (2d Cir. 1984).

78. *Biotronik Mess-und Therapiegeraete GmbH & Co. v. Medford Medical Instrument*, 415 F. Supp. 133 (D.N.J. 1976).

79. 149 N.E.2d 885 (N.Y. 1958). Interestingly, the decision in *Knickerbocker* was rendered the same year that the Convention was being negotiated.

80. *Id.* at 888.

81. *Id.*

82. *Id.*

83. *Id.*

action.⁸⁴ The appellate court reversed, holding that the liquidation scheme, in particular Article XVI of the New York Insurance Law,⁸⁵ vested exclusive jurisdiction over all claims concerning an insolvent insurer in the Supreme Court.⁸⁶

Knickerbocker argued on appeal that the Superintendent stands in the shoes of the insolvent insurance company in the prosecution of a claim against a debtor, and thus, could not disregard an arbitration clause in a contract entered into between the insolvent company and the debtor prior to liquidation.⁸⁷ Knickerbocker made a distinction between that situation and the prosecution of a claim by the creditor of an insurer in liquidation against the Superintendent.⁸⁸

In rejecting this argument, the New York Court of Appeals held that Article XVI of the New York Insurance Law, as it pertained to the liquidation of insolvent insurance companies, furnished a comprehensive method for the winding up of affairs by the Superintendent.⁸⁹ The Court of Appeals held that these provisions were "exclusive in their operation and furnish[ed] a complete procedure for the protection of the rights of all parties interested."⁹⁰ The Court of Appeals found that the Supreme Court was intended to have exclusive jurisdiction of claims for and against an insurer in liquidation.⁹¹

The *Knickerbocker* court stated that at the time of insolvency and liquidation the contractual provisions relating to arbitration became of no effect.⁹² Further, it was noted that Knickerbocker was on notice when it entered into the contract that the arbitration provisions were subject to the New York Insurance Laws.⁹³

Recognizing that the Superintendent takes the place or steps into the shoes of the insolvent insurer, the *Knickerbocker* court held that the Legislature did not contemplate turning over liquidation proceedings to arbitration tribunals.⁹⁴ The court noted that federal bankruptcy laws vest exclusive jurisdiction in district courts and permit arbitration only when express authorization is provided

84. *Id.*

85. Article XVI of the New York Insurance Law has since been amended. For a discussion of the provisions of Article XVI, see *Levy v. Lewis*, 635 F.2d 960, 962 (2d Cir. 1980).

86. *Knickerbocker*, 149 N.E.2d at 888.

87. *Id.*

88. *Id.*

89. *Id.* at 888-89.

90. *Id.* at 889, (quoting *Matter of Lawyers Title & Guar. Co.*, 5 N.Y.S.2d 484, 486 (1938)).

91. *Id.* at 889.

92. *Id.*

93. *Id.*

94. *Id.* at 889.

in the Bankruptcy Act.⁹⁵

The court stated that, since Article XVI of the Insurance Law contains no statutory authority for arbitration, the Supreme Court "may not be ousted of jurisdiction in favor of an arbitral tribunal."⁹⁶ The court noted that it was essential that the assets of the insolvent company be administered under the supervision of one court so as to provide for an efficient liquidation.⁹⁷ The court also noted that "other courts, except when called upon by the court of primary jurisdiction for assistance, are excluded from participation."⁹⁸

The *Knickerbocker* court stated that "perhaps" the Legislature's reason for the withholding of authorization for arbitration was as follows:

The change from a court of law to an arbitration panel may make a radical difference in ultimate result. . . . Arbitrators do not have the benefit of judicial instruction on the law; they need not give their reasons for their results; the record of their proceedings is not as complete as it is in a court trial; and judicial review of an award is more limited than judicial review of a trial.⁹⁹

Finally, the court concluded that its decision was not concerned with non-residents, as the parties in that case were New York residents.¹⁰⁰ Indeed, the *Knickerbocker* court was not confronted with the Federal Arbitration Act or the Convention. It would be ten years before the Second Circuit Court of Appeals was confronted with a request to arbitrate under the Federal Arbitration Act.¹⁰¹

In *Hamilton Life Ins. Co. of N.Y. v. Republic Nat'l Life Ins. Co.*,¹⁰² the district court granted Hamilton's motion to compel arbitration under 9 U.S.C. § 4 of the USAA, and Republic lodged on appeal.¹⁰³ Hamilton was under the supervision of the Insurance

95. *Id.* at 889-90.

96. *Id.* at 890. This language reminds one of the British justification for declining arbitration.

97. *Id.*

98. *Id.* (quoting *Mottow v. Southern Holding and Sec. Corp.*, 95 F.2d 721, 725-26 (8th Cir. 1938)). It may well be this comment that the liquidation court in *Corcoran v. AIG Multi-Line Syndicate, Inc.*, 539 N.Y.S.2d 630 (N.Y. Sup. Ct. 1989), *rev'd*, 562 N.Y.S.2d 933 (N.Y. App. Div. 1990), relied upon in retaining jurisdiction of a dispute between an insolvent insurer and its reinsurers for purposes of any award rendered while referring the matter to arbitration. Indeed, in referring a matter to arbitration the Court "of primary jurisdiction" (i.e., New York's Supreme Court can be deemed to "call upon" the arbitration tribunal "for assistance").

99. *Knickerbocker*, 149 N.E.2d at 890-91 (quoting *Bernhardt v. Polygraphic Co.*, 350 U.S. 198, 203 (1956)).

100. *Id.* at 891.

101. See *Hamilton Life Ins. Co. of N.Y. v. Republic Nat'l Life Ins. Co.*, 408 F.2d 606 (2d Cir. 1969).

102. 408 F.2d 606 (2d Cir. 1969).

103. *Id.* at 607.

Department.¹⁰⁴ Republic argued on appeal that it was entitled to a trial as to the existence of a written agreement to arbitrate, that the powers granted to the arbitrators under the arbitration agreement violated due process of law, that the court lacked *in personam* jurisdiction, and that the agreement was in violation of the McCarran-Ferguson Act.¹⁰⁵ With reference thereto, Republic argued that the McCarran-Ferguson Act barred arbitration under the USAA.¹⁰⁶ Hamilton reasoned that the McCarran Act laid the ground work for state regulation of insurance, free from federal intervention.¹⁰⁷ The Second Circuit found that only when a state has *not* acted would federal regulation become effective.¹⁰⁸

The court held that the McCarran Act does not exempt the business of insurance from all federal statutes which do not specifically apply to insurance.¹⁰⁹ The McCarran Act only precludes application of federal statutes to insurance when they invalidate, impair or supersede relevant state regulation.¹¹⁰

While the *Hamilton* court did not extensively discuss this issue, it noted that the arbitration laws only regulate the method of handling contract disputes in general¹¹¹ and, thus, do not implicate the McCarran Act since they do not regulate the business of insurance.

Bernstein v. Centaur Ins. Co.,¹¹² involved a suit by Ambassador Insurance Company and Horizon Insurance Company against Centaur Insurance for sums due under reinsurance contracts.¹¹³ Am-

104. *Id.* at 608.

105. *Id.*

106. *Id.* at 610.

107. *Id.* at 611.

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.* Similarly, the district court in *Mutual Reins. Bureau v. Great Plains Mut. Ins. Co.*, 750 F. Supp. 455 (D. Kan. 1990), concluded that a state statute, in effect, precluding arbitration with respect to "contracts of insurance" was not applicable to an arbitration clause in a reinsurance agreement.

In *Mutual Reinsurance*, a Kansas state arbitration statute provided for the enforceability of arbitration clauses except for those in a "contract of insurance." *Id.* at 461. The court found that a reinsurance contract was a "contract for insurance" not a "contract of insurance" and, thus, not within the ambit of the statute. *Id.* (Most reinsurance professionals would likely disagree with this statement and view reinsurance as a contract of insurance. See KRAMER, *supra* note 6, at 4 (reinsurance is "an insurance contract"). Nevertheless, the court in *Mutual Reinsurance* seems to have reached the correct result. It does not seem likely that the Kansas legislature by its statute was attempting to preclude arbitration in the reinsurance context even in the absence of a liquidation proceeding since to do so would contradict the longstanding historical custom of reinsurers to arbitrate. The court in *Mutual Reinsurance* could have reached the same result by recognizing that the strong federal policy for arbitration would not invalidate, impair or supersede the Kansas arbitration statute.

112. 606 F. Supp. 98 (S.D.N.Y. 1984).

113. *Id.* at 100.

bassador and Horizon were placed into liquidation and the New York and Vermont Rehabilitators were substituted as plaintiffs.¹¹⁴ The court reasoned that no state law explicitly precluded arbitration, and that the case law which infers that rule does so with respect to cases within the jurisdiction of the Supreme Court.¹¹⁵

The *Bernstein* court held that *Knickerbocker* did not govern the case at bar because the case was not brought within the exclusive jurisdiction of the State Supreme Court and was not brought under Article XVI of the New York Insurance Law.¹¹⁶ It was noted that, unlike *Knickerbocker*, the defendant was a non-resident of New York.¹¹⁷ Interestingly, the court also found that the McCarran Act exempted state practices from preemption only if a states' law is invalidated, impaired or superseded.¹¹⁸ According to the *Bernstein* court, the McCarran Act did not exempt "state policies for which no specific law is enacted."¹¹⁹

It was not long before *Bernstein* was criticized by a New York State Supreme Court in *Michigan Nat'l Bank-Oakland v. American Centennial Ins. Co.*¹²⁰ There, the court held that *Bernstein's* conclusion that *Knickerbocker* represented state policy and not state law was incorrect.¹²¹ The *Michigan Nat'l* court held that the *Knickerbocker* court's reading of Article XVI was "the law of the state."¹²² The *Michigan Nat'l* court utilized as a rationale that arbitration could result in piecemeal litigation, duplication of effort and inconsistent results.¹²³

114. *Id.*

115. *Id.* at 103.

116. *Id.*

117. *Id.*

118. *Id.*

119. *Id.* at 103. It should be noted that *Bernstein* was followed in *Ainsworth v. Allstate Ins. Co.*, 634 F. Supp. 52 (W.D. Mo. 1985). There, a court in Missouri held that arbitration under the Federal Arbitration Act should proceed, however, it was noteworthy that in *Ainsworth* the plaintiff could not point to a specific provision in the Missouri Insurance code which prohibited arbitration. Thus, the court concluded that arbitration would not "invalidate impair, or supersede" any Missouri law.

120. 521 N.Y.S.2d 617 (N.Y. Sup. Ct. 1987). Prior to *Michigan National*, a federal district court in New York rejected the reasoning in *Bernstein*. In *Washburn v. Corcoran*, 643 F. Supp. 554, 556 (S.D.N.Y. 1986) the court held that arbitration of a claim against the liquidator of an insolvent insurer would violate the McCarran-Ferguson Act in that it would impair or supersede Article 74 of the New York Insurance Law.

The *Washburn* court concluded that New York's highest court (i.e., the *Knickerbocker* court) construed the Insurance Law to provide "exclusive jurisdiction over the liquidation of insurance companies in the New York Supreme Court that takes charge of the liquidation, and to override and nullify arbitration agreements. *Id.*

121. *Michigan Nat'l Bank-Oakland*, 521 N.Y.S.2d at 620.

122. *Id.*

123. *Id.*

In *Corcoran v. AIG Multi-Line Syndicate, Inc.*,¹²⁴ a New York Supreme Court directed arbitration to proceed on the ground that the Convention was the supreme law of the land with precedence over local statutes.¹²⁵ The court noted that the issue of the application of the Convention was not raised in *Michigan Nat'l* and that *AIG Multi-Line* involved foreign corporations.¹²⁶ In analyzing the Superintendent's argument that the arbitration clauses were ineffective, the court reviewed Article V(1)(a) and Article V 2(b) of the Convention.¹²⁷ The court viewed the incapacity exception (Article V(1)(a)) in light of "internationally recognized defenses[s] such as duress, mistake, fraud, or waiver"¹²⁸ and held that the exception was inapplicable. Additionally, the court held that the incapacity referred to in Article V(1)(a) dealt with an incapacity at the time the parties entered into the contract.¹²⁹

The court also noted that the public policy exception under Article V(2)(b) is construed narrowly and must contravene "the forum state's most basic notions of morality and justice."¹³⁰

124. 539 N.Y.S.2d 630, 636 (N.Y. Sup. Ct. 1989), *rev'd*, 562 N.Y.S.2d 933 (N.Y. App. Div. 1990).

125. *Id.* at 636.

126. *Id.* at 637. Seven of the reinsurers had their principal place of business in Hamilton, Bermuda.

127. *Id.* at 636. The Court, in addressing Article V(1)(a), referred to an incapacity which might render the agreement "null and void". *Id.* However, it does not appear that the Court addressed Article II (3)'s "null and void" exception to arbitration. Indeed, the Court did not address any of Article II's exceptions to the enforceability of the arbitral agreement, but simply reviewed defenses that would exist under Article V in the event an award was rendered.

128. *Id.* at 636 (quoting, *Rhone Mediterranee Compagnia v. Lauro*, 712 F.2d 50, 53 (3d Cir. 1983)).

129. *Id.*

130. *Id.* (quoting, *Parsons & Whittemore Overseas Co. v. Societe Generale de L'Industrie du Papier (Rakta)*, 508 F.2d 969, 974 (2d Cir. 1974)). The decision in *AIG Multi-Line* was appealed by the liquidator to the Appellate Division, First Judicial Department. *Corcoran v. AIG Multi-Line Syndicate, Inc.*, 562 N.Y.S.2d 933 (N.Y. App. Div. 1990). The Appellate Division reversed in light of its own decision in *Ardra*, which was affirmed by the Court of Appeals on December 20, 1990. It is interesting to note that *AIG Multi-Line* was commenced by Union Indemnity Insurance Company of New York ("Union") on February 7, 1985 prior to its liquidation. Union was placed into liquidation by order entered July 16, 1985, and the Superintendent of Insurance was substituted as a party plaintiff. The reinsurers initially moved to compel arbitration on March 2, 1985. Because of Court confusion over the conversion of the New York State Court System from a Special Term to an Individual Assignment System, whereby Judges would be assigned a case through trial similar to the federal court system, it was years before a Judge was assigned to hear the case and not until March 6, 1989 that the matter was referred to arbitration by the Supreme Court. The Appellate Division, First Judicial Department reversed on November 29, 1990, and the parties are now engaged in the initial phases of discovery as of the date of this publication. If the matter had been placed into arbitration somewhere near the time that the reinsurers had made their initial motion, in all likelihood, the dispute would have been arbitrated to a conclusion by now. It is interesting to note that for the years 1976 to 1980, the National Center for

IV. ARDRA

A. Background and Holding

In *Corcoran v. Ardra Ins. Co.*,¹³¹ Nassau Insurance Company was a New York corporation, licensed to conduct insurance business in New York. Nassau was owned by Jeanne S. DiLoreto and Richard A. DiLoreto.¹³² In 1976, the DiLoretos formed Ardra Insurance Company, Ltd., a foreign corporation with its principal place of business in Hamilton, Bermuda. The president of Ardra was Jeanne DiLoreto.¹³³

Nassau and Ardra entered into three international reinsurance agreements between 1978 and 1982.¹³⁴ The reinsurance agreements pertained to policies written by Nassau covering commercial automobile liability, general liability, lawyers and professional liability, excess liability and personal injury protection benefits issued pursuant to the New York statutory no fault laws.¹³⁵ Under the reinsurance agreements, Nassau ceded to Ardra a substantial portion of the risks under each policy issued by Nassau.¹³⁶ Nassau paid Ardra \$10,682,924 in reinsurance premiums.¹³⁷ The reinsurance agreements contained broad arbitration clauses, which required arbitration of any dispute between Nassau and Ardra.¹³⁸

Nassau experienced financial difficulties and attempts were made to rehabilitate the company.¹³⁹ In 1981, the Superintendent commenced a liquidation proceeding under Article 74 of the New York Insurance Law.¹⁴⁰ The Supreme Court of New York appointed plaintiff as the liquidator and authorized him to wind up Nassau's affairs, including the taking of possession of property, collection of outstanding debts, payment of claims and collection of reinsurance recoverables.¹⁴¹ The Superintendent began to settle claims under Nassau's policies.¹⁴² Ardra reimbursed Nassau for certain claims under the reinsurance agreements, but ceased to

State Courts examined medium disposition times for 32 civil courts in urban areas. The New York Supreme Court finished 27th in the study with a median disposition time of 931 days. THE NAT'L CTR. FOR STATE COURTS, THE REPORT OF ACTION UNIT NO. 6 OF THE NEW YORK STATE BAR ASSOCIATION 2-3 (Apr. 1, 1985).

131. 567 N.E.2d 969, 970 (N.Y. 1990), *cert. denied*, 111 S. Ct. 2260 (1991).

132. *Id.* at 970.

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.*

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.*

142. *Id.*

make payments thereunder sometime in February 1985.¹⁴³ Richard DiLoreto wrote to the Superintendent repudiating the reinsurance agreements on the ground that the Superintendent had refused to allow Ardra's representatives to participate in court proceedings involving third party claims against insureds of Nassau.¹⁴⁴ The Superintendent then commenced action seeking reinsurance recoverables alleged to be due from Ardra and damages from the DiLoretos arising from their purported use of a "shell" corporation to obstruct recovery of Nassau's obligations to its creditors and insureds.¹⁴⁵

The defendants moved for a dismissal¹⁴⁶ and to compel arbitration under the Convention as well as provisions of the Federal Arbitration Act.¹⁴⁷ The Supreme Court of New York denied the motion, concluding that the McCarran-Ferguson Act protected the Superintendent from the requirements of the Convention and the Federal Arbitration Act.¹⁴⁸ This decision was affirmed by the Appellate Division, First Judicial Department,¹⁴⁹ which held that arbitration was not required due to various exceptions in the Convention which removed the Superintendent from the provisions thereof. Specifically, the Appellate Division held that the arbitral agreement was "null and void" under Article II(3) of the Convention.¹⁵⁰ The court found that Article 74 of the New York Insurance Law vested "exclusive jurisdiction" over the affairs of an insolvent insurer in the Supreme Court, thereby rendering arbitration clauses inoperative.¹⁵¹

The Appellate Division also held that the dispute was not of a commercial nature under Article I(3) of the Convention.¹⁵² The court found that the liquidation of Nassau transformed the relationship of the parties from a commercial nature to one of a regulatory nature.¹⁵³ This was because the Liquidator sued Ardra as a fiduciary on behalf of Nassau, as well as policyholders and the general

143. *Id.*

144. *Id.*

145. *Id.*

146. Prior to this motion, defendants had removed the action to federal court. The district court remanded on grounds of abstention. *Corcoran v. Ardra*, 657 F. Supp. 1223 (S.D.N.Y. 1987). The order of remand was affirmed on appeal by the United States Court of Appeals for the Second Circuit at 842 F.2d 31 (2d Cir. 1988).

147. *Ardra*, 567 N.E.2d at 970.

148. *Id.* at 971.

149. *Corcoran v. Ardra Ins. Co.*, 553 N.Y.S.2d 695 (N.Y. App. Div. 1990).

150. *Id.* at 697.

151. *Id.*

152. *Id.* at 698.

153. *Id.*

public at large.¹⁵⁴

The Appellate Division also held that the dispute was not arbitrable under Article V, 1(c),¹⁵⁵ Article V, 2(a)¹⁵⁶ and Article V, 1(a)¹⁵⁷ of the Convention.¹⁵⁸ The defendants appealed to New York's highest court, the Court of Appeals.¹⁵⁹

In a unanimous opinion the Court of Appeals stated that the threshold question was preemption.¹⁶⁰ The court noted that under the Supremacy Clause of the United States Constitution, all treaties "shall be the supreme Law of the Land."¹⁶¹ The court acknowledged that any state or federal law that prevented the federal government from speaking with one voice in international trade matters should bow to superior authority.¹⁶² According to the court, if the Convention mandates arbitration, it preempts the McCarran-Ferguson Act, the Federal Arbitration Act, and the state insurance laws which empower the Superintendent to litigate on behalf of insolvent insurers.¹⁶³ The court thus focused on the applicability of the Convention and not on the Federal statutes.¹⁶⁴

The court discussed implementation of the Convention in the United States and then plaintiff's first contention that the Convention was not applicable because the dispute was not of a commercial nature.¹⁶⁵ The Superintendent argued that the dispute was not commercial, because he was a fiduciary implementing a statutory regulatory scheme at the direction of the court.¹⁶⁶ The court dis-

154. *Id.*

155. *Id.* The court found that there did not exist "a difference not contemplated by or not falling within the terms of the submission to arbitration." *Id.*

156. *Id.* The court found that the subject of the dispute was not capable of settlement by arbitration.

157. *Id.* The court found that the parties were "under some incapacity."

158. Interestingly, the Court "assumed" that the strict standard applicable to the public policy defense (Article V (2) (b)) had not been met. *Id.* at 697.

159. *Corcoran v. Ardra Ins. Co.*, 567 N.E.2d 969 (N.Y. 1990), *cert. denied*, 111 S. Ct. 2260 (1991).

160. *Id.* at 971.

161. *Id.*

162. *Id.* It is clear that any purported conflict between the Convention and the McCarran Act should meet with an attempt for resolution of the two provisions. However, it can be legitimately argued that the Convention would not "invalidate, impair or supersede" the states' regulation of the business of insurance. This is because arbitration will not truly oust the liquidation court of jurisdiction. In referring a dispute to arbitration, a court does not *a fortiori* relinquish its jurisdiction over a case. It retains jurisdiction pending referral to an arbitration panel subsequent to which the court can pass on the validity of the award. See text accompanying footnote 151 for a discussion of whether referral of a dispute to arbitration would "invalidate, impair or supercede" New York insurance law.

163. *Id.*

164. *Id.*

165. *Id.* at 971-72.

166. *Id.* at 972.

agreed with the Superintendent's argument in this regard. The court concluded that the nature of the relationship between the two entities should be determined at the inception of the agreement and not at the time enforcement of rights and obligations thereunder are sought.¹⁶⁷ The court noted that the original agreements between Nassau and Ardra were commercial and thus found that the dispute arose out of a commercial relationship within the meaning of Article 1(3).¹⁶⁸

Recognizing that the drafters did not intend to require arbitration in all international commercial disputes, the court went on to discuss certain exceptions to the Convention.¹⁶⁹ The court noted that Article II requires recognition of an arbitral agreement only when it pertains to a subject matter capable of settlement by arbitration, and that the court may refuse to compel arbitration if the agreement is null and void, inoperative or incapable of being performed.¹⁷⁰ The court noted that these exceptions must be implemented by examining the domestic law of the acceding nation.¹⁷¹ The court stated that insurance is generally a matter of state concern, and therefore, the laws of the individual states should govern.¹⁷² The court thus applied Article 74 of the New York Insurance Law in interpreting exceptions under the Convention.¹⁷³

The court determined that the original contracting parties and their relationships had changed, since Nassau no longer existed.¹⁷⁴ The court recognized that the Superintendent "stepped into the shoes" of Nassau in the sense that he succeeded to its property.¹⁷⁵ However, the court determined that the Superintendent was a fiduciary, subject to exclusive jurisdiction of the Supreme Court and

167. *Id.*

168. *Ardra*, 567 N.E.2d at 972. On this point, the Court of Appeals disagreed with the Appellate Division which apparently was of the view that the relationship had been transformed to one of a regulatory nature. 553 N.Y.S.2d at 698.

169. *Ardra*, 567 N.E.2d at 972.

170. *Id.*

171. *Id.*

172. *Id.* There is authority for the proposition that a federal statute will not preempt the exercise by a state of authority in an area "traditionally occupied by a state law" unless that is clearly the purpose of Congress. *Southland Corp. v. Keating*, 465 U.S. 1, 18 (1984) (Stevens, J., concurring in part and dissenting in part).

However, in *Mitsubishi Motors Corp. v. Solar Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985), the Court stated:

Concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes require that we enforce the parties' agreement, even assuming that a contrary result would be forthcoming in a domestic context.

173. *Ardra*, 567 N.E.2d at 972.

174. *Id.*

175. *Id.*

possessing only those powers authorized by the Legislature.¹⁷⁶ The court cited Article 74 of New York Insurance Law.¹⁷⁷ The liquidator's duty is to protect policy-holders, stockholders and the public.¹⁷⁸ It was noted that the legislature had not granted the Superintendent the power to participate in an arbitration proceeding.¹⁷⁹ The court noted that, in fact, despite the ruling in *Knickerbocker* and enactment of amendments to the Insurance Law, the Legislature had not authorized the Superintendent to arbitrate.¹⁸⁰ Thus, the court concluded that the arbitration clause was not capable of being performed (Article II(3)), and that the claims were not capable of settlement by arbitration (Article II(1)).¹⁸¹

The court noted that its interpretation was also supported by Article V of the Convention.¹⁸² Under Article V, arbitral awards may be denied if "the subject matter of the difference is not capable of settlement by arbitration under the law of that country."¹⁸³ It was noted that the practical results of the Article II and Article V exceptions were to relieve parties from proceeding through a futile arbitration where the award would be unenforceable.¹⁸⁴ The court noted that its decision construing the exceptions was appropriate so as to give effect to New York's strong public policy in the maintenance of Supreme Court jurisdiction over liquidation proceedings.¹⁸⁵

The court recognized strong contrary policy concerns of international comity, which militate in favor of arbitration.¹⁸⁶ However, the court found that the underlying concerns of the Convention were not implicated there.¹⁸⁷ The DiLoretos were principals of both Ardra and Nassau, and they owned both companies.¹⁸⁸ Nassau and the Diloretos were New York residents, amenable to process in

176. *Id.*

177. *Id.*

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.* at 973.

182. *Id.*

183. *Id.*

184. *Ardra*, 567 N.E.2d at 973. Interestingly, it has been noted that the Convention delegates did not intend the exceptions under Articles II and V to be in conformity. Thus, the Article II(3) language with respect to agreements was not linked to the enforcement provisions of Article V. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 531 n.10 (1974) (dissenting opinion). Nonetheless, it is clearly preferable to avoid enforcement of an agreement under Article II if the subsequent award would not be enforceable under Article V. See *WESTBROOK*, *supra* note 70, at 631 n.142.

185. *Ardra*, 567 N.E.2d at 972.

186. *Id.*

187. *Id.*

188. *Id.*

New York both personally and by designating a New York agent to receive process.¹⁸⁹ The reinsurance contracts also referred to New York law in their clauses.¹⁹⁰ According to the court, Ardra had reason to anticipate when the contracts were executed that arbitration was not permitted under Article 74 of the New York Insurance Law.¹⁹¹ The court stated that this case did not "present an international merchant subjected to unfamiliar judicial proceedings and the vagaries of foreign law."¹⁹² Thus, the court concluded that while the reinsurance agreements fell within the broad terms of the Convention, the Superintendent was excepted from the terms thereof.¹⁹³

V. ANALYSIS

In determining that the threshold question was one of preemption, it appears that the *Ardra* court properly focused on the Convention, and not on Chapter I of the USAA or on the McCarran-Ferguson Act. The court determined that the Convention took precedence over the McCarran Act,¹⁹⁴ although there was previous decisional law that application of the McCarran Act precluded arbitration under Chapter 1 of the USAA.¹⁹⁵

The court properly recognized that the nature of the relationship between the Superintendent and Ardra should be determined at the inception of the agreement. It is recognized that a liquidator steps into the shoes of an insolvent company for purposes of any dispute. His rights emanate solely from that company, and he is subject to the same defenses that could be asserted against the insolvent.¹⁹⁶ Moreover, Article I(3)'s commercial limitation provision

189. *Id.*

190. *Id.*

191. *Id.*

192. *Id.*

193. *Id.*

194. It does appear that the Convention would prevail over the McCarran-Ferguson Act, since it is a later expression of the sovereign will. LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 167-70 (1978); Louis Henkin, *The Treaty Makers and the Law Makers; The Law of the Land and Foreign Relations*, 107 U. PA. L. REV. 903, 906 (1959). Where there is a conflict "between an Act of Congress and a treaty, — both being the supreme law of the land — the later in date must prevail in the courts." *Ribas Y Hijo v. United States*, 194 U.S. 315, 324 (1904); *United States v. White*, 508 F.2d 453 (8th Cir. 1974), *reh'g denied* (1975); *United States v. Felter*, 546 F. Supp. 1002 (D. Utah 1982), *aff'd*, 752 F.2d 1505 (10th Cir. 1985). The Convention was enacted in 1970. The McCarran-Ferguson Act was enacted in 1945.

195. *Washburn v. Corcoran*, 643 F. Supp. 554, 555 (S.D.N.Y. 1986); *Matter of Union Indem.*, 521 N.Y.S.2d 617, 619 (N.Y. Sup. Ct. 1987).

196. See *supra* text accompanying note 133 for a discussion of the liquidator's rights as derived from the insolvent company.

applies to the nature of the dispute or "differences," and not to the status of a party.

Nonetheless, the court in *Ardra* determined that, since exceptions to the Convention must be construed under domestic law, and since insurance is generally a matter of state concern, the laws of individual states governed construction of the exceptions. Thus, the court held New York law to be controlling in determining applicability of the Convention's exceptions.¹⁹⁷ In so holding, the court ensured that international arbitral policy concerns would fall to the New York rule which precludes arbitration in a liquidation situation.

Determination of the law applicable to evaluate arbitrability under Article II is no easy task. The Convention does not specify what substantive law is applicable in construing whether a matter should be referred to arbitration under Article II.¹⁹⁸ In *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth, Inc.*,¹⁹⁹ the Supreme Court stated as follows:

[T]he Convention . . . requires the recognition of agreements to arbitrate that involve "subject matter capable of settlement by arbitration," [and] contemplates exceptions to arbitrability grounded in domestic law. (citations omitted) And it appears that before acceding to the Convention the Senate was advised by a State Department memorandum that the Convention provided for such exceptions.²⁰⁰

In the context of our federal system, the *Ardra* Court determined that state law would be applicable in construing Article II.²⁰¹

197. *Ardra*, 567 N.E.2d at 973. In making this determination, the court necessarily viewed the liquidation of insurance companies as constituting the business of insurance, thereby falling within the ambit of state regulation under the McCarran Act. This characterization of the liquidation of an insolvent insurance company appears to be reasonable under the criteria established by the United States Supreme Court. See, e.g., *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 134 (1982); *SEC v. National Sec., Inc.*, 393 U.S. 453, 460 (1969).

198. Interestingly, Article V is more specific as to what body of law is applicable to determine enforcement of the award. For example, Article V(2)(a) bars enforcement of an arbitral award when the "subject matter of the difference is not capable of settlement by arbitration under the law of that country." Article V(2)(b) is applicable when "enforcement of the award would be contrary to the public policy of that country." Article V(1)(a) bars enforcement of an arbitral award if the parties were "under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it." As noted in footnote 111, *supra*, however, the Convention delegates excluded references to the applicable law from Article II. It has been stated that determination of the validity of the arbitral agreement by a court should be made on the basis of its own country's law, which includes conflict of law rules. CONTINI, *supra* note 66, at 296.

199. 473 U.S. 614 (1985).

200. *Id.* at 639 n.21. However, in that same footnote, the Court stated that the usefulness of "the Convention in promoting the process of international commercial arbitration depends upon the willingness of national courts to let go of matters they would normally think of as their own." *Id.*

201. *Ardra*, 567 N.E.2d at 972.

To be sure, Article XI of the Convention contemplates that countries with federal systems might possibly limit operation of the Convention.²⁰² It is nevertheless arguable that the Court was wrong on this point, in that it applied New York State law or, at the very least, did not give due consideration to the federal policy favoring arbitration.

It has been stated that determination of arbitrability under Article II should not only be made in light of the policy which favors the enforcement of arbitral agreements, but should also promote "standards which can be uniformly applied on an international scale."²⁰³ In *I.T.A.D. Assocs., Inc. v. Podar Bros.*,²⁰⁴ the Fifth Circuit was confronted with the issue of whether a party had waived its right to arbitrate by virtue of its alleged delay and limited participation in a legal action. Against the policy favoring arbitration and in an attempt to foster the adoption of standards to be applied on an international scale, the court directed arbitration to proceed under the Convention.²⁰⁵ Similarly, in *Rhone Mediterranee Campagnia v. Lauro*,²⁰⁶ the Third Circuit held that the law referred to in Article II(3) is the law of the United States, not the local law of a particular state.²⁰⁷ The court in *Rhone* based its conclusion on 9 U.S.C. § 203, which provides that a proceeding falling within the Convention shall be construed to arise under the laws and treaties of the United States and that such an action is removable to federal court under 9 U.S.C. § 205.²⁰⁸ The court in *Rhone* found Article II(3) applicable so as to preclude arbitration only when the agreement is subject to an "internationally recognized defense such as duress, mistake, fraud, or waiver . . . or . . . when it contravenes fundamental policies of the forum state."²⁰⁹

Similarly, the First Circuit in *Ledee v. Ceramiche Ragno*,²¹⁰ refused to interpret provisions of the law of the Commonwealth of Puerto Rico so as to render an arbitral agreement null and void.²¹¹ The court found that the parochial interests of the nation could not

202. Significantly, however, Article XI(b) contemplates that the federal government shall encourage the Constituent States to take action to require arbitration. See *supra* note 152.

203. *I.T.A.D. Assoc., Inc. v. Podar Bros.*, 636 F.2d 75, 77 (4th Cir. 1981) (right to arbitration under Convention not waived).

204. 636 F.2d 75 (4th Cir. 1981).

205. *Id.*

206. 712 F.2d 50, 53 (3d Cir. 1983) ("null and void" within Article II(3) construed in light of "an internationally recognized defense such as duress, mistake, fraud or waiver").

207. *Id.* at 54.

208. *Id.*

209. *Id.* at 53.

210. 684 F.2d 184 (1st Cir. 1982).

211. *Id.* at 187.

be the measure by which to interpret an arbitration clause under Article II(3), much less could the parochial interests of a Commonwealth or State be taken into account in that regard.²¹² The court found that the "null and void" language in Article II(3) encompasses instances that could be applied neutrally on an international scale.²¹³

More recently, the court in *Meadows Indem. Co. v. Baccala & Shoop Ins. Servs., Inc.*,²¹⁴ directed arbitration to proceed under a number of reinsurance contracts, concluding that they all encompassed claims of fraud. The court held that the question of arbitrability under Article II(1) should not be based on the domestic laws of only one country, but on standards which can be applied on an international scale.²¹⁵ With reference to Article I(3), the court applied the *Rhone* standard.²¹⁶

It is submitted that a neutral standard that could be applied on an international scale could arguably result in denial of arbitration in a liquidation situation just as easily as it could result in an order compelling it. Opponents to arbitration might contend that a rule denying arbitration in this situation could easily be developed and recognized in the international community at large. What seems to be important, however, as noted by the court in *I.T.A.D.*, is to consider the strong policy reasons in favor of arbitration, while at the same time attempting to foster an international standard.²¹⁷

The policy behind American adoption of the Convention was to encourage the recognition of arbitral agreements and to unify the standards governing their recognition and enforcement. It can be posited that the international standard, which is embodied in the Convention, is to encourage arbitration. The use of a standard that would recognize arbitration in a liquidation situation unless the liquidator's rights were prejudiced might take into account those considerations underlying the Convention. It can be asked why a state liquidation rule should trump this well-recognized international policy in the absence of a compelling reason.

212. *Id.*

213. *Id.* The court described those possible situations to include fraud, duress, mistake and waiver.

214. 1991 U.S. Dist. LEXIS 4144, at 30 (E.D.N.Y. March 29, 1991).

215. *Id.* This standard raises interesting questions as to how the determination can be made that a law could be applied neutrally on an "international scale." Thus, with reference to insolvency, should a court review the applicable precedent in a number of jurisdictions, or alternatively, should it attempt to formulate its own standard that it perceives to be easily and justly applied in other countries? For a discussion of a national arbitration, defined as one not governed by any particular nation's law, see, e.g., Hans Smit, *A-National Arbitration*, 63 TUL. L. REV. 629 (1989).

216. *Id.*

217. See *I.T.A.D. Assocs., Inc. v. Podar Bros.*, 636 F.2d 75, 77 (4th Cir. 1981).

The court's holding that the arbitral agreements were incapable of being performed and thus that claims were not capable of settlement by arbitration under Article II, on the ground that the New York legislature had not empowered the liquidator to arbitrate,²¹⁸ ignores the fact that the liquidator's rights are consistent with those of the insolvent. Although the court recognized that the liquidator steps into the shoes of the insolvent company, it was postulated that the liquidator was a fiduciary, subject to the exclusive jurisdiction of the Supreme Court, without power to arbitrate.²¹⁹ However, the fiduciary position in which the liquidator finds himself should not override the original intent of the parties to the original contract, particularly where arbitration will not prevent the liquidator from carrying out his fiduciary duty to protect the interests of policyholders, stockholders and the public. Indeed, the liquidator, as noted, has no different position than the insolvent and takes the latter's rights subject to the same defenses as existed prior to insolvency.²²⁰

If insolvency does not change the relationship of the parties from one of a commercial nature, the insolvency similarly should not work to undermine the arbitrability of the dispute under Article II(1). Indeed, Article II(1), refers to the subject matter of the dispute. Likewise, Article II(3) refers to the subject matter or type of the agreement, not the status of a party at the time of arbitration. The liquidator's involvement, if it does not change the nature of the relationship under Article I(3) (i.e., commercial nature), should not change the nature of the dispute for purposes of Article II(1).²²¹

218. *Corcoran v. Ardra Ins. Co.*, 567 N.E.2d 969, 972 (N.Y. 1990), *cert. denied*, 111 S. Ct. 2260 (1991).

219. *Id.*

220. This rule has been recognized by the common law for some time. *See, e.g., Arizona Corp. Comm. v. California Ins. Co.*, 236 P. 460 (Ariz. 1925); *Ray v. First Nat'l Bank*, 63 S.W. 762, 770 (Ky. 1901); *Bohlenger v. Zangor*, 117 N.E.2d 338, 341 (N.Y. 1954); *All Star Ins. Corp. v. APS Ins. Agency, Inc.*, 332 N.W.2d 828 (Wis. Ct. App. 1983); *Kelly v. Commonwealth Mut. Ins. Co.*, 299 A.2d 604, 606 (Pa. 1973).

As stated in *Korlann v. E-Z Pay Plan, Inc.*:

It is a well-established principle that a liquidator or receiver occupies no better position than his insolvent occupied at the time of insolvency. He takes the property and rights of the one for whom he acts, subject to the same equities and defenses in others that existed before insolvency.

428 P.2d 172, 176 (Or. 1967) (citations omitted).

221. This is not to say that Article I(3) and Article II(1) are identical in application. As should now be apparent, Article I(3) refers to differences arising out of relationships which are commercial and broadly addresses the scope of the Convention. Article II(1) refers to differences which concern a subject matter capable of settlement by arbitration and pertains to enforceability of the arbitration agreement for purposes of referral of a matter into arbitration. Nevertheless, if a relationship is sufficiently commercial for the purpose of falling under the scope of the Convention despite the liquidator's involvement (Article I(3)), the subject matter of the dispute should not be considered incapable of

The argument that resolution of a dispute with an insolvent is subject to exclusive jurisdiction of the Supreme Court is not dissimilar to the judicial vigilance which protected diminishment of jurisdiction through arbitration prior to the adoption of the USAA. Specifically, the *Ardra* court stated:

Arbitrators are private individuals, selected by the contracting parties to resolve matters important only to them. They have no public responsibility and they should not be in a position to decide matters affecting insureds and third-party claimants after the contracting party has failed to do so. Resolution of such disputes is a matter solely for the Superintendent, subject to judicial oversight, acting in the public interest.²²²

This hostility seems outdated in light of the extensive inroads that arbitration has made in other areas. For example, it now appears difficult to accept that arbitration should yield to New York's Liquidation law where claims under state securities law,²²³ the Securities Exchange Act of 1934,²²⁴ the Racketeer Influenced and Corrupt Organizations Act (RICO),²²⁵ the Securities Act of 1933,²²⁶ and antitrust claims²²⁷ are arbitrable. Indeed, there is no express statutory authorization to arbitrate any of these claims.

Moreover, arbitrators generally do view themselves as having the responsibility to render a fair and just decision. The Code of Ethics of the American Arbitration Association requires that arbitrators must seek to uphold both the integrity and fairness of the arbitral process,²²⁸ should conduct proceedings fairly and diligently²²⁹ and should render a just, independent and deliberate decision.²³⁰ I submit that these standards are generally followed by all arbitrators.

Arbitrators also are capable of adjudicating complex matters, particularly in the technical field of reinsurance. Indeed, an arbitration panel with significant business experience may be in a better position to understand the intricacies of a reinsurance

settlement by arbitration (Article II(1)) by virtue of the involvement of that same liquidator.

222. *Ardra*, 567 N.E.2d at 973.

223. *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 223 (1985).

224. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 242 (1987).

225. *Id.*

226. *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 485 (1989).

227. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 640 (1985).

228. CODE OF ETHICS FOR ARBITRATORS IN COMMERCIAL DISPUTES Canon I (1977). The Code of Ethics was prepared by a Joint Committee which consisted of a Special Committee of the American Arbitration Association and the American Bar Association, respectively.

229. *Id.* at Canon IV.

230. *Id.* at Canon V.

transaction than a court of general jurisdiction presiding over a liquidation. If the resolution of United States antitrust claims could be entrusted to Japanese businessmen, it might not be inappropriate to have a reinsurance professional preside over a reinsurance dispute.

The *Ardra* court ensured application of the state rule due through its conclusion that "[t]he underlying concerns of the Convention [were] not implicated here."²³¹ This was based on the finding that *Ardra* was not "an international merchant subjected to unfamiliar judicial proceedings and the vagaries of foreign law requiring a 'sensitivity to the need of the international commercial system for predictability in the resolution of disputes.'"²³² The court arrived at this conclusion because the DiLoretos were principals of both Nassau and *Ardra*, amenable to process in New York and the contracts referred to New York law as applicable.²³³

The founding fathers clearly desired treaties to be binding on states.²³⁴ Recognizing that a treaty was the focal point of inquiry, the court in *Ardra* should have given greater weight to the policies underlying the treaty power in general and the Convention in particular. There is clearly an argument for supremacy of international law, and/or the policies that favor arbitration, over the New York Liquidation laws. This "supremacy" derives in part from membership in the world community. Professor Thomas Franck had this to say:

It is easily demonstrable that the international community believes, and acts on the belief, that a rule-hierarchy exists and obligates states. The most recent instance of this is to be found in an advisory opinion rendered by the International Court of Justice on April 26, 1988. In it, the judges unanimously aver the existence of an obligation deriving its pull to compliance not from specific consent but from membership in a community. That opinion was given at the request of the United Nations General Assembly after the U.S. Congress had enacted a law, later signed under protest by President Reagan, requiring the closing of the Observer Mission of the Palestinian Liberation Army. That law violated the U.S. Government's own interpretation of its obligations under the U.N. Headquarters Agreement. In such a conflict between a treaty obligation and a national law, the Court said, the treaty obligation is paramount. It confirmed the fundamental principle of international law that it prevails over domestic law and, in support, cited its own earlier opinion that in the relations between Powers who are contracting Parties to a treaty, the provisions of municipal law cannot pre-

231. *Corcoran v. Ardra Ins. Co.*, 567 N.E.2d 969, 973 (N.Y. 1990), *cert. denied*, 111 S. Ct. 2260 (1991).

232. *Id.* (quoting, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 629 (1985)).

233. *Ardra*, 567 N.E.2d at 973. The court apparently concluded that *Ardra* should not reap the benefit of the policies underlying the Convention.

234. For a discussion of treaties as law, see, e.g., LOUIS HENKIN, *CONSTITUTION, DEMOCRACY AND FOREIGN AFFAIRS* 62-63 (1990).

vail over those of a treaty. The point was confirmed in a concurring opinion of the U.S. Judge, Stephen M. Schwebel, who wrote that a State cannot avoid its international responsibility by the enactment of domestic legislation which conflicts with its international obligations. In other words, the sovereign will of states is subordinate to obligations that derive from their status as members of a community.²³⁵

Additionally, this is not a situation where the treaty power would unreasonably encroach on states' rights.²³⁶ The power given to states pursuant to the McCarran Act was via Congressional legislation to allow states to regulate the insurance industry. It is not unreasonable to conclude that the policies favoring arbitration underlying the Convention should outweigh the states' power to regulate insurance. This is particularly so where referral of the dispute to arbitration will not work truly to the detriment of the liquidator. The liquidator will not be abdicating his fiduciary duties by proceeding in an arbitration forum. His prosecution of the insolvent's claims can proceed in arbitration, subject to "judicial oversight," in that the liquidation court retains the ability to confirm or reject the award.

VI. CONCLUSION

The Court of Appeals' decision is not a positive development in the law of either arbitration or reinsurance. First, in relegating international policy concerns to New York's interest in state court liquidation proceedings, the decision will cause confusion and uncertainty among foreign reinsurance corporations. Uncertainty will not foster the development of business in the international reinsurance market.²³⁷

Second, this confusion could have a detrimental effect on New York's effort to promote itself as a center for international arbitration. If New York state law does not enforce the right to arbitrate, reinsurance corporations might question the desirability of utilizing New York as an arbitration forum. The certainty of arbitration, as opposed to uncertainty dependent upon whether a corporation is sufficiently an "international" merchant, would only encourage the continued use of New York as a viable arbitration location.

Third, *Ardra* could hinder effective resolution of international reinsurance disputes by requiring bifurcated proceedings. For ex-

235. THOMAS FRANCK, *THE POWER OF LEGITIMACY AMONG NATIONS* 188-189 (1990) (footnotes omitted).

236. See, e.g., Robert B. Looper, *Limitations On the Federal Treaty Power*, 34 N.Y.U. L. REV. 1045, 1049 (1959).

237. Indeed, recent court rulings have imposed security on foreign reinsurers in litigation in New York. It is questionable whether an arbitration panel would require the posting of such security. In this respect, the litigation of a reinsurance case in New York could have very real adverse consequences to a reinsurer, which would not otherwise exist in an arbitration situation.

ample, in a situation where a cedent seeks recoverables from various reinsurance participants in an arbitration, the insolvency of one reinsurer would cause the cedent or liquidator to pursue recovery in both arbitration and in court. This result is even less desirable in a situation where insolvency occurs during the course of an arbitration after the expenditure of substantial effort by the parties. The decision in *Ardra* would require the parties to go back to square one in liquidation court. Indeed, there is even a possibility of inconsistent results where a cedent pursues a claim against solvent reinsurers in arbitration and against the insolvent reinsurer in liquidation.

Finally, the decision could add significant legal costs and delay to the Superintendent's task where reinsurers continue to seek arbitration on the ground that *Ardra* is distinguishable from their situation. For example, a foreign reinsurer might seek to compel arbitration, arguing that it is genuinely a foreign corporation, unlike the *Ardra* corporation, which the superintendant argued was only a "shell" owned by New York residents.

These adverse results could be avoided through either a limited reading of *Ardra* by future courts or a more practical analysis of the situation, while at the same time protecting the liquidator's desire to obtain a fair, just and speedy resolution of the Estate. Arbitration should not be viewed as ousting the New York Supreme Court of its exclusive jurisdiction. It only provides an alternative forum in which the parties submit their factual dispute to the panel for adjudication. The award itself does not become binding as a judgment until reviewed by the Supreme Court on an application to confirm, and the court has the power to reject the award under Article V in appropriate circumstances. In this manner, the referral of a dispute to arbitration should not be viewed as dissimilar to the referral of a case to a referee or federal magistrate to hear and report, although the standards for review are not all in accord. The liquidation court thus remains involved in the dispute resolution process and essentially retains jurisdiction of the action while "referring" the dispute to the arbitration panel for a determination on the merits.²³⁸ Indeed, even after referral of a case to arbitration the parties may resort to Court before rendition of the arbitral award for assistance in appointment or removal of arbitrators and/or discovery under appropriate circumstances. In that regard, the Court can exercise control over the proceedings itself prior to passing on the enforce-

238. This distinction was at least tacitly recognized by the court in *Corcoran v. AIG Multi-Line Syndicate, Inc.*, 539 N.Y.S.2d 630, 637 (N.Y. Sup. Ct. 1989), *rev'd*, 562 N.Y.S.2d 933 (N.Y. App. Div. 1990). There the matter was referred to arbitration, while the court explicitly stated that it would "retain jurisdiction with respect to any award rendered." *Id.* See *supra* text accompanying notes 93-97 for a discussion of the *AGI Multi-Line* case.

ability of the award. Judges should be mindful of the ways in which arbitration can be utilized to ease the burden on their courts.

In view of *Ardra*, it may well be that a state legislative pronouncement explicitly authorizing courts to refer matters to arbitration while retaining jurisdiction under Article 74 should be considered, so as to avoid confusion and uncertainty in future international reinsurance arbitration situations. The U.S. Congress could facilitate arbitration itself either through the adoption of its own legislation providing for referral of a dispute with a liquidator to arbitration, or through encouragement of state legislatures to take action to require arbitration under these circumstances.²³⁹

The arbitrability of a dispute with a liquidator should not be viewed as adversely affecting the liquidator, policyholders, stockholders or the public at large. Arbitration can provide a speedy, just, and fair resolution of the dispute, while alleviating the burdensome workload of the liquidation court. This is particularly true in the technical field of reinsurance. The referral of a dispute to arbitration will effectuate the intent of the original contracting parties and alleviate uncertainty in the dispute resolution process, thereby encouraging the continued utilization of New York as a center for international reinsurance arbitration.

239. With reference to federal States, the Convention provides under Article XI as follows:

- (a) With respect to those articles of this Convention that come within the legislative jurisdiction of the federal authority, the obligations of the federal government shall to this extent be the same as those of Contracting States; (b) with respect to those articles of this Convention that come within the legislative jurisdiction of constituent states or provinces which are not, under the constitutional system of the federation, bound to take legislative action, the federal government shall bring such articles with a favorable recommendation to the notice of the appropriate authorities of constituent states or provinces at the earliest possible moment.

The Convention, *supra* note 1, at Article XI.

