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Feature Articles

IRU, Inc.
Intermediaries & Reinsurance Underwriters Association

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Contents

Intermediaries & Reinsurance Underwriters Association

Mission Statement

To promote professionalism and educational advancement, and to provide a forum for the useful exchange of ideas among member companies.

Purposes

The purposes for which IRU, Inc. (Intermediaries & Reinsurance Underwriters Association) was formed are to foster and promote the interests of those individuals, partnerships, firms, associations and corporations who are engaged in the business of non-life treaty reinsurance.

- To encourage an exchange of ideas among members, and to disseminate educational information for the benefit of members and for the betterment of the reinsurance industry.
- To promote professionalism among members.
- To maintain liaison with other segments of the insurance industry, for the discussion and debate of insurance and reinsurance issues.
- To develop and present programs on topics germane to the fields of insurance and reinsurance.
- To organize and conduct meetings for the members of the association.
- To facilitate research into problems and issues significant to either the membership or the reinsurance industry.
- To disseminate, through printed matter and other appropriate means, general news and information concerning the association and its members, the proceedings of the associations meetings and programs.
- To promote programs designed to increase awareness and enhance positive image of the reinsurance industry.

Journal of Reinsurance
Editorial Board

General Information

The *Journal of Reinsurance* is an official publication of the Intermediaries & Reinsurance Underwriters Association. It is published quarterly in January, April, July, and October.

All opinions and views expressed in any material in the *Journal of Reinsurance* are those of the author(s) and do not necessarily represent the views of the editor, the editorial staff, the Intermediaries & Reinsurance Underwriters Association or its members.

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Letter from the Editor

As the saying goes, "who would have thunk it?" At the point of this writing, we are in the middle of the hurricane season, with the industry coping with millions of underwriting loss from Hurricanes Gustav and Ike, not to mention the myriad of flood losses suffered from Tropical Storm Fay and, instead, the talk of the town is the overwhelming loss from the credit and investment crisis.

Industry concern to date in 2008 has been largely focused on the softening market and increased competition, and while housing problems had begun to affect the economy at large, there seemed to be little angst among the insurance and reinsurance community which perceived minimal impact of those troubles on corporate balance sheets.

And then came the fall, including the bail-out of AIG, not to mention the Lehman bankruptcy, etc. Those woes have thus far exceeded the loss of all the '08 windstorms combined, with the fear that the financial industry's contagion may impact other venerable institutions before running its course. Again, who would have thunk it? A nervous time, indeed.

Ah well, the industry has survived tough times before, and it will overcome this crisis, but perhaps not before some additional weeping, wailing, and gnashing of teeth.

In any event, I am pleased to report that normalcy prevails at the Journal of Reinsurance, and in that vein, we are delighted to offer the following scholarly efforts dealing with other topical issues which, at least temporarily, been relegated to the back pages of the daily press.

Starting off is an excellent update on the evolution of property coverage issues in my home state, as presented in their article entitled **Catastrophe Risk in Florida: Efforts to Manage The Unmanageable** by Fred Karlinsky and Richard Fidei. Fingers are crossed that Florida will be spared the wrath of Forces 3, 4, and 5, but real questions remain whether the state's financial resources can withstand the next "big ones."

On a related theme, Robin Olson offers his intriguing perspective dealing with **Climate Change: Risk Management Issues** which sets out various steps for consideration in proactively managing the daunting phenomenon of global warming.

In her treatise on **The Emergence of Takaful and Retakaful Companies**, Anne Foster brings our readership up to date on the activities of some of the newer industry players which are influenced, not by traditional business practice, but rather by the fundamentals of Islamic law.

Challenges and issues emanating from the area of dispute resolution have been concerning themes, not only in industry circles, but also among Journal topics in recent years. This quarter's presentation, **Judicial Review of Arbitration Awards: The Challenge of the Supreme Court's Decision** by Andrew Boris and Michael Conlon deal with the significance of key provisions in the Federal Arbitration Act which impact the appealability of arbitration decisions.

Hoping the selection of articles in this issue will pique your interest and stimulate thought, please continue to let us know of any themes and topics which will enhance the Journal's informative value in your professional pursuits.

With best wishes for productive stability during the upcoming renewal season,

Paul Walther, Editor

Catastrophe Risk In Florida: Efforts To Manage The Unmanageable

By

Fred E. Karlinsky and Richard J. Fidei

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His practice includes all elements of the insurance and reinsurance business, as well as operational issues such as start-up activities, structuring and financing, vendor relationships, regulatory issues and administrative and court proceedings, including administrative supervision, liquidation and insolvency issues.

In addition to his active role in the Association of Insurance Compliance Professionals, Mr. Fidei, a member of both the Florida and Pennsylvania Bars, also is a member of the Federation of Regulatory Counsel, the American Association of Managing General Agents and the International Association of Insurance Receivers.

An experienced legal instructor and lecturer, Mr. Fidei prepares and delivers insurance and reinsurance presentations worldwide.

Fred E. Karlinsky, Esq., a shareholder in the law firm of Colodny, Fass, Talenfeld, Karlinsky & Abate, practices in the areas of insurance regulatory and administrative law and related matters and governmental affairs.

A member of the Florida Bar, Mr. Karlinsky has served as a primary industry strategist for all recent Florida insurance-related legislative initiatives regarding property and casualty, automobile, health, workers'

compensation and medical malpractice. One of the chief architects of a substantial revision to Florida's automobile insurance law, he also was involved in the redrafting of Florida's property residual market statute, as well as the re-write of Florida's workers' compensation and medical malpractice laws.

Mr. Karlinsky, who serves as Florida counsel to the Property Casualty Insurers Association, is a member of the Association of Insurance Compliance Professionals, among many other professional affiliations. Recently, he was appointed an Adjunct Professor of insurance law by Florida State University College of Law.

Abstract: Florida has undergone over the last few years a significant upheaval in its direct residential property insurance market. Significant efforts have been undertaken to manage Florida's hurricane catastrophe risk. The hurricanes of 2004 and 2005 have transformed Florida to a market which is relying heavily upon state-backed direct residential property coverage through Citizens Property Insurance Corporation and catastrophe reinsurance through the Florida Hurricane Catastrophe Fund. What are the forces which have led to this transformation? What initiatives have been implemented in Florida to address the risk of catastrophe? In final analysis, the availability and affordability of residential property insurance remains an ongoing challenge for Florida's policymakers and the efficacy and ramifications of their efforts to date are the subjects of considerable interest.

In the wake of two tumultuous storm seasons, Florida has experienced the significant growth of both its state-backed insurer and reinsurance fund. This article briefly summarizes the major legislative, regulatory, and market developments in Florida's property insurance industry over the past four years. It is also intended to highlight the state's metamorphosis into a full-fledged market competitor and the deliberate steps the state took in making that transition. This article concludes with an overview of the new problems facing a state that continues to struggle with a shrinking voluntary property

insurance market while state officials remain perplexed over the failure of recent reform to result in meaningful rate reduction.

NATURAL DISASTER AND GOVERNMENT REACTION

During the 2004 and 2005 hurricane seasons, a total of eight hurricanes made landfall in Florida.[1] These storms caused an estimated $36 billion in losses based on approximately 2.8 million claims.[2] Insurers generally reacted to these unprecedented losses by submitting new rate filings and asking for rate increases. Also, some insurers began to withdraw from the property insurance market or reduce their exposure in Florida's riskiest areas - primarily its heavily populated coastlines. In the aftermath of these storms, three of the state's largest insurers, State Farm, Allstate, and Nationwide, collectively non-renewed tens of thousands of homeowners policies in these coastal areas. These actions caused policyholders to be confused because many had never filed claims with their carriers.[3]

In early 2006, the Florida Legislature began taking steps to address a growing concern regarding the health of the state's voluntary insurance market. Of particular concern to state officials was the solvency of Citizens Property Insurance Corporation (Citizens) the state's "insurer of last resort." Citizens had been created in 2002 by the merger of Florida's existing Property and Casualty Joint Underwriting Association and Windstorm Joint Underwriting Association.[4] During the

2004 and 2005 hurricane seasons, Citizens as a residual market insurer, provided wind coverage to those Florida homeowners in certain designated high risk areas, who were unable to procure policies in the voluntary market. In addition, Citizens offered multi-peril residential coverage in certain areas throughout the state.[5]

As a result of the 2005 storms, Citizens incurred over $2.5 billion in losses and was faced with a shortfall deficit of $1.7 billion.[6] In 2006, the Florida Legislature passed Senate Bill 1980, which granted Citizens a $715 million appropriation to partially offset its deficit.[7] The balance of the deficit of approximately $1 billion was the subject of an emergency assessment amortized over ten years requiring certain Florida insureds to make a Citizens assessment payment on all new and renewal policies.[8]

The 2006 Legislature also created the Insurance Capital Incentive Build-Up Program to provide state funded low interest loans to insurers under certain conditions. Insurers which brought new capital to the Florida market would be eligible for a matching funds loan from the state. This program provided an incentive for private insurers to infuse new capital into the Florida market. With limited exception, insurers had to have at least $50 million in surplus after participation in the Program and were initially required to maintain at least a 2:1 surplus to net written premium ratio.[9] A total of $250 million was allotted for this loan program by the state[10] and, by the middle of 2007, all money had been utilized.[11]

The 2006 legislation did little, however, to stem ongoing non-renewals of homeowners policies by private insurers. It also failed to address the decisions of some insurers to stop writing, or restrict the writing of, new business in a state that these insurers felt presented unacceptable levels of risk. Although smaller private insurers were encouraged - and were, at one time, promised bonuses - to remove policies from Citizens, the takeouts by these carriers did not ameliorate the problem of availability for many homeowners who continued to have to seek coverage from Citizens. Additionally, premiums for these "take out" policies, as well as the policies of many insurers, reached new heights.[12]

By the summer of 2006, the combination of the decreased availability and affordability of homeowners insurance in Florida was continuing to breed discontent among residents in all parts of the state. Despite the $715 million legislative appropriation, Citizens still faced a substantial deficit which was being recouped through policyholder assessments. In June 2006, in response to growing public concern, then Governor Jeb Bush issued an Executive Order, creating the Property and Casualty Insurance Reform Committee.[13] The Committee was charged with examining Florida's insurance market and formulating recommendations to reduce the cost of premiums, increase the availability of insurance, and reduce the risk to homeowners and businesses. Chaired by then Lieutenant Governor, Toni Jennings, the Committee held public meetings across the state during a three-month period in 2006. The Committee heard testimony from multiple witnesses, including homeowners, carriers, reinsurers,

catastrophe modelers, insurance agents, and even realtors, and it ultimately produced a report containing dozens of recommendations for legislative action.[14]

In the meantime, Governor Bush's last term of office was coming to an end, and Republican Charlie Crist, then Florida's Attorney General, was elected Governor of Florida. Governor Crist campaigned heavily on issues related to the availability and affordability of homeowners insurance. His term commenced in January 2007.[15]

Among the Committee's most significant recommendations were the augmentation of the Florida Hurricane Catastrophe Fund (FHCF) and the expansion of Citizens. Many of these recommendations were carried out, in one form or another, during the January 2007 Special Session of the Florida Legislature. Spurred by newly elected Governor Crist, the Legislature enacted sweeping reforms that impacted many aspects of the property insurance industry in Florida. From revisions to the state building code to programs designed to fund home mitigation measures, the Special Session legislation had two chief goals: making insurance more available to and affordable for, Florida homeowners.[16]

AVAILABILITY AND STATE-BACKED INSURANCE

The Florida Legislature took a number of steps in 2007 to attempt to make insurance available to homeowners who had been nonrenewed by their carriers. The January 2007 Special

Session legislation, along with an Emergency Order issued by Governor Crist, resulted in a temporary freeze on cancellations and nonrenewals of existing homeowners policies.[17] The legislation also changed the rules for the required notice period necessary to cancel or nonrenew policies during hurricane season so insureds would receive longer advance notice in order to be able to find alternative coverage.[18] It also prohibited insurers from writing, in the Legislature's opinion, more profitable automobile insurance policies if the insurer wrote homeowners coverage in any other state unless the insurer also offered homeowners policies in Florida.[19]

A major component of the Legislature's effort to increase availability, however, involved Citizens. As a residual market insurer, Citizens was previously required by statute to charge premiums higher than the state's top twenty voluntary market insurers.[20] However, Citizens' legally mandated high rates became increasingly unpopular as more homeowners faced cancellations or nonrenewals from their private carriers and found themselves paying significantly higher premiums for Citizens' coverage. In fact, after Citizens' policy population more than doubled between 2002 and 2006, frustrated Florida residents formed "Homeowners Against Citizens" and actively campaigned for Citizens to provide more affordable insurance rates.[21]

These demands were met in January 2007 when state legislators abandoned the original theory that Citizens, as a state-run insurer of last resort, should not compete with the

voluntary market. Perhaps the most significant change implemented by the legislation was the requirement that Citizens' rates be "actuarially sound" and subject to the standards that apply generally to private carriers. As a result, Citizens became competitive with the voluntary market. Temporarily, the Legislature rolled back Citizens' rates to a prior, lower level and froze any rate increases by Citizens until 2009.[22] These events, as well as rate increases in the voluntary market, made Citizens' rates lower than many carriers in the private market. Importantly, this created competitive disadvantages for the private market since Citizens does not have to maintain any surplus and its rates: (i) do not have to reflect private reinsurance costs or a profit margin; (ii) are not subject to all of the taxes imposed on the private industry; and (iii) can be lower because Citizens has the authority to make assessments for any deficits it incurs.

The 2007 legislation expanded eligibility for coverage in Citizens in the residential market by repealing a provision enacted in 2006 that rendered nonhomestead properties ineligible for coverage from Citizens. This restored Citizens' policyholder base to include vacation homes and other non-homestead properties. The legislation also provided that a Citizens policyholder would remain eligible for coverage with Citizens regardless of whether the policyholder received an offer of coverage from a private market insurer. This change allowed a policyholder to choose to stay in Citizens and to reject any "take-out" offers from the voluntary market. Eligibility for coverage with Citizens also was extended to new applicants who received offers from private insurers that

were 15% greater than comparable coverage from Citizens, a lower threshold than previously existed.[23]

The 2007 legislation also expanded Citizens' role in providing coverage for commercial risks and in offering multiperil coverage. Citizens assumed the commercial policies formerly held by the state's recently revived Property and Casualty Joint Underwriting Association.[24] Additionally, the legislation permitted Citizens to provide multiperil coverage for commercial residential properties in all areas of the state, including the multi-million dollar condominium developments that dominate significant parts of Florida's high-risk coastlines. In August 2007, Citizens began offering multiperil policies. In 2008, Citizens will begin offering commercial multi-peril non-residential policies.[25]

Finally, the 2007 legislation substantially expanded the types of insurance policies and premiums that are subject to assessments to fund deficits of Citizens. The assessment base was expanded to encompass virtually the same base subject to assessment by FHCF, including all lines of property and casualty insurance, but not workers' compensation, accident and health, medical malpractice and miscellaneous others.[26]

Partially as a result of these changes and market conditions, Citizens has become the largest property insurer in Florida. Citizens currently has more than 1.2 million policies and more than $3 billion in direct written premium.[27]

AFFORDABILITY AND STATE-BACKED REINSURANCE

The other principal focus of the January 2007 Special Session was the expansion of the Florida Hurricane Catastrophe Fund. FHCF was created by the Florida Legislature in 1993 in the aftermath of Hurricane Andrew, which caused an estimated $20 billion worth of damage. Financed through mandatory premiums paid by insurance companies that write residential property insurance in the state, FHCF functions as a reinsurer, offering participating insurers reimbursement for a percentage of their catastrophic losses. FHCF was originally intended to serve as a supplement to, but not a replacement for, the private reinsurance market. The FHCF has certain advantages not available to private reinsurers, in that the FHCF is not obligated to pay federal income tax and can issue tax-exempt bonds. In part, this allows the FHCF to offer lower rates for reinsurance than is otherwise available in the private reinsurance market.[28]

The Florida Legislature, believing that the availability of cheaper reinsurance would lead to lower homeowners premiums, entered the January 2007 Special Session determined to expand the role of FHCF in the reinsurance market. The 2007 legislation allowed insurers to select options to expand their FHCF coverage either above or below the then existing level of coverage and established two types of coverage - mandatory and optional. "Mandatory" coverage was simply a continuation of FHCF's traditional coverage, and every insurer writing residential property insurance in the

state is required to purchase at least a portion of its reinsurance from FHCF. Each insurer's individual retention, or deductible, is determined by its share of FHCF reimbursement premiums and based on a factor, or retention multiple. For example, if the factor is 2.5 for the 2008 FHCF contract year, then an insurer that pays a $1 million FHCF reimbursement premium for 2008 will have a retention of $2,500,000. Although an insurer's retention is on a "per occurrence" basis, there is a fixed and limited amount of coverage to which an insurer is entitled for all hurricane events causing losses in a contract year.[29]

The new "optional" coverages could be obtained either above or below the FHCF mandatory coverage layer. The Temporary Emergency Additional Coverage Option (TEACO) allowed an insurer to purchase its share of a specified layer of coverage below the mandatory coverage at rate-on-line pricing[30] The Temporary Increase in Coverage Limits (TICL) allowed an insurer to purchase one of twelve layers of coverage above the mandatory FHCF coverage. Pricing is based on the average annual loss, plus expenses, without a risk load or a rapid cash build-up factor. Unlike the mandatory FHCF layer of coverage, the optional layers of coverage are fixed and do not expand with exposure growth.[31] These layers were established only for a three year period starting in the 2007 FHCF contract year. During this period, the TEACO industry-wide retention will be set as low as $3 billion and the TICL industry-wide capacity will be as high as $32 billion.[32]

Because of the substantial expansion of FHCF, the 2007 legislation mandated that private insurers pass on to policyholders the savings they would enjoy from the purchase of the expanded, lower-priced, state provided reinsurance. The Office of Insurance Regulation (OIR) calculated presumed factors which were to provide an actuarial estimation of the rate reductions expected as a result of the FHCF expansion. Each insurer was required to utilize these presumed factors in formulating its new rates. The savings to be reflected in the presumed factors rate filings applied to any policy written or renewed on or after June 1, 2007. Importantly, these savings needed to be reflected in rate filings before many insurers' catastrophe reinsurance programs, and the costs related thereto, had been finalized.[33]

Subsequently, insurers were required by September 30, 2007, to make "true up" filings based on their actual reinsurance costs and pass on to the insureds the actual savings which resulted from the expanded FHCF coverage.[34] The "true up" filings by some companies have been the subject of high profile criticism by the Governor, various members of the Legislature and OIR because the savings and rate reductions have not been as significant as anticipated and suggested by OIR.

SIGNIFICANT ISSUES PERSIST

In one sense, the Florida Legislature's 2007 efforts met with a certain amount of success in the view of many policymakers. Many homeowners were able to procure coverage through

Citizens. They also paid lower rates than they otherwise would have paid thanks to the Citizens' rate rollback and temporary rate increase freeze. For these homeowners, property insurance certainly became more available and somewhat more affordable in the short term.

For millions of other Florida homeowners, however, the results have been less favorable. Despite the expansion of state backed reinsurance through FHCF and the resultant rate filings to reflect the benefits of this expanded coverage, the average price of property insurance did not sharply decline, but in many instances, continued to rise. At the height of the 2007 insurance reform effort, state leaders indicated homeowners could expect to see reductions in premiums ranging from 24% to 50%.[35] One year later, OIR reported that approximately one-third of Florida policyholders had experienced no rate relief.[36] One of the state's largest insurers, State Farm, previously agreed to a 9% rate reduction.[37] Nationwide also reduced its rates after proceeding to arbitration following OIR's disapproval of a previously filed rate increase.[38] However, the large insurers have continued to drop policies throughout the state and there is growing concern by some that more policyholders are now being insured by smaller, more thinly capitalized insurers.

Compounding the apparent failure of the legislative reforms to increase voluntary market participation and decrease prices is the enormous financial risk now resting squarely on the state's shoulders. In the event of a significant catastrophic event like Hurricane Katrina, or a series of smaller storms as seen in 2004 and 2005, Citizens could deplete its cash on hand and find itself

in the unpopular position of having to levy assessments. The state could then find itself in a familiar position - facing a massive deficit and looking to policyholders to supply the difference through payment of assessments.

FHCF, with its $29 billion exposure, would be even more deeply affected by a catastrophic event since both Citizens and private insurers would turn to it for reimbursement. Although the state has authorized FHCF to sell $30 billion in bonds to finance its risk exposure, critics note that the largest sale of municipal bonds in American history was an $11 billion bond issue in California. There is no guarantee that sufficient bond buyers could be found, especially in view of the fact that Citizens and the Florida Insurance Guarantee Association (FIGA) may also be in a position of having to issue bonds to fund their deficits. In fact, FHCF was only able to initially sell approximately $3.5 billion in bonds from a $7 billion issuance. Liquidity issues with FHCF could impair its ability to timely pay insurers reinsurance benefits due to them which would implicate solvency issues for those insurers in the aftermath of a hurricane or series of hurricanes.[39]

In any event, each entity would be required to fund bond repayments. All of these entities would still be faced with the daunting task of paying for any bonds they did sell. To do so, FHCF would levy an assessment which would be borne by all policyholders within its assessment base. Under the 2007 legislation, the expanded policyholder assessment base would also be responsible for any Citizens assessment. As noted, a further compounding factor is that policyholders could be

required to pay assessments of FIGA if any private insurers are forced into liquidation as a result of storm claims.

THE AFTERMATH OF THE 2007 LEGISLATIVE SESSION

State officials were perplexed over the failure of the 2007 insurance reforms to bring about meaningful rate reduction. In October 2007, the OIR served Allstate with broad subpoenas, demanding an explanation of the criteria Allstate used when it began dropping 300,000 homeowners policies starting in 2005, information on their claims paying practices, and justification for their rate filings. These subpoenas requested voluminous documentation regarding a variety of issues, including communications involving the trade associations, rating agencies, reinsurers, brokers, and risk modelers. This reflected public accusations of possible collusion among various industry groups in the rate making process.[40]

After Allstate failed to comply with the subpoenas, Insurance Commissioner Kevin McCarty suspended nine Allstate insurer affiliates from writing new policies in the state until they complied with the OIR's request. Subsequently, a state appellate court upheld the propriety of the Commissioner's suspension order.[41] Commissioner McCarty ordered a stay of the suspension of the Allstate licenses after Allstate finally submitted an affidavit certifying it had complied with OIR's requests.[42]

On August 15, 2008 Commissioner McCarty announced the entry by OIR of a Consent Order with Allstate. Under the Consent Order: (i) Allstate Insurance Company agreed to pay OIR a $5 Million penalty, which may not be included as an expense in the ratemaking process in Florida; (ii) Allstate Insurance Company agreed to forgive a $175 Million surplus note issued by Allstate Floridian Insurance Company, in order to enhance the capital and capacity for new business of Allstate Floridian; (iii) Allstate Floridian Insurance Company and Allstate Floridian Indemnity Company committed to use their best efforts to collectively write at least 100,000 new policies (at least 50,000 or which shall be homeowners or similar policies) dispersed throughout the state within three years after their agreed rate reductions go into effect; (iv) for each homeowners or unit owners policy non-renewed by Allstate over this three year period to reduce hurricane exposure, they must write new policies of the same type as they non-renewed by a factor of 1.5; (v) Allstate Floridian Insurance Company and Allstate Floridian Indemnity Company committed to uniformly reduce their territorial base rates for the homeowners and renters lines by 5.6% and to not increase their residential property insurance rates for one year; and (vi) Allstate shall cooperate with OIR in connection with its ongoing investigations of Allstate's claims paying practices and regarding insurers' relationships with the rating organizations, trade associations, modelers, reinsurers, reinsurance brokers and other entities.

Other companies have been subpoenaed by OIR, including Cincinnati Insurance Group, Auto Owners Insurance

Company and certain of its affiliates and various State Farm insurer entities. Furthermore, the Florida Senate has convened a Select Committee on Property Insurance Accountability, which took testimony regarding the availability and affordability of insurance. Senior insurance executives from Hartford, American Strategic Insurance Company, Nationwide, Florida Farm Bureau, and Allstate Floridian testified before the Senate Committee, and many faced difficult questioning and harsh rebukes regarding various market issues.[43] The Committee also requested that Allstate provide documentation similar to what was subpoenaed by OIR and all internal documents having to do with the 2007 Special Session legislation for their review.

These actions reveal the depths of the frustration experienced by state officials with Florida's insurance industry. In January 2008, Governor Crist announced that he had commissioned a team of attorneys to determine whether the state could file a class action lawsuit against the insurance industry on behalf of state residents.[44] Governor Crist and Commissioner McCarty have recently updated a web site to assist consumers looking to acquire or change homeowners insurance. Commissioner McCarty stated there are over twenty-five new homeowners insurers in Florida since 2006, and consumers are encouraged to shop around for a better price.[45]

2008 REGULAR LEGISLATIVE SESSION

Several significant insurance related bills were passed in the 2008 regular legislative session, including the "Homeowner's Bill of Rights Act." This ombudsman insurance bill contained

multiple provisions extending the legislature's role in insurance reform.

This bill, among other things, maintains Citizens' rates at their current level through January 1, 2010; clarifies that the maximum percentage for regular Citizens assessments is lowered from 10% to 6%, after accounting for the Citizens policyholder surcharge; for deficits incurred in or after 2008, a surcharge upon renewal or issuance of policies shall be issued for up to twelve months, and the maximum policyholder surcharge upon renewal or issuance of a policy is increased to 15%; requires 180 days advance notice of nonrenewal, cancellation, or termination of a personal lines or commercial residential policy if the policy has been in effect for five or more years; provides an insurer planning to non-renew more than 10,000 residential policies within a twelve month period must provide ninety days' advance notice to OIR; extends for another year the prohibition on use-and-file rates for property insurance; requires that projected hurricane losses must be estimated using a commission-approved model; requires insurers to use, without modification or adjustment, commission-approved models in determining probable maximum loss for rate filings made more than sixty days after the model is approved; and requires the seller of residential property to disclose the property's windstorm mitigation rating to the buyer.

The bill also created the Citizens Property Insurance Corporation Mission Review Task Force. The task force is to review available data and recommend changes necessary to return Citizens to its former role as a state-created non-compet-

itive residual market. The task force must submit its report by January 31, 2009.[46]

Of significance, the provision in the bill that would have allocated $250 million from Citizens' surplus for funding the Insurance Capital Build-up Incentive Program was vetoed by Governor Crist. This would have provided funding to continue the previously successful low interest matching loan program that was designed to encourage the infusion of more private capital into Florida's residential property market.

Another insurance related bill that was a product of the 2008 regular legislative session was HB 7103 relating to hurricane mitigation enhancement. The bill makes several changes to the My Safe Florida Home program administered by the Department of Financial Services (DFS) that provides hurricane mitigation inspections and grants for specified improvements; requires insurers to accept as valid uniform mitigation verification forms certified by DFS or signed by specified professionals; and sets aside $10 million to implement the program.[47]

There was one significant insurance related bill that did not pass during the 2008 regular legislative session. Florida CFO Alex Sink proposed reform to FHCF to reduce the potential for future FHCF assessments on Florida's insurance consumers.

As previously indicated, House Bill 1A, enacted during the January 2007 Special Session, created the TICL layer for insurers to purchase additional coverage from the FHCF above the maximum limits of the mandatory coverage layer. The

TICL layer option allows an insurer to purchase additional coverage for its share of $12 billion, in $1 billion increments, above the mandatory FHCF coverage limit.

The bill proposed by CFO Sink would have reduced the TICL layer from $12 billion to $9 billion. The bill also would have limited FHCF's reimbursement to 70% of the insurer's losses. Under existing law, FHCF reimburses insurers at either 45%, 75% or 90% of their losses, with the vast majority of insurers electing the 90% reimbursement option. However, CFO Sink's proposed legislation failed to pass.[48]

On June 9, 2008, the Florida Hurricane Catastrophe Fund Advisory Council (Council) met to discuss post-event revenue bonds and pre-event financial products for FHCF. The Financial Services Team commissioned by the Council had been evaluating reinsurance and other financial product options for pre and post-event debt financing.

The need for pre-event financial products stems from an increase in the size of FHCF to approximately $29 billion. FHCF currently has approximately $8 billion available to pay claims - $3 billion in cash and $5 billion in pre-event financing.

The two products discussed included liquidity products (i.e.: put options) and risk transfer products (i.e.: reinsurance). The Financial Services Team reported that risk transfer options have a higher front-end expense and are not an ideal product for the FHCF. Liquidity options, historically used by FHCF, are also not ideal because financial market liquidity is at a historically low capacity.

Through a "put option," a financial institution would promise to purchase potential bonds at a price set at the time of the option contract. The rough estimated cost of this product on $5 billion was approximately 4.5% ($225,000,000). A risk transfer option such as private reinsurance on $5 billion would be approximately $1.5 billion.

On July 2, 2008, SBA authorized FHCF to issue $4 billion in bonds through a tax-exempt "put" option with Berkshire Hathaway for $224 million. This "put" option guarantees Berkshire Hathaway will purchase $4 billion in bonds if FHCF is subjected to a certain amount of losses at the TICL coverage layer. The Florida Cabinet approved the deal on July 29, 2008. Governor Crist and CFO Sink voted in favor of the arrangement, while Florida Attorney General Bill McCollum called the agreement "a bad deal."[49]

CONCLUSION

Citizens' actuaries and executives testified before the 2008 legislature that their rates are substantially below what would be considered adequate. Furthermore, the rates are frozen through the end of 2009. Interestingly, had a similar rate freeze not been imposed in 2000, Citizens would have had enough reserves to pay its losses from the 2004-05 hurricanes without additional assessments. Now, a family with a residential insurance policy and two automobile policies could potentially incur three policy assessments from three sources: Citizens, FHCF and FIGA.[50]

As of March, 2008, there has been a decline in premium volume on a statewide basis, probably due to a combination of factors, including rate decreases related to the 2007 legislation. While new companies have entered the Florida insurance market and removed thousands of policies from Citizens, these "takeout" companies are required to charge rates at or below what policyholders are currently paying Citizens. This raises additional concerns that a catastrophic hurricane could render the new companies insolvent, requiring FIGA to pay claims that would result in further assessments on policyholders.[51]

So far, as of the date this article was completed for publication, Florida has been spared of any significant hurricane activity. However, Louisiana was not as lucky, having just experienced the destruction of hurricane Gustav. Also, hurricane Ike and tropical storm Josephine have been formed and pose real threats to Florida, as we proceed into the peak of the hurricane season.

Whether further state intervention into the voluntary market will, in the long run, achieve the goal of lower rates and improve the availability of coverage continues to remain an open issue. Significant questions have been raised as to whether these efforts have served to stabilize the Florida insurance market or discouraged private insurers and reinsurers from investing more capital into the market. The capacity of both Citizens and FHCF to pay claims is also in question, thereby implicating the claims paying capacity and solvency issues for the private market. In the meantime, millions of Floridians will again anxiously await the first sign that the wind

is starting to blow.

Editor's Note: An earlier version of this article appeared in the Summer, 2008 issue of The Insurance Receiver, portions of which have been reprinted with the permission of the International Association of Insurance Receivers.

ENDNOTES:

[1] Hurricanes Charley, Frances, Ivan, and Jeanne in 2004; Hurricanes Dennis, Katrina, Rita, and Wilma in 2005. See National Weather Service, National Hurricane Center Archive of Hurricane Seasons, http://www.nhc.noaa.gov/pastall.shtml.

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Climate Change:
Risk Management Issues

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Abstract:: The debate as to whether or not global warming is occurring appears to be losing steam, as more and more scientists are convinced that planet Earth is becoming warmer. There is now a shift in focus from this debate to the steps that various public and private organizations can take to proactively manage this daunting phenomenon. Thus, this article applies the risk management process of identification, measurement, and treatment to global climate change, including a series of recommendations for a wide variety of entities.

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Climate change risk management is receiving increasing attention during the last few years. This concept refers to a risk management approach that focuses on reducing the vulnerability associated with climate risk by incorporating climate-sensitive decision-making in the risk management process. The risk manager takes climate-related decisions or actions that make sense in overall business strategy terms, whether or not a specific climate threat actually materializes in the future.

This overview of climate change risk management focuses on key aspects of this approach. The debate over global warming, including background information, is first considered. Next, the various types of climate risk, such as physical, regulatory, and reputational are described. Lastly, the article looks at the appropriate risk treatment of these various risks, including risk control, risk financing, and risk transfer. A list of recommended references concludes the article.

Climate Change Debate

It is argued that climate change or global warming will lead to a growing number of extreme weather events, such as more frequent heat waves and higher storm surges. Global warming could also cause rising sea levels due to melting glaciers and ice sheets and by warming the upper ocean, causing it to expand. This sea-level rise could accelerate erosion, resulting in the loss of wetlands and beaches.[1] Higher temperatures could lead to greater heat stress and the rapid increase in the spread of insect-borne diseases.[2] The issues surrounding

global warming and climate change are not, however, without controversy.

The climate change debate could be defined as a dispute concerning the nature and consequences of global warming. Proponents of global warming argue that a growing body of scientific evidence indicates that global warming is a reality. The United Nations Intergovernmental Panel on Climate Change (IPCC) maintains that 23 of the 24 warmest years on record have occurred since 1980.[3] The IPCC now contends that the scientific evidence makes it a near certainty that climate change is occurring on the planet. A 2004 article reported a survey of 928 abstracts of peer-reviewed papers related to global climate change and found a near consensus position substantiating that climate change is a global reality.[4]

The debate is more heated when it comes to the causes of global warming. There are questions pertaining to the proportion of scientists who agree or disagree on whether humans' actions are behind global warming. Various government reports, environmental groups and European media often claim virtual unanimous agreement in the scientific community supporting human-derived global warming. The IPCC contends that emissions of greenhouse gases grew 70 percent from 1970 to 2004.[5]

Opponents, however, argue that some scientists consider human-derived global warming unproven and claim that

contrarian views are stifled. One prominent scientist argues that global warming is simply a result of ocean circulation changes and other natural weather cycle changes on earth.[6] In spite of the controversy, there appears to be a shift in concentration from whether or not global warming exists (and its possible causes) to the steps that various governmental regulators, industrial and manufacturing organizations, other corporations and businesses, insurers, and consumers can take to proactively manage this phenomenon.

Climate Change Risks

Many scientists project that the impact of climate change on future losses will likely be significant. New avenues of risk are emerging on a regular basis that can affect myriad industries, countries, and individuals. Areas of risk to address include physical risks, litigation risks, stockholder risks, regulatory risks, reputational risks, and competition risks.

Physical Risks

Physical and business interruption risks arise from the growing possibility of extreme weather events, increasing temperatures, and stresses on water supplies that put pressure on businesses and their supply and distribution channels. For example, Hurricane Katrina, occurring in 2005, was the costliest hurricane in the history of the United States. The Insurance Information Institute (III), in a 2007 report, estimates that insurers paid out an estimated $40.6 billion on 1.7 million claims for damage to homes, businesses, and

vehicles, the largest loss in insurance history. The National Flood Insurance Program reported that it paid nearly $16 billion in flood claims as a result of Katrina. The III also reported that scientists expect that the continuation of warming in the Atlantic will increase the probability of hurricanes in the northeastern part of the U.S. To exacerbate matters, the U.S. Census Bureau reported in 2005 that the value of U.S. coastal property could grow as much as 1 percent per year, with an exposure in 2025 of nearly $12 trillion.[7] The growing threat of hurricanes and other extreme weather-related events, coupled with major increases in people living in disaster-prone areas, could dramatically increase hurricane, windstorm, and flood-related losses in the future.

Global warming may also add significant pressure to coastal environments. According to the IPCC, global sea levels in the U.S. are most likely to rise about 2 feet along the Atlantic coast by the end of the twenty-first century. There is a one percent chance that there could be a 4 foot rise.[8] A rise in sea levels could be accompanied by erosion to valuable coastal property, resulting in billions of dollars in property losses.

Some scientists argue that climate change poses a severe threat to fresh water supplies, particularly in the American west. For example, one scientist claims that even the most optimistic climate models for the second half of the twenty-first century suggest that 30 to 70 percent of the snow pack in Northern California will disappear.[9] The shortage of fresh

water could have a profound impact on manufacturing operations, since they typically use large quantities of fresh water.

Health risks may increase due to climate change, with heat stress and the rise of insect-borne diseases a cause for concern. This enhanced risk may strain medical personnel and facilities, employers, and employees. For example, pressure on employers' health care costs and benefits may escalate even more dramatically as a result of these potential risks.

Physical risks could also lead to production shortfalls. For example, hurricanes damaging businesses along coastal regions could shut down these operations for weeks or months. As a result, there are associated risks of transportation and supply chain disruptions, power supply disruptions, and the inability of employees to return to work. In addition, droughts could affect the production of farms and agricultural-related businesses. While it is likely that climate change physical risks could disproportionately affect certain industry sectors, such as health care, insurance, real estate, tourism, and offshore energy infrastructures, all organizations have the potential for being impacted by such risks.

Litigation Risks

Litigation risks may arise from legal action alleging wrongful actions contributing to climate change. Many insurers are now taking notice of this threat, believing that they can face liability claims if their commercial insureds are found liable for contributing to climate change. For example, states and

landowners are pursuing litigation against greenhouse gas (GHG) emitters for property damage allegedly arising from global warming. In a 2007 decision, the U.S. Supreme Court ruled that the EPA has the right to regulate GHG emissions and that states and various property owners can legally pursue claims based on property damage caused by global warming.[10]

There are a variety of sources for such risks, including individual shareholders, class action suits, and regulatory agencies. Lawsuits from stockholders could focus on whether a company became unprofitable due to a lack of planning for climate change by officers and directors. With the growth of class action lawsuits, climate change mismanagement could become a more common type of litigation. In addition, with the expected growth in regulations limiting emissions, enforcement action can occur against companies not complying with all of the regulations.

Several global warming lawsuits have already been filed. They allege that the defendants are liable for the damages caused by global warming under a variety of theories.[11]

- In Connecticut v American Elec. Power Co., 406 F. Supp. 2d 265 (S.D.N.Y. 2005), various states, a city, and various organizations, filed suit against five power companies alleging that CO2 emissions from their power plants constitute public and private nuisances. In October 2007, the defendants settled the case by agreeing to pay $4.6 billion to install pollution

controls that reduce emissions of nitrogen oxide and sulfur dioxide, which cause acid rain and smog. The settlement also included $60 million for reducing emissions from barges and trucks in the Ohio River Valley, cleaning up the Chesapeake Bay and the Shenandoah National Park, and investing in conservation and alternative energy projects.

• In Open Space Institute, Inc. v American Elec. Power Co., No. 1:04-CV-05670-LAP (S.D.N.Y. filed July 21, 2004), environmental groups asserting the right to protect public and private lands filed suit against the same five power companies to force a reduction in their point source emissions.

• In California ex. rel Lockyer v General Motors Corp., No. 3:2006 Civ. 05755-MJJ (N.D. Cal. filed Sept. 20, 2006), dismissed (N.D. Cal. Sept. 17, 2007), the California Attorney General filed suit against the six largest U.S. car manufacturers to recover public costs associated with combating global warming.[12]

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dismissed, 2006 U.S. Dist. LEXIS 33123 (S.D. Miss. 2006), several property owners along the Gulf Coast brought suit for negligence and trespass against dozens of oil and coal companies and chemical manufacturers, alleging that their business practices contributed to global warming, which in turn intensified the effects of Hurricane Katrina.

- Thus, there are emerging legal risks for companies if they do not properly consider climate change concerns, and the risks of litigation will rise if the company is seen to have acted culpably. Industrial and manufacturing companies as well as other larger companies that delay taking action on climate change could be viewed as easy targets for lawsuits from a variety of stakeholders.

Stockholder Risks

Stockholders and investment managers are increasingly asking companies about their fiduciary responsibility to take action in this area. These questions are being asked not only of energy producing entities, steel and aluminum industries, oil and gas producers and distributors, and automobile manufacturers, but also of financial institutions, restaurant chains, retailers, publishers, and a host of other major corporations. Investors may reconsider investing in a company that ignores this key issue, resulting in a downward pressure on its stock price. Note that there are also an increasing number of mutual funds that focus solely on

investing in "green" companies.

Regulatory Risks

Regulatory risks arise from the probability of more rigorous disclosure requirements and the emergence of minimum performance standards tied into energy utilization and consumption along with GHG emission controls. These risks are particularly prevalent among the European Union (EU) countries, with thousands of companies facing mandatory emissions reduction targets and potent noncompliance penalties.[13]

The key international regulations on climate change are covered under the Kyoto Protocol of the United Nations Framework Convention on Climate Change. The Koyoto Protocol contains legally binding emissions targets for developed countries for the post-2000 period. The EU and its member states ratified the Protocol in May 2002. The developed countries committed themselves to reducing their collective emissions of six key greenhouse gases by at least 5 percent below the 1990 level.[14] At this time, the U.S. has not adopted the Kyoto Protocol.

Regulatory action in the U.S., though, will likely follow suit in the near future. One example that has already occurred is the Regional Greenhouse Gas Initiative, signed into law by nine Northeast and Mid-Atlantic states which limits the GHG emissions for power plants in those jurisdictions.[15]

Additional regulatory risks in the future include possible carbon taxes; increased requirements for energy efficiency; and mandated uses of greener technologies, building materials, and building design.

Since regulatory laws can vary by country, companies with international exposures may face contradictory and possibly broader requirements and issues than U.S. companies with simply domestic exposures. Risk managers of companies with international operations and/or exposures should be aware of these differences and plan accordingly.

Reputational Risks

Companies that are publicly condemned for their poor environmental policies or high GHG emissions might eventually suffer a blow to their reputation. A tarnished brand can negatively influence (a) jurors who sit in judgment in court cases, (b) townships and communities that make decisions on corporate expansion and new construction, (c) reporters who cover a corporation's business activities, (d) consumers who are potential customers, (e) environmental activists who may protest a company's operations, and (f) investors.

Competition Risks

Companies may become competitively disadvantaged if they fail to take measures to reduce climate change risks. As these interest groups become more focused on climate change concerns, inactive or sluggish companies may find themselves

at a disadvantage if their competitors establish proactive and effective policies dealing with climate change exposures. Further, the failure to take proactive measures could lead to increasing production costs due to obsolete technologies and a corresponding loss of profits.

Risk Treatment.

As with other risk management decisions, risk control, risk finance, and risk transfer techniques should be considered.

Risk Control.

Like many other loss exposures, risk control is arguably the most important technique when it comes to climate change risks. There are a host of policies and actions that companies can take to reduce their exposure to climate change-related losses, as listed in Exhibit A.

Exhibit A: Risk Control Techniques

- Dedicated climate change risk management team/person
- Risk avoidance
- Disclosure of financial risks
- Disaster planning
- GHG emissions reduction
- Energy conservation and alternate energy usage
- Green building measures and approaches
- Utilization of stricter building codes
- Corporate governance

- Integration of climate change with overall business strategies
- Dedicated climate change risk management team/person

Dedicated climate change risk management team/person

A logical first step in the climate change risk management process is to designate a person or team dedicated to this evolving loss exposure. The team should possess a working knowledge of climate change issues and should be able to apply them to address the company's exposures.

Risk avoidance

Proposals to reduce GHG emissions may uncover important information in developing new strategic directions. Organizations can leave increasingly risky business areas in favor of more secure options by calculating environmental costs and risks correlating to particular products or process lines. As a result, new market and greener product opportunities may present themselves when analyzing current business strategies with a climate change focus.

Disclosure of financial risks

Corporations are facing growing pressure from investor groups to disclose their financial risks due to climate change. This pressure for "transparency" is coming from investors petitioning the Securities and Exchange Commission (SEC) to require companies to disclose this risks.[16] A detailed disclosure

indicates a company's good faith effort to measure, mitigate, and control climate change loss exposures. These types of disclosures can reduce the likelihood of shareholder suits and/or SEC action.

Disaster planning

Climate change could lead to more frequent storms and other natural catastrophic events. According to the American Red Cross, up to 20 percent of small businesses do not reopen after a major disaster. These shuttered businesses were unprepared for a disaster; they had no disaster plan or back up system.[17] As a result, companies need to generate or improve comprehensive disaster planning in order to recover from these events as quickly as possible.

For example, evacuation plans may need to be developed and alternative facilities arrangements made far in advance. Emergency supplies should be kept on hand and companies should back up computer data frequently throughout the day. The key is to get the business back and running as soon as possible after one of these events.

GHG emissions reductions

Companies with GHG emissions in their operations should focus on reducing such emissions through an assessment of internal reduction opportunities as opposed to externally available approaches such as carbon trading (discussed later in this article). The dozens of technologies and practices

designed to lower GHG emissions are constantly being refined and improved for a wide variety of businesses, particularly industrial and high-technology companies. The Union of Concerned Scientists (www.ucsusa.org) offers a variety of ideas in this area. Thus, a proactive approach, rather than a reaction to inevitable regulatory mandates, is the preferred route.

Energy conservation and alternate energy usage

Related to emissions reductions is the whole area of energy conservation and the adoption of alternative energy technologies. Energy conservation includes actions that even the smallest company can take, such as using energy efficient windows and light bulbs. Alternate energy approaches, such as wind power and solar power, make increasing sense for a wide variety of businesses in many locales.

Green building measures and approaches

A green building is a residential or commercial structure that is built in a manner which promotes energy conservation, uses environmentally friendly construction products in an efficient way, and creates a healthy place to live or work. The use of geothermal heat pumps, rainwater collection, and radiant ceilings, are examples of green building techniques and processes. Many of these technologies can be used for new or existing properties.

Utilization of stricter building codes

Companies should support and use stricter building codes since this emphasis may prevent or reduce hurricane and other climate-related losses. For example, structures on the Gulf coast with stricter building codes survived Hurricane Katrina much more successfully. Thus, companies should make sure that roofs are properly fastened in hurricane-vulnerable areas to minimize roof damage and should add hurricane shutters to minimize breaches. In addition, homes with fire resistant features fared better overall in the San Diego fires of 2007.

Corporate governance

The passage of the Sarbanes-Oxley Act of 2002 (SOX) occurred in response to several notable corporate and accounting scandals, including those at Enron and WorldCom. The intersection of climate change risk management strategy and fiduciary responsibility is gaining attention, particularly with regard to the materiality of GHG emissions under SOX. As a result, corporations should consider having at least one director responsible for oversight of climate change risk management strategies.

Integration of climate change with overall business strategies

Proactive companies should consider climate change risk management within the context of major business decisions. Senior executives must factor in the consequences of climate

change loss exposures when making decisions on business strategies. In addition, companies should consider amending their climate-related strategy from one focused solely on risk management to one that also emphasizes business opportunities.

Risk Finance

Risk finance approaches include techniques such as risk assumption and insurance. The key risk finance technique to explore concerning climate change loss exposures is insurance. Insurance coverages to consider are property, general liability/environmental, and directors and officers (D&O) liability.

Property

Climate change may lead to increased property losses if it causes more frequent and severe damage from floods, wild-fires, and hurricanes. Property insurance costs could rise, particularly for businesses in affected communities, and some insurance availability issues may arise. Organizations should work closely with their agents and brokers to determine how climate change risks may affect their property structures and take steps to mitigate and control the losses. For example, complying with stricter building codes and using higher retention amounts, can keep property insurance costs from rising as quickly.

General liability/environmental

General liability policies may provide some coverage for defense costs and liability arising from climate change litigation. This door was opened in April 2007 in the U.S. Supreme Court's ruling in Massachusetts v. Environmental Protection Agency, 549 U.S. 1438 (2007). In this case, several states challenged the EPA's position that it lacked the authority to regulate GHG emissions. The court agreed with the states, ruling that GHG emissions are air pollutants under federal law and that the EPA can regulate them. Thus, insurers will rely on the pollution exclusion to deny these claims. However, state and federal courts interpret the pollution exclusion in myriad ways, and policies written before 1973 do not have pollution exclusions.[18]

A theoretical argument, however, can be made that the GHG emissions are not pollutants per se since secondary levels of effects may cause the actual damage to another party. For example, assume an auto manufacturer is facing litigation for allegedly contributing to global warming. If this global warming eventually causes rising sea levels and flooding in Manhattan, it could be argued that the flood is the proximate cause of the loss and not climate change. The flooding would not be considered a pollutant and thus the pollution exclusion may not apply-thus leading to possible coverage under the general liability policy.[19]

Due to the potential lack of coverage under the general liability policy, risk managers should consider environmental

liability policies for coverage. However, insurers will likely contend that these policies will only pay if it can be proven that the insured's action caused actual and measurable harm. The scientific debate as to the cause of global warming and the difficulties in measuring these effects would likely be reasons that many insurers would deny coverage even under environmental liability policies.

The development of environmental liability products specifically designed to cover climate change losses is in its infancy stage. According to ACE Environmental Risk, it is too soon to begin writing these policies since the risk is currently impossible to ascertain.[20]

Directors and Officers

The growing oversight of climate change risks from investors, regulators, and other stakeholders has implications for D&O liability insurance. In particular, shareholder concerns and resolutions are becoming more common. D&O claims may be triggered by failure to disclose liabilities, loss of revenues or market share, and reputational damage.

Risk managers should closely review the pollution exclusion in the D&O policy. The risk manager would not want to see this exclusion include the phrase "climate change" or "global warming" within it. One authority stated that he has not seen this verbiage in any of the D&O policies at this time.[21] Other D&O liability coverage issues to review include the breadth of bodily injury and property damage exclusions, whether liability

is alleged based upon a covered "personal injury" tort, and intentional misconduct restrictive provisions.[22]

In addition, risk mitigation steps also should be undertaken to improve the possibility of attaining appropriate coverage for this exposure. Examples would include the full disclosure of financial risks and the accelerated use of alternate energy sources.

Risk Transfer

Risk managers should also consider risk transfer techniques outside of traditional insurance policies. Two techniques in particular are worth exploring-weather derivatives and carbon trading.

Weather derivatives

Weather derivatives are financial instruments that can be used by organizations to reduce financial risk associated with adverse weather conditions, including phenomena such as rain, temperature, and wind. Fears of global climate change are greatly expanding the demand for these products among companies such as power suppliers. For example, a ski resort could use this technique to mitigate the financial risk arising from insufficient snowfall. Other potential users are the hospitality, agriculture, retail, transportation, and construction sectors. The Chicago Mercantile Exchange reported in 2007 that the use of these derivatives have increased 100-fold since 2000.

Carbon trading

Carbon or emissions trading is an administrative approach used to control the overall amount of pollution in a given geographical area or country. A central authority, such as a government or international body, establishes a cap on the overall amount of a pollutant that can be emitted. Companies are issued emission permits and are also required to hold an equal number of credits or allowances which represent the right to emit specific amounts of pollutants. The total amount of credits cannot exceed the cap, limiting overall emissions to this level. Companies that need to increase their emissions beyond their allocation would be required to buy credits from those organizations that pollute less. The transfer of these credits is called a trade.

Thus, the buyer of these credits is paying a charge for their emissions beyond their initial allotment, whereas the seller is being rewarded for reducing their emissions below their initial allotment. As a result, those companies that can readily reduce GHG emissions most inexpensively will do so, achieving the pollution reduction at an overall lower cost to the environment.

Sectors that are actively trading emission credits include energy, iron and steel production, minerals, and pulp and paper.[23] For GHG emissions, the largest program is the European Union Emissions Trading Scheme. The voluntary Chicago Climate Exchange program is the world's second-largest carbon-emissions trading market. Its members consist of utilities, cities, multinational companies, and agricultural organizations.

Conclusion

Climate change is one of the most important issues facing the international community in the twenty-first century. As the world's climate becomes warmer, it will pose vast and far-reaching risks for a wide variety of businesses and governmental entities. Approaching this problem with a proactive and integrated risk management program can mitigate the risks in myriad ways.

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Recommended Resources

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2. Chicago Mercantile Exchange. See http://www.cme.com/
3. Environmental Protection Agency (EPA). See http://epa.gov/climate-change/index.html
4. Intergovernmental Panel on Climate Change (IPCC). See www.ipcc.ch/
5. Regional Greenhouse Gas Initiative (RGGI). See www.rggi.org/
6. Union of Concerned Scientists. See http://www.ucsusa.org/

The Emergence of Takaful and Retakaful Companies

By

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Abstract: The market for takaful and retakaful - the Islamic equivalent of insurance and reinsurance - has seen rapid growth in recent years. This article looks at the reasons behind this growth, the challenges which the market faces and its future potential.

The recent growth in Islamic finance arising out of the burgeoning economies of the Gulf countries has focussed the attention of practioners in the conventional insurance and reinsurance markets on takaful and retakaful, the Islamic equivalent of insurance and reinsurance. The key questions being asked are how do takaful and retakaful differ from their conventional counterparts and do they offer any potential for our business?

The fact that the last two years has seen major players from the conventional industry like Munich Re and Hannover Re establish retakaful operations - Munich Re in Labuan, Malaysia and Hannover Re in Bahrain - suggests that they consider that there are good business reasons to be entering into this still young but growing market. Premium income from takaful, approximately USD170 million in 2006,[i] is growing at a rate of 20 per cent per annum globally and at a rate of 25 per cent in the GCC in particular. By 2015, premium income globally from takaful could be as much as USD 12 billion.[ii] With premium income racing towards this level, the reinsurance and retakaful markets can expect that the takaful companies will be wanting to use the capacity of the reinsurance/retakaful markets to manage their exposure.

Why does takaful/retakaful exist?

Islam does not preclude a person taking steps to protect against risk; in fact, it does the opposite. Prophet Mohammed was asked by a man whether submitting to the will of Allah and therefore accepting his fate meant that he should take steps to avoid his camel wandering off by tying it to a tree or should he just leave it loose. The Prophet replied that he should first tie up his camel and then let fate take its course.

As well as the concept of risk management, the concept of paying to protect against risk also existed in seventh century Arabia. The people travelling as part of the caravans journeying between cities would pay a sum to the caravaneer in return for protection on the journey. If they suffered injury

or loss, the caravaneer would pay compensation.

However, insurance/reinsurance as it exists in the modern world is considered by Shari'ah scholars to have elements of *riba* (interest), *gharar* (uncertainty) and *maysir* (gambling), all of which are *haram* (or prohibited) under Shari'ah law:

- Insurance and reinsurance companies invest premium income in interest-bearing investments which in turn fund claim payments;

- It is not certain whether a claim will occur and therefore whether the insured/reinsured will receive any benefit in return for the premium he has paid or what the level of that benefit will be;

- The insured/reinsured will only receive a payment on the happening of a fortuity - he runs the risk of not receiving any payment at all - and any payment he does receive is likely to be significantly greater than the sum which he paid in premium to the insurer/reinsurer.

Therefore if a Muslim is to comply with Shari'ah, he should not purchase insurance or reinsurance. However, the Shari'ah scholars have recognised that there may be times when it is necessary for a person or a company to purchase insurance or reinsurance, for example when motor cover is required by statute. In these circumstances, the doctrine of *darura* (necessity) will apply. Under this doctrine, if Shari'ah compliant cover is not available, using the example of

mandatory motor cover, a person is permitted to purchase the minimum amount of conventional insurance required in order to comply with the statute.

The minimum amount of protection permitted, applying *darura*, is clearly not sufficient for a worldwide Muslim population, currently estimated to be 1.5 billion. Therefore the concept of takaful (and more recently, retakaful) came to be developed. The first takaful company was established in Sudan in 1979. However, takaful really started to be developed in Malaysia during the 1980s, with the passing of the Takaful Act in 1984 and the establishment of the first Malaysian takaful company, Syriakat Takaful Malaysia, in 1985. In the same year, takaful was approved as the Shari'ah compliant alternative to conventional insurance by the Fiqh Council of the Organisation of the Islamic Conference.

"Takaful" is derived from the Arabic verb, Kafala, meaning "to guarantee." In simple terms, takaful is the creation of a fund as a result of monetary contributions (*tabarru'*). The fund is invested in Shari'ah compliant investments and is used to indemnify the contributors in the event they suffer a loss covered by the fund. Consequently, the contributors to the fund share in its profits (if the contributors have a good claims record) as well as in any losses. Any surplus in the fund is distributed at the end of the financial year to the contributors. Takaful is not dissimilar to mutual insurance, with its elements of mutual help, co-operation and solidarity.

The Takaful Models

A key distinction between a takaful company and a conventional insurance company is that there is no transfer of risk to the takaful company - the risk remains with the fund which is owned by the contributors to the fund. The role of the takaful company is to operate the fund and to provide an interest free loan (*quard hasnan*) to the fund in the event that claims exceed the amount of the combined contributions to the fund. The *quard hasnan* is repayable from future profits of the fund.

There are two basic models for a takaful company - the mudarabah and the wakala. The mudarabah model was adopted by the first takaful companies established in Malaysia. In return for operating the fund, the takaful company is entitled to a percentage of the surplus (including any investment income) of the fund. The wakala model has been adopted as the basis for the takaful companies established in the GCC. In this model, the takaful company deducts a set fee from the contributions before they are transferred into the fund and does not take any share of the fund's surplus. The shareholders of the takaful company derive their profits from the fees or profit share which the company receives from the fund. Retakaful companies operate in the same way as takaful companies.

Recently in Malaysia, the move has been away from the mudarabah model towards the wakala model such that eight out of the nine takaful companies in Malaysia now operate on

the wakala model. Critics of the mudarabah model argue that the underwriting surplus which remains after claims have been paid (as opposed to the income derived from the investment of the fund) should not be considered a "profit" and, that in a co-operative environment such as takaful, that surplus is the property of the contributors and the takaful company has no claim to it. A further criticism of the mudarabah model is that the company shares in the underwriting surplus but it does not share in any losses which the fund may suffer as a result of claims.

Some of the Gulf companies for example, Salama, Takaful Re and Hannover Re operate on a hybrid of the two models. The company receives a set fee from the contributions and also receives a percentage of the investment income of the fund. All takaful (and retakaful companies) are required to have a Shari'ah board which usually comprises usually three Shari'ah scholars. The function of the Shari'ah board is to ensure that the business of the company and how it operates are compliant with Shari'ah law. Therefore how the company chooses to structure its relationship with the fund (i.e. mudarabah or wakala or a hybrid of both) must be approved by the company's Shari'ah board. There are different schools of thought in Shari'ah law. Consequently views may differ between scholars as to whether a particular structure is Shari'ah compliant or not; for example, the hybrid model is not approved for use in Saudi Arabia.

The Current Market

There are currently approximately 125 takaful companies worldwide, offering general and life products. Whilst the vast majority of these companies are based in countries with predominantly Muslim populations, potential takaful operators are starting to consider establishing operations in non-Muslim countries that have significant Muslim populations. In July 2008, Principle Insurance, the first takaful company in the UK, began trading, initially offering motor cover. Although Principle's focus is the 1.2 million Muslims living in the UK, its products are also available to non-Muslims. As a company licensed by the Financial Services Authority, Principle will be able to take advantage of the "passporting" regime which exists between the states of the European Union ("EU") to market and sell its products to Muslims and non-Muslims resident in other EU states. Europe's Muslim population is estimated to reach 20 million by 2015. Having access to a potential market of this size, makes opening an operation in an EU state attractive to those considering entering the takaful market.

The split between general and family (as "life" is termed) takaful is currently 90% general / 10% family based on gross takaful contributions[iii]. This marked difference reflects the traditional cultural attitude towards providing support in old age and in times of need namely that support (including financial) is provided by family members. Companies like Bank Aljazira in Saudi Arabia which last year entered into a

joint venture with the British life insurer, Prudential, is working hard to change this attitude. Bank Aljazira offers a number of "life" products including savings plans for university fees, marriage and retirement as well as covers familiar to the conventional life market such as critical illness.

With 60 per cent of the world's Muslim population under the age of 25[v] , the potential growth for takaful in the years to come is obvious. Against the growing market in takaful, has developed an increasing amount of retakaful capacity. Whilst the first retakaful company, Asean Retakaful International Limited, was established in 1997, the issue with retakaful companies until recently, was the fact that they were not rated by the rating agencies and therefore did not provide sufficient security. Now with companies like Tokio Marine Retakaful (AA), Hannover Retakaful (A) and Takaful Re (BBB) being rated by Standard & Poors and the other rating agencies, the retakaful market has become viable and credible. The companies are well capitalised - Tokio Marine Retakaful (USD 25 million), Hannover Retakaful (USD 53 million) and Takaful Re (USD 125 million)[vi]. May 2008 saw the launch by the Dubai Group of ACR Retakaful, a joint venture between the Dubai Group, Khazanah Nasional (the investment arm of the Malaysian Government) and Asia Capital Reinsurance (based in Singapore), capitalised at 176 million euros. At the recent Second International Takaful Summit in London, the CEO of Takaful Re, Chakib Abouzaid commented that the amount of retakaful capacity now available exceeded what was required by almost 90 per cent of the existing takaful market. Where previously takaful

companies were able to rely on *darura* to off-set their risk with conventional reinsurance, this will no longer be the case. Sufficient capacity now exists for compliance with Shari'ah to be maintained. At the London Summit, Dawood Taylor, the General Manager of Bank Aljazira reported that his company's reinsurance requirements were now met 100 per cent by retakaful.

Market Challenges

As with any new and growing market, the management of takaful and retakaful companies face a number of challenges. While those individuals leading the market are highly skilled and hugely expert at what they do, there is a dearth of suitably qualified personnel (underwriters, actuaries) to fulfil the needs of a growing industry. People are being trained but there will inevitably be a gap between supply and demand in the meantime.

As Shari'ah compliant companies, takaful and retakaful companies are required to maintain and invest their capital in Shari'ah compliant investments. Inevitably, this raises the possibility of concentration of risk due to the smaller universe of Islamic funds available. In addition, the companies are faced with the challenge of how to balance their investment portfolios to ensure proper returns for shareholders whilst at the same time not exposing themselves to undue risk and also how to ensure compliance with their regulator's capital adequacy requirements. Because of the lack of lower risk sukuks (the Islamic equivalent to bonds/debt instruments), the

investment portfolios of takaful and retakaful companies are currently skewed towards equities which are higher risk. Until a market in sukuks is developed - sukuks tend to be taken up by large institutions on issue who hold them until maturity - takaful and retakaful companies will be operating at a disadvantage to their conventional counterparts.

Takaful companies also face the challenge of increasing customer awareness of their products, of overcoming the traditional view that "insurance" is haram. Countries like Saudi Arabia and the United Arab Emirates are helping to increase demand for takaful by making the purchase of certain insurance covers like accident and health, mandatory. However, there is no set answer to the question of how to inform and persuade people to buy a product which they have traditionally considered to be haram. Overcoming this hurdle is going to take time.

A separate challenge for the retakaful companies is going to be to persuade takaful companies to move their business to them from their existing conventional reinsurance providers. While *darura* may no longer justify the use of conventional reinsurance capacity, the fact remains that the takaful companies will have built up relationships over time with their reinsurers and moving their business away from them is not something that they will necessarily be keen or willing to do. Certainly, the move to using retakaful capacity is not something that is going to happen overnight.

The Future

Takaful and retakaful are not passing phenomena - they are here to stay. The signs are that the significant growth which the market has seen in the last few years will continue and will expand into countries outside the traditional Muslim world. Certainly, the industry faces challenges but its leaders have the spirit and the determination to make the industry a success story. Now that major players from the conventional reinsurance market have thrown their hats into the "retakaful ring", it is unlikely to be long before others from the reinsurance industry consider that they, too, should be part of the story.

Endotes:

[i] Ernst & Young "The World Takaful Report 2008"

[ii] Ajmal Bhatty, CEO Takaful Tokio Marine Middle East - "Will Takaful penetration match conventional insurance" - Second International Takaful Summit, London (15-16 July 2008)

[iii] Ernst & Young "The World Takaful Report 2008"

[iv] Dawood Yousef Taylor, General Manager Takaful Ta'awuni - "Developing a Family Takaful operation in the Kingdom of Saudi Arabia. Bank Aljazira's Takaful Ta'awuni - a Modern Day Success Story" - Second International Takaful Summit, London (15-16 July 2008)

[v] Ernst & Young "The World Takaful Report 2008"

[vi] Chakib Abouzaid, CEO Takaful Re - "The need for Retakaful & existing capacity" - Second International Takaful Summit, London (15-16 July 2008)

Judicial Review of Arbitration Awards: The Challenge of the Supreme Court's Decision

By

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Abstract: When Congress enacted the Federal Arbitration Act under Title 9, it did so with a two-fold purpose in mind: 1) ease the strain increased litigation had placed on the court system; and 2) elevate the negative perception of "arbitration" by declaring agreements-to-arbitrate binding. Over the years, courts have struggled to rule consistently under what has been described as the FAA's conflicting dual-purpose. In *Hall Street Assoc. v. Mattel, Inc.*, the US Supreme Court attempted to resolve the ambiguity as it relates to the enforceability of expanded judicial review for arbitration awards. Yet, if rulings since *Hall Street* are any indication, the challenge to rule consistently on this issue is alive and well.

This article chronicles the rise of *Hall Street* -- exploring the origins of the FAA and federal jurisprudence leading up to the recent Supreme Court ruling, with a focus on what future implications such a ruling may have as courts continue to struggle with conflicting legislative intent.

Alternative means of dispute resolution have become a prevalent force in the current legal market. An overwhelming number of contracts, including a great deal of reinsurance contracts, contain language that provides for arbitration as the sole method of dispute resolution. While the movement toward use of alternative dispute resolution has proven to be cost-effective in many instances and alleviated some of the strain placed on the American court system, the enforceability of arbitration awards has been the source of contention and, at times, protracted litigation.

Under §§ 2, 9, 10 and 11 of the Federal Arbitration Act of 1925 (the "FAA")[1], Congress not only sought to strictly uphold the enforceability of arbitration clauses, but also restricted a court's power to vacate, correct or modify an award issued by an arbitration panel. It has been argued that parties should be free to negotiate (and include in their contracts) the parameters of judicial review for arbitration decisions. However, others maintain that the FAA should operate as the controlling standard for judicial review of arbitration awards. This inherent conflict has led to a split in federal jurisprudence.

On March 25, 2008, the United States Supreme Court, in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, spoke on the issue by directly addressing the extent to which parties may contractually expand the statutorily imposed judicial review standards for vacating, modifying or correcting arbitral awards identified within §§ 10 and 11 of the FAA[2]. In short, the Supreme Court held in *Hall Street* that §§ 10 and 11 provide

the exclusive means of review for parties seeking expedited review under §9 of the FAA, abrogating decisions spanning over a decade from five of the eleven Federal Circuit Courts of Appeals permitting judicial review beyond the guideposts specifically identified in the FAA.

This article discusses the origins of the debate behind expanded judicial review of arbitral awards, focusing on the original statutory intent and purpose of the FAA, the conflicting federal jurisprudence leading up to the Supreme Court's acceptance of *Hall Street*, and an evaluation of *Hall Street* and its potential future implications.

The Federal Arbitration Act - Origins and Purpose

In 1925, Congress enacted the Federal Arbitration Act utilizing its plenary powers under the Commerce Clause with a two-fold purpose: first, to allow parties the opportunity to avoid "the costliness and delays of litigation," simultaneously reducing the strain put on the courts through increased litigation; and second, to elevate the negative perception and enforceability of arbitrations by placing arbitration agreements "upon the same footing as other contracts."[3] This dual-purpose, however, resulted in conflict when federal courts attempted to interpret and enforce the FAA in accordance with its stated legislative intent.

According to *Scherk v. Alberto-Culver Co.*, prior to the enactment of the FAA, the American court system generally shared the traditional belief of the English courts, which regarded

irrevocable arbitration agreements as "ousting the courts of jurisdiction" -- refusing to enforce such agreements.[4] However, as industrialization proliferated in this country, Congress viewed the enactment of the FAA as "practically appropriate," finding that the "agitation" caused by increased litigation could be "largely eliminated by agreements for arbitration."[5] Therefore, in order to alleviate strain placed on the courts and "[t]o overcome judicial resistance to arbitration," the FAA was enacted by Congress, prompting a new national policy favoring arbitration.[6]

A by-product of contract law, the FAA was further enacted to reinforce a party's freedom to bargain and negotiate the terms and conditions of their own contracts, without interference. According to the Supreme Court in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, while Congress intended for the introduction of the FAA to encourage swifter resolutions for matters in dispute, its passage "was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered,' requiring courts to enforce privately negotiated agreements to arbitrate, like other contacts, in accordance with their terms."[7] As such, agreements to arbitrate placed within a written contract were made valid, irrevocable and enforceable under § 2 of the FAA,

> A written provision in … a contract … to settle by arbitration a controversy thereafter arising out of such contract… or an agreement in writing to submit to arbitration an existing controversy arising out of such

> contract… shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.[8]

Not only were arbitration clauses validated under the FAA, but, to further encourage arbitration as a final resolution tool, Congress also built in language to restrict judicial scrutiny of awards resulting from such a clause. Under § 9,

> If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, [then] … any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title.[9]

Under the FAA, therefore, a court ***must confirm*** an award unless it is vacated, modified, or corrected as prescribed under §§ 10 and 11. Sections 10 and 11 enumerate a short list of circumstances under which a federal court may exercise its review powers with respect to arbitral awards.

§ 10 provides vacation of the award only, (1) where the award was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption in the arbitrators, or either of them; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence

pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.[10] While, § 11 allows for modification or correction only, (a) where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award; (b) where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted; (c) where the award is imperfect in matter of form not affecting the merits of the controversy.[11]

In general, the provisions of §§ 10 and 11 have been regarded as extremely limited, reinforcing the general policy behind arbitration to avoid judicial involvement. As the Seventh Circuit pointed out in *Carpenter Local No. 1027, Mill-Cabinet-Indus. Div. v. Lee Lumber and Building Material Corporation*,

> Contracting parties who agree to submit disputes to an arbitrator for final decision have chosen to bypass the normal litigation process. If parties cannot rely on the arbitrator's decision-if a court may overrule that decision because it perceives factual or legal error in the decision-the parties have lost the benefit of their bargain. Arbitration, which is intended to avoid litigation, would instead become merely the starting point of litigation.[12]

The Tenth Circuit agreed, commenting, "maximum deference is owed to the arbitrator's decision. In fact, the standard of review of arbitral awards 'is among the narrowest known to the law'."[13] Likewise, the Fifth Circuit shared a similar sentiment when it found that arbitration award review is "extraordinarily narrow,"[14] quoting a U.S. Supreme Court case, *Wilko v. Swan*, in which the Supreme Court noted that judicial review of an arbitration award is even narrower than judicial review of a trial proceeding.[15]

Of significant note, *Wilko* has also been used to support the position that the Supreme Court introduced an additional judicially created standard of review to be used in conjunction with the statutory review standards of §§ 10 and 11.[16] In *Wilko*, the Supreme Court stated, "the interpretations of the law by arbitrators in *contrast to manifest disregard* are not subject, in the federal courts, to judicial review for error in interpretation."[17] Several federal courts use that single sentence to stand for the position that, in addition to the limited number of allowable reasons that a court may review a decision by an arbitration panel identified in the FAA, an award displaying "manifest disregard for the law" is automatic grounds for review in the arbitral setting.[18]

For instance, the United States Court of Appeals for the Sixth Circuit, quoting *Wilko*, stated in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Jaros* that, "[a]s an alternative to these statutory grounds, a separate judicially created basis for vacation obtains where the arbitration award was made 'in manifest disregard of the law'," further commenting,

"[a]lthough the parties have bargained for a resolution by way of arbitration, a blatant disregard of the applicable rule of law will not be tolerated."[19] Likewise, the Ninth Circuit in *Todd Shipyards Corp. v. Cunard Line, Ltd.* commented that, "[i]t is generally held that an arbitration award will not be set aside unless it evidences a 'manifest disregard for law'."[20] However, even if all courts agreed with the addition of the *Wilko* standard (which they do not), that would still provide limited review capabilities for courts faced with parties appealing their arbitration awards.

As identified above, an inherent inconsistency exists between the competing interests behind the enactment of the FAA, which has resulted in a split in federal jurisprudence. Many argued that the restrictions placed on judicial review of arbitral awards under §§ 10 and 11 conflict with general freedom of contract principles - supporting contract clauses that individually expand (or further restrict) judicial review of arbitration awards as a product of mutual negotiation. Proponents of this line of thinking focus on cases highlighting the congressional intent behind the FAA to place arbitration agreements "upon the same footing as other contracts."[21]

On the other hand, others have strongly held the position that the congressional intent to ease the burden placed on the court systems, while avoiding "the costliness and delays of litigation" should be the proper focus, arguing that the strict judicial review standards specifically enumerated in §§ 10 and 11 were meant to be exclusive. The United States Court

of Appeals for the First Circuit highlighted the debate in *Puerto Rico Tel. Co. v. U.S. Phone Mfg. Corp.*, commenting, "[the] two policies contained within the FAA- the policy favoring arbitral resolution…, and the policy favoring enforcement of arbitration agreements according to general contract principles-are potentially in conflict…"[22] Over the past decade, the federal circuit courts have attempted, unsuccessfully, to address and resolve this conflict - essentially, splitting right down the middle.

Five Federal Circuit Courts Align with Expandable Review Rationale

In 1995, the United States Court of Appeals for the Fifth Circuit took the stance that a party's contractual agreements should pre-empt any statutorily imposed limitations to judicial review of arbitral awards.[23] After acknowledging that arbitration decisions are subject to extraordinarily limited review, the Fifth Circuit distinguished instances where the parties "contractually agreed to permit expanded review of the arbitration award by federal courts."[24] The court noted that, "[a]rbitration under the [FAA] is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit."[25] Under the rationale that the purpose behind the enactment of the FAA was to uphold contracts as written, the court upheld the insertion of language within the arbitration clause permitting direct appeal for errors of law.[26] Subsequently, the Fourth Circuit ruled similarly in an unpublished 1997 opinion when it upheld the

party's negotiated language allowing for de novo review of an arbitration award where the arbitrator "commit[s] errors of law or legal reasoning."[27] In doing so, the court specifically agreed with the Fifth Circuit in finding that, "the FAA does not prohibit parties who voluntarily agree to arbitration from providing contractually for more expansive judicial review of the award."[28]

The Third Circuit, likewise, found merit in the congressional intent to uphold contract principles, affirming the parties' insertion of references to state law judicial standards into their arbitration agreement on the grounds that, "…[the] rule is simply that courts must enforce the terms of arbitration agreements."[29] In doing so the court, "join[ed] with the great weight of authority and [agreed] that parties may opt out of the FAA's off-the-rack vacatur standards and fashion their own (including by referencing state law standards)."[30] Ultimately, the court in this instance found that the conflicting "choice-of-law" provision was too generic to "demonstrate a clear intent to displace the FAA's vacatur standards," however, agreed with the mentality that the parties are free to negotiate individual terms that may deviate from statutory standards.[31]

Similarly, the Sixth Circuit also addressed a case where the parties inserted a generic choice-of-law provision into their contract, resulting in a dispute as to whether the limited vacatur standards of the FAA applied versus the more thorough state standard of review.[32] The court again found, in

line with *Mastrobuono v. Shearson Lehman Hutton, Inc.*, that generic choice-of-law provisions will not displace the federal standard for vacatur, but acknowledged that the outcome may be different in situations where there is an "unequivocal inclusion" of another state's law.[33] The First Circuit in *Puerto Rico Tel. Co. v. U.S. Phone Mfg. Corp* also found that judicial review provisions of the FAA can be displaced by explicit contractual language evincing the parties' clear intent to subject the arbitration award to a different standard of review.[34] Although the court ruled in line with its sister states, finding that the language at issue in that dispute did not rise to the level of "clear intent" to displace, it further emphasized that, "…the principal objective behind the passage of the FAA was enforcement of the parties' agreements, and that efficient dispute resolution should not be favored over the FAA's primary goal of enforcing private agreements to arbitrate."[35] Accordingly, parties under *Puerto Rico* are free to displace the FAA standard of review, provided the displacement is made clear under the contractual language.[36]

Ultimately, in five circuits [the First, Third, Fourth, Fifth and Sixth], the courts placed greater emphasis on the parties' ability to enter into private contracts with individually negotiated terms, including terms that address the judicial review of arbitration awards.

Five Federal Circuit Courts Align with Limited Review Rationale

On the other side of the federal precedent addressing the issue, five Circuits have ruled in line with the argument that the

policy behind the FAA was primarily to encourage arbitration as a means toward final resolution, upholding the FAA's limited judicial review standards and refusing to allow contractually negotiated review standards. In *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, the language within the arbitration clause at issue included broader standards for vacatur than just those identified in §§ 10 and 11 of the FAA. After a complex procedural history, the Ninth Circuit definitively held that a federal court may only review an arbitral decision on the grounds set forth in the FAA.[37] In doing so, the court summarized the limited review standards enumerated in §§ 10 and 11 of the FAA, and commented on their intentionally narrow construction and purpose,

> In sum, the Federal Arbitration Act allows a federal court to correct a technical error, to strike all or a portion of an award pertaining to an issue not at all subject to arbitration, and to vacate an award that evidences affirmative misconduct in the arbitral process or the final result or that is completely irrational or exhibits a manifest disregard for the law. These grounds afford an extremely limited review authority, a limitation that is designed to preserve due process but not to permit unnecessary public intrusion into private arbitration procedures.[38]

The court in *Kyocera* explicitly identified the legislative purpose behind the inclusion of more limited standards for judicial review, stating, "Congress's decision to permit sophisticated parties to trade the greater certainty of correct legal

decisions by federal courts for the speed and flexibility of arbitration determinations is reasonable legislative judgment that we have no authority to reject."[39] Ultimately, *Kyocera* rejected the parties expanded language and held, "Congress has specified standards for confirming an arbitration award, federal courts must act pursuant to those standard and no others."[40]

The Tenth Circuit took a similar position in *Bowen v. Amoco Pipeline Co.*, when confronted with the issue of expanded judicial review provisions.[41] *Bowen* also pointed to the legislative purpose behind the FAA to "avoid the expense and delay of court proceedings" (specifically rejecting the focus placed on the freedom to contract as recognized by other Circuits) and rejected the negotiated language allowing an expanded review of awards by emphasizing the independence of the arbitration process.[42]

Quoting *Bowen*, the Second Circuit, in *Hoeft v. MVL Group, Inc.*, also questioned the enforceability of a private agreement providing for different review standards than those found both statutorily (§§ 10 and 11) and judicially (*Wilko*).[43] In *Hoeft*, while the court acknowledged parties' freedom of contract (and the possibility for expanded review), it further commented that such freedom does not extend to limit the judicial review power granted by Congress, stating, "judicial review is not a creature of contract, and the authority of a federal court to review an arbitration award - or any other matter - does not derive from a private agreement."[44]

Referencing the split in federal jurisprudence, and summarizing the positions advanced within those cases, the Eighth Circuit also refrained from enforcing contractually-placed narrower review standards to override the FAA's standards stating, "we … express skepticism as to whether parties can contract for heightened judicial review of arbitration awards, which would seemingly amend the FAA, crown arbitrators mini-district courts, force federal trial courts to sit as appellate courts, and completely transform the nature of arbitration and judicial review."[45]

Finally, although not expressly addressing the issue, the Seventh Circuit also weighed in on the finality of arbitration awards, creating noteworthy precedent regarding judicial review for other courts to follow.[46] In *Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc.*, the Seventh Circuit commented that while parties are free to negotiate for arbitral awards to be reviewed by an arbitration panel, they have no such authority for judicial review.[47] Simply stated, "[parties] cannot contract for judicial review of [an] award; federal jurisdiction cannot be created by contract."[48] The court further commented that it is "forbidden" from substituting its own interpretation of the issue placed in dispute, "even if the arbitrator's interpretation was not only wrong, but plainly wrong."[49]

As highlighted in the split of precedent from ten of the eleven Federal Circuits, the issue concerning judicial review of arbitration awards is one that clearly failed to reach resolution, prompting the United States Supreme Court to accept *Hall*

Street Associates, L.L.C. v. Mattel, Inc.[50]

Hall Street Associates, L.L.C. v. Mattel, Inc.

Hall Street involved a commercial lease dispute between a landlord, Hall Street Associates, LLC ("Hall Street") and a tenant, Mattel, Inc. ("Mattel"). According to the terms of the subject lease, Mattel agreed to indemnify Hall Street for any costs resulting from the failure of Mattel or its predecessor lessees to follow environmental laws while using the premises for its manufacturing operations.[51] At one point, while Mattel was still occupying the property, the Oregon Department of Environmental Quality ("DEQ") found pollutants in the property's water well. Three years later, when Mattel sought to terminate its lease, Hall Street filed suit arguing that the termination was invalid and Mattel was obligated to indemnify Hall Street for the costs of remediation of any contaminated property. The District Court ruled in favor of Mattel on the termination issue, and after an unsuccessful mediation attempt, the parties sought to arbitrate the issue of indemnification. The arbitration agreement, which was drafted during the course of litigation and approved by the District Court, provided in relevant part that,

> [t]he United States District Court for the District of Oregon may enter judgment upon any award, either by confirming the award or by vacating, modifying or correcting the award. The Court shall vacate, modify or correct any award: (i) where the arbitrator's findings of fact are not supported by substantial evidence, or (ii)

where the arbitrator's conclusions of law are erroneous.

The arbitration resulted in a ruling in favor of Mattel on indemnification, finding that compliance with the Oregon Drinking Water Act ("Water Act") was not a type of federal, state or local environmental law Mattel was obligated to comply with under the terms of its lease. Hall Street took the award back to the District Court on appeal, which overturned the arbitration award finding that the Water Act was, in fact, a type of environmental law covered by the contract. In vacating the award, the District Court remanded the matter back to arbitration citing *LaPine Technology Corp. v. Kyocera Corp.*, as its authority to review the arbitration award under the terms agreed to by the parties.[52]

On remand, the arbitrator reversed its prior ruling and found in favor of Hall Street; both parties appealed for modification. The District Court again upheld the expanded judicial review clause. The parties then each sought direction from the Ninth Circuit Court of Appeals. Since the original District Court ruling, the Ninth Circuit had vacated *LaPine* with its en banc decision in *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, prompting Mattel to change its position and argue that the expanded judicial review provision was unenforceable completely. The Ninth Circuit agreed, remanding to the District Court with instructions to, "confirm the original award…unless…the award should be vacated on the grounds allowable under 9 U.S.C § 10, or modified or corrected under the grounds allowable under 9 U.S.C. § 11." The District Court again held for Hall Street, the Ninth Circuit against reversed,

and the United States Supreme Court decided it was time to address this issue directly.

The Supreme Court began by commenting on the congressional purpose behind the enactment of the Federal Arbitration Act, discussing the line of cases introduced earlier, and the split in federal jurisprudence, ultimately holding that §§ 10 and 11 provide the FAA's exclusive grounds for expedited vacatur and modification.[53] In doing so, the Court addressed each of Hall Street's two main arguments. First, the Court found that Hall Street's reliance on *Wilko* and the judicially created review authority for "manifest disregard for the law" was misplaced.[54] In doing so, the Court noted that, "[a]lthough it is true that the Court's discussion includes some language arguably favoring Hall Street's position, arguable is as far as it goes."[55] As previously discussed, in *Wilko* the Supreme Court commented that, "the interpretations of the law by arbitrators *in contrast to manifest disregard* are not subject, in the federal courts, to judicial review for error in interpretation."[56] The Supreme Court acknowledged the line of cases that have taken that sentence to create additional grounds for vacatur, but plainly stated it should be taken for what it is, "without embellishment."[57] There is nothing in that statement to support the leap that Hall Street and other courts have suggested. In fact, if nothing else, the Court noted, the statement expressly rejects what Hall Street seeks from it, general review for an arbitrator's legal error.[58] As an alternative, the court noted, the language could simply be an ill-phrased attempt at summarizing the grounds for vacatur specifically enumerated in §§ 10 and 11 -- a shorthand description of sorts. Ultimately, while the Supreme

Court did not specifically reject the various *Wilko* interpretations, it certainly created a question whether "manifest disregard" can serve as a judicially created standard of review under the FAA.

The Court subsequently addressed Hall Street's second position, that the main congressional purpose behind the FAA was to encourage the freedom of contract principles, and uphold the agreements as negotiated and entered into freely by parties. As such, the grounds for vacatur, correction or modification found in §§ 10 and 11 of the FAA are merely threshold grounds, with the parties free to negotiate therefrom. Again, the Court noted, "the argument comes up short."[59] While the FAA does allow parties freedom to negotiate certain terms and conditions in the arbitration setting, "judicial review" is the one condition unequivocally and intentionally limited. The Court points to the language of the FAA in support, noting that § 9 specifically provides that the reviewing court "must grant" the order "unless the award is vacated, modified or corrected as prescribed," stating further that "there is nothing malleable about 'must grant,' which unequivocally tells courts to grant confirmation in all cases, except when on of the 'prescribed' conditions applies."[60] According to the Court, there is no "hint of flexibility" in this language.[61]

Had Congress intended this to be a default provision, enumerating merely threshold grounds, it would have done so explicitly, as it did in §5 providing, "if no method [of naming or appointing an arbitrator] be provided herein…then the court shall designate and appoint an arbitrator."[62] Explaining its rationale,

the Court emphatically stated that "'[i]f no method be provided' is a far cry from 'must grant …unless'."[63] Ultimately, the Supreme Court upheld the limitation on review provided within the FAA, commenting, "[i]nstead of fighting the text, it makes more sense to see the three provisions, §§ 9-11, as substantiating a national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straightaway."[64]

In sum, the Court vacated the judgment and remanded for further proceedings consistent with the idea that judicial review under the FAA be expressly limited to those grounds enumerated under §§ 10 and 11.

Future Implications of Hall Street

It is uncertain how future courts will handle the Supreme Court's recent *Hall Street* ruling. For those parties agreeing with the Second, Seventh, Eighth, Ninth and Tenth Circuits, *Hall Street* will undoubtedly serve as the main support for their argument that (with the exception of the limited §§ 10 and 11 grounds) binding arbitrations are just that, binding, as was always the intent and purpose of the FAA. However, for those parties still seeking to encourage contractually negotiated expansions in line with the First, Third, Fourth, Fifth and Sixth Circuits, the answer may rest in *Hall Street's* explicit limitation. In the decision, the Supreme Court specifically opened the door for other grounds, outside the FAA, for judicial review of arbitration awards, providing,

> In holding that §§ 10 and 11 provide exclusive regimes for the review provided by the statute, we do not purport to say that they excluded more searching review based on authority outside the statute as well. The FAA is not the only way into court for parties wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable.[65]

This "window of opportunity," may serve as a guide for future litigants attempting to expand judicial review under their arbitration clauses. For example, parties may rewrite their arbitration clauses to explicitly and with "clear intent" designate that a particular state law will govern the review of arbitration awards. Or, perhaps *Hall Street* signals the decline of arbitration as a preferred alternative dispute resolution method in general, a possibility the Supreme Court itself acknowledged in *Hall Street* when it commented, "[we] cannot say whether the exclusivity reading of the statute is more of threat to the popularity of arbitrators or to that of courts" (in response to *Hall Street's* assertions that parties will flee from arbitration if expanded review is not available).[66] Again, only time will reveal the full extent of impact *Hall Street* has on future litigation.

However, if recent rulings are any indication, the debate concerning the extent of permissible judicial review is far from complete. Since the *Hall Street* decision was rendered, courts have struggled to interpret the Supreme Court's ruling

in a consistent manner, particularly with respect to the applicability of *Wilko's* judicially created "manifest disregard of the law" standard.

At least one Circuit has read *Hall Street* to be an elimination of the "manifest disregard of the law" standard.[67] In *Ramos-Santiago*, Horving Ramos-Santiago, a driver for UPS, was terminated after failing to deliver thirty-seven packages over the span of two business days. UPS alleged Horving had violated the collective bargaining agreement governing the terms of his employment, which allowed for discharge of an employee who declares "an unauthorized strike, work stoppage, walkout or …other action that paralyzes, obstructs or interrupts the operations of the Company."[68] Represented by his Union, Horving challenged the discharge through arbitration. The arbitrator determined that the discharge was proper, and the District Court for the District of Puerto Rico (after UPS removed the matter from state court) confirmed the award.

On appeal, the United States Court of Appeals for the First Circuit affirmed the ruling based on an analysis of the purported review standards, which included primarily, manifest disregard of the law. In doing so, the court referenced *Hall Street*, stating "[w]e acknowledge the Supreme Court's recent holding [in *Hall Street*] that manifest disregard of the law is not a valid ground for vacating or modifying an arbitral award in cases brought under the Federal Arbitration Act."[69] However, the court went on to

distinguish the applicability of *Hall Street* to the present action stating the matter was not governed by the Federal Arbitration Act because neither party invoked the expedited review under the FAA and the original complaint was filed in state court. The court continued with its analysis of manifest disregard of the law, and affirmed the ruling. Still, *Ramos-Santiago* appears to be the first Circuit court to interpret *Hall Street* as an elimination of the manifest disregard of the law standard when brought under the FAA.

Several District Courts have read *Hall Street* similarly.[70] For example, the United States District Court of Minnesota provided a detailed discussion of *Hall Street* in *Prime Therapeutics LLC v. Omnicare, Inc.*, specifically asking, "[d]oes [*Hall Street*] suggest that courts can no longer vacate an arbitration award based on judicially-created grounds such as 'manifest disregard of the law'?"[71] Answering its own question, the court stated, "[a]fter *Hall Street*, this Court believes the answer to that question is yes."[72] Thus, the court adhered strictly to the statutorily created review grounds under §§ 10 and 11 of the FAA. Further, the District Court for the Southern District of New York declined to follow its Second Circuit precedent which had previously applied the manifest disregard standard routinely, stating, "[a]s the Second Circuit's traditional understanding of *Wilko* and § 10 - that *Wilko* endorsed manifest disregard and that § 10's grounds are not exclusive - is inconsistent with the basis for the holding in *Hall Street*, the Court finds that the manifest disregard of the law standard is no longer good law."[73] Thus, for several courts, *Hall Street* is a clear elimination of the

manifest disregard standard.

However, other courts are not as convinced. At least one District Court has found *Hall Street* vague on this point and cautiously refused to extend its ruling as an elimination of the manifest disregard standard.[74] Although the Southern District of Texas in *Halliburton* acknowledged that the Supreme Court declined to extend the "manifest disregard" standard in *Hall Street*, it noted that, "the Supreme Court did not expressly decide whether the 'manifest disregard' standard remains a separate basis for federal court review of arbitration decisions in at least some circumstances."[75] Because of this ambiguity, and the fact that the Fifth Circuit has traditionally recognized the "manifest disregard" standard, the court in *Halliburton* "out of an abundance of caution," analyzed the matter using manifest disregard as "both a summary of some of the statutory grounds [§ 10 and 11] and as an additional ground for vacatur."[76] Another court ignored *Hall Street's* discussion of manifest disregard all together.[77] The Eastern District Court of Michigan was faced with a post-*Hall Street* arbitration award issue, and ruled exclusively on "manifest disregard of the law" standards. In doing so, the court first acknowledged *Hall Street's* ruling on exclusive statutory grounds for review, but then stated, "[i]n addition to these statutory grounds, a court may vacate an award if arbitrators have 'manifestly disregarded the law'."[78] The court then analyzed the entire case on the manifest disregard standard, apparently ignoring the Supreme Court's discussion of the judicially - created standard in *Hall Street*.

Still other courts have attempted to hold onto the "manifest disregard" standard by both acknowledging the Supreme Court's apparent denial of the standard while upholding its applicability as an extension of the statutory grounds.[79] For example, the Southern District of Texas noted, "*Hall Street* overrules Fifth Circuit precedent establishing manifest disregard of clearly applicable law as an additional ground for vacatur," but further agreed that, "[t]he Court left open the possibility that the manifest disregard standard may remain good law as a derivation of one, or several, of the enumerated statutory grounds.[80] Likewise, quoting a New York State court, the Northern District of New York as recently as July 8, 2008, commented that, "Hall Street appears to have done nothing to jettison the 'manifest disregard' standard of *Wilko*."[81] Accordingly, the court continued, "this court will view 'manifest disregard of law' as judicial interpretation of the section 10 requirement, rather than as a separate standard of review."[82]

Judging from the recent jurisprudence interpreting and discussing *Hall Street*, it appears courts will continue to debate the issue of judicial review standards for arbitration awards. Although *Hall Street* clearly provides that §§ 10 and 11 of the Federal Arbitration Act are exclusive means for award review under the FAA, the judicially-created "manifest disregard" and more-narrowly tailored arbitration agreements may serve as powerful loopholes for parties seeking to circumvent the limitations placed on FAA arbitral award review under *Hall Street.*

Endnotes:

[1] 9 U.S.C § 1 *et seq.* (2000).

[2] *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 128 S.Ct.1396 (2008).

[3] *Scherk v. Alberto-Culver Co.*, 517 U.S. 506, 511 (1974)(quoting H.R. Rep. No.96, 68th Cong., 1st Sess., 1, 2 (1924); see also S.Rep.No.536, 68th Cong., 1st Sess. (1924)).

[4] *Scherk*, 517 U.S. 506, 511 n.4 (1974)(quoting H.R. Rep. No.96, 68th Cong., 1st Sess., 1, 2 (1924)); *see also Puerto Rico Tel. Co. v. U.S. Phone Mfg. Corp.*, 427 F.3d 21, 31 (1stCir. 2005).

[5] H.R. Rep. No.96 at 7 (1924).

[6] *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006); *see also Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 474 (1989).

[7] Volt, 489 U.S. 468, 474 (1989)(quoting *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219-220 (1985)); *see also Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53 (1995).

[8] 9 U.S.C § 2.

[9] 9 U.S.C § 9.

[10] 9 U.S.C. § 10(a).

[11] 9 U.S.C. § 11.

[12] *Carpenter Local No. 1027, Mill-Cabinet-Indus. Div. v. Lee Lumber and Building Material Corporation*, 2 F.3d 796 (7th Cir. 1993).

[13] *ARW Exploration Corp. v. Aquirre*, 45 F.3d 1455, 1462 (10th Cir.1995)(quoting, *Litvak Packing Co. v. United Food & Commercial Workers, Local Union No. 7*, 886 F.2d 275, 276 (10th Cir.1989)).

[14] *Antwine v. Prudential Bache Securities, Inc.*, 899 F.2d 410, 413 (5th Cir.1990).

[15] *Wilko v. Swan*, 346 U.S. 427 (1953), overruled on other grounds by *Rodriquez de Quijas v. Shearson/Am. Express*, 490 U.S. 477 (1989).

[16] *Id.*

[17] *Id*. at 436-437 (emphasis added).

[18] *See Tanoma Mining Co. v. Local Union No. 1269*, 896 F.2d 745, 749 (3d Cir.1990).

[19] *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Jaros*, 70 F.3d 418, 421 (6th Cir.1995); *see also Jacada (Europe) Ltd. v. Int'l Marketing Strategies, Inc.*, 401 F.3d 701 (6th Cir. 2005).

[20] *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056, 1059-60 (9th Cir. 1991).

[21] *Volt*, 489 U.S. 468, 474 (1989)(quoting *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S., at 219-220 (1985))

[22] *Puerto Rico*., 427 F.3d 21, 28 (1st Cir. 2005).

[23] *Gateway Tech., Inc. v. MCI Telecomm. Corp.*, 64 F.3d 993 (5th Cir.1995).

[24] *Id.* at 997.

[25] *Id.*

[26] *Id*.; *see also Harris v. Parker Coll. of Chiropractic*, 286 F.3d 790, 793-94 (5th Cir. 2002)(acknowledging *Gateway* and upholding contractual language that provided that each party held the right to retain appeal power for questions of law).

[27] *Syncor Int'l Corp. v. McLeland*, 120 F.3d 262, 1997 WL452245 at *6 (4th Cir.1997)(unpublished table opinion).

[28] *Id*. (quoting *Gateway Tech*., 64 F.3d 993 997 n.3 (5th Cir.1995).

[29] *Roadway Package Systems, Inc. v. Kayser*, 257 F.3d 287, 293 (3d Cir. 2001).

[30] *Id.*

[31] *Id.*

[32] *Jacada (Europe) Ltd. v. Int'l Marketing Strategies, Inc.*, 401 F.3d 701 (6th Cir. 2005).

[33] *Id.* at 710 (quoting *Ferro Corp. v. Garrison Indus., Inc*., 142 F.3d 926, 937 (6th Cir. 1998).

[34] *Puerto Rico*, 427 F.3d 21, 31 (1st Cir. 2005).

[35] *Id.*

[36] *Id.*

[37] *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987 (9th Cir. 2003)(en banc).

[38] *Id*. at 997-998.

[39] *Id.* at 999.

[40] *Id*. at 1000.

[41] *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 934-36 (10th Cir. 2001).

[42] *Id*. at 934-36.

[43] *Hoeft v. MVL Group, Inc.*, 343 F.3d 57 (2d Cir. 2003).

[44] *Id*. at 66.

[45] *Schoch v. InfoUSA, Inc.*, 341 F.3d 785, 789 n.3 (8th Cir. 2003), *cert. denied*, 540 U.S. 1180 (2004).

[46] See *Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc.*, 935 F.2d 1501 (7th Cir. 1991).

[47] *Id.* at 1505.

[48] *Id.*

[49] *Id.*

[50] *Hall Street*, 128 S.Ct.1396 (2008).

[51] *Id.* at 1400.

[52] *LaPine Technology Corp. v. Kyocera Corp.*, 130 F.3d 884, 889 (C.A.9 1997).

[53] *Hall Street*, 128 S.Ct.1396, 1403 (2008).

[54] *Id.*

[55] *Id.*

[56] *Wilko v. Swan*, 346 U.S. 427 (1953), overruled on other grounds by *Rodriquez de Quijas v. Shearson/Am. Express*, 490 U.S. 477 (1989).

[57] *Hall Street*, 128 S.Ct.1396, 1404 (2008).

[58] *Id.*

[59] *Id.*

[60] *Id.* at 1405.

[61] *Id*. at 1399.

[62] *Id*. at 1405.

[63] *Id.*

[64] *Id.*

[65] *Id*. at 1406.

[66] *Id.*

[67] *See Ramos-Santiago v. United Parcel Service,* 524 F.3d 120 (1st Cir. 2008).

[68] *Id.* at 123.

[69] *Id*. at 125.

[70] *See Robert Lewis Rosen Assoc., Ltd. v. Webb*, 2008 WL 2662015 (S.D.N.Y July 7, 2008); *Prime Therapeutics LLC v. Omnicare, Inc.*, 2008 WL 2152207 (D.Minn. May 21, 2008); *ALS & Assoc., Inc. v. AGM Marine Constructors, Inc.*, 2008 WL 2230770 (D.Mass. June 2, 2008).

[71] *Prime Therapeutics*, 2008 WL 2152207 at *6

[72] *Id.*

[73] *Robert Lewis*, 2008 WL 2662015 at *4

[74] *Halliburton Energy Services, Inc. v. NL Industries*, 553 F.Supp.2d 733 (S.D.Tex. 2008).

[75] *Id.* at 753.

[76] *Id.*

[77] *See Fitzgerald v. H&R Block Financial Advisors, Inc.*, 2008 WL 2397636 (E.D.Mich June 11, 2008).

[78] *Id.* at *4.

[79] *See Mastec North America, Inc. v. MSE Power Systems, Inc.*, 2008 WL 2704912 (N.D.N.Y. July 8, 2008); *Wood v. Penntex Resources LP*, 2008 WL 2609319 (S.D.Tex. June 27, 2008).

[80] *Wood*, 2008 WL 2609319 at *8 n.4.

[81] *Mastec*, 2008 WL 2704912 at *3 n.4 (quoting *Chase Bank, USA, N.A. v. Hale*, 859 N.Y.2d 342 (N.Y.Sp.Ct., N.Y. County, March 31, 2008).

[82] *Id.*

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The Intermediaries & Reinsurance Underwriters Association is pleased to announce the sale of advertisements in the Journal of Reinsurance, please respond promptly if you have an interest in reserving the front inside or back inside covers.

About the Journal of Reinsurance

The Journal of Reinsurance is an official publication of the Intermediaries & Reinsurance Underwriters Association. It is published quarterly in January, April and July, and October. Focused on issues confronting the reinsurance community in today's complex environment, the Journal of Reinsurance applies the best research and practices to the strategic challenges and operating problems of today's environment. The Journal of Reinsurance is designed to keep reinsurance and insurance underwriters, insurance company executives, brokers, regulators, academicians and those interested in reinsurance abreast of developments which will impact on reinsurers and the reinsurance market.

Advertising Deadlines (Volume 16)

•Volume 16, No. 1, Winter 2009: December 15, 2008
•Volume 16, No. 2, Spring 2009: March 15, 2009
•Volume 16, No. 3, Summer 2009: June 15, 2009
•Volume 16, No. 4, Fall 2009: September 15, 2009

Ad Placement Requirements

All ads must accompany an advertising agreement by specific Journal deadline date and final payment no later than 14 days after Journal deadline.

For additional information, incuding ad rates please call the IRU Member Service Center at (908) 203-0211 or by email info@irua.com.

The Intermediaries & Reinsurance Underwriters Association

In 1967, executives from seven midwestern insurance companies met in Milwaukee to discuss reinsurance concerns.

From that first meeting, the IRU has grown to become an organization comprised of more than 60 member companies and firms engaged in the assumption, placement or purchase of property/casualty treaty reinsurance.

In October of 1993, the IRU expanded its membership to include reinsurance intermediaries in addition to its broad spectrum of professional reinsurers and assumed reinsurance departments of multiple line carriers. Approximately 25% of the IRU's current membership is comprised of intermediaries. In September 2002, the IRU further expanded its membership to include reinsurance ceded operations of primary insurance companies. While all IRU members operate principally in the U.S. reinsurance market, some are active in international reinsurance markets as well.

The IRU is a not-for-profit corporation, organized for the purposes of reinsurance education and research, and the dissemination of information relevant to the reinsurance industry. The IRU does not speak on behalf of its membership on industry issues nor does it engage in lobbying.

To learn more about IRU visit our internet site at www.irua.com.

Commentary or Corrections?

The IRU welcomes your comments and suggestions, as well as information regarding errors or omissions that call for correction. Please send your electronic message to jor@irua.com or by telephone at 908-203-0211. To correspond with Paul Walther, Editor of the Journal of Reinsurance, directly please send your emails to editor@irua.com.

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