HOUSTON GENERAL INSURANCE COMPANY, Petitioner, -v- CERTAIN UNDERWRITERS AT LLOYD'S LONDON AND OTHER INSURERS SUBSCRIBING TO REINSURANCE AGREEMENTS F96/2992/00 and F97/2992/00, Respondents.

02 Civ. 7599 (JSR)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

2003 U.S. Dist. LEXIS 19516

October 31, 2003, Decided
October 31, 2003, Filed

DISPOSITION: [*1] Petitioner's petition to confirm arbitration award granted.

CORE TERMS: discovery, arbitration panel, arbitration, petition to confirm, arbitration award, fraudulently, concealed, undue, software, confirmation, arbitrators', sworn statement, subrogated, unlinking, admit

COUNSEL: For Houston General Insurance Company, PLAINTIFF: Richard J Hoskins, Schiff Hardin & Waite, New York, NY USA.

For Houston General Insurance Company, PLAINTIFF: Paul A Scrudato, Schiff Hardin & Waite, New York, N.

JUDGES: JED S. RAKOFF, U.S.D.J.

OPINIONBY: JED S. RAKOFF

OPINION:

MEMORANDUM ORDER

JED S. RAKOFF, U.S.D.J.

Underwriters at Lloyd's of London and certain other insurers (collectively, the "Reinsurers") contracted with Houston General Insurance Company ("Houston General") to reinsure a share of the latter's liability under insurance policies issued by it to Warrantech Consumer Products Services, Inc. ("Warrantech") for periods from April 1, 1995 to December 31, 1997. With the Reinsurers' knowledge and acquiescence, Houston General delegated its claims payment responsibilities to its insured, Warrantech. Subsequently, however, a dispute between Houston General and the Reinsurers concerning the propriety of Warrantech's claims payment practices was submitted to arbitration pursuant to the reinsurance contracts.

On August 19, 2002, an arbitration panel awarded Houston General $ 39 million. On September 19, 2002, the [*2] day the award was due to be paid, Houston General filed with this Court the instant petition to confirm the arbitration award. On that same date, but six minutes later, the Reinsurers filed in Texas state court a petition to vacate the award, as well as a complaint alleging that Warrantech had engaged in fraudulent claims processing. n1 The Reinsurers then moved in this Court to transfer the instant petition to confirm to the United States District Court for the Northern District of Texas; but on October 29, 2002, the Court denied that motion. See Order dated October 29, 2002. Thereupon, after receiving briefing and oral argument on the substance of the petition to confirm, see transcript, 12/2/2002, the Court issued a short Order grating the petition and confirming the arbitration award. See Order dated December 16, 2002. This Memorandum Order serves to reconfirm the latter order and to state the reasons therefor.

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n1 Nonetheless, the Reinsurers went ahead and paid the full amount of the arbitration award, but did so under protest.

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The instant petition is governed by the Convention on the Recognition of Foreign Arbitral Awards (the "Convention") and its implementing legislation, 9 U.S.C. § 201, et seq.. The Reinsurers argue that the award should be set aside because it was procured

through "corruption, fraud, or undue means." 9 U.S.C. § 10(a)(1). In particular, the Reinsurers allege that Warrantech used certain software programs ("AS4000" and "WISE") to fraudulently "link" claims with "shell" contracts, thereby transforming uncovered claims into covered ones, and that Houston General fraudulently concealed this information from the arbitration panel, thus warranting denial of the petition to confirm or, at least, further discovery.

In making this argument, the Reinsurers face substantial hurdles. To begin with, there is in the Second Circuit a "strong presumption in favor of enforcing arbitration awards," Wall Street Assocs., L.P. v. Becker Paribas Inc., 27 F.3d 845, 849 (2d Cir. 1994). To overcome this presumption and have an award vacated on grounds of fraud or undue means, the party seeking vacatur must (1) establish the existence of the alleged [*4] fraud or undue means by clear and convincing evidence, (2) demonstrate due diligence in attempting to discover the fraud before entry of the award, and (3) demonstrate that the fraud was material to the arbitrators' decision. See, e.g., A.G. Edwards & Sons, Inc. v. McCollough, 967 F.2d 1401, 1404 (9th Cir. 1992).

In their attempt to meet these high burdens, the Reinsurers rely on two items of information that the Reinsurers claim were concealed from the arbitration panel by Warrantech and Houston General. The first item derives from a request for admission served by Warrantech on Reinsurers in connection with the post-arbitration Texas litigation. The request asks Reinsurers to "admit that Houston General has released any claims against Warrantech to which Lloyd's contends it is subrogated." This, in the Reinsurers' view, is not only evidence that such a release exists, but also that, as a result, Houston General's representations to the arbitration panel that Reinsurers "could sue [Warrantech] for fraud," Arbitration Hearing Transcript ("Tr."), August 16, 2002, at 2 (attached as Ex. Y(30) to Documents Filed Under Seal), were therefore fraudulent. But this argument [*5] fails on numerous grounds.

To begin with, the language of the request to admit is open to various interpretations, and hardly mandates the existence of the alleged release. Houston General, indeed, has provided a sworn declaration denying knowledge of the existence of any such release, see Declaration of Seigo Ishmaru, dated November 25, 2002 (attached as Exhibit 3 to Houston General's Reply Memorandum of Law in Support of its Petition to Confirm), and the Reinsurers, while asking for discovery on this issue (see infra), have not adduced any other evidence that such a release exists, let alone that Houston General knew of it at the relevant time.

Moreover, even assuming arguendo that Houston General is lying to this Court and that such a release not only existed but also was known to exist by Houston General at the time of the arbitration, there is nothing in the record to suggest that this would negate the accuracy of the Reinsurers' representation to the arbitrators that Reinsurers could sue Warrantech for fraud. This is because the hypothetical release, to the extent evidenced by the request for admission, only releases those claims against Warrantech to which the [*6] Reinsurers claim to be subrogated, i.e. contract claims, and therefore in no way would preclude Houston General from suing Warrantech for fraud.

Finally, even if Houston General's representations to the panel that it could sue Warrantech for fraud could somehow be said to be false, it would be immaterial, as the Reinsurers have totally failed to make a meaningful showing that those representations were likely to have affected the panel's determination in any material respect. See, e.g., Karppinen v. Karl Kiefer Machine Co., 187 F.2d 32, 35 (2d Cir. 1951) (affirming confirmation of arbitration award because the alleged fraud and undue means related only to a "collateral matter").

The second piece of information is part of a sworn statement given by Keith Nadolski, a consultant hired by Warrantech as a computer programmer, in connection with the Reinsurers' Texas litigation against Warrantech. Nadolski states (1) that Thomas Fontanetta, Warrantech's computer systems officer, "would have" directed Nadolski to write a certain kind of software program, and (2) that Warrantech had used a computer program specially designed to "unlink" consumer claims that had been [*7] "linked." See Sworn Oral Statement of Keith Nadolski, dated October 16, 2002, at 9 (attached as Ex. U to Reinsurers' Declaration in Support of Memorandum of Law in Opposition to Petition to Confirm). The Reinsurers argue that Nadolski's statement provides evidence that Fontanetta perjured himself before the arbitration panel when he testified that he had no knowledge of and was not involved in the transition from one computer system (the AS400 system) to another (the WISE system). See Tr., January 22, 2002, at 108-09, 113, (attached as Ex. Y)(13) to Documents Filed Under Seal). Additionally, the Reinsurers argue that the statement shows that Houston General fraudulently concealed the existence of the "unlinking" software from the panel.

On its face, however, Nadolski's sworn statement about what someone else "would have" done is in no way inconsistent with his prior testimony about what he himself knew and did. Even more important, Fontanetta's testimony was not "furnished" by Houston General, the "prevailing party," at the arbitration hearing. See Karppinen, 187 F.2d at 34. Instead, the panel requested Fontanetta's presence, and the above-quoted testimony was [*8] elicited by counsel for the Reinsurers. Therefore, the alleged perjury cannot be characterized as fraud on the part of Houston General.

Similarly, the Reinsurers have failed to adduce any evidence that Houston General concealed the "unlinking" software from the panel. To the extent that Nadolski's testimony indicates concealment on the part of Warrantech, that alleged impropriety cannot, without any proof of collusion between Warrantech and Houston General, be attributed to Houston General. Moreover, even if it could, the Reinsurers have failed to show that this "newly discovered" evidence could not have been discovered during the course of

the arbitration. The Reinsurers had every opportunity to depose Nadolski in connection with the arbitration, and came within a hair's breadth of doing so before determining that his testimony was no longer necessary. See Documents Filed Under Seal, Ex. 7 (Letter from Reinsurers' Counsel to Arbitration Panel, dated March 7, 2002). Accordingly, the Reinsurers have fallen far short of meeting their burden of proof in this matter.

Finally, the Reinsurers have not persuaded the Court that further discovery is warranted to probe the question of [*9] whether Warrantech and Houston General conspired to hide evidence from the panel. n2 As explained above, neither Warrantech's request for admission nor Nadolski's statement remotely suggests that Houston General acted improperly -- let alone fraudulently. Although courts have sometimes taken the position that further discovery is appropriate in connection with challenges to arbitration awards, see, e.g., In re Waterspring, S.A., 717 F. Supp. 181, 186-87 (S.D.N.Y. 1989) (allowing 60 days for discovery on constitution of arbitration panel), the Court sees no ground here for second-guessing the panel's determination on the flimsy showing here made. See Imperial Ethiopian Gov't v. Baruch-Foster Corp., 535 F.2d 334, 337 (5th Cir. 1976) ("The loser in arbitration cannot freeze the confirmation proceedings in their tracks and indefinitely postpone judgment by merely requesting discovery.").

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n2 Since the Reinsurers' discovery request is denied, the Court need not consider their renewed motion to transfer the case to the Northern District of Texas, which is premised on the convenience of such discovery.

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Accordingly, for the foregoing reasons, Houston General's petition to confirm the arbitration award is hereby granted. Clerk to enter judgment.

SO ORDERED.

JED S. RAKOFF, U.S.D.J.

Dated: October 31, 2003