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# Federal Judge Confirms $16.4 Million Award, Plus Interest, in Favor of AXA

NEW YORK - A federal judge has confirmed an award in which an arbitration panel refunded AXA Versicherung AG $15,357,760 overpaid by the reinsurer — plus $1 million in exemplary damages and 6.5 percent compound interest — during its participation in an AIG (NYSE:AIG) reinsurance facility.

In the July 27 unanimous award, an arbitration panel found that AIG “obscurely and imprecisely” communicated to AXA the nature of the reinsured risks and AXA’s true participation in the facility. The arbitration panel was comprised of umpire Richard L. White and arbitrators Mark S. Gurevitz and Jonathan Rosen.

In a Sept. 6 order, Judge Jed S. Rakoff noted that the parties stipulated to confirmation of the award.

In 1996, AXA's predecessor, Albingia Versicherung AG, agreed to take on a 20 percent participation for the first year in a $10 million reinsurance facility and a 25 percent participation for the second year. This participation was later increased to 72.72 percent and 52.08 percent respectively, without Albingia's knowledge or consent.

AIG allegedly told Albingia that the facility covered risks written by American International Underwriters Energy Division in the southern Pacific Rim and would be ceded to the 1996/97 facility on a "facultative obligatory basis."

In 1997, AIG expanded the scope of the facility to include property and construction risks "including advance loss of profits and/or business interruption" and "third party liabilities, operating risks for oil and petrochemical, chemical, utilities, boiler and machinery and power generation as agreed." The facility included risks written "worldwide," except for the United States and England. AXA took on a 25 percent participation in the 1997/98 facility.

After sustaining massive losses, AXA sued AIG subsidiaries New Hampshire Insurance Co., American Home Assurance Co. and National Union Fire Insurance Company of Pittsburgh, Pa. AXA alleged that AIG used the facility "as a dumping ground for volatile, risky or unprofitable insurance policies AIG would not have otherwise written" and intentionally misrepresented the size and nature of the risks.

AXA claimed that it was not aware of AIG's misrepresentations until May 2004, when one of AXA's own reinsurers, Everest Reinsurance Co., sought to void its reinsurance contract with AIG on the basis of "misleading" information concerning the 1997/98 facility. AXA initiated an investigation, which it said revealed the extent of AIG's misrepresentations.

AXA sued AIG in the U.S. District Court for the Southern District of New York, asserting claims of intentional and negligent misrepresentation, material nondisclosure, bad faith and conspiracy to commit fraud. The case proceeded to trial and a jury rendered a verdict in AXA's favor, holding AIG liable in the amount of $34,373,170, including $5.75 million in punitive damages, for fraudulently inducing Albingia to enter into two reinsurance facilities. The District Court entered final judgment in February 2008.

AIG appealed and the 2nd Circuit remanded the case, directing the District Court to address the question of whether AXA's claims were subject to certain arbitration clauses. Specifically, the District Court was directed to "address in the first instance the extent to which AXA's allegations sound in contract as opposed to fraud," and to resolve the issue of whether AIG waived its right to arbitration.

The District Court concluded that the pre-contractual fraudulent inducement claim sounded in fraud, rather than in contract, and therefore was not subject to arbitration. AIG appealed that order.
The 2nd Circuit agreed with the District Court that AXA's allegations sound in fraud. However, the appellate court concluded that AXA's pre- contractual fraudulent inducement claims are time-barred under New York law because AXA's duty of inquiry arose as early as 1998 and no later than September 2000.

On remand, the District Court entered judgment in favor of AIG on the pre-contractual fraud claims and the court clerk recommended that AIG receive $210,778.57 in costs. However, in March 2011, the District Court granted AXA’s motion to set aside the bill of costs. The court explained that “the jury’s unanimous determination that AIG defrauded AXA to the tune of nearly $30 million was only reversed on appeal because the 2nd Circuit found that AXA was ‘on inquiry notice’ of the fraud outside the applicable limitations period.” Under these circumstances, “it would be inequitable to impose costs on AXA,” the court concluded.

In December 2010, the District Court lifted the stay of arbitration so that the parties could arbitrate the contractual issues subject to the arbitration clause.

In the arbitration, AXA disputed AIG’s claim that AXA owed it $7.7 million plus interest, attorney’s fees and costs. AXA also brought counterclaims, asserting that AIG breached the treaties.

AXA asserted that the business ceded to the facility was a product of adverse selection evidenced by the abnormally high loss ratio.

The panel noted, however, that the record did not establish that the AIG underwriting of these risks was systematically designed or used to produce a greater ceded loss potential. The facility was designed to cover the first $10 million of loss, therefore the loss to the facility from the ceded risks would be relatively greater to the participating reinsurers than the loss in excess of that limit to reinsurers of the excess component; that differential was dealt with by the premium charged for use of the facility, the panel explained.

Next, the panel concluded that AIG’s underwriting offices used “pernicious adverse selection of facility risks.” The panel noted that despite the “extreme” underwriting loss for the 1997-98 period (a 480 percent incurred loss ratio on $7 million of premium), the parties’ underwriting experts could not conclude from the record that “a pervasive and perverse pattern of underwriting” was apparent in the AIG offices ceding the construction-all-risks and energy-all-risks (CAR-EAR) business to the facility.

“Whether this inconclusive aspect of the experts’ reports/testimony resulted from insufficient underwriting data or other factors within the samples selected, the record does not reflect a conscious use of asymmetric data by AIG to channel relatively poorer risks to the facility,” the panel concluded.

AXA also asserted that the administration of cessions to the facility was so flawed that it constituted a breach of the contracts. The panel concluded, however, that AIG did not breach the contracts through its administration, noting that AXA “generally acquiesced” to AIG’s practices.

The panel also found that AIG did not breach the contracts by ceding marine risks and multi-year policies to the energy facility. The marine nature of the risks was incidental to the underlying energy component and the procedure applied to the multi-year policies did not represent improper judgments on the part of the AIG underwriters, the panel found.

The panel then turned to AXA's demand for adjustment of its participation in the facility to reflect its intended participation. AXA clearly intended to participate in a $10 million facility of CAR/EAR energy type risks, the panel noted, and the first period participation was 20 percent and second year participation was 25 percent. However, AIG's brokers were only able to complete a $2.75 million and $4.8 million facility for the respective periods, the panel observed.

"The pattern of written communication on this percentage participation matter is one of repeated obfuscation by AIG's broker," the panel concluded. "Early on, AIG could have simply stated that the facility was undersubscribed and that AXA's 1997 20 percent participation in the expected facility represented 72.72 percent in the actual facility or that AXA's 25 percent participation in the expected renewal facility 52.08 percent in the actual renewal facility."

The panel determined that AXA's actions following formation of the contract do not show that it knew of, and accepted, the higher participation percentage. The panel directed AIG, within 30 days of the date of the award, to refund AXA $15,357,760 overpaid by AXA for its share of losses ceded to the facility, plus interest.

The panel also recognized that actual premiums ceded to the facility were also overstated when recalculated on the AXA intended participation percentage. The panel declined to credit AIG with an adjustment for the ceded premium to the facility.

"AIG's broker placed retrocessional protection for the facility's reinsurers and understood that the related retrocessional premium would be a function of the expected premium to be ceded to the facility, which was estimated at some $10 million," the panel explained. "That AIG broker, who charged commissions to the reinsurers for placing the retrocessional coverage, knew or should have known that the undersubscribed facility would not generate the expected premium income and that the related retrocessional reinsurance premium would be overstated thereby harming the reinsurers. At minimum this should have been disclosed to AXA."

In addition, the panel awarded AXA $1 million in exemplary damages as to AIG's conduct in the operation of the 1997 facility.

"The evidence in this arbitration is overwhelming that time after time AIG opted for the obscure and imprecise communication rather than the clear and explicit," the panel found. "Were the subject matters of this deficient communication minor or routine, we need not find fault with AIG. But such matters were anything but minor or routine. They dealt with the most fundamental aspect of this reinsurance relationship, i.e. the nature of the reinsurance transaction and the participation therein."

Finally, the panel awarded AIG $5,411,267, plus interest, in presently due amounts, noting that AIG did not adversely select risks for or improperly administer the facility. The panel allowed AIG to credit this sum against the amount awarded to AXA.

AXA is represented by Joseph T. McCullough IV and Robin C. Dusek of Freeborn & Peters in Chicago and Sean T. Keely of Hogan Lovells in New York.

Counsel for AIG are Stuart Cotton and Ann E. Halden of Mound Cotton Wollan & Greengrass in New York.



_AXA Versicherung AG v. New Hampshire Insurance Co., et al._, No. 12-6009 (S.D. N.Y.)