Pine Top Receivables, LLC v. Banco De Seguros Del Estado: The Seventh Circuit Exorcises some Ghosts of Reinsurance Past, but has it Summoned an Erie Ghost of Reinsurance Future?

Part II: What Transpired in Pine Top?

In our last post on Pine Top Receivables, LLC v. Banco De Seguros Del Estado, ___ F.3d ___, Nos. 13-1364/2331, slip op. (7th Cir. Nov. 7, 2014) (per curiam) (here), we offered our take on the case and what it might mean, particularly as respects the Court's suggestion that state pre-answer security statutes may be procedural under the Erie doctrine, possibly inconsistent with federal procedural law and thus inapplicable in diversity cases. Now let's take a closer look at what transpired in Pine Top, for even apart from the Court's allusion to a possible Erie doctrine issue (our Erie ghost of reinsurance future), it involved a number of classic reinsurance issues (our ghosts of reinsurance past), as well as a notable appellate jurisdiction issue and the question whether the assignee of the insolvent ceding company acquired the right to demand arbitration against the reinsurer.

Background

Pine Top Insurance Company (?Pine Top Insurance?) was placed into liquidation back in 1986, but it wasn't until 2008 that Pine Top Insurance's court-appointed liquidator (the ?Liquidator?) demanded that Uruguay-owned reinsurer Banco de Seguros del Estado (?Seguros Estado?), pay $2,352,464.08 allegedly due Pine Top Insurance under certain reinsurance contracts (the ?Treaties?).

Pine Top Receivables of Illinois, LLC (?Pine Top?) was an entity that was formed to purchase Pine Top Insurance's account receivables, a transaction that was memorialized in a purchase agreement (the ?Purchase Agreement?).Pine Top then commenced an action in an Illinois federal district court against Seguros Estado.

Illinois, like New York and several other states, has a statute which requires unauthorized insurers or reinsurers to post security in actions brought by Illinois resident insureds or reinsureds prior to filing an answer or otherwise defending on the merits. See 215 Ill. Comp. Stat. § 5/123(5); N.Y. Ins. Law § 1213(c)(1)(A). Seguros Estado filed an answer without posting security, so Pine Top moved to strike the answer.

The district court denied the motion holding that the Foreign Sovereign Immunities Act, 28 U.S.C. § 1602-11 (2013) (the ?FSIA?) prohibits courts from attaching foreign state's property and that an order requiring Seguros Estado to post security was an ?attachment? proscribed by the FSIA. Pine Top appealed under the collateral order doctrine, which authorizes interlocutory appeals of security orders. See Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541 (1949); Habitat Education Center v. United States Forest Service, 607 F.3d 453, 455 (7th Cir. 2010).

Pine Top also moved to compel arbitration, arguing that the Purchase Agreement assigned to Pine Top the right to do so. The district court denied that motion and Pine Top also appealed that order.

FSIA Immunity

The FSIA states that ?property in the United States of a foreign state shall be immune from attachment arrest and execution except as provided in sections 1610 and 1611 of this chapter.? See 28 U.S.C. § 1609 (2013) (emphasis added). According to Pine Top, ?attachment? meant only ?a historical procedure to obtain jurisdiction over a foreign sovereign[,]? and Illinois' pre-answer security requirement was thus not an ?attachment? for purposes of the FSIA. See Slip op. at 5. Seguros Estado argued that ?attachment? encompassed ?all security requirements designed to ensure? judgment enforcement. See Slip op. at 5.

Though the FSIA does not define ?attachment,? the Court found support for Seguros Estado's position in the Act's text. Section 1610 authorizes an exception to FSIA attachment immunity where: (a) the ?property of a foreign state? is ?used for a commercial activity in the United States[;]? (b) ?the foreign state has explicitly waived its immunity from attachment prior to judgment[;]? and (c) ?the purpose of the attachment is to secure satisfaction of a judgment that has been or may be ultimately entered against the foreign state, and not to obtain jurisdiction.? See 28 U.S.C. § 1610(d); slip op. at 6 (emphasis added by Court).

Section 1610(d) thus expressly exempted from Section 1609's grant of immunity from attachment an attachment designed ?not to

obtain jurisdiction,? but to secure enforcement of a judgment. So ?unless § 1609 includes attachments ?the purpose of [which] is to secure satisfaction of a judgment' § 1610(d) is superfluous.? See slip op. at 6-7. Illinois' pre-answer security requirement was designed not to obtain jurisdiction, but to secure judgment enforcement, and thus constituted an ?attachment? within the meaning of the FSIA.

The Court also relied on two Second Circuit cases, S&S Machinery Co. v. Masinexportimport, 706 F.2d 411, 418 (2d Cir. 1983), and Stephens v. National Distillers & Chemical Corp., 69 F.3d 1226 (2d Cir. 1995). In S&S Machinery, the Second Circuit ?held that prejudgment ?attachment,' properly understood, included ?any other means to effect the same result.'? See slip op. at 7 (quoting S&S Machinery, 706 F.2d at 418). ?With S&S Machinery as a backdrop,? the Seventh Circuit explained, ?the court in Stephens had no difficulty in concluding that. . . [New York's pre-answer] security requirement was barred by the FSIA.? See slip op. at 8.

No Waiver of FSIA Immunity

Pine Top claimed Seguros Estado ?explicitly? waived its immunity under Section 1610 by: (a) agreeing ?to a reserves clause in the reinsurance contracts and? (b) deciding ?to transact reinsurance business in the state of Illinois, which imposes the security requirement.? See slip op. at 9. The Court rejected both arguments. See slip op. at 9-11.

These ?reserves clauses? were apparently a form of unauthorized reinsurance clause, which require unauthorized reinsurers to fund or post collateral for loss incurred under reinsurance contracts. Such clauses are required for ceding companies to take balance sheet credit for unauthorized reinsurance.

According to the Seventh Circuit, the reserves clauses ?required [Seguros Estado], during the term of its agreement, to ?deposit with' Pine Top Insurance ?the amount of reserves in respect of [Seguros Estado's] share of ... unearned premiums [and] outstanding losses and loss expenses,' and to do so quarterly and within a month of a request.? See slip op. at 9.

While unauthorized reinsurance clauses generally impose obligations on reinsurers that survive termination or expiration of the contract term, the Court found it significant that these reserve clause apparently did not. The Court characterized the clauses as ?set[ting] up a structure designed to ensure that the [reinsurer] maintains sufficient cash reserves to meet its ongoing obligations[,]? something distinctly different, conceptually and practically, from a waiver of protection from a judicial order of prejudgment security.? See slip op. at 9. ?[T]he reserves arrangement,? said the Court, ?ensures the smooth operation of the contract during its term? the statutory security provision requires a party to surrender its assets to a court potentially long after the contract ends.? See slip op. at 9. According to the Court, the reserves clause ?provides that the reserves are calculated routinely during the term of the contract?? the clause ?does not even hint at consent to post security long after the contract's end to satisfy a potential judgment[;]? and ?Pine Top has not requested the placement of reserves pursuant to the contract, but rather a judicial order of security.? See Slip op. at 9.

The Court also concluded that Seguros Estado's transaction of business with ?an entity located within Illinois? did not waive its FSIA immunity. Seguros Estado, the Court explained, ?may have been unaware of the security requirement, or it may well have agreed to transact business believing that the FSIA would protect it.? See slip op. at 9-10.

In any event, the Court concluded that ?any ?waiver' that we could discern either from the transacting of business with an entity in Illinois or from reserves clauses that do not speak to orders of pre-answer security in judicial proceedings would not be ?explicit,' and therefore would not come within the statute's exemption. See Slip op. at 10 (citing 28 U.S.C. § 1610(d)(1) & S&S Machinery, 706 F.2d at 416).

The Court also distinguished Banco de Seguros del Estado v. Mutual Marine Office, Inc., 344 F.3d 255 (2d Cir. 2003), where the Second Circuit held that Seguros Estado had waived immunity from judicial confirmation of an arbitrator-imposed pre-hearing security order. The Court pointed out that in Mutual Marine the reinsurance contracts contained: (a) honorable engagement clauses, which authorized ?the arbitrator to abstain from following strict rules of law and to proceed without judicial formalities[;]? and (b) unauthorized reinsurance clauses that required Seguros Estado to post a letter of credit from a financial institution. See slip op. at 10. The Second Circuit, said the Court, ?read these two provisions as demonstrating a ?clear and unambiguous intent to waive all claims of immunity in all legal proceedings.'? The Court reasoned that Mutual Marine ?is also not analogous to our situation because the

Second Circuit was employing a different standard of review: it could not overturn the arbitrator's security requirement if there was any justification for the arbitrator's decision.? See slip op. at 10-11.

Pine Top did not Preserve its McCarran-Ferguson Act Argument

Pine Top also argued that the McCarran-Ferguson Act, 15 U.S.C. §§ 1011--15 (2013), reverse preempted the FSIA. The McCarran-Ferguson Act states:

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance ....

15 U.S.C. § 1012(b) (2013).

Pine Top contended that if the FSIA is reverse preempted by Illinois' pre-answer security statute?a state law ?regulating the business of insurance??then the FSIA does not apply because it does ?specifically relate[] to the business of insurance. . . .? See slip op. at 11.

But the Court said ?[t]hat's not so clear.? See slip op. at 12. ?Maybe knocking out the FSIA for the insurance industry would return us to the older regime of common-law sovereign immunity discussed in [Argentina v. NML Capital, Ltd., 134 S.Ct. 2250, 2256 (2014)].? Or ?[m]aybe other considerations would block the enforcement of the state statute.? See slip op. at 11 (citing Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308, 333 (1999) (?Because such a remedy was historically unavailable from a court of equity, we hold that the District Court had no authority to issue a preliminary injunction preventing petitioners from disposing of their assets pending adjudication of respondents' contract claim for money damages.?) As discussed in our prior post (here), these ?other considerations? relate to the Seventh Circuit's questions whether the Erie doctrine requires federal courts to apply state pre-answer security statutes in diversity cases.

The Court did not decide whether Pine Top's argument had merit, however, because it concluded that Pine Top had forfeited it. See slip op. at 11, 13. According to the Court, Pine Top's somewhat cryptic allusions to McCarran-Feguson in the district court briefing did not constitute a ?direct argument? that McCarran-Ferguson renders ?the FSIA inapplicable to the insurance business.? See slip op. at 13.

Appeal of District Court's Denial of Motion to Compel Arbitration

Appellate Jurisdiction

In a case falling solely under Federal Arbitration Act (?FAA?) Chapter One, appellate jurisdiction over an order denying a motion to compel arbitration is straightforward: a denial is immediately appealable. See 9 U.S.C. § 16(a)(1)(B) (2013). But Uruguay and the U.S. are signatories of the Inter-American Convention on International Commercial Arbitration (a/k/a the ?Panama Convention?), and thus Chapter Three of the FAA, which implements the Panama Convention, governed arbitration under the Treaties.

FAA Section 16 was enacted after Congress enacted Chapter Two of the FAA implementing the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the ?New York Convention?), but before it enacted Chapter Three, which implements the Panama Convention. FAA Section 16(a)(1)(B) authorizes immediate appeal of an ?order. . .denying a petition under [FAA] Section 4. . . to order arbitration to proceed,? and Section 16(a)(1)(C) authorizes appeal of an ?order. . . denying an application under [FAA] section 206. . . to order arbitration to proceed.? 9 U.S.C. § 16(a)(1)(B) & (C). FAA Section 206, governs motions to compel arbitration in cases falling under the New York Convention.

When Congress enacted Chapter 3 of the FAA, it did not amend FAA Section 16 to address the appealability of orders concerning agreements and awards falling under Chapter 3. Thus, while Section 16 expressly makes appealable denials of motions to compel arbitration under agreements falling under Chapters One, Two or both, it says nothing about denials of motions to compel arbitration under agreements falling under Chapter Three.

The Seventh Circuit observed that ?[t]he problem posed by a lack of specific reference to the Panama Convention proceedings in § 16 is one that has escaped the attention of our sister circuits.? Slip op. at 18. Ultimately the Court resolved the problem by concluding that Section 307 incorporated by reference Chapter 1, including Section 16(a)(1)(A)'s appealability provisions.

Section 307 provides that ?Chapter 1 applies to actions and proceedings brought under? Chapter 3 ?to the extent chapter 1 is not in conflict with this chapter or the Inter-American Convention as ratified by the United States.? Section 303 of Convention empowers courts to compel arbitration of disputes under the Panama Convention, but says essentially nothing about what procedures govern such a motion or application:

(a) A court having jurisdiction under this chapter may direct that arbitration be held in accordance with the agreement at any place therein provided for, whether that place is within or without the United States. . . .

(b) In the event the agreement does not make provision for the place of arbitration or the appointment of arbitrators, the court shall direct that the arbitration shall be held and the arbitrators be appointed in accordance with Article 3 of the Inter-American Convention.

9 U.S.C. § 303.

Section 4 of the FAA features a detailed set of procedures designed to address motions to compel arbitration, although, unlike Section 303, which allows a federal court having subject matter jurisdiction to compel arbitration to be held wherever agreed, here or abroard, Section 4 states that ?the hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed.? 9 U.S.C. § 4.

The Court reasoned that, because Section 4 contains fairly detailed procedural provisions and Section 303 does not, a district court considering a motion to compel arbitration under Section 303 would look to Section 4 for procedural guidance. And since section 16 authorized immediate appeals of denials of motions to compel arbitration under Section 4, the Court concluded it had appellate jurisdiction.

Seguros Estado contended that Section 303 conflicted with Section 4 because Section ?4 permits a district court to order that arbitration proceed only within the judicial district in which the petition is filed[;]? a number of the reinsurance treaties specified that arbitration was to be held in Phoenix, Arizona, that is, outside the district; and accordingly, ?a district court considering this case under § 4 could not order relief consistent with the agreement. . . .? See slip op. at 20.

But the Court rejected Seguros' Estados' argument and concluded that ?the other procedural specifications in § 4 are consistent with § 303, so § 307 incorporates them.? Slip op. at 20. And, ?[j]ust as importantly, nothing outside of § 4 tells a district court what procedures to employ in considering a § 303 motion[,]? which means that ?Section 4 provides the procedures a federal court uses to determine the arbitrability of any dispute under any chapter of the FAA, with only a few exceptions.? See slip op. at 20.

The Purchase Agreement did not Transfer Pine Top Insurance's Right to Compel Arbitration under the Treaties

Pine Top made four types of arguments for reversal of the district court's denial of its motion to compel arbitration: (a) Purchase-Agreement text-based arguments; (b) Uniform Commercial Code gap-filling arguments; (c) parol-evidence-based arguments; and (d) equitable estoppel arguments. See slip op. at 22. The Court rejected all of them.

Purchase Agreement Text

The Purchase Agreement transferred certain ?Debts? to Pine Top, which were defined as:

The net balances due ... or which may become due ... from the ... Debtors to the Assignor pursuant to the terms of the Policies? ... including all rights securing payment of such balances, such as funds in the hands of brokers, letters of credit or collateral pledged with respect to such Debts.

Clause 2.1 of the Agreement provided that ?the Assignor shall ... assign to the Assignee all of its rights, title, benefit and interest in the Debts absolutely and with full title ....?

Clause 5.2 provided that:

As of the Effective Date. . . , Assignor authorizes Assignee to demand, sue for, compromise and recover all amounts as now are, or may hereafter become, due and payable for or on account of the Debts. Assignor grants to Assignee full authority to do all things necessary or useful to enforce the Debts and Assignor's rights thereunder pursuant to this Assignment Agreement. It is specifically understood and agreed, however, that Assignee's rights under this paragraph are discretionary and Assignee may exercise or decline to exercise such powers at Assignee's sole option. Nothing in this Agreement shall create any obligation on the part of Assignee to any person other than the Assignor.

Pine Top argued that ?full authority to do all things necessary or useful to enforce the Debts and Assignor's rights thereunder pursuant to this Assignment Agreement[]" included the right to demand arbitration under the treaties.

But, as the district court recognized, that interpretation ?becomes implausible? when Clause 5.2 is read in light of Clause 5.1. Clause 5.1 delegated to Pine Top the ?right to obtain information ?relating to the Debts or any Policies from which such Debts might have arisen, to the same extent and under the same conditions as the Assignor could have done so in an exercise of its contractual rights.'? According to the Court, ?[t]his shows that the drafters of the Purchase Agreement knew how to communicate a full and complete transfer of rights, but, with respect to the debts, authorized a more limited transfer.? See slip op. at 23.

Summarizing why it thought the district court's decision not to compel arbitration to be ?sound,? the Court explained:

- The contract ?vests full titile in the debts and authorizes Pine Top to ?demand, sue for, compromise and recover all amounts' of those debts.? Slip op. at 23-24.
- The delegation of ??full authority to do all things necessary or useful'? ?follows this specific assignment of rights and authorizes actions related to the four specifically enumerated actions above (?demand, sue for, compromise and recover?). Slip op. at 24.
- It ?does not incorporate new or additional? contract rights, including the contractual right to arbitrate. Slip op. at 24.
- ?Not only is ?demand arbitration' not specifically included in the transferred rights, it is of an entirely different character.? Slip op. at 24.
- Owning ?a debt may imply the right to recover the debt absent some legal impediment, but it does not imply the right to use a means not otherwise established as a right under the law.? Slip op. at 24.
- The Purchase Agreement does not transfer the reinsurance contracts to Pine Top, only the debts under them?Clause 2.1 states: ??The assignment. . . shall not. . . be construed to be a novation or assignment of the policies.'? Slip op. at 24.

The Court also noted that the reinsurance treaties' ?right to demand arbitration is reciprocal, and the Purchase Agreement states that Pine Top does not accept any responsibility to anyone other than the Liquidator.? Slip op. at 24. Pine Top was not given ?an obligation to submit to arbitration at [Seguros Estado]'s request[,]? and?noting that Seguros Estados ?has not argued that an assignment of the debt, without Pine Top's consent to arbitration at Banco's behest, is invalid??it was ?not clear? to the Court ?how the Liquidator could transfer a one-way right to demand arbitration without imposing any reciprocal obligation on Pine Top.? Slip op. at 24 (emphasis in original).

UCC Gap Fillers, Even if Applicable, are Irrelevant

The parties disputed whether the UCC governed the Purchase Agreement, a dispute the Court did not need to resolve. Pine Top argued that UCC provisions applying to situations where parties agree to assign ?the contract? or ?all my rights under the contract? operate to make the transfer ?subject to ?all terms of the agreement.'? Slip op. at 25 (quoting 810 Ill. Comp. Stat. §§ 5/2-210(5) & 5/9-404(a)).

But, as the Court aptly observed, had the assignment ?employed such language in transferring rights in the debt to Pine Top, resort to the UCC would be unnecessary[]? because ?the agreement itself would have transferred the right to demand arbitration.? See slip op. at 25. The assignment did not say anything of the sort and thus Pine Top's argument rested on a faulty premise. See id.

Parol Evidence is Irrelevant

Pine Top submitted affidavits from the Liquidator's staff alleging that the Liquidator had done all it could to maximize the price at which it could sell the debts, had the authority to sell any of Pine Top Insurance's assets (including the right to demand arbitration under the treaties) and intended to ?sell all available assets.? Slip op. at 25-26.

Noting that ?[n]either the affidavits nor anything else Pine Top proposed to offer concerns discussions during negotiations or the meaning of any concrete language in the documents[,]? the Court considered the evidence ?useless? because it did not ?illuminate[] the meaning of? the ?contract's language.? Slip op. at 25-26.

No Equitable Estoppel

Pine Top contended that Seguros Estado was estopped from denying its alleged obligation to arbitrate with Pine Top because Seguros Estado presented contract defenses that relied on the language of the reinsurance treaties. This argument, however, missed

the point.

The issue was not whether Seguros Estado was a party to the reinsurance treaties; the issue was whether Pine Top had purchased from the Liquidator Pine Top's right to demand arbitration against Seguros Estado. As the Court pointed out, ?[t]he validity and amount of. . . debts cannot be determined other than by looking to the terms of the [reinsurance treaties]; this compelled [Seguros Estado] to refer to the contract.? The treaties, said the Court, ?are simply the backdrop by which the amount of debt is established[,]? but did ?not otherwise govern the current parties' rights.? See slip op. at 27.