# ARBITRATION OF INSURANCE DISPUTES: *FUNCTUS OFFICIO* AND THE CLARIFICATION EXCEPTION

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A core tenet of arbitration is its finality. Indeed, if "truth seeking is the hammer of justice, finality is the overlooked anvil."[1] In arbitration, this principle has become enshrined in the doctrine of *functus officio*, which forbids arbitrators from altering an award after the award has been rendered. Yet, the doctrine has several exceptions. One is the clarification exception, which allows an arbitration panel to clarify an ambiguous final award. In *General Re Life Corporation v. Lincoln National Life Insurance*,[2] the U.S. Court of Appeals for the Second Circuit joined several other circuits in expressly adopting this exception, applying it in a reinsurance dispute. The opinion can have significant implications for arbitrators and parties and may influence how arbitration provisions are drafted in insurance agreements

## *Functus Officio*

*Functus officio* has long been a cornerstone of American arbitration.[3] The term is Latin for "office performed," as in, the arbitrator has performed his office and has thus been discharged from it.[4]

The doctrine's logic is twofold. First, finality is necessary to the integrity of the adversarial process. Second, the doctrine aims to remove the "potential evil of outside communication and unilateral influence" which might affect "one who is not a judicial officer and who acts informally and sporadically."[5]

Despite these good intentions, the doctrine has faced its criticisms. In his seminal opinion on the doctrine, former U.S. Court of Appeals for the Seventh Circuit Judge Richard Posner laid out five:

1) the doctrine creates a gap in our system of private arbitral justice by depriving parties appellate review and reconsideration;

2) the doctrine assumes arbitrators are infallible and need not visit prior awards;

3) the doctrine reduces value of arbitration by limiting the authority of arbitrators in comparison with judges;

4) the doctrine's exceptions often swallow the rule; and

5) the doctrine is a product of historical judicial hostility to arbitration.[6]

Still, *functus officio* remains an accepted common-law principle across the federal circuit courts.[7] Since it is a common-law principle, and since arbitration is inherently a matter of contract, the doctrine is subject to various exceptions, one of which the Second Circuit recently adopted.[8]

## *General Re Life Corporation v. Lincoln National Life Insurance*

### The Facts

Lincoln National is a life insurer. In January 2002, it entered into a reinsurance agreement with General Re. The agreement allowed General Re to increase reinsurance premiums if the increase was founded on a change in the "anticipated mortality" of Lincoln National's insureds. But there was a catch: If General Re exercised this option, the reinsurance agreement authorized Lincoln National to cancel the contract and "recapture" its life insurance policies. In other words, if General Re increased premiums, Lincoln National could walk away and the parties would wash their hands of the agreement.

Twelve years later, the reinsurance agreement was proving unprofitable for General Re. So, in March 2014, it exercised its option to increase premiums effective April 1, 2014. Soon after, Lincoln National elected to arbitrate the increase under the agreement's arbitration clause, challenging General Re's determination of a change in anticipated mortality.

Following a hearing, the arbitration panel issued its Final Award. In it, the panel held that there was a change in anticipated mortality and that General Re was entitled to increased premiums. The panel also held that if Lincoln chose to exercise its recapture option, the recapture would run retroactive to April 1, 2014—the day premiums increased. Most important to the subsequent lawsuit, the panel ruled that, in the event of recapture, "[a]ll premium and claim transactions paid by one party to the other following the effective date of the recapture (i.e., from April 1, 2014) shall be unwound."

A dispute arose around the meaning of this final phrase. Lincoln National had a practice of paying premiums a year in advance. For instance, in February 2014, Lincoln paid General Re for a year's worth of reinsurance for all policies renewing in February. General Re took the view that it was entitled to keep those premiums—even those paid for months following the April 1, 2014 recapture date. Lincoln National, in contrast, asserted that it was entitled to repayment of any advanced payments made for months following the recapture date and coverage for claims for deaths that occurred before the recapture date.

With about $17 million on the line, the parties went back to the arbitration panel, who then issued a Clarification of its Final Award. The Clarification held that the award meant General Re was entitled to all premiums advanced before the April 1, 2014 recapture date, with one caveat: It was also liable for all deaths covered under policies for which Lincoln National had advanced premiums, even if those deaths occurred on or after April 1, 2014.

Displeased with this result, General Re sought to have the original, unclarified award confirmed in federal district court. On the other side, Lincoln National filed a cross-petition to confirm the clarified award. The district court ruled in Lincoln's favor and affirmed the clarified award. General Re then appealed to the Second Circuit.

## The Opinion

On appeal, General Re made two arguments. It first asserted that Lincoln National waived its right to dispute the prepaid premiums since the issue was not raised before the arbitration panel. General Re also argued that the panel overstepped its bounds in clarifying the award, violating the doctrine of *functus officio*.

Writing for the panel, Judge Rosemary Pooler rejected both arguments and ruled for Lincoln. Addressing first the threshold issue of waiver, the court held that the issue was not waived since analysis of the recapture provision was not necessary to the arbitration. The court stated that the arbitration focused on whether the premium increase was founded on a change in anticipated mortality, not the mechanics of the recapture clause. And, the Final Award did not compel Lincoln National to invoke the recapture clause at all; it could have chosen to pay the increased premiums instead. As a result, Judge Pooler held that Lincoln National had no reason to raise the recapture issue at the arbitration hearing. Thus, the issue was never waived.

Turning next to General Re's substantive argument, the Second Circuit examined the doctrine of *functus officio*. As the court explained, the doctrine generally sets an arbitrator's award in stone: It "dictates that, once arbitrators have fully exercised their authority to adjudicate the issues submitted to them, their authority over those questions is ended, and the arbitrators have no further authority, absent agreement by the parties, to redetermine those issues."[9]

Still, like most rules, *functus officio* has its exceptions. One such exception is the clarification exception, which applies where an "arbital award fails to address a contingency that later arises or when the award is susceptible to more than one interpretation."[10] The court reasoned that the exception was a logical extension of the Second Circuit's well-settled rule "that when asked to confirm an ambiguous award, the district court should instead remand to the arbitrators for clarification."[11] So, recognizing that the U.S. Courts of Appeals for the Third, Fifth, Sixth, Seventh, and Ninth Circuits have adopted the exception,[12] the Second Circuit did as well.

Having adopted the clarification exception, the panel went on to explain how it should be applied. The court held that an arbitrator may clarify a final award when: "(1) the final award is ambiguous; (2) the clarification merely clarifies the award rather than substantively modifying it; and (3) the clarification comports with the parties' intent as set forth in the agreement that gave rise to arbitration."[13]

Applying those factors to General Re's case, the court found that all the exception's conditions were met. First, Judge Pooler reasoned that the arbitrators' determination that the Final Award was ambiguous was due deference under Second Circuit law. Indeed, because both parties had proffered reasonable interpretations of the Final Award, the arbitration panel's finding that the award was ambiguous was reasonable and not due to be disturbed. Next, the court held that the arbitrators' clarification decision was in fact a clarification, not a modification, because it simply explained that the Final Award was to be read in a manner consistent with the agreement. This, the arbitration panel explained, meant that General Re was entitled to prepaid premiums, but was also liable for any claims for which it retained a premium. As put by the court: "This clarifies the Final Award. It does not rewrite it." Finally, the court rejected General Re's argument that the arbitrators' Clarification was inconsistent with its prior ruling that Lincoln's premium payments were too low. In a strong rebuke, the court held that the Clarification was entirely consistent with the reinsurance agreement and "that the premiums proved inadequate may be the result of a poor business decision, but it no way requires Lincoln to make up General Re's losses."[14]

## Practice Implications in the Insurance Context

This case offers several lessons for insurance disputes. The first relates to waiver. As shown in this case, litigants in an insurance dispute must be sure to raise all possible issues before an arbitration panel. Though the court concluded that the issues addressed in the arbitration panel's clarification were unnecessary to the initial arbitration and thus had not been waived, the risk of an adverse ruling on this issue was nevertheless present. To avoid that risk, parties should think through all possible scenarios prior to arbitration and raise all relevant issues before the panel to properly preserve them for litigation down the road.

Another lesson is this: To date, every circuit to consider the issue has validated the clarification exception to the doctrine of *functus officio*.[15] And of the circuits that have yet to expressly adopt the exception, several have shown some willingness to allow an arbiter to clarify at least some aspects of a final award.[16] Litigants should be aware of the exception's elements throughout the arbitration. Arguments invoking the exception should be couched in the exception's language.

Finally, if a litigant wants to avoid the added expense of post-award clarification litigation, it should consider drafting arbitration language that explicitly limits an arbitrator to one award without subsequent clarification. After all, arbitration is a creature of contract, and parties are free to negotiate the parameters of arbitration.

## Conclusion

*Functus officio* freezes an arbiter's initial award, except when it does not. As shown in *General Re Life Corporation v. Lincoln National Life Insurance*, courts may allow an arbitrator to clarify an already-settled award. To protect themselves, litigants should raise all possible issues before the arbitration panel. If the award is unclear, litigants may seek clarification from the arbitrators and then defend any clarification by the arbitration panel using the elements laid out by the Second Circuit. And if a litigator seeks to avoid this possibly expensive pitfall altogether, it could draft its arbitration clause accordingly.

## Notes

[1]. Michael Cavendish, *Fortress Arbitration: An Exposition of Functus Officio*, 80 Fla. Bar J. 2, https://www.floridabar.org/news/tfb-journal/?durl=%2Fdivcom%2Fjn%2Fjnjournal01.nsf%2FAuthor%2F8FBEA031119BD95B852571060054ACF4.

[2]. 2018 WL 6186078, at *1 (2d Cir. Nov. 28, 2018).

[3]. *See Bayne v. Morris*, 68 U.S. (1 Wall.) 97, 99 (1863) ("Arbitrators exhaust their power when they make a final determination on the matters submitted to them. They have no power after having made an award to alter it; the authority conferred on them is then at an end.").

[4]. *Glass, Molders, Pottery, Plastics & Allied Workers Int'l Union*, AFL-CIO, CLC, Local 182B v. Excelsior Foundry Co., 56 F.3d 844, 845 (7th Cir. 1995).

[5]. *Colonial Penn Ins. Co. v. Omaha Indem. Co.*, 943 F.2d 327, 331–32 (3d Cir. 1991).

[6]. *See supra* note 1 (citing Excelsior Foundry Co., 56 F.3d at 845).

[7]. *See Excelsior Foundry Co.*, 56 F.3d 844 (collecting cases).

[8]. *See, e.g., Hyle v. Doctor's Assocs., Inc.*, 198 F.3d 368, 370 (2d Cir. 1999) (holding that an arbitrator can reconsider final award if there is "agreement by the parties"); *Excelsior Foundry Co.*, 56 F.3d at 848 (recognizing that *functus officio* "is merely a default rule, operative if the parties fail to provide otherwise"; but, if the parties do provide otherwise, "[t]here is no legal bar to authorizing arbitrators to reconsider their decisions").

[9]. *Supra* note 2 at *3.

[10]. *Id.* (citations and internal quotes omitted).

[11]. *Supra* note 2 at *4.

[12]. *See Sterling China Co. v. Glass, Molders, Pottery, Plastics & Allied Workers Local No. 24*, 357 F.3d 546, 554 (6th Cir. 2004); *Brown v. Witco Corp.*, 340 F.3d 209, 219 (5th Cir. 2003); *Excelsior Foundry Co.*, 56 F.3d at 847; *Colonial Penn. Ins. Co. v. Omaha Indem. Co.*, 943 F.2d 327, 334 (3d Cir. 1991); *McClatchy Newspapers v. Central Valley Typographical Union No. 46*, 686 F.2d 731, 734 n.1 (9th Cir. 1982).

[13]. *Supra* note 2 at *4.

[14]. *Supra* note 2 at *5.

[15]. *See supra* notes 2 and 12.

[16]. *See Int'l Bhd. of Elec. Workers, Local Union 824 v. Verizon Florida, LLC*, 803 F.3d 1241, 1245 (11th Cir. 2015) (providing that under *functus officio* and Rule 50, "an arbitrator may correct clerical, typographical, or computational errors in a final award, [but] has no power to revisit the merits of the award after it has issued"); *Barranco v. 3D Sys. Corp.*, 734 F. App'x 885, 889 (4th Cir. 2018) (same).

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