

Pre-Answer Security and Preclusion Based on Arbitral Decision — Who Decides?

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In reinsurance disputes where one party is insolvent or has financial difficulties, the other side often demands security. Where a non-domiciliary is involved, some states have pre-answer security requirements, which have been held to apply in reinsurance arbitrations. In a procedurally complicated case, where an arbitration panel issued a security award and then stayed the arbitration pending litigation, a federal court was faced with its own motion for security after the arbitrator's interim order for security was confirmed and reduced to a judgment.

In *In re Platinum-Beechwood Litigation*, 18-cv-6658 and 18-cv-1208 (JSR), 2019 U.S. Dist. LEXIS 114645 (S.D.N.Y. Jul. 10, 2019), cross-claims were brought by cedents against its insolvent reinsurer for breach of contract within a case by investors claiming wrongdoing against the reinsurer, the cedents and others. The cedents sought an order compelling the reinsurer to post security for the cross-claims or striking the reinsurer's pleadings and entering a default judgment for failure to post security as required by state law. Previously, an arbitration between the cedents and the reinsurer resulted in an interim security award in favor of the cedents, but at a much smaller amount. That interim security award was confirmed by the federal court and entered as a judgment. The arbitration between the cedents and the reinsurer was stayed pending this litigation, with the panel retaining jurisdiction over the security award.

The reinsurer argued that the cedents were precluded from bringing their motion by the interim arbitration award that was confirmed and reduced to a judgment by the court. The reinsurer also argued that the pre-answer security statutes did not apply to it as an insolvent reinsurer. In denying the cedent's motion, the court held that the security statutes applied to the reinsurer even though it was in liquidation. The court stated that the statutes clearly applied to the reinsurer and that the motions the reinsurer were making were considered pleadings under the security statutes. While sympathetic to the equitable concerns raised by the reinsurer, the court said that it was unable to square these concerns with the plain text of the security statutes. The court held that the security statutes applied, notwithstanding the liquidation proceedings.

But that was not the end of the tale. The court determined that the arbitration panel must decide in the first instance whether its interim security order as confirmed by the court precluded the cedents from moving to seek security (in this case a substantially greater amount than had been granted by the arbitration panel) before the court. The court noted that the reinsurance agreements had very

broad arbitration clauses and that under Second Circuit precedents, the claims-preclusive effect of a prior federal judgment confirming an arbitration award must be left to the arbitrators to determine. Thus, the court denied the cedents' motion, although noting that if the arbitration panel concludes that the cedents are not precluded from bringing the security motion, then the parties can return to the court for further proceedings on the matter.

Notably, pending before the court are motions by the reinsurer to dismiss part of the cedents' cross-claims and to compel arbitration. The court refused to stay those motions, which will be heard later this summer.

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