College of Commercial Arbitrators

Insurance Coverage Arbitration

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Abstract: Although there is a long history of arbitration in commercial insurance disputes in the reinsurance and high excess catastrophic liability contexts, insurance coverage disputes are more often litigated in a traditional courtroom setting. However, the procedural flexibility inherent in arbitration can be used to resolve insurance coverage disputes in an efficient and cost-effective manner. To illustrate, this article begins with an example of one creative arbitration structure developed and used by the parties to a complex insurance coverage dispute. Then, to highlight the procedural options available in arbitration and the contexts in which those options arose, the article explores the key features of reinsurance and high excess catastrophic liability arbitrations. The discussion then returns to the ways in which arbitration has been—and can be—used to resolve all types of insurance coverage disputes, and offers tips for drafting arbitration clauses for primary and excess liability policies.

I. Introduction

As a general rule, insurers have more confidence in insurance industry experts to resolve disputes than they have in juries, and favor confidentiality and the non-creation of precedent over the right to take an appeal. Conversely, and again speaking in general terms, commercial policyholders come out the other way, favoring juries and appellate rights to expertise and confidentiality. Hence, even sophisticated commercial insureds have resisted arbitration of insurance disputes.

The tradeoffs between the insured and each insurer in the negotiation of policies—assuming negotiation is possible—including the presence or absence of arbitration clauses and the terms of such clauses—will dictate what happens years later in the event of a dispute regarding coverage of a particular claim (both in the first party and third party contexts). These tensions, when they are resolved in favor of inclusion of an arbitration clause, often give rise to unusual procedural issues from the vantage point of the arbitrator; and, despite the tensions between the goals of the insurers and insureds, these parties take advantage of the flexibility of arbitration to craft rules and procedures by agreement that facilitate efficient resolution of their disputes.

This party-driven creativity is best illustrated by way of an example. Following the denial of coverage for a loss related to a large-scale industrial project, the insured brought suit against the primary and excess insurers in court, and the insurers, each having an arbitration provision in its insurance policy with the insured, successfully moved to dismiss the case and compel arbitration.

Once the issue of arbitrability was resolved, the parties agreed to consolidate the arbitrations against the primary insurer and the excess insurers into one proceeding. If they had not, separate confidential arbitrations would have been required for each layer of insurance, a situation that has arisen in other cases, and which will be discussed below.

After agreeing to consolidation, the parties negotiated and drafted detailed procedures and rules to govern the arbitration. Under these rules, the insurers (jointly) and the insured each selected a neutral Arbitrator, who, borrowing from the reinsurance context, was required to be an expert in insurance. In the first instance, the party-appointed Arbitrators were to attempt to agree on the resolution of all procedural and substantive issues. However, anticipating the possibility that the Arbitrators would not agree, the parties jointly selected an Umpire—the author of this article—to resolve any disputes on matters about which the Arbitrators could not agree.

The agreed-upon rules also sought to maximize finality by including appellate procedures in the protocol. The parties would jointly appoint one Appellate Arbitrator to determine appeals by any party. As part of the appellate process, the parties could elect to rely on the memoranda or briefs previously submitted to the Arbitrators and Umpire, and not to submit additional argument to the Appellate Arbitrator. In addition, the rules specified that the scope of appellate review would be broader than the limited grounds for review provided for in the Federal Arbitration Act.

In this matter, when the Arbitrators disagreed as to whether a choice of law provision in the policies precluded a claim under another state's laws, the Umpire resolved the dispute and issued a decision dismissing that claim. Later, the parties moved for summary disposition on three distinct issues. The Arbitrators failed to agree on two of the issues, but agreed on the outcome of the third issue which was, they also agreed, dispositive of the insured's claim for breach of the insurance agreements resulting in the dismissal of the claim for coverage.

The insured then invoked the appellate procedures under the Rules. The parties, in an effort to be cost-effective agreed to designate the same Umpire previously selected to be the Appellate Arbitrator to rule on the issue that had been resolved by the Arbitrators. The rules were flexible enough that the parties also stipulated that the Appellate Arbitrator was not to rule on the other two issues—except that if he reversed the agreed-upon dismissal, he would then be re-designated as Umpire and rule on the two issues about which the Arbitrators had disagreed, and any appeal from those rulings would be made to a different Appellate Arbitrator.

In crafting this creative arrangement, the parties borrowed some of the components used in other insurance arbitration contexts. These contexts are discussed in the following section. The discussion then returns to the ways in which arbitration has been—and can be—used to resolve coverage disputes to the satisfaction of both policyholders and insurers.

II. A Brief History of Insurance Arbitration

While parties have arbitrated insurance disputes for hundreds of years,[1] arbitration has been used more frequently in certain areas than others.[2] As is relevant here, confidential binding arbitration

[1] *New England Mut. Marine Ins. Co. v. Dunham*, 78 U.S. 1, 31 (1870) ("[I]t is well known that the contract of insurance sprang from the law maritime, and derives all its material rules and incidents therefrom. It was unknown to the common law; and the common law remedies, when

has historically been used in the insurance arena to resolve disputes among insurers in the reinsurance context[3] and between insureds and insurers under high excess catastrophic liability policies, which have become known as "Bermuda Form" arbitrations. But, as discussed below, arbitration is also now being used more frequently in all types of insurance disputes involving coverage of first-party property claims and third-party claims (including third-party claims under errors and omissions (E&O) and directors and officers (D&O) policies).

Historically, agreements in the reinsurance context were less formal than typical contracts: "The business of insurance was conducted by assurances written on the bottom of slips of papers that described risks on which insurance was sought (hence the term 'underwriters')."[4] The parties relied on trust and good faith over formal terms. The number of reinsurers was not that large, making cooperation between the insurers and reinsurers all the more important.[5]

Indeed,

> In some ways, the arbitration section is the heart of the reinsurance agreement in that it summarizes the degree of trust and good faith inherent in reinsurance. The ceding company and reinsurer agree to act in the highest good faith toward each other. They agree to attempt to resolve any

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applied to it, were so inadequate and clumsy that disputes arising out of the contract were generally left to arbitration, until the year A. D. 1601, when the statute of 43 Elizabeth was passed creating a special court, or commission, for hearing and determining causes arising on policies of insurance.").

[2] "[A]rbitration is standard in many disputes involving the ISO Commercial General Liability policy as well as in matters involving automobile insurance, crop insurance and various types of commercial insurance, including those relating to directors and officers (D&O), employment liability, cyber liability, and errors and omissions (E&O). Arbitration is also common in other types of insurance, including healthcare insurance. However, many states have prohibited arbitration of insurance disputes pursuant to the doctrine of reverse preemption under the McCarran-Ferguson Act." S.I. Strong, *The Special Nature of International Insurance and Reinsurance Arbitration: A Response to Professor Jerry*, 2015 J. Disp. Resol. 283, 287 n.25 (2015) (internal citations omitted); *see generally* Robert H. Jerry, II, *Dispute Resolution, Insurance, and Points of Convergence*, 2015 J. Disp. Resol. 255 (2015).

[3] In a reinsurance contract, the initial insurer "cedes" risk to another insurer, who becomes the reinsurer (and, of course, the reinsurer could cede a portion of its risk to yet another reinsurer). Hence, disputes arise between insurers, rather than between an insurer and a non-insurer policyholder.

[4] Jerry, *supra* note 3, at 277.

[5] *See* Eugene Jericho, *Arbitrating Reinsurance Disputes: Restore Utmost Good Faith to Avoid Litigation*, 24 FALL Brief 16 (1994) (explaining that insurers prefer "early settlement of disputes, which enables a reinsurer to continue to do business with a firm that temporarily is an adversary").

> dispute amicably and without resort to technical arguments not founded on normal insurance and reinsurance practices.[6]

Reinsurance arbitrations, which often take place in international fora, were and are today confidential and were and are typically conducted by tripartite panels made up of two party-selected insurance industry insiders—usually independent, although not neutral, current or former insurance company executives—who will choose a third arbitrator, either another insurance industry insider or a professional arbitrator, to act as umpire.[7] In addition, most agreements will require the administrator or a court with jurisdiction to pick the umpire in the absence of agreement on the third arbitrator.[8]

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[6] Jerry, *supra* note 3, at 277 (internal quotation marks omitted).

[7] *See, e.g.*, *id.* ("[E]ach party will participate in the choice of a panel of arbitrators, usually three, who will listen to the problem and resolve it. The arbitrators are not professionals at resolving disputes, but are executives of the life insurance industry who are much more familiar with the workings and expectations of the insurance industry than would be any judge or jury.") (internal quotation marks omitted).

The first arbitration clause used in an insurance contract in North America, dating back to 1793, is more or less typical of the clauses used to this day in reinsurance agreements, and set forth the following arrangement:

> And it is agreed, that if any Dispute should arise relating to the Loss on this Policy; it shall be referred to two indifferent Persons, one to be chosen by the Assured, the other by the Assurer, who shall have full Power to adjust the same; but in case they cannot agree, then such two persons shall choose a third; and any two of them agreeing, shall be obligatory to both parties.

Brian Winn, Earl Davis, *Arbitration of Reinsurance Disputes: Is There A Better Way?*, 59 Disp. Resol. J. 22, 22 (2004) ("What is so striking about this clause is that the process it describes is largely being used in contracts between insurers and reinsurers today."). *See Allstate Ins. Co. v. OneBeacon Am. Ins. Co.*, 989 F. Supp. 2d 143, 145-46 (D. Mass. 2013) ("The arbitration agreements under both contracts are substantially the same and require arbitration to be conducted before a Board of Arbitration composed of two party-appointed arbitrators and one umpire. To select the umpire according to the Protocol, both party-appointed arbitrators name three qualified individuals after which each arbitrator strikes two names chosen by his or her counterpart. The umpire is then chosen by lot from the two remaining names."); *Jefferson-Pilot Life Ins. Co. v. LeafRe Reinsurance Co.*, No. 00 C 5257, 2000 WL 1724661, at *1 (N.D. Ill. Nov. 20, 2000) (describing agreement where the panel of arbitrators was to be selected under the rules of the American Arbitration Association and "shall consist of three neutral arbitrators each of whom must be an active or retired officer of a life or health insurance company familiar with the reinsurance business").

[8] *See, e.g.*, JAMS Comprehensive Arbitration Rules & Procedures Rule 15 (describing method of arbitrator selection including designation by JAMS in the event of party disagreement); and AAA Commercial Arbitration Rules and Mediation Procedures Rules 12, 13, 14 (discussing the circumstances in which the AAA will choose an arbitrator).

Notably, the party-appointed arbitrators, while independent, are often non-neutral:

> The arbitration clause used in . . . [reinsurance agreements] does not require all of the arbitrators to be neutral. The only time the word "neutral" is used is to describe the umpire. Thus it can allow party-appointed arbitrators to be partial to the side that appointed them and even serve as advocates for them. This leaves the dispute to be decided by the neutral umpire.
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> Using party-appointed arbitrators who were not impartial did not violate the Code of Ethics for Arbitrators in Commercial Disputes adopted in 1977 by the American Bar Association and the American Arbitration Association, which acknowledged that these arbitrators need not be neutral. However, the Code required all arbitrators, even those who were partial party-appointed, to adhere to Canon I, which stated that "[a]n arbitrator should uphold the integrity and fairness of the arbitration process." It also opined that "non-neutral" arbitrators should not engage in delaying tactics or harassment of parties or witnesses.[9]

Under the revised AAA/ABA Code of Ethics, arbitrators are presumed to be neutral, but the parties can specify that they want to use non-neutral arbitrators in their arbitration agreement, and this will be honored.[10] Although non-neutral, those arbitrators in the U.S. who adhere to Canons I and V of the AAA/ABA Code must act fairly and in good faith and uphold the integrity of the arbitration process.[11]

Although the trend is changing, in the reinsurance context "[t]he arbitrators are [frequently] directed not to worry about technical legal principles but to attempt to fairly and even-handedly

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[9] Winn and Davis, *supra* note 8, at 23-24.

[10] *See also* JAMS Comprehensive Arbitration Rules & Procedures Rule 7(c) ("Where the Parties have agreed that each Party is to name one Arbitrator, the Arbitrators so named shall be neutral and independent of the appointing Party, unless the Parties have agreed that they shall be non-neutral."). Note that neutrality is not the same as independence, which is a requirement that the arbitrator not have a financial or business interest in the parties. Independence is assumed, and typically required.

[11] Likewise, under Guideline X of JAMS Arbitrators Ethics Guidelines, "[a] non-neutral Arbitrator may be predisposed toward the Party who appointed him or her but in all other respects is obligated to act in good faith and with integrity and fairness." Note also that many of the elements of arbitration provisions in reinsurance agreements that are described here and in the following paragraph, such as the use of non-neutral arbitrators, can also be found in arbitration clauses involving insurers and policyholders, as will be described below.

put the ceding company and the reinsurer in the positions they should occupy."[12] Indeed, the arbitration clause may contain an "honorable engagement provision" directing the arbitrators to treat the agreement as "an honorable engagement rather than merely a legal obligation" and stating that the arbitrators are "relieved of all judicial formalities and may abstain from following the strict rules of law." As one court explains, these clauses provide "a huge advantage[, because] the prospects for successful arbitration are measurably enhanced if the arbitrators have flexibility to custom-tailor remedies to fit particular circumstances."[13]

As with reinsurance, arbitration of disputes involving high excess catastrophic liability—such as mass tort liability—is also the norm for dispute resolution in these contexts, but these arbitrations are highly unlikely to be held in the U.S. Starting in the mid-1980s, market conditions made it difficult to acquire affordable catastrophic liability coverage, in part because of unfavorable court rulings in U.S. courts. The insurance market responded by establishing two new insurers, Ace Ltd. and XL Group P.L.C., both located in Bermuda and offering specialized policies—now commonly referred to as "Bermuda Form" policies. Among other things, the Bermuda Form requires confidential arbitration, with New York law—as modified—to govern substantive issues, and an arbitration to be heard in London under the English Arbitration Act of 1996.[14] The modifications to New York law include the removal of certain doctrines, such as the rule of *contra proferentem*, thought by insurers to favor insureds. Because English law only permits appeals of arbitration awards based on errors of English law, the selection of New York law eliminates the right to appeal.

Bermuda Form arbitrations are conducted with tripartite panels, with each side selecting a party-appointed arbitrator and the party-appointed arbitrators selecting a third arbitrator.[15] Significantly, each arbitrator is neutral, which is the norm in London-based arbitration:

> In the insurance sector, London-based arbitration is thought generally preferable to US arbitration, because of London's tradition of neutrally composed tribunals and reasoned awards. By contrast, the non-neutral tradition of arbitration remains prevalent in US insurance disputes. In such arbitrations, a three-person tribunal will include two party "hired guns," meaning only the chairman or umpire can be considered impartial. Those arbitrators sitting as wings are often dependent on their appointer attorneys for income and will normally argue the case on behalf of their appointer. The result is that there is no opportunity for the chairs to

[12] Jerry, *supra* note 3, at 277 (internal quotation marks omitted).

[13] *First State Ins. Co. v. Nat'l Cas. Co.*, 781 F.3d 7, 12 (1st Cir. 2015).

[14] Note that "this split between procedural and substantive competence has been adopted in other types of international insurance and reinsurance matters." Strong, *supra* note 3, at 304.

[15] Under the English Arbitration Act, as in other contexts, there are mechanisms for selection of the third neutral in the absence of agreement.

> be objectively second guessed, and confidence in the process and the veracity of the awards is diminished.
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> In 2011, ARIAS US, the body that promotes the improvement of insurance and reinsurance arbitration proceedings, established a task force to look at, among other things, the arbitrator selection process and the use of 'neutral panels.' There is an acknowledgement that the system has its flaws. London-based arbitration is different in that all arbitrators on the panel are expected to be dispassionate and nonaligned.[16]

As the forgoing features of the Bermuda Form suggest, it "attempts to provide a relatively balanced approach to the interests of policyholders and investors while also avoiding various substantive problems associated with traditional modes of insurance coverage."[17]

Although there are significant differences between appraisal and arbitration, it is also worth noting that property insurance policies often include appraisal provisions. These provisions provide that when the parties fail to agree on the amount of loss, either party may demand an appraisal. A typical appraisal provision will require the parties to each select a neutral appraiser who then jointly select a disinterested umpire. As with arbitration agreements, if the appraisers fail to agree on the umpire, the parties can request that a court appoint the umpire.[18] The appraisal process itself can be either formal, consisting of adversarial hearings, or less formal, consisting of meetings among the appraisers and the umpire.

Finally, property insurance policies may also include, in addition to or in lieu of appraisals, optional or mandatory arbitration provisions both for the determination of the amount of loss and also to address coverage questions.

III. Advantages of Arbitration in Insurance Coverage Disputes

In the insurance coverage context, arbitrations typically proceed under either (1) the standard commercial arbitration model in which the parties select either one neutral arbitrator or a tripartite panel of neutral arbitrators or (2) a modified reinsurance model where the parties each select two non-neutral arbitrators with insurance industry expertise or experience, who in turn select a neutral umpire, more likely now to be a professional arbitrator (and frequently someone with insurance experience). There are several advantages to arbitrating insurance coverage

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[16] Chris Crowe, *Bermuda form: A happy union of US law and English procedure*, JAMS International ADR Blog (December 16, 2014) accessible at www.jamsinternational.com/blog/international-arbitration/bermuda-form-happy-union-us-law-english-procedure.

[17] Strong, *supra* note 3, at 303.

[18] *See generally Hartford Lloyd's Ins. Co. v. Teachworth*, 898 F.2d 1058, 1059 (5th Cir. 1990).

disputes, including first-party claims and third-party claims. Excess policies are likely to incorporate the occurrence and exclusion provisions of the primary policy, meaning that each layer of insurance is triggered by the happening of the same occurrence, and subject to the same exclusions. Thus, common issues may arise concerning conditions of coverage, applicable exclusions, and the sufficiency of notice. Sometimes these are purely legal questions, but often they are mixed questions of fact and law. One advantage of arbitration is that obtaining a ruling on an issue of contract interpretation, which will affect each layer of insurance, is likely to occur far more expeditiously than obtaining dispositive rulings in court with the attendant burdens and delay of civil litigation.

Sometimes when there is a coverage issue, and frequently when there is a dispute as to the *value* of a claim, there will be a need for a fact-based inquiry. Another advantage of arbitration over litigation in this context is that the parties can mix and match procedures in order to narrow the issues in dispute and make the fact-finding process more efficient. For instance, the parties to an arbitration can craft a narrow hearing, as opposed to a full-blown trial, to deal with discrete fact issues, while resolving purely legal issues on the papers.[19] Thus, in the coverage context, hearings are frequently streamlined and used for the purpose of oral argument or expert testimony rather than fact witnesses. Furthermore, like most arbitrations, there is a presumption that discovery will be limited. Generally, the policyholder is entitled to the claims file, excluding attorney client privileged material, and the insurer is entitled to any relevant documents explaining or attendant to the underlying claim itself. Depositions of fact and expert witnesses are also permitted, but limited.[20]

As an example, the creative arbitration structure and procedures described in Part I incorporated features of reinsurance and Bermuda Form arbitration as well as the commercial model. The competing concerns of the insured and the insurers can be seen in the use of industry insiders as party-appointed arbitrators, while also having a professional arbitrator as the Umpire, the latter to be used only in cases of disagreement, as well as in the expansion of the grounds for appellate review. These procedures were not only creative, but they worked, enabling the resolution of a multi-party, and otherwise substantively complex, dispute efficiently and fairly.

Arbitration may be advantageous, but getting agreement on an efficient arbitration process may require some work. An oft-occurring situation is that an insured—particularly a large commercial insured—typically enters *separate* policies with each insurer in a tower of insurance, and there is no contract between the insurers. This fact raises clear obstacles with respect to arbitration. First, not every policy will contain an arbitration clause. Second, even if all or most

[19] The primary insurer is likely to have a duty to defend the insured in an underlying law suit that establishes the insured's liability, if any, to a third-party. Thus, one initial dispute that might find its way to arbitration, is whether the primary insurer has a duty to defend the insured in the underlying third-party lawsuit. These disputes are often resolved as a matter of law, and, often, under expedited procedures in the arbitration. Arbitration is also far more efficient in resolving disputes about the reasonableness of legal fees incurred by the insured in the third-party lawsuit. In a courtroom setting, the reasonableness of fees would be resolved by a jury, which would likely be less efficient than trial to an experienced arbitrator.

[20] In the context of third-party insurance, the parties have the benefit of a full record from the underlying law suit.

of the policies contain arbitration clauses, those clauses may call for arbitrations in varying fora under different rules—one may be Bermuda Form, another may require arbitration in New York with a tripartite panel consisting of two non-neutral arbitrators and one professional arbitrator, and so on. Third, even if all policies contain arbitration clauses, and each clause specifies the same forum, each insurer will have the right to a separate, confidential arbitration, and consolidation generally cannot be compelled under the FAA.[21]

These issues present obstacles to global resolution of a dispute, but parties have not shrunk from the challenge, and the flexibility inherent in arbitration has proved useful. For instance, parties not compelled to arbitrate may agree to do so because the language of the excess policies frequently tracks the language of the primary policy, meaning that if the insured has an interpretation dispute regarding the primary policy, it is likely to have the same dispute with respect to the excess policy; obtaining from one adjudicator an interpretation that applies to all of the insurers may be in the interests of the insurers as well as in the interests of the insured. At the same time, an excess insurer is unlikely to settle a dispute until the insurer below it in the tower has settled or has had its coverage dispute resolved. Thus, along with the inconvenience that multiple inconsistent rulings would provide, as a practical matter it is far more expeditious to consolidate arbitrations into a single forum in a single arbitration.

Even so, insurers have sometimes insisted on their right to separate, confidential arbitrations. In those situations, the policyholder is likely to have the same party-appointed arbitrator in each arbitration, but there will likely be a different insurer-appointed arbitrator and a different umpire. Thus, just as neutrality issues must be self-policed,[22] it is imperative that arbitrators respect and maintain party confidentiality, even in such unusual and potentially cumbersome circumstances.[23] In situations where arbitrations do not proceed simultaneously—meaning, for

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[21] *See, e.g.*, *Georgia Cas. & Sur. Co. v. Excalibur Reinsurance Corp.*, 4 F. Supp. 3d 1362, 1367 (N.D. Ga. 2014). Under emerging rules of arbitration providers, consolidation can be required in certain circumstances, generally on grounds of efficiency, except where the parties' arbitration agreement or governing law prohibits such consolidation.

[22] As a practical matter, it is imperative that both neutral and non-neutral arbitrators and umpires understand their roles and their duties and police themselves accordingly; the parties are often stuck with arbitrators up until an award is issued, even if there is bias. *See, e.g.*, *Gulf Guar. Life Ins. Co. v. Conn. Gen. Life Ins. Co.*, 304 F.3d 476, 490 (5th Cir. 2002) ("[T]he FAA appears not to endorse court power to remove an arbitrator for any reason prior to issuance of an arbitral award" and thus, "prior to issuance of an award, a court may not make inquiry into an arbitrator's capacity to serve based on a challenge that a given arbitrator is biased").

[23] *See, e.g.*, JAMS Comprehensive Arbitration Rules & Procedures Rule 26(a) ("JAMS and the Arbitrator shall maintain the confidential nature of the Arbitration proceeding and the Award, including the Hearing, except as necessary in connection with a judicial challenge to or enforcement of an Award, or unless otherwise required by law or judicial decision."); JAMS Arbitrators Ethics Guideline IV.A ("Unless otherwise agreed by the Parties, or required by applicable rules or law, an Arbitrator should keep confidential all matters relating to the Arbitration proceedings and decisions."); and Statement of Ethical Principles for the American Arbitration Association, an ADR Provider Organization ("An arbitration proceeding is a private process. In addition, AAA staff and AAA neutrals have an ethical obligation to keep information

example, that by the time of the second arbitration, the liability of the primary insurer may have already been determined—arbitrators have successfully kept proceedings confidential.

Notably, efficiency can be achieved even where there are separate proceedings, by coordinating discovery and other procedural matters. In one instance, where there were four simultaneous coverage arbitrations relating to the same set of occurrences, each with its own tripartite panel made up of two party-appointed arbitrators and an umpire (although the same umpire was used in two arbitrations), the parties devised rules and procedures under which each tripartite panel had autonomy over substantive issues in the respective arbitrations, but the three chairs sat as overall masters of discovery and procedure. It was thus possible to maintain confidentiality, keep the costs to the parties down, and resolve each proceeding in a coordinated fashion. In other instances in which there are multiple related but unconsolidated proceedings, the parties have agreed that certain common substantive issues can be resolved together without the need of multiple hearings on those common issues. Alternatively, the parties in these circumstances have agreed to a sequence of the hearings such that the result—either the Final Award or the results on particular issues—in the first arbitration might be argued to be precedent, or at least persuasive or instructive, in the subsequent hearings, or might inform settlement efforts in those other hearings.

IV. Drafting Arbitration Agreements

Whether an arbitration clause is included as part of the insurance policy or agreed to after a dispute has arisen, parties drafting arbitration agreements governing primary and excess policies should consider issues relating to scope, forum, governing rules (including with respect to discovery), the number of arbitrators and how those arbitrators are appointed, consolidation, confidentiality, and the form of the award.

Scope — Parties should be careful to define the scope of the disputes that are subject to mandatory arbitration. An agreement can cover all disputes among the parties, all disputes except claims of extra contractual remedies, or simply disputes regarding interpretation of the insurance policy.[24] The agreement may also specify whether as a preliminary matter the arbitrator or a

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confidential. However, the AAA takes no position on whether parties should or should not agree to keep the proceeding and award confidential between themselves. The parties always have a right to disclose details of the proceeding, unless they have a separate confidentiality agreement. Where public agencies are involved in disputes, these public agencies routinely make the award public.").

[24] *See* Tyrone R. Childress, *The Use of Arbitration in Insurance Coverage Disputes: A Policyholder Perspective*, Aspatore, 2010 WL 284497, at *4 ("Even if a particular coverage dispute is subject to an arbitration clause, a claim for the breach of the covenant of good faith and fair dealing by the insurer is generally not subject to arbitration. Arbitrators are generally not entitled to award punitive damages unless the arbitration clause specifically provides otherwise. Thus, a policyholder could find itself arbitrating the contractual interpretation portion of a coverage dispute and, thereafter, litigating the claim again as part of bad faith litigation in court. Where a bad faith claim is part of the dispute, it may be more efficient for the insurer and policyholder to just litigate all issues at once rather than engaging in a piecemeal arbitration followed by litigation covering many of the same facts, documents, and witnesses. In any event,

court should address issues of arbitrability or enforceability of the arbitration clause, although the selection of the rules of a particular arbitration administrator that authorize an arbitrator to make such determinations may be sufficient.[25] Finally, while injunctive relief is rarely at issue in coverage disputes, it is advisable not to limit the power of the arbitrator to particular types of relief, as this may create a need for continued proceedings in court following or during the arbitration.

Forum, governing law, and rules — The arbitration agreement should identify the forum, which may include the venue of the hearing, and can also include a specific institution charged with administering the arbitration. As in many other contexts, the chosen venue or forum is a significant consideration, including for reasons of convenience to the parties. A primary consideration for a domestic insured purchasing excess coverage from an international carrier is whether the carrier requires the arbitration of disputes in a foreign jurisdiction.[26] Parties should keep in mind that despite the inclusion of a governing law clause in the contract, conflict of laws issues are likely to be determined by the conflict of laws principles of the forum state (unless the clause specifically disclaims reference to conflicts of law of the forum state). Parties should also consider that while the underlying policy may specify what law governs the interpretation of its terms, it is sometimes advisable to specify a different law to govern the interpretation of the arbitration clause itself. By the same token, if the underlying policy fails to indicate the governing law for substantive claims, the parties can identify that law in the arbitration agreement.

Parties should not attempt to create a set of governing procedural rules out of whole cloth. Instead, they can choose the procedural rules of a particular arbitration administrator by naming that administrator in the arbitration clause and adopting its rules (or simply by adopting the rules) or, alternatively, stipulate that the procedural rules of a particular jurisdiction apply.[27] (The latter

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a policyholder should be careful not to allow any potential bad faith claims to somehow be limited by the existence of an arbitration clause.").

[25] *See, e.g.*, *Washington v. William Morris Endeavor Entm't, LLC*, No. 10 Civ. 9647, 2011 WL 3251504, at *1 (S.D.N.Y. July 20, 2011) (enforcing incorporated rule of arbitration association authorizing arbitrator to decide arbitrability issues); *see* JAMS Comprehensive Arbitration Rules & Procedures Rule 11(b) ("Jurisdictional and arbitrability disputes, including disputes over the formation, existence, validity, interpretation or scope of the agreement under which Arbitration is sought, and who are proper Parties to the Arbitration, shall be submitted to and ruled on by the Arbitrator. The Arbitrator has the authority to determine jurisdiction and arbitrability issues as a preliminary matter."); and AAA Commercial Arbitration Rules and Mediation Procedures Rule 7(a) ("The arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement or to the arbitrability of any claim or counterclaim.").

[26] As discussed above, in the context of high excess catastrophic liability coverage, a policy requiring Bermuda Form arbitration may be the purchaser's only option.

[27] It is also not uncommon for parties to stipulate that particular rules of discovery or evidence apply.

suggestion – for example, to apply the civil procedure rules of a given state – is discouraged; rules that might make sense for litigation in court frequently do not apply for arbitration.) At the same time, as is stressed in this article, unlike in a litigation where the parties' selection of a forum subjects them to the court's rules, in arbitration—even when a specific administrator's rules are selected—the parties can modify the governing rules, including with respect to evidence and discovery, so that the process unfolds in a manner that best suits the parties' needs. So long as modifications are made explicit they will almost always be honored.[28]

Number of arbitrators/type of arbitrators/method of selection — When drafting an arbitration provision, the parties should specify whether a panel of one or three arbitrators will be used. Again, the parties have ample discretion as to the composition of the panel. In the case of a tripartite panel, the parties can choose how the arbitrators and the umpire will be selected and whether to require the panel to be comprised of insurance insiders, insurance law experts, and/or professional arbitrators, and whether party-appointed arbitrators will be neutral or non-neutral. At least one practitioner has argued that "[g]iven that there are far more people who work on the insurer side of the industry than work on the policyholder side, [the inclusion of either an insurance company insider or insurance law expert] . . . builds a pro-insurer bias into the process."[29] However, there is a clear difference between an insurance-industry insider and an expert in insurance law, such as an attorney who may have represented policyholders, and insurance company insiders are bound by ethical duties when they act as arbitrators. Finally, parties should be mindful that if the required arbitrator credentials are too specific it may be difficult to find a qualified, non-conflicted arbitrator within a reasonable timeframe.

Consolidation and confidentiality — The parties may wish to include a provision that allows either party to seek consolidation with an arbitration between the policyholder and another insurer in the same tower of insurance and to permit such consolidation when requested. Such a provision will allow multiple disputes to be addressed in a single arbitration. If party-selected or non-neutral arbitrators are used, the parties must consider rules for maintaining confidentiality across consolidated arbitrations. Another consideration will be the extent to which and what types of ex parte communications are permitted.

Form of award — The agreement should specify the form of the award. For example, the parties may also find it advisable to require a reasoned award, in which an arbitrator sets forth the facts, governing law, and the basis for his or her ruling. Finally, the agreement should specify that judgment may be entered on the award.

V. Conclusion

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[28] *See, e.g.*, AAA's *Drafting Dispute Resolution Clauses - A Practical Guide*, at 7 ("The parties are free to customize and refine the basic arbitration procedures to meet their particular needs. If the parties agree on a procedure that conflicts with otherwise applicable AAA rules, the AAA will almost always respect the wishes of the parties.").

[29] Childress, *supra* note 26, at *1.

The use of arbitration for insurance-related disputes has a long and interesting history. But, as in many other contexts, the use of arbitration in this context is also developing and changing—particularly as both insurers and policyholders become more comfortable with those features of arbitration, especially flexibility, which can make it more attractive to all involved.