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Are your companies' insurance policies governed by New York law – and should you care?

By: Finley Harckham*

Many companies from in the US and around the world have one very odd thing in common: they have insurance policies that are governed by New York law. This is not a coincidence. Many insurance companies have decided that risks with little or no connection with New York should be decided under its law.

The reasons for doing so appear to be twofold: first, applying the law of a single jurisdiction helps to achieve some degree of uniformity and predictability in the interpretation of standard-form insurance policies; second, the selection of New York law, instead of the law of some other jurisdiction, often coupled with requirements that it be applied in a manner that is detrimental to policyholders, can give the insurance company a significant advantage in the resolution of a dispute.

Insureds, like insurers, can benefit from the uniform interpretation of standard-form insurance policies. Unfortunately, standard provisions are frequently given different interpretations by courts in different jurisdictions, causing confusion and providing an incentive for an insurer and it's insured to engage in forum shopping to find a court or arbitration venue whose law will be most beneficial. Contractual choice-of-laws provisions can at least partially eliminate these problems by ensuring that disputes arising from standard-form policies will be resolved under the same legal standards wherever they are addressed. In theory, this will give policyholders and insurers alike a clear picture of the coverage afforded by the policy and reduce the number of contested claims.

However, the uniform interpretation of insurance policies does not benefit insureds when the applicable law favours the insurance company, which is often the case with New York law. For example, unlike other jurisdictions in the US and other countries, as a general rule New York law does not recognize a cause of action for insurer bad faith in the handling of claims by corporate insureds. That means that there may be no negative consequence for an insurer that unreasonably denies coverage or delays payment of a claim. Further, New York law can be harsh in its application to insurance contract conditions, resulting in the forfeiture of coverage for technical breaches. For example, most liability policies require prompt notice of claims. As a general rule, courts will excuse untimely notice as long as there is no resulting prejudice to the insurer. New York law follows that rule, but only for policies issued or delivered in that state.[1] Insureds who are located elsewhere, but whose policies are governed by New York law, may face a forfeiture of coverage for late notice, even if there has been no prejudice to the insurers.

Worse still, many policies contain arbitration clauses which require the tribunal to modify the application of New York law to the detriment of policyholders. One commonly used form provides:

> This Policy shall be governed by and construed in accordance with the internal laws of the State of New York, except insofar as such laws may prohibit payment in respect of punitive damages hereunder; provided, however, that the provisions, stipulations, exclusions and conditions of this Policy are to be construed in an evenhanded fashion as between the insured and the Company; without limitation, where the language of this Policy is deemed to be ambiguous or otherwise unclear, the issue shall be resolved in the manner most consistent with the relevant provisions, stipulations, exclusions and conditions (without regard to authorship of the language, without any presumption or arbitrary interpretation or construction in favor of either the Insured or the Company and without reference to parol evidence).

*Finley Harckham (fharckham@andersonkill.com) is a Shareholder in the New York office of the law firm of Anderson Kill P.C. He regularly represents corporate insurance policyholder in insurance coverage matters, including arbitrations and litigations.

Note that the clause not only requires the application of New York law, but also modifies its law by requiring construction of the policy on an 'evenhanded' basis. While such a construction can make sense in the context of a carefully negotiated commercial agreement between parties of equal bargaining power, New York law recognises that insurance companies draft insurance policies with little input from the policyholder – and, therefore, courts applying such law typically construe ambiguities against the drafter.[2] Thus, the requirement of 'evenhandedness' ignores the settled rules of contract interpretation, which are based on logic and fairness. In sum, the clause requires arbitrators to ignore the fact that standard-form insurance policies are contracts of adhesion, offered on a 'take it or leave it' basis with no negotiation or actual agreement between the parties on what is covered and what is not.

Insureds can and should take steps to address the potential problems raised by such clauses and level the playing field when resolving disputes with insurance companies. First, they should be proactive in attempting to keep one-sided provisions out of their policies. While the purchase of insurance in many companies is assigned to a risk manager, and not the legal department, counsel's input can be valuable to review choice-of-laws and arbitration provisions in policies before coverage is bound, and consider seeking to have them modified or eliminated.

Second, it might be possible to convince a court or arbitration tribunal that such a clause should not be enforced. In the US, there is a strong presumption in favour of enforcing agreements to arbitrate, and choice–of–laws provisions will generally be upheld as long as there is a rational basis for the selected law. Nonetheless, even in the US a choice-of laws provision may not be enforced if there is no connection between the insurance contract or risks insured and the law in question. Also, arbitration tribunals outside the US, or those governed by international rules, might not feel constrained to enforce such clauses.

Third, if faced with an arbitration in which one of those clauses is enforced, insureds should develop arguments which use the 'evenhanded' standard to their benefit. For example, if untimely notice of a claim is an issue, the insured can argue that New York law is one-sided, and unduly punitive, so the tribunal should apply the more lenient standard followed in most jurisdictions which forgives late notice as long there has been no prejudice to the insurer. Also, when construing coverage grants or exclusions, insureds can argue that even if the rule of contra proferentem is not to be applied, the tribunal should follow the New York rule that insurance policies should be interpreted in accordance with the objectively reasonable expectations of the insured.[3] Under that rule, the policy is to be interpreted in the manner that a reasonable insured in the position of the actual policyholder would understand the coverage. It certainly can be argued that the reasonable expectations doctrine is consistent with a mandate to construe the policy in an evenhanded manner.

Depending upon the issues raised in connection with a particular claim, there may be other arguments available for avoiding the negative consequences of a New York law provision.

Conclusion

A choice-of-law provision in an insurance policy must be carefully considered, and not treated as a secondary consideration to the scope of coverage provided and the rates charged. When faced with a claim governed by the law of New York or any other jurisdiction, policyholders should secure the advice of an expert in that law to assist in developing the best arguments to avoid the impact of negative precedent.

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[1] N.Y. Ins. Law § 3420.

[2] *See, e.g., Westchester Resco Co. v. New England Reinsurance Corp.*, 818 F.2d 2, 3 (2d Cir. 1987) ("[W]here an ambiguity exists in a standard-form contract supplied by one of the parties, the well-established contra proferentem principle requires that the ambiguity be construed against that party. In particular, New York law, which the parties agree governs here, recognizes a general rule that ambiguities in an insurance policy are to be construed strictly against the insurer.")

[3] *Cragg v. Allstate Indem. Corp.*, 17 N.Y.3d 118, 926 N.Y.S.2d 861 (N.Y. Court. App. 2011).

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