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Cyber Insurance Disputes: Will Arbitration Clauses be a Battleground?

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Commercial insurance companies are marketing cyber risk policies with messages such as, "Just about any organization that uses technology to do business faces cyber risk." In response to such risk, insurance companies are offering scores of "cyber" insurance products that get tweaked regularly and vary greatly in quality and terms. That lack of uniformity foretells coverage disputes — and litigation over insurance coverage for cyber claims began to emerge recently.

In such cases, the dispute resolution mechanism may pose an important threshold issue. Some cyber insurance policies may purport to require a mediation before litigation can be commenced,[1] while others may have no dispute resolution clause at all. Still others may attempt to bind the policyholder to use mandatory arbitration in the event of a coverage dispute. Mandatory arbitration has its advantages and disadvantages,[2] and a policyholder should be aware of the implications of such provisions before agreeing to them.

In some cases, a mandatory arbitration clause in the policy may prove unenforceable. Some states have laws barring arbitration of insurance disputes, and establishing such a state as the venue for a dispute may enable a policyholder to obtain its day in court. If the dispute involves a foreign entity, however, insurance companies will likely argue that the Federal Arbitration Act and related law preempt state anti-arbitration statutes, rendering arbitration mandatory.

State Anti-Arbitration Provisions: Preemption and Reverse Preemption

Nearly half the states have laws imposing some form of limitation on the enforceability of mandatory arbitration provisions in insurance disputes.[3] The McCarran-Ferguson Act leaves regulation of insurance to the states, providing that "[n]o Act of Congress shall be construed

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to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance." Accordingly, state laws limiting mandatory arbitration provisions in insurance disputes are generally enforced. McCarran-Ferguson therefore "reverse preempts" federal law to the extent a federal law invalidates, supersedes, or impairs the state law that regulates the business of insurance. *See, e.g.*, *Riverview Health Institute v. Medical Mutual of Ohio* (6th Cir. 2010).

Reverse preemption generally does not apply however, when a "foreign element" is involved. Such cases are generally subject to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (also known as the New York Convention). See, e.g., Safety National Cas v. Certain Underwriters at Lloyd's, London (5th Cir. 2009); ESAB Group v. Zurich Ins. (4th Cir. 2012). The New York Convention, to which more than 130 countries including the United States are parties, provides for mutual recognition and enforcement of arbitral awards by contracting states, and limits the defenses that may be raised in opposition to the confirmation of an award.

To assess whether the New York Convention applies to an arbitration agreement, the following four-factor test is applied: (1) whether a written arbitration agreement between the parties exists, (2) whether the arbitration agreement provides for arbitration in the territory of a signatory of the New York Convention, (3) whether the relationship between the parties involves a commercial subject matter, and (4) whether the relationship between the parties is something other than entirety domestic. See, e.g., Murphy Oil USA, Inc. v. SR Int'l Bus. Ins. Co. (W.D. Ark. Sept. 20, 2007).

Thus, assuming the factors point in favor of applying the New York Convention to a dispute, courts are likely to find that the application of the New York Convention trumps McCarran-Ferguson and applicable state anti-insurance arbitration statutes. The general rationale, as set forth in *Murphy Oil*, 2007 U.S. Dist LEXIS 69732, is as follows:

> To allow parties to international agreements to rely on state-law defenses to render arbitration clauses unenforceable would damage the fabric of international commerce and trade and would diminish the willingness of foreign businesses and individuals to enter into international commercial agreements. The Supreme Court has given much deference to principles of international comity in its treatment of international agreements to arbitrate as distinct from domestic agreements.

Of course, there are exceptions to every rule, and one such exception comes in the form of a Kentucky appellate court decision denying a motion to compel arbitration, based in large part on the fact that the insurance company was not truly "foreign." *See Scott v. Louisville Bedding Co., 404 S.W.3D 870* (Ky Ct. App. July 2013) (a Swiss entity was not "foreign" when it conducted all of its business in Texas).

Mandatory Arbitration in Cyber Policies: *New Hotel Monteleone*

Early this year, a suit was filed that may be the first cyber coverage dispute to involve the enforceability of an arbitration clause. In *New Hotel Monteleone, LLC v. Certain Underwriters at Lloyd's of London, Subscribing to Ascent Policy No. ASC14C000944 et al.*, a hotel sued Lloyd's of London in Louisiana state court for failing to make payments under a CyberPro policy following a cyber attack. According to the initiatory pleading, the cyber attack resulted in a security breach such that "payment card numbers allegedly were compromised and were no longer confidential." Following the attack, the hotel was held liable for multiple types of losses and received a demand for damages from a payment card processor. The crux of the coverage dispute appears to be the limit of liability applicable to the dispute and, relatedly, the scope of a Payment Card Industry Fines or Penalties Endorsement.

The insurance company removed the action from state court to federal court and then moved to dismiss or, in the alternative, compel arbitration (pursuant to the policy's arbitration clause) and stay the court action. In their moving papers, Lloyd's argued that the arbitration agreement in the insurance policy was subject to the New York Convention. Because, according to Lloyd's, the New York Convention applied, a Louisiana state law that barred the enforcement of arbitration agreements in insurance policies could not overcome the force of the international treaty.

Lloyd's motion was not adjudicated as the parties agreed to stay the federal case and refer the matter to alternative dispute resolution. The case, however, demonstrates that even in the cyber insurance arena, policyholders should review and understand dispute resolution provisions prior to purchase. Further, those policyholders purchasing "layered" cyber insurance programs should also check their excess "follow form" cyber policies to see if their terms are truly follow-form in actuality. While a primary cyber policy may be devoid of an arbitration provision, it is possible that one or more excess policies in the tower contain their own dispute resolution clauses including one calling for binding arbitration in the United States or perhaps even abroad.

Policyholders should also be aware that there are means of challenging such provisions after a coverage dispute arises, but that the presence of a foreign element will complicate such a challenge.

ENDNOTES

[1] *Columbia Cas. Co. v. Cottage Health Sys.*, Case No. CV 15-03432, 2015 U.S. Dist. LEXIS 93456 (C.D. Cal. Jul. 17, 2015).

[2] *See* Peter A. Halprin, "Arbitration in Insurance Coverage Disputes: Pluses and Minuses." *Policyholder Advisor* (Jan. 6, 2015).

[3] *See* Public Citizen, "State Laws Regulating Arbitration in Insurance Contracts," http://www.citizen.org/congress/article_redirect.cfm?ID=6560

About Anderson Kill

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