Determining the Arbitration Obligation

by Peter A. Halprin

In television programs and movies, following some slight or wrong, an aggrieved party will turn to the aggressor and say, "I'll see you in court!" From the vantage point of the viewer, this is reassuring—justice may soon be served. But courtroom justice is not always available in insurance disputes. Depending on the provisions set forth in insurance policies and contracts, other options, such as mediation or arbitration, may be available as an alternative to litigation.

Mediation is a dispute resolution mechanism where the parties agree to participate in what is typically a non-binding process involving a neutral mediator who facilitates a settlement of the dispute. This often utilizes shuttle diplomacy, with the mediator traveling between the parties involved.

Arbitration, by contrast, is a dispute resolution mechanism where the parties agree to participate in what is typically a binding process involving one or more arbitrators who, using adjudicative procedures, hold hearings and render an award.

Although parties must agree to participate in arbitration for it to proceed, policyholders are sometimes unaware that their insurance policies contain provisions requiring the arbitration of disputes.

Arbitration has both advantages and disadvantages, most of which generally benefit sophisticated parties while posing challenges for those that are unaware of such clauses or unable to negotiate their terms.

On the plus side, arbitration is generally considered cheaper and faster than litigation because arbitration awards are subject to limited judicial review, and appellate procedures are rare. In addition, the arbitration principles of party autonomy and procedural flexibility mean that parties are free to agree on the laws, procedure, and rules applicable to their disputes. Unlike in court, this permits parties to employ streamlined, custom procedures, further reducing the cost and length of proceedings.

Parties can also adopt educational, vocational or other requirements for arbitrators, ensuring those on the arbitration panel have the skills or expertise to better understand the issues in dispute. The confidentiality of arbitration can offer another advantage, particularly where sensitive materials, such as trade secrets, are involved. Of course, all of the above can prove problematic if the parties are unable to fully, freely and fairly negotiate the terms of the arbitration agreement.

As for its disadvantages, some experts point out that arbitration is often just as expensive and time-consuming as litigation. These critics cite the increasing complexity of arbitration disputes and the fact that counsel sometimes treats arbitration no differently than it does litigation.

Beyond this, others see the lack of judicial review or appellate mechanisms as a disadvantage since it leaves an aggrieved party with little recourse in the event of a decision with which they disagree. Autonomy and procedural flexibility can become problems for a party that is less experienced in arbitration, as procedures that are disadvantageous to one party can be difficult to change after the fact.

For example, an arbitration clause barring depositions or extensive document production can disfavor a party that needs such information to support their claims. Similarly, a clause limiting the arbitrators to current or former insurance executives could result in an arbitration panel that is not truly neutral in insurance matters. Likewise, confidentiality can be an issue insofar as decisions by arbitration panels are not made public and lack precedential value. It is therefore important for parties to work with counsel to understand their arbitration clause and develop a dispute resolution program that suits their needs.

As courts generally favor the enforcement of agreements to

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arbitrate, avoiding arbitration provisions is often challenging. But there are certain circumstances where it is possible.

One such circumstance is where state law permits it. Insurance law is governed by state law and certain state laws bar the arbitration of insurance coverage disputes. Thus, in a state where arbitration is barred, this law may be invoked to avoid the process. Based on the interplay between state law, federal law and certain treaty obligations, the general rule is that state law will be effective in matters involving domestic parties.

Where there is a foreign element or the provision does not impair state law that regulates insurance, however, courts may find that federal law or related treaty obligations will require the arbitration provision to be enforced.

In December, for example, in *Zurich Insurance Co. v. Crowley Latin American Services, LLC*, the U.S. District Court for the Southern District of New York evaluated the position that applicable state law barred the enforcement of an arbitration clause but found that the application of federal law requiring arbitration did not contravene state law. Thus, policyholders seeking to avoid arbitration must rigorously evaluate whether state law provides a basis for doing so.

A policyholder may also be able to avoid arbitration when an insurance policy contains language calling for both arbitration and litigation as dispute resolution mechanisms. Although courts typically enforce arbitration clauses, case law, including the 2016 Canadian decision in *Trade Finance Solutions Inc. v. Equinox Global Limited, et al.*, supports the notion that the presence of both provisions can require litigation rather than arbitration.

In TFS, decided under Ontario law, the policy contained an arbitration provision as well as a Canada-specific endorsement that included an "action against insurer" portion. This latter provision contained wording to permit a lawsuit against the insurers. Because the endorsement, per its terms, prevailed in the event of conflict between the policy wording and the wording in the endorsement, the endorsement was determined to be the controlling factor in the dispute.

In 2013, facing similar facts, the United States Court of Appeals for the Eighth Circuit affirmed a ruling in *Union Electric Co. v. Aegis Energy Syndicate* barring arbitration on the grounds that an arbitration clause in the policy conflicted with a provision in an endorsement permitting the use of the courts. Thus, policyholders should carefully review their policies to determine whether policy endorsements permitting resolution of disputes in court trump dispute resolution provisions calling for arbitration.

Policyholders and brokers should make sure that they are aware of the dispute resolution mechanisms in proposed insurance policies. In reviewing the dispute resolution mechanism language, policyholders need to discuss the relevant provisions with counsel to understand the potential impact on insurance recovery in the event of a dispute. Sometimes it is not a matter of dispensing with a provision in its entirety but instead modifying it so that the process works just as well for policyholders as it does for insurers. ■

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