The Hidden World of Policy Arbitration

by Joshua Gold

For the last couple of decades, arbitration has been heralded as a cheaper, more efficient and more expedient way to resolve commercial disputes. A significant segment of the property/casualty insurance market seized on this refrain by imposing mandatory arbitration clauses or other forms of alternative dispute resolution provisions in their insurance products. Off-shore insurance companies, especially in Bermuda, are particularly insistent on using arbitration rather than allowing their customers to file suit in the United States should a claim dispute arise.

Many policyholders who have arbitrated a significant claim have discovered that the arbitration process is anything but cheap, however. Policyholders have to cover the expense of their coverage counsel, often pay some or all of the expenses of foreign solicitors, barristers, party arbitrators and pay half the fees of the umpire or panel chair. The costs for policyholders are increased further given the increasing weakness of the dollar against other foreign currencies. Perhaps even worse, some arbitrations languish, taking years to be decided—a far cry from expedient dispute resolution.

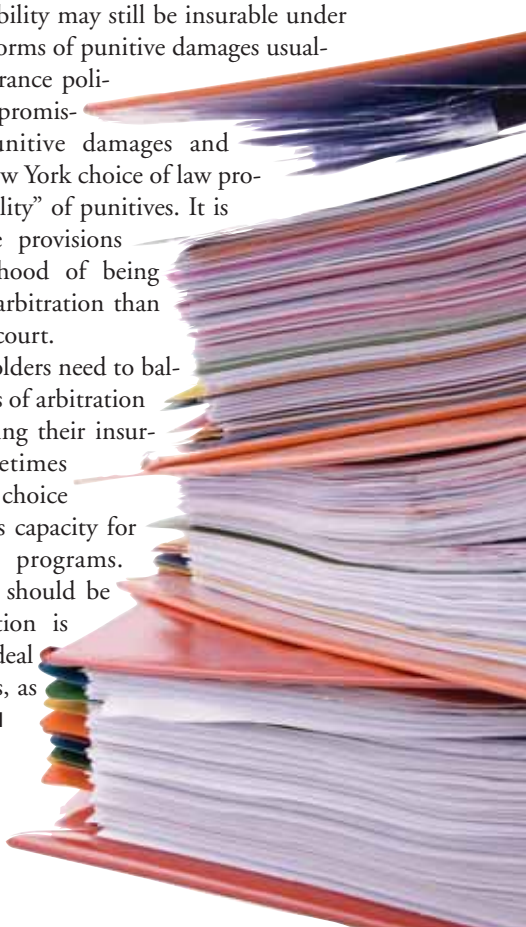
To compound the problem, choice of law provisions are typically coupled with arbitration provisions in certain forms of commercial insurance, including D&O, property and general liability. Some Bermuda-based carriers argue that the presence of these choice of law provisions is mutually beneficial because of the "certainty" factor involved with knowing what law will control the rights and obligations of the parties. The problem however is that this "certainty" usually favors the insurer. Certainty of house-advantage is normally of no benefit to the customer.

Choice of law clauses inserted into commercial policies often provide for the application of New York law—but with a twist. The main positive feature of New York insurance law for policyholders—that any uncertain policy terms will be construed in favor of coverage and against the insurance company—is jettisoned in many choice of law clauses. Unfortunately, some of the less favorable aspects of New York law are left intact. It will be interesting to see if the off-shore insurance companies further modify their New York choice of law clauses based upon the recent *Bi-Economy* decision, which found that insurance companies could be held responsible for consequential damages on the basis of wrongful claims conduct.

Additional litigation costs associated with arbitration can be incurred where the policyholder has purchased a large layered or subscription insurance program, and two or more of the insurance policies sneak in arbitration clauses. If there is a coverage dispute, the policyholder may be forced into a situation where it is simultaneously conducting multiple arbitrations and a court proceeding, even when the issues disputed are identical. Very rarely will an insurance company agree to consolidate an arbitration with another pending arbitration proceeding, let alone a court proceeding.

While arbitration presents some drawbacks for policyholders, there are aspects of arbitration that can be helpful under certain sets of circumstances. Because many arbitrations take place overseas and are private forums, for example, policyholders can often avoid the opportunity for underlying claimants to collect and exploit certain information that would otherwise be public in a court setting. Another possible advantage to arbitration in certain cases involves the modified New York choice of law provisions that can accompany arbitration clauses. Certain provisions regularly purport to modify New York's "prohibition" against insuring punitive damages. While punitive damages awarded under a theory of vicarious liability may still be insurable under New York law, other forms of punitive damages usually are not. Some insurance policies deal with this by promising coverage for punitive damages and excepting from the New York choice of law provision the "uninsurability" of punitives. It is a fair bet that these provisions have a greater likelihood of being given effect in a UK arbitration than they would in a state court.

Obviously, policyholders need to balance the pros and cons of arbitration clauses when purchasing their insurance policies. Sometimes they may have little choice when seeking precious capacity for their insurance programs. Regardless, one thing should be plainly clear: arbitration is not the panacea to deal with coverage disputes, as it is so often touted. ■



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