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The Fourth Circuit Rules Against State Anti-Arbitration Statutes

By John G. Nevius and Peter A. Halprin

Following the U.S. Court of Appeals for the Fifth Circuit's decision in *Safety National*, the U.S. Court of Appeals for the Fourth Circuit recently held not to give effect to a South Carolina anti-arbitration statute barring arbitration of insurance coverage disputes.

In *ESAB Group*, the policyholder sought to avoid arbitration on the basis of a South Carolina law that makes insurance policy provisions requiring the arbitration of insurance disputes unenforceable. *See* S.C. Code Ann. § 15-48-10(a). The insurance company moved to compel arbitration and the U.S. District Court granted this motion. On appeal, the Fourth Circuit held that the Convention on the Recognition and Enforcement of Foreign Arbitral Awards is unaffected by the McCarran-Ferguson Act, which regulates "domestic commerce legislation" but expressly leaves insurance regulation to the states. *ESAB Group, Inc. v. Zurich Ins. PLC*, Nos. 11-1243, 11-1655, 2012 WL 2697020 (4th Cir. Jul. 9, 2012).

The Convention

The New York Convention entered into force on June 7, 1959, and became effective in the United States on Dec. 29, 1970. According to the U.N. Commission on International Trade Law, the New York Convention is widely recognized as a foundation instrument of international arbitration and requires courts of contracting states to give effect to an agreement to arbitrate in a matter covered by an arbitration agreement and also to recognize and enforce awards made in other countries, subject to specific limited exceptions.

McCarran-Ferguson Act

The "primary objective" of the McCarran-Ferguson Act of 1945 was to "grant the states broad regulatory authority over the business of insurance." See 15 U.S.C. §§ 1011-1015.

Under McCarran-Ferguson:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business ... unless such Act specifically relates to the business of insurance.

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Safety National and *ESAB Group*

The Fifth Circuit in *Safety National Cas. Corp. v. Certain Underwriters at Lloyd's, London*, 587 F.3d 714 (5th Cir. 2009), could have considered the unique nature of insurance and the intent of McCarran-Ferguson, but instead held that,

> [a] treaty remains an international agreement or contract negotiated by the Executive Branch and ratified by the Senate, not by Congress. The fact that a treaty is implemented by Congress does not mean that it ceases to be a treaty and becomes an "Act of Congress."

The Fourth Circuit in *ESAB Group* sought to avoid the "Act of Congress" issue and held that,

> [E]ven assuming Article II of the Convention is non-self-executing, the Convention Act, as implementing legislation of a treaty, does not fall within the scope of the McCarran–Ferguson Act. Instead … Supreme Court precedent dictates that McCarran–Ferguson is limited to legislation within the domestic realm, and prior precedent of this court and our sister circuits supports a narrow reading of the Act.

ESAB Group, at *9.

The above decisions likely were influenced by the international nature of the disputes and the strong presumption in favor of arbitration. However, insurance policies are contracts of adhesion and the illusion of mutual agreement is the very purpose of state anti-arbitration laws such as that of South Carolina. In addition, as discussed in our article, "Arbitration of Insurance Coverage Disputes: A Policyholder's Definitive Survival Guide" in the Fall 2010 issue of *The John Liner Review*, there are a number of reasons why arbitration may not be in a policyholder's interests, such as limited discovery and the lack of appellate review.

As discussed in an earlier article, "Will Policyholders be Compelled to Arbitrate International Coverage Disputes?" in the February/March 2010 issue of *Executive Counsel*, though rejected in *Safety National* and *ESAB Group*, and questioned in a subsequent U.S. Court of Appeals for the Second Circuit opinion, there remains a Second Circuit decision which is contrary to the rulings in *Safety National* and *ESAB Group*. *See Stephens v. American International Ins. Co.*, 66 F.3d 41 (2d Cir. 1995). Given the apparent split, this issue may reach the U.S. Supreme Court in due time.

About Anderson Kill & Olick, P.C.

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