

The London Arbitration Provision: Insurance Buyers Beware

By R. Mark Keenan and David A. Kochman

In light of the insurance industry's growing trend of burying mandatory London arbitration clauses within their policies, it is necessary to examine the giant trapdoor these clauses portend for unsuspecting policyholders. Increasingly, we find in our London insurance coverage work that these binding provisions cause many problems for U.S. policyholders including denying their right to a full hearing as well as obstructing access to the very documents which are critical to their case.

The insurance industry proclaims that arbitration clauses are merely a "private-sector alternative to the courts, a way of streamlining and speeding up the judicial process while controlling costs." *Consumer and Media Alert: The Small Print That's Devastating Major Consumer Rights* (July 28, 2003), at <http://www.consumerlaw.org/initiatives/model/arbitration>.

However, a cursory look at how these arbitration clauses are used by the insurance industry evidences some of the truly disturbing aspects of these provisions. The insurance company selects the arbitration situs and service. Mandatory confidentiality rules ensure that no one else finds out about proceedings that expose wrongdoing — a colossal departure from the transparency of the public court system — meaning that only the arbitration clause's proponent can track past decisions to determine whether individual arbitrators they may use again have previously ruled in their favor. Finally, the unavailability of appeals in arbitration frequently renders even gross legal errors in an arbitrator's decision beyond remedy.

When one party to a legal proceeding picks the locale, writes the rules and mandates that testimony never come to light, the deck begins to seem really stacked against the policyholder.

This inherent inequity is clearly evidenced by looking at the reasons insurance companies pick London as their preferred venue for arbitration. One reason is the historical and institutional bias

in the U.K. against American style discovery — particularly of third-parties not subject to the arbitration contract. While in the U.S., pre-trial depositions are considered the most common and effective device to obtain and flesh out relevant evidence, under U.K. law, depositions are rarely granted. English counsel advises us that, in essence, there are no mechanisms in a London arbitration to mandate discovery from a third-party who is not a U.K. citizen, *Commerce Ins. Co. v. Lloyd's Underwriters*, 1 W.L.R. 1323 (2002), or to obtain deposition discovery of a material witness prior to an arbitration hearing. *South Carolina Co. v. Assurante N.V.*, 1 A.C. at 35 (H.L.(Eng.) 1987).

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"... [London arbitration] provisions are causing many problems for U.S. Policyholders ..."
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In the U.S., parties are entitled to schedule and conduct depositions without the court's assistance.

A U.K. arbitrator, schooled in the customary practices of English courts, would not readily consider deposition testimony a necessary component to a full and fair adjudication. Thus, for a U.S. citizen, being compelled to arbitrate in London is fraught with peril.

Consider the plight of a U.S. policyholder with a well-founded fraudulent inducement claim that the insurance policy, marketed and sold to him by a New York broker on behalf of an English insurance company, was materially different from the "policy" the insurance company used to deny his claim — i.e., a classic misrepresentation claim. Suppose further that the basis for denying the claim is a "Rule Book" that contains provisions, including a London arbitration clause, enabling the insurance company to deny coverage for just about any reason. Finally, assume the key issue in

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Appointment

Virginia I. Miller, an attorney in the Philadelphia office of Anderson Kill & Olick, P.C., has been appointed to serve as Committee Chair of the Insurance Committee of the Business Law Section of the Philadelphia Bar Association, effective February 10, 2005.

Ms. Miller's practice concentrates in the areas of commercial litigation, with particular emphasis on insurance and ERISA matters. Recent clients include Penn-Mont Benefit Services, Inc., plaintiffs in an intellectual property suit against Travelers Life and Annuity Company, currently pending in Federal District Court in Philadelphia. The District Court recently rejected a defendant's motion to dismiss this case, ruling that a tort claim could proceed even though the conduct on which the tort is based falls within the scope of a contract (Dec. 30, 2004).

Ms. Miller is an active member of the bars of the Commonwealth of Pennsylvania; the New Jersey State Court; the United States District Court, Eastern District of Pennsylvania; the United States District Court, Middle District of Pennsylvania; the United States District Court, District of New Jersey; and the United States Court of Appeals for the Third Circuit. She is a member of the American, Pennsylvania and Philadelphia Bar Associations.

A Major with the Air National Guard, Ms. Miller is a highly decorated combat veteran with 3,000+ flying hours, including tours in support of recent conflicts in Kuwait, Bosnia, Afghanistan, and Iraq. She holds a J.D. with distinction from the International Honors Program, Rutgers-Camden School of Law, and a B.S./B.A. from Bowling Green State University. ■

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the dispute is whether the English insurance company tendered the Rule Book to the New York broker.

If the policyholder could bring suit in the U.S., U.S. courts would order complete discovery of all documents and personnel relating to the making of the insurance policy, including depositions, in order to fully investigate the misrepresentation claim. *Allen v. Crowell-Collier Publishing Company*, 21 N.Y.2d 403 (1968). Indeed, it would be reversible error to deny a party such discovery. *RLC Electronics, Inc. v. American Electronics Laboratories Inc.*, 39 A.D.2d 757 (Second Dept. 1972); *Kenford Co. Inc. v. County of Erie*, 41 A.D.2d 586 (Fourth Dept. 1986). An arbitrator's failure to grant such discovery in a fraudulent inducement claim would constitute more than adequate grounds for a court to vacate the arbitration award. *Tempo Shain Corporation v. Bertek*, 120 F.3d 16 (2d Cir. 1997).

United States courts have firmly held that failing to consider the testimony of the only witnesses with evidence of the fraudulent conduct is grounds for vacating an arbitration award. 9 U.S.C. § 10(a); *Hoteles Condado Beach v. Union de Tronquistas Local 901*, 763 F.2d 34 (1st Cir. 1985). Further, faced with this situation, courts in the U.S. would likely require pre-trial deposition testimony of the insurance brokers. *Burton v. Bush*, 614 F.2d 389 (4th Cir. 1999); *Bigge Crane and Rigging Co. v. Docutel Corp.*, 371 F.Supp. 240 (E.D.N.Y. 1973).

Yet the same policyholder may face a markedly different outcome if he is required to arbitrate in London under English rules. U.K. attorneys tell us that there are very limited grounds upon which a party can obtain discovery from third parties to the insurance policy, a group which includes insurance brokers. In essence, discovery in the U.K. is limited to voluntary document production. In the U.S., however, full discovery of every document and witness involved with the making of the contract is considered a right so fundamental that denying a party this discovery constitutes a failure of due process.

Following the hypothetical situation set forth above, key evidence regarding the making of an insurance policy would inevitably include full discovery from the New York broker. An insurance broker, the policyholder's intermediary with the insurance company, undoubtedly possesses highly germane files recording communications conducted in the process of negotiating the policy. In fact, the insurance broker may be the only party possessing evidence of an insurance companies' fraud. It is therefore axiomatic that one would expect to obtain full discovery of an insurance broker when alleging fraudulent inducement of an insurance policy.

But if the New York broker is resistant to the policyholder's voluntary requests for information and is beyond the arbitrator's jurisdictional grasp, what does the U.S. policyholder do? How can

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WHO
SAID
WHAT?

"Insurers are litigation experts. It makes little sense to systematically insulate them from liability for negligent refusals to settle that impose damage on their policyholders."

Answer on page 3

our policyholder, arbitrating in London, obtain the requisite discovery of their insurance broker located in the U.S.? The road is highly unstable.

One avenue is to pursue depositions in aid of the London arbitration through the U.S. courts. *See e.g.* McKinney's C.P.L.R. § 3101. But this presents many precedential pitfalls. First, U.S. policy disfavours "interfering" with arbitration panels in the midst of their proceedings. *In the Matter of Trans Chemical*, 978 F.Supp 266 (S.D.Tex. 1997). Additionally, American courts are loathe to order depositions to aid an English arbitration except upon the arbitrator's explicit request. *DeSapio v. Kohlmeyer*, 35 N.Y.2d 402 (1974); *In the Matter of Katz*, 3 A.D.2d 238 (First Dept. 1957). While United States litigants presuppose the occurrence of deposition testimony as an elementary component of discovery, neither English judges nor arbitrators are accustomed to the practice of ordering depositions.

A second approach is to seek discovery of the brokers via discovery in a direct action in United States courts. *See Wright v. SFX Entertainment*, 2001 WL 103433 (S.D.N.Y. 2001). This seems intuitive since the brokers are not bound by any arbitration agreement between the insurance company and the policyholder. However, even assuming a court's sympathetic view of the policyholder's predicament, courts may decline to assist parties attempting to circumvent unfavorable procedural rules.

In short, a U.S. policyholder forced to arbitrate in the U.K. is often caught in a Catch-22: he is forced to arbitrate in London because of a fraudulently induced contract which, as a result of U.K. discovery rules, effectively precludes discovery of the only evidence of that fraud.

This unpalatable result is avoidable by taking a few preventative measures when negotiating the terms of your insurance policy. Insisting upon provisions identifying the location of an arbitration is one thing. Specifying the governing law regarding substantive and procedural aspects is another. For instance, the policy can stipulate that even though the arbitration is to be conducted in London, New York law controls and that arbitration procedures will allow for deposition discovery. Savvy U.S. policyholders bound to arbitrate in London wisely insist upon such prophylactic protections. ■



R. Mark Keenan is a senior shareholder in the New York office of Anderson Kill & Olick, P.C., and Co-Chair of Anderson Kill's Financial Services Group. Mr. Keenan has extensive experience resolving complex insurance matters and regularly represents policyholders in domestic and international coverage disputes involving large corporate transactions, financial institutions and director and officer coverage as well as representing U.S. policyholders in a number of U.K. insurance insolvencies. Mr. Keenan can be reached at (212) 278-1888 or mkeenan@andersonkill.com.



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RECENT DEVELOPMENTS

Delayed Disclaimer Unreasonable, New York Justice Holds. *American Home Assurance Co. v. Ivory Holding Co. Inc.* American Home Assurance Co., an AIG company, said that it had no obligation to defend or indemnify Ivory Holding Co. Inc. ("Ivory"), an apartment building owner, regarding a lead paint abatement order issued by the New York City Department of Health. The abatement order was issued on March 4, 1994. The insurance company received notice of the order on October 22, 1996 and disclaimed coverage on January 6, 1997 based on alleged failure to provide timely notice of an "occurrence." Ivory filed a motion for summary judgment in the New York Supreme Court saying that the insurance company's disclaimer was untimely as a matter of law. New York insurance law requires an insurance company to disclaim coverage by written notice "as soon as reasonably possible." New York Supreme Court Justice, Mary Ann Brigantti-Hughes granted Ivory's motion for summary judgment on February 9, holding that AIG gave no explanation for the 76-day delay in disclaiming coverage and considered the delay unreasonable as a matter of law. The New York Supreme Court Justice scheduled a hearing for April 5 to determine whether Ivory is entitled to recover attorney fees. The "American Rule" prohibits recovery of attorney fees in the absence of a statute or an enforceable contract provision. New York Courts recognize an exception to the general "American Rule" where the policyholder has been put in a defensive position by the insurance company's legal actions to relieve itself of coverage obligations. ■

—Claudie Ilie

WHO SAID WHAT?

Cincinnati Insurance Company

Cincinnati's Brief in Support of its Motion for Partial Summary Judgment, dated Nov. 15, 2000 at 13, *Cincinnati Ins. Co. v. Zurich Ins. Co.*, No. 5:1999cv00138 (W.D.N.C.)

Mark Your Calendar

Anderson Kill Participates at RIMS 2005 Annual Conference & Exhibition

April 17-20, 2005 — Philadelphia Convention Center

Come Visit Us at Booths 2301 and 2303

Our attorneys have also been invited to speak at the RIMS Industry Sessions:

Tuesday, April 19 • 1:45-3:15pm
#IN100

THE BASICS: How To Read An Insurance Policy

This session will stress fundamentals for those new in risk management.

Coordinator/Speaker: William G. Passannante

Speakers: Jeffrey M. Posner, JM Posner, Inc.; and John B. Hughes, Alex Lee, Inc.

Tuesday, April 19 • 3:30-5:00pm
#LL300

How To Try A Complex Insurance Case

This session will help insurance professionals make better use their existing insurance program.

Coordinator/Speaker: William G. Passannante

Speakers include: John B. Berringer, Anderson Kill & Olick, P.C.; and George M. Ward, VHA, Inc.

Wednesday, April 20 • 1:45-3:15pm
#LL100

The ABC of an Insurance Law J.D.

This session is designed to be a fundamental introduction to the basic legal relationships and doctrines underlying the insurance transaction.

Coordinator/Speaker: Timothy P. Law

Speakers include: John N. Ellison, Anderson Kill & Olick, P.C.; Randy J. Maniloff, White and Williams; and David Hershey, Sprague Energy

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