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# Will Policyholders be Compelled to Arbitrate International Coverage Disputes?

By John G. Nevius and Peter A. Halprin

Do state laws barring arbitration of insurance disputes trump private international agreements to arbitrate? According to a recent Fifth Circuit Court of Appeals decision, the answer to this question is a resounding "No." In Safety National Casualty Corp. v. Certain Underwriters at Lloyd's, London, the United States Court of Appeals for the Fifth Circuit held that Louisiana law does not trump the Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Louisiana law purports to bar enforcement of arbitration clauses in insurance contracts. Surprisingly, this was not enough for the Fifth Circuit, which took issue with a contrary decision by the Second Circuit. Both cases involved attempts by foreign corporations to enforce arbitral agreements against American parties.

These two opposing views could eventually play out before the U.S. Supreme Court, and which view prevails will have significant consequences for U.S. policy holders involved in international insurance coverage disputes.

The fundamental difference between the two decisions is a divergent interpretation of the phrase "Act of Congress" as used in the federal McCarran-Ferguson Act. The "primary objective" of McCarran-Ferguson was to "grant the states broad regulatory authority over the business of insurance." It states: "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."

The fundamental question facing both circuit courts was: Are international treaties dealing with arbitration (such as the Convention on the Recognition and Enforcement of Foreign Arbitral Awards) "Acts of Congress" for purposes of applying McCarran-Ferguson?

International treaties must be ratified by the Senate, but may also involve or require enabling legislation and adoption by both houses of Congress. Whether the Congressional adoption of a treaty can be considered an "Act of Congress" for purposes of implementing the McCarran-Ferguson Act is what led to a split of opinion between the two Circuit courts.

More specifically, the divergence turned on whether an international treaty was adopted pursuant to an Act of Congress or whether it was a "self-executing treaty." A self-executing treaty would not run afoul of McCarran-Ferguson and therefore could bar the states from prohibiting arbitration over coverage disputes.

On the other hand, the enabling legislation associated with the Convention could trigger McCarran-Ferguson's bar on interference with state regulation of insurance.

*The Convention*

The Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the New York Convention, entered into force on June 7,1959. It initially was adopted at the United Nations by diplomatic conference on June 10, 1958. According to the U.N. Commission on International Trade Law, the 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 states, subject to specific limited exceptions.

The United States adopted the Convention in the fall of 1970 and it became effective on December 29, 1970. The adoption act provides that "This Act [enacting this chapter] shall be effective upon entry into force of the Convention…"

The Second Circuit reasoned that the adoption act prevents the Convention from being self-executing and, therefore, it constitutes an "Act of Congress" or a legislative act. According to the holding in Stephens v. American International Insurance, a treaty is only "[t]o be regarded in the courts of justice as equivalent to an act of legislature, whenever it operates of itself, without the aid of any legislative provision."

Thus, because an adoption act was necessary, the Convention is not self-executing and a Kentucky state-law provision barring arbitration was held to control.

The Fifth Circuit, alternatively, held in Safety National 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.'"

Having rejected the Second Circuit's approach and determined that the Convention may not be an Act of Congress, the Fifth Circuit then examined the actual text of the treaty to evaluate the extent to which it could be considered "self executing." Expressly distinguishing its opinion from that of the Second Circuit in Stephens, the Fifth Circuit held that later Second Circuit precedents, including a subsequent Stephens decision, had applied federal law to the insurance industry despite state laws to the contrary. Specifically, the Fifth Circuit quoted the subsequent Stephens decision in that the Act "does not force a federal law that clearly intends to preempt all other state laws to give way simply because the insurance industry is involved."

The Safety National decision was far from unanimous. A forceful four-judge dissent characterized the majority's decision as "a doctrinal novelty of our circuit's own creation" and a "trail-blazing holding" that "creates a circuit split with the Second Circuit and goes against other circuits."

*Implications for Policyholders*

The implications of the decision should be frightening to policyholders doing business globally. While the majority of states do not have anti-arbitration insurance statues, insurance companies in those that do may be able to enforce arbitration agreements despite the presence of contrary statutes.

After all, compulsory arbitration, common in consumer contracts as well as insurance agreements, has become the norm. Insurance companies and large retailers are aware of the significant benefits of avoiding state and federal courts.

First, arbitration clauses, where enforceable, may act to bar state law protections intended to level the playing field between policyholders and their insurance companies. This can include, for example, laws awarding attorneys fees to prevailing policyholders to account for breaches of the insurance contract.

Second, as a corollary, arbitration clauses may include terms which contravene important aspects of public policy. For example, some purport to do away with "contra proferentem" (the legal concept whereby ambiguous language is construed against the drafter). The absence of this important rule of construction hinders the purpose of governmental regulation of insurance by undermining protections for policyholders who are unable to negotiate the terms of their policies on equal footing with insurance companies.

Third, arbitration provides insurance companies with a distinct institutional advantage. Insurance companies, as drafters of their policies, can dictate the terms of arbitration provisions in the policies. This allows them to select the most favorable laws and procedures for arbitration and, more importantly, the arbitral forum. In a 2007 study by Public Citizen, consumers lost nearly 94 percent of credit card disputes administered by the National Arbitration Forum. This occurs, predictably, because arbitration organizations are businesses with economic interests which means they are unlikely to "bite the hand that feeds them."

Fourth, insurance companies are supposed to apply policy terms and conditions, as well as claim and handling principles, in a consistent manner. Arbitrations are not public and do not lend to the development of common law, so insurance companies are free to take any position which suits their interests and ignore consistency or appearances in taking outlandish coverage positions.

*Further Developments*

Given the Circuit split created by Safety National, it is likely that the Supreme Court will address these issues in a subsequent case. The implications of such a decision, in either direction, could be significant. At least eleven states have enacted laws that specifically refuse to allow the arbitration of insurance disputes. A decision in favor of the Fifth Circuit's position would all but nullify such anti-arbitration statutes with respect to global trade disputes.

Recent legislative activity, however, may render these legal disputes academic. In the last year, three bills have been introduced which seek to repeal or limit the McCarran-Ferguson Act. As of this writing, two such bills seem to be making headway in conjunction with the establishment of some form of national health care. Specifically, Sen. Patrick Leahy and Rep. John Conyers have introduced bills, in the Senate and House respectively, that exempt health or medical malpractice insurance policy issuers from the protections of McCarran-Ferguson.

In other words, the bills allow the Federal Government to prevent anti-competitive or collusive behavior by insurance companies in the specified areas. Although this Federal power is limited, insurance companies might one day be subject to federal antitrust laws.

Federal regulation of insurance might, in turn, have mixed results for policyholders. On the one hand, federal regulation of anti-competitive behavior could theoretically result in less collusion, more competition, and ultimately, savings to policyholders. On the other hand, in the absence of McCarran-Ferguson, it is likely that state anti-insurance arbitration laws would no longer be safe from preemption and policyholders would therefore be subject to one-sided arbitration clauses that they are powerless to negotiate away.

Policyholders and insurance companies alike will want to monitor these developments closely to be prepared for any changes as a result of regulatory reform or further appellate decisions.

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