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Overcoming One-Sided Insurance Policy Arbitration Agreements

by Robert M. Horkovich

In recent years, insurance companies have increasingly included arbitration clauses in their insurance policies and related side-agreements with policyholders. The arbitration clauses, however, often contain conditions that stack the deck against policyholders in a dispute with their insurance companies. Thus, requirements such as arbitrators being ex-insurance industry executives or not being bound strictly to apply the law are increasingly common. Policyholders should be aware that a number of avenues may exist to overcome these one-sided arbitration agreements.

The Federal Arbitration Act (FAA) embodies the national policy favoring arbitration agreements and generally provides that arbitration agreements are valid and enforceable unless they are the product of fraud or duress or are otherwise unconscionable. These defenses to the enforcement of an arbitration agreement may be difficult to prove for the average policyholder. An additional avenue to challenge the validity of an arbitration agreement may exist, however, through the McCarran-Ferguson Act, a federal law enacted to ensure that the regulation of insurance companies was left to the states. Under the McCarran-Ferguson Act, a state law governing insurance generally cannot be invalidated, impaired or superseded by a federal law.

In a recent decision, a New York appeals court applied the McCarran-Ferguson Act to support its decision to void the arbitration clauses contained in a number of side-agreements between AIG and its policyholders. In *In re Monarch Consulting, Inc., et al. v. National Union Fire Insurance Co. of Pittsburgh, PA.*, the court considered a consolidated appeal of three cases involving California policyholders who had purchased workers compensation insurance from AIG. After the issuance of the workers comp policies, AIG required each policyholder to sign a payment agreement relating to the provision of funds by the policyholders to provide collateral for any workers comp payments that had to be made which fell within the policies' deductibles. Those payment agreements each also contained clauses requiring arbitration of any disputes and further requiring that any dispute regarding the arbitration clauses be heard in the New York courts. After disputes arose between the policyholders and AIG regarding the collateral provided under the payment agreements, AIG sought to enforce the arbitration clauses in the payment agreements. Two New York trial courts upheld AIG's position while one trial court, in *National Union Fire Insurance Co. et al. v. Source One Staffing, LLC.* rejected AIG's position and held that the arbitration clause contained in the payment agreement was void.

In the appellate decision governing all three cases, the New York appeals court held that the arbitration clauses were void and could not be enforced. In reaching its decision, the court adopted the reasoning of the Source One court in key particulars. First, it focused on California law requiring AIG to file and obtain approval from the California Department of Insurance California (CDI) of any workers comp policies sold in California. The Monarch court found that the payment agreements were part of the workers comp policies and therefore were required to be filed with the CDI and that AIG had not done so. As a result, the court held that under California law the failure to file the payment agreements rendered the arbitration clauses in those agreements void. Finally, once more affirming the Source One decision, the appeals court specifically noted that because the McCarran-Ferguson Act left regulation of insurance to the states, California insurance law must be enforced notwithstanding the FAA policy supporting arbitration:

[T]he California regulatory and statutory scheme requires close scrutiny of workers compensation insurance programs. Thus, the policy in favor of arbitration must yield to the

primacy of California state law and to California's prerogative to regulate its own insurance practices.

While the Source One decision held out the possibility of relief to policyholders forced into an unfavorable arbitration forum, the appellate decision in *Monarch* provides more substantial relief. The *Monarch* decision is an important reminder to policyholders facing a potentially unfavorable arbitration forum to explore all avenues before conceding any right to arbitrate. To the extent that an arbitration clause contained in an insurance policy or related documentation violates state insurance law, policyholders may have a right to have any dispute adjudicated in court. Indeed, even if an arbitration clause does violate state insurance law as in the *Monarch* case, other avenues may exist to challenge such clauses. ■

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