Practice and Procedure in US Insurance Arbitration

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A Practice Note describing the unique aspects of insurance arbitration in the US. This Note describes the stages of an arbitration proceeding and how it differs from other commercial arbitration in the US.

SCOPE OF THIS NOTE

This Note provides a general overview of insurance arbitration in the US between policy holders and insurance carriers. It covers typical practices and procedures in the insurance industry that differ from other types of commercial arbitration in the US. For an explanation of reinsurance disputes between insurance carriers, see Practice Note, US Reinsurance Arbitration: Overview (W-005-6722).

ARBITRATION AGREEMENTS

Like any commercial arbitration, the terms of the parties' arbitration agreement govern US insurance arbitration. The arbitration clause in an insurance policy likely specifies the location and governing law for the arbitration. A well-drafted clause also details:

- How the parties wish to conduct the arbitration.
- The parties' preferences on the arbitrators' background and experience.

INSURANCE ARBITRATION PANEL

Insurance arbitrations usually arise out of clauses in insurance policies. They typically require a panel of three arbitrators composed of:

- Two party-appointed arbitrators, one selected by each party (see Partiality of the Party-Appointed Arbitrators).
- A "neutral" or "umpire" selected by the party-appointed arbitrators who serves as the panel's chair (see Umpire).

The contractual arbitration clause often requires that each arbitrator have ten years or more of experience either as:

- An executive or former executive of an insurance company.
- An attorney litigating insurance matters.

PARTIALITY OF THE PARTY-APPOINTED ARBITRATORS

In most non-institutional insurance arbitrations, the party-appointed arbitrators (sometimes called "wings") remain non-neutral and partial throughout the proceedings, with only the chair serving in a neutral and impartial capacity. The partiality of arbitrators in insurance arbitration differs from other commercial arbitration where party-appointed arbitrators usually must remain independent and impartial unless the parties expressly agree otherwise (see the ABA/AAA Code of Ethics for Arbitrators in Commercial Disputes, Canon I).

An example of this type of common clause is:

> "One arbitrator shall be chosen by the Company and one shall be chosen by the Insured. The third arbitrator shall be chosen by the other two arbitrators within 10 days after they have been appointed. If either the company or the Insured fails to appoint an arbitrator within 30 days after being requested by the other party in writing to do so, or if the arbitrators fail to appoint a third arbitrator within 30 days of a written request from either arbitrator to the other to do so, such arbitrator shall be appointed by a court of competent jurisdiction in the State of [STATE]. **The third arbitrator shall be financially disinterested and impartial.** All three shall be present or former officers of a property or casualty insurance or reinsurance company."

The bold emphasis was added. Where the parties' agreement authorizes non-neutral arbitrators, courts find that the parties waived the evident partiality ground for vacatur of the resulting arbitration award (see *Sphere Drake Ins. Co. v. All Am. Life Ins. Co.*, 307 F.3d 617, 620 (7th Cir. 2002) (finding that parties consented to waive the evident partiality ground to the arbitral award), cert. denied, 538 U.S. 961 (2003); *Merit Ins. Co. v. Leatherby Ins. Co.*, 714 F.2d 673, 679 (7th Cir.) (parties "choose their method of dispute resolution, and can ask no more impartiality than inheres in the method they have chosen"), cert. denied, 464 U.S. 1009 (1983); *In re Arbitration between Astoria Med. Grp. & Health Ins. Plan of Greater N.Y.*, 227 N.Y.S.2d 401, 405 (1962)).

DIMINISHED ARBITRATOR DISCLOSURE BY PARTY-APPOINTED ARBITRATORS

As in all arbitrations, the parties expect arbitrators to fully disclose their business or personal relationships with any party and with

counsel. Parties expect and accept prior connections between the wing arbitrators and the appointing party or counsel. Most potential conflicts are overlooked, even if the wing arbitrator:

- Served on previous panels with the same parties and counsel.
- Has some business or social relationships with them.

However, a significant but undisclosed relationship may cause a court to vacate an arbitration award (see, for example, *Certain Underwriting Members at Lloyd's of London v. Ins. Co. of the Ams.*, 2017 WL 5508781, *10-11 (S.D.N.Y. Mar. 31, 2017) (vacating a reinsurance arbitration award because a party arbitrator failed to disclose that he and the party shared office space and a former employee)).

In insurance arbitration, parties typically agree that routine conflict disclosures regarding the wing arbitrator's relationship with the appointing party either do not:

- Take place.
- Disqualify the arbitrator unless:
  - the proposed wing arbitrator has represented the opposing party as an attorney; or
  - the opposing party recently retained that arbitrator as a wing in another proceeding.

UMPIRE

The arbitrators' selection of the chair is crucial because of the non-neutrality of two of the three arbitrators. Unless the arbitration clause in the policy has a timeframe and built-in default mechanism for selecting the neutral, it may take them many weeks or months to select a neutral. Parties and their selected wing arbitrators spend many hours in due diligence inquiries to obtain the right chair, since that person will likely cast the deciding vote. The wing arbitrators, acting in full consultation with in-house counsel for the party that selected them, routinely:

- Interview potential umpire candidates either in person or telephonically.
- Require umpire candidates to complete lengthy background forms (umpire selection forms are available on the *Association Internationale de Droit des Assurances* (AIDA) Reinsurance & Insurance Arbitration Society (ARIAS•US) website).

The parties generally incur significant costs related to the selection process. They rarely object to the cost because the umpire plays a key role in the arbitration.

The parties may identify candidates based on referrals from one or both wings. Both wings often know the chosen umpire well and one or both may have served with the umpire in a previous arbitration panel.

Courts hold umpires to the Federal Arbitration Act's (FAA) evident partiality standard (*Nat'l Indem. Co. v. IRB Brasil Reseguros S.A.*, 675 F. App'x 89, 90 (2d Cir. 2017)). Under this standard, courts vacate an arbitral award where an arbitrator exhibits "evident partiality" (9 U.S.C. § 10(a)(2); see also Practice Note, Challenges Based on Arbitrator Bias in US Arbitration (W-004-5309)). A party hoping to vacate the award bears a heavy burden, however. It must show that a reasonable person, considering all the circumstances, would have to conclude that an arbitrator was partial to one side (see *Applied Indus. Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi A.S.*, 492 F.3d 132, 137 (2d Cir. 2007)).

ARBITRAL RULES AND PROVIDER ORGANIZATIONS

Many insurance arbitration clauses do not specify:

- An administrative organization to conduct the arbitration.
- Rules that govern the arbitration.

Parties therefore conduct insurance arbitrations as ad hoc arbitrations, without applying any particular institutional rules or procedures. The ad hoc arbitral panel, usually with the agreement of the parties, specifies the various steps and procedures leading up to and through the final hearing.

Parties may find the ARIAS•US website a helpful resource. ARIAS•US does not administer arbitrations. ARIAS•US:

- Serves the insurance industry.
- Is run by former insurance company executives.
- Provides rules and forms that parties can use in arbitrations for:
  - reinsurance arbitrations; and
  - disputes between a carrier and policy holder.

See Standard Clause, AIDA Reinsurance and Insurance Arbitration Society (ARIAS US): reinsurance arbitration clause (6-534-8525).

A knowledgeable panel can overcome the lack of structure using its own experience as a guideline. A weaker panel, particularly a less-experienced umpire, typically encounters difficulty without rules to follow. When disputes arise, the lack of guidelines may lead to prolonged, chaotic handling procedures. To avoid this, the parties should agree to abide by some institution's rules after the arbitration begins, even if the insurance policy is silent on that point.

For more information on ad hoc arbitration, see Practice Note, Ad hoc arbitrations without institutional support (8-204-1373).

EX PARTE COMMUNICATIONS

Unless a motion is pending, insurance arbitrations allow and expect ex parte communication between the wing arbitrators and their appointing party until any one party makes the first submission of final pre-hearing briefs.

The parties' arbitration agreement or procedural orders entered by the panel generally prohibit ex parte communication when a party makes a substantive or procedural motion during the pre-hearing phase. The parties generally agree to:

- Prohibit ex parte communications after the moving party first serves the motion papers.
- Resume ex parte communications after the panel's ruling.

Allowing ex parte communications enables the wing to focus the party on the arguments and issues it must address to strengthen its case. It also enables wing arbitrators to advocate, in confidence, to their appointing party to start or pursue settlement discussions if the

wing senses from discussions with the other two arbitrators that the party is unlikely to prevail in the arbitration.

Violation of the ex parte cut-off rule for an arbitration may provide grounds for a motion to vacate under the evident partiality or misconduct prongs of FAA § 10(a)(2) (see, for example, *Lefkovitz v. Wagner*, 395 F.3d 773, 779 (7th Cir. 2005)). However, a mere showing of unauthorized ex parte contact does not suffice in the absence of prejudice (see *Everett v. Paul Davis Restoration, Inc.*, 771 F.3d 380, 387 (7th Cir. 2014); *Pac. Reinsurance Mgmt. Corp. v. Ohio Reinsurance Corp.*, 935 F.2d 1019, 1025 (9th Cir. 1991)).

PRELIMINARY HEARING

In ad-hoc insurance arbitrations or those taking place under ARIAS•US rules, many preliminary hearings are held in person, often with a court reporter present. The transcript may constitute the preliminary hearing order without anything more formal. Since there is no rule, written or unwritten, it is better practice to have a formal preliminary hearing order as is standard in commercial arbitration (see Standard Document, Report of Preliminary Hearing and Scheduling Order for US Arbitrations (W-000-9960)). An advantage to the in-person preliminary hearing is:

- The panel members have the opportunity to get to know each other face to face.
- The parties can become familiar with the panel.
- The parties can get a better sense of the arbitration to develop the scope of any substantive motions they may make.

ARIAS•US provides a sample agenda for the preliminary hearing and a preliminary hearing order form on its website.

DISCOVERY

Most discovery of litigated disputes in insurance arbitrations center on demands for an insurer's underwriting and claims files, which typically include advice obtained from counsel on insurance coverage. Insurers often:

- Resist these demands and assert that the attorney-client privilege protects these materials.
- Identify the documents containing counsel's advice on a privilege log.
- Move for a protective order.

The insured generally opposes the motion by arguing that these documents do not contain legal advice, but rather contain business advice given the business of the insurer.

Most insurance arbitration panels generally conduct an analysis of the relevant facts and circumstances on a case-by-case basis (see Practice Note, Attorney-Client Privilege: Scope of Protection: Legal Versus Business Advice (7-502-9405)). Arbitration panels frequently order *in camera* review of the documents in question, and may require production of a subset of the materials initially withheld as privileged. Arbitrators often treat advice from counsel on insurance coverage as business advice and therefore do not protect them from disclosure, but they rarely require production of all the documents on the privilege log.

A party may wish to request documents held by a third party, typically the broker placing the particular insurance policy. If the other side resists production, the requesting party may seek a third-party subpoena from the arbitrators (see Practice Note, Compelling Evidence from Non-Parties in Arbitration in the US (1-586-9513)).

MOTION PRACTICE

The parties to an insurance arbitration generally engage in significantly more substantive motion practice than parties in other commercial disputes. While a motion is pending, ex parte communication with the wing arbitrators stops (see Ex Parte Communications).

Motions for summary judgment resolve many insurance cases, because the question of coverage under an insurance policy is a question of law. If the panel rules that there is no coverage, the arbitration ends. The parties usually decide to settle the dispute if the panel rules that:

- The insurance policy covers the insured's claim.
- It must resolve factual issues that may trigger coverage..

In many insurance arbitrations, the parties can expect each panelist to write the panelist's own decision on important motions (see Awards and Dissents). The panelists rarely reach a unanimous decision on a party's substantive motion.

The parties often authorize the umpire to handle discovery disputes alone.

AWARDS AND DISSENTS

Party-appointed arbitrators in insurance matters usually vote in favor of the party that appointed them. The parties and the arbitrators understand that the umpire generally resolves the matter, together with one of the two wing arbitrators.

Each wing arbitrator focuses on lobbying the chair throughout the arbitration. In this way, each wing tries to influence and convince the chair of the strength of that wing's appointing party's case. Although this concept is generally prohibited in standard commercial arbitrations, it is customary in most three-panelist, ad hoc insurance arbitrations.

Wing arbitrators commonly issue dissenting opinions in final awards and in rulings on motions. The parties and the arbitrators understand that the chair usually makes the decisions with one of the two wing arbitrators.

The following sample language for use in an insurance policy arbitration clause reflects this practice:

> "If the Insured and the Company fail to agree in whole or in part on the liability of the Insured or the amount of loss or damage, each party shall, within twenty days after demand in writing by either party appoint a competent and disinterested arbitrator and the two chosen shall before commencing the arbitration select a competent and disinterested umpire. If the arbitrators together shall so fail to agree, they will submit their differences to the umpire and the award in writing of any two, duly verified, shall determine the same, and be binding on both parties."

This sample insurance policy arbitration clause requires there to be an attempt to have each of the two party-selected arbitrators agree on a result or write their own opinions when they do not. Even when the wing arbitrators agree on the ultimate outcome, they generally write separate opinions to show their appointing party their logic in arriving at the result. If they disagree, as they most commonly do, then the two arbitrators submit their written opinion to the umpire who sides with one or the other. The umpire may either:

- Adopt one of the two opinions.
- Write a separate opinion explaining the umpire's rationale for siding with one of the two wings.

Unanimity generally arises only when the evidence or the law overwhelmingly favors one side and the umpire aggressively pushes the wings to produce a unanimous result.

Arbitrators may not leak panel deliberations or draft panel rulings to counsel for their appointing party (ARIAS•US Code of Conduct, Canon VI; *Nw. Nat'l Ins. Co. v. Insco, Ltd.*, 2011 WL 4552997, at *6 (S.D.N.Y. Oct. 3, 2011)).

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