

## CHAPTER 5

# ARBITRATION CLAUSES IN INSURANCE POLICIES

A PRIMER FOR THE CONSTRUCTION PROFESSIONAL

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## § 5.01 INTRODUCTION

The construction industry is no stranger to contracts that contain arbitration clauses or to the types of construction-related disputes that are resolved through the arbitration process. Resolution of construction disputes through arbitration and other forms of binding and non-binding alternative dispute resolution (ADR) has become the rule rather than the exception. Indeed, the standard industry forms governing the relationship between the construction manager and owner and the general contractor and subcontractor have included arbitration clauses as standard provisions for many years.<sup>1</sup> As a result, many professionals in the construction industry are generally comfortable and certainly familiar with arbitration clauses and the resultant procedure. Such familiarity fosters a perception that arbitration clauses and the right to resort to arbitration are an important contractual right that efficiently resolves disputes in a forum for and by the construction community.

Arbitration often is touted as a dispute resolution mechanism that is more efficient and expeditious than litigation. Although this is true in many instances, the U.S. Supreme Court has specifically rejected the suggestion that the overriding goal of the Federal Arbitration Act (FAA) is to promote the expeditious resolution of claims.<sup>2</sup> Rather, the Supreme Court has reasoned that the “principal objective” and the “underlying motivation” of the FAA are to enforce agreements into which parties have entered and privately negotiated.<sup>3</sup>

Arbitration clauses are appearing with increasing frequency in professional liability, commercial liability, builder’s risk, and other casualty insurance policies. Any comfort born of familiarity with arbitration between a construction manager and owner regarding an alleged defect in architectural plans, or between a contractor and a subcontractor regarding the sequencing of the subcontractor’s work, pricing of change orders, or reasons for project delay, may be misplaced. Such

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<sup>1</sup> Use of ADR as a means of dispute resolution has been encouraged by Congress, through the Administrative Dispute Resolution Act, 5 U.S.C. §§ 571 *et seq.*, and by a statute directing the federal courts to adopt rules providing for ADR in virtually all civil cases. 28 U.S.C. § 651(b). Similarly, ending the long-held hostility to “private” resolution of civil disputes, virtually all the states have enacted some form of legislation approving arbitration of disputes. Thus, virtually anyone involved in a commercial controversy today will be faced with some form of ADR, often in the form of non-binding mediation, whether by agreement or as a judicially mandated prerequisite to a “day in court.”

<sup>2</sup> *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219 (1985). In *Byrd*, some of the claims a plaintiff brought against its broker were arbitrable and some were not. The broker moved to compel arbitration of the arbitrable claims. The lower court refused, reasoning that the FAA’s goals of speedy and efficient decision-making warranted keeping the claims together in one proceeding. The Supreme Court disagreed, and in effect ordered a bifurcation of the proceedings between the arbitrable claims and non-arbitrable claims that had to be resolved in court.

<sup>3</sup> *Id.* at 220.

comfort and familiarity may not apply in considering arbitration of insurance coverage issues with an obstinate insurance carrier that has delayed payment for construction-related damages that the parties otherwise have reason to believe should be fully or partially insured.

For example, suppose that during the testing and commissioning phase of a major project that an accident occurs, resulting in a significant failure, fire, explosion, or other catastrophe that causes a halt in the project. The delay in investigating the cause, repairing the damage, and renewing the start-up process will, aside from the issue of who pays repair costs, invariably lead to disputes regarding who was at fault and whether the party at fault must be held responsible for delay damages. Such a dispute probably will include claims for substantial liquidated damages for delay in start-up of the facility under construction. The failure may have been caused by a design flaw, by faulty workmanship,<sup>4</sup> by negligence during the testing and commissioning process, or by some as yet unknown or difficult-to-discover, but possibly fortuitous, cause unrelated to the alleged design or operational negligence originally suspected as the cause. The issue may be further complicated if the damage is not immediately apparent and does not become apparent until after preliminary or final acceptance of the project.

Who is then responsible? Is there insurance coverage for any portion of the loss? Which policy has been triggered—the builder’s risk policy, which usually terminates on completion; the owner’s property/operational policy, which commences on acceptance or occupancy; the design engineer’s professional liability policy; or a subcontractor’s commercial general liability policy? Given these uncertainties, the claims at issue likely will generate one or more demands for arbitration or lead to litigation. As noted in a prior edition of *Construction Law Update*, resolution of the potentially time-consuming, expensive, and often uncertain disputes among the owner and various contractors on a project by means of insurance may be the most cost-effective and expeditious means of settling the controversy, obtaining prompt payment for the damages incurred, and providing for timely repair and completion of the project with minimal additional cost.<sup>5</sup>

While arbitration of a construction dispute before a panel of construction professionals usually makes economic sense, an arbitration clause in an insurance

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<sup>4</sup> As noted succinctly in a recent edition of this treatise, “[c]onstruction defect claims present some of the most difficult liability insurance coverage issues.” C. Shapiro & H. Pietrkowski, “Insurance Coverage for Construction Defects: Selected Hot Topics,” 2003 *Construction Law Update* N. Sweeney, ed. (Aspen Publishers 2003).

<sup>5</sup> See generally E. Kneisel & J. Leonard, “Allocation of Settlement Payment Among Self-Insured Policyholders, Insurance Carriers and Others Having ‘Interests’ in Construction Industry Liability Claims,” 2000 *Wiley Construction Law Update*, N. Sweeney, ed. (Aspen Publishers 2000). The parties to a construction contract may seek to avoid such disputes by means of insurance, such as an owner-controlled insurance program (OCIP). While builder’s risk insurance usually is a component of such programs, “delay in start-up” coverage is rarely obtained because of its cost.

contract calling for arbitration before a panel of “insurance professionals” (and insurance arbitration clauses usually do just that) may not be so appealing to a contractor or other policyholder who is not an insurance professional. The advantages of quick resolution and economy that might be gained by arbitration may be far outweighed by the disadvantage of having the insurance industry effectively police itself. Both parties to a typical construction arbitration will be professionals in the construction industry whose claims may be appropriately resolved by arbitration before other industry professionals. However, the typical construction industry policyholder is not an “insurance professional” or member of the insurance industry who will get the same level of respect by a panel of such persons that may be accorded to another insurance industry “professional,” *i.e.*, the carrier.

For this and other reasons discussed in this chapter, construction risk managers or other construction personnel reviewing insurance policies must be alert and even wary of insurance brokers or underwriters who propose including a mandatory arbitration clause in the insurance policy covering construction risks, especially if the clause requires binding arbitration of all disputes under the policy, including coverage disputes. Such binding arbitration waives any right to have the dispute resolved in court by a jury and potentially waives the sometimes significant threat of extra-contractual, punitive, or multiple damages, which insurance carriers always hope to avoid.<sup>6</sup>

This chapter will assist the construction industry professional in becoming informed about threshold issues presented by the insertion of an arbitration clause in an insurance policy or related agreement. Following a brief historical background regarding arbitration of insurance disputes, this chapter describes a basic taxonomy of the common elements of an arbitration clause, focusing on its meaning when such a clause appears in an insurance policy. We also discuss the legal implications incident to arbitration of a construction-related insurance dispute and what defenses may be invoked to avoid arbitration of such disputes.

## § 5.02 HISTORY AND ENFORCEABILITY OF INSURANCE ARBITRATION CLAUSES

### [A] Increasing Frequency of Arbitration Clauses in Insurance Contracts

As noted above, the use of arbitration clauses has been on a sharp and steady increase for several decades, especially in construction contracts.<sup>7</sup> This trend holds

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<sup>6</sup>As noted recently by one commentator, potential liability for “bad faith,” including sometimes significant punitive damages awards for wrongfully denying coverage, “remains a dramatic threat to insurers.” D. Richmond, *Bad Insurance Bad Faith Law*, 30 Tort Trial & Ins. Prac. L.J. 1 (2003). Certainly, the “dramatic threat” posed by such damages is one reason that arbitration clauses will often seek to bar the panel from awarding any form of extra-contractual damages. See discussion in § 5.04[C], *infra*.

<sup>7</sup>See text accompanying note 1, *supra*.

true in a variety of other commercial situations, to the point that “arbitration clauses appear in nearly every type of contract imaginable.”<sup>8</sup> Insurance contracts are not exempt from this trend, and arbitration agreements increasingly are “popping up” in insurance contracts.<sup>9</sup> Most construction professionals are aware that insurance policies, especially property insurance policies, have long included arbitration-type clauses, which typically are limited to appraisal and valuation of a property damage loss when an insurer agrees that a loss is covered but the parties disagree regarding value of the damaged property. Such clauses may be particularly useful in certain types of fine art or other “inland marine” policies where the property is a total loss and the cost of repair or replacement is not the appropriate measure of damages. In such cases, the services of an expert appraiser may be necessary, and disputes regarding value may be efficiently and effectively resolved through arbitration. Such clauses are limited in scope and usually cannot be triggered where there is a dispute regarding coverage.

Increasingly, the arbitration clauses that are being included in insurance policies are not designed merely to streamline the process of appraising and valuing the loss. Instead, insurers are broadening the scope of arbitration clauses to include the threshold issue of coverage. Moreover, such clauses are being used in various types of third-party liability policies, as well as in first-party property policies. Insurers invoke such clauses to deny insureds the opportunity to have a judge and jury decide insurance coverage issues and evaluate the insurer’s claims-handling practices for possible bad faith. The effect on a carrier of a potential claim for bad faith and an award of extra-contractual damages, as specified by statute, or of punitive damages, should not be underestimated.<sup>10</sup> The fact that carriers sometimes wrongfully and perhaps even frivolously deny coverage for insured losses or unjustifiably delay paying the claim is the principal reason most states, often by statute, allow policyholders to pursue claims for insurer “bad faith” in failing to pay a covered claim.

Arbitration usually is quicker, cheaper, and more predictable than litigation. Arbitration (or other ADR) of disputes between a contractor and subcontractor or owner may be useful when the goal is to resolve a dispute promptly and before members of the construction industry who do not need a construction primer to resolve the issues in controversy. The same considerations may not apply when the dispute is between an insurer and general contractor, especially when the goal of

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<sup>8</sup> Angela Kimbrough, *Consumers In a Bind*, 37 Trial 36 (June 2001). “Eager to jump on the arbitration bandwagon, insurance companies began to insert arbitration clauses into their contracts with policyholders in the mid-1980s. Since then, any policyholder seeking to take a dispute with an insurer to court has had to find a way to show that the FAA does not apply to the insurance contract at issue.” *Id.* at 36–37.

<sup>9</sup> Best’s Insurance News, Thursday, Oct. 9, 2003, 2003 WL 59121462 (reporting that “insurers and other businesses like arbitration agreements because they keep conflicts out of courts, where disputes can turn costly, messy and public”).

<sup>10</sup> See note 6, *supra*.

one party (the policyholder) is to be compensated promptly for a significant loss, and the goal of the other party (the insurer) often is to delay or avoid payment of the loss as long as possible. Moreover, aside from delay in payment, which is discouraged by bad-faith statutes and court decisions, the cost of arbitration is not necessarily cheaper when one considers that the court system is publicly subsidized and the cost of arbitration is not.<sup>11</sup> Thus, if an arbitration clause calls for a panel of three arbitrators, and the arbitrators demand high hourly rates in advance (as many do), the equation begins to change; and the issue as to whether arbitration is desirable, or at least less expensive, demands reevaluation.

No matter one's opinion on the desirability of an arbitration clause in an insurance policy, insurance policies are largely contracts of adhesion. Most courts recognize this and invariably hold that policies are to be construed against the drafter (the insurance carrier) and in favor of coverage.<sup>12</sup> A panel of arbitrators who are also "insurance professionals" may be less likely to apply the rules of *contra preferentem* to critically evaluate policy language than a court, which unlike an arbitration panel, is bound to apply the common law and statutory law of the state in which the court sits. While it may be impossible to avoid the inclusion of an arbitration clause in an insurance policy, an informed risk manager may be able to negotiate discreet, yet important, changes to the insurer's proposed arbitration clause in ways that could level the playing field between insurer and insured in the arbitration arena.

## [B] The Federal Arbitration Act

American state and federal courts historically disfavored arbitration clauses as an unauthorized displacement of judicial authority.<sup>13</sup> While members of the business community began agreeing to contractual dispute resolution alternatives, courts refused to enforce arbitration clauses, reasoning that parties had no right to entrust their disputes to private parties who may or may not be competent to render correct decisions. In the insurance context, judicial hostility to binding arbitration manifested most often in cases involving uninsured motorist policies,

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<sup>11</sup> For a discussion, see *Arbitration Clauses in Insurance Contracts: The Urgent Need for Reform*, Public Citizen, available at <[http://www.citizen.org/print\\_article.cfm](http://www.citizen.org/print_article.cfm)>.

<sup>12</sup> *Twin City Fire Ins. Co. v. Delaware Racing Ass'n*, 840 A.2d 624, 630 (Del. 2003) (principle of *contra preferentem* dictates that an ambiguity in a contract must be construed against the drafter and that "[c]onvolved or confusing terms are the problem of the insurer . . . not the insured"); *Northern Ins. Co. of N.Y. v. Ekstrom*, 784 P.2d 320, 323 (Colo. 1989) (same); *Claussen v. Aetna Cas. & Sur. Co.*, 380 S.E.2d 686, 688 (Ga. 1989) (same).

<sup>13</sup> A discussion of the historical hostility to arbitration can be found in *DiMercurio v. Sphere Drake Ins. Co.*, 202 F.3d 71 (1st Cir. 2000). In its discussion, the *Sphere Drake* court noted that "the prevailing attitude has changed," and courts view arbitration agreements as "contractual arrangements for resolving dispute rather than as an appropriation of a court's jurisdiction." *Id.* at 76.

which were among the first policies to include provisions requiring binding arbitration.<sup>14</sup> Early black letter law held that:

In accordance with general principles applicable to all contracts, it is the rule that a provision in an insurance policy that all disputes arising under the policy shall be submitted to arbitrators, or a provision similar in substance and effect, is not binding. On the other hand, the view prevailing in nearly all jurisdictions is that a stipulation not ousting the jurisdiction of the courts, but leaving the general question of liability for a loss to be judicially determined, and simply providing a reasonable method of estimating and ascertaining the amount of the loss, is valid.<sup>15</sup>

As noted at the beginning of this chapter, older court decisions refusing to enforce arbitration clauses have been overturned by statute, and the trend towards ADR is inevitable and overwhelming in the system of dispute resolution in place today.

In 1925, Congress passed the Federal Arbitration Act (FAA).<sup>16</sup> The most significant language in the FAA is the congressional proclamation that “an agreement in writing to submit to arbitration an existing controversy arising out of such a contract . . . shall be valid, irrevocable, and enforceable.”<sup>17</sup> However, the potentially vast and all-encompassing power of that statement was slow to be recognized. By the early 1980s, however, the U.S. Supreme Court had clearly decided that through the FAA, Congress had directed courts to enforce arbitration clauses like any other contract, “notwithstanding any state substantive or procedural policies to the contrary.”<sup>18</sup> Indeed, so long as the issue involves the interpretation of an arbitration provision “touching upon matters of interstate commerce,”<sup>19</sup> there is now a reflexive presumption in favor of arbitration. The Supreme Court has repeatedly enforced the proposition that “any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. . . .”<sup>20</sup>

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<sup>14</sup> See, e.g., *Hartford Accident & Indem. Co.*, 520 P.2d 1368, 1374 (Wash. 1974) (“authorities are uniform that the question of coverage is not an issue for arbitration”); *Boughton v. Farmers Ins. Exch.*, 354 P.2d 1085, 1089 (Okla. 1960) (arbitration provisions that deprive the courts of jurisdiction are contrary to public policy); *Allstate Ins. Co. v. Horn*, 321 N.E.2d 285, 292 (Ill. App. Ct. 1974) (coverage disputes not covered by arbitration provisions in automobile liability policies); *Murtaugh v. American States Ins. Co.*, 187 N.E.2d 518, 520 (Ohio Ct. App. 1963) (“coverage questions are not arbitrable”).

<sup>15</sup> 29A Am. Jur. 699, Insurance § 1611 (as quoted in *Childs v. Allstate Ins. Co.*, 117 S.E.2d 867, 870 (S.C. 1961)).

<sup>16</sup> The FAA is codified at 9 U.S.C. §§ 1 *et seq.*

<sup>17</sup> 9 U.S.C. § 2.

<sup>18</sup> *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983) (finding that lower court abused its discretion in failing to promptly compel arbitration between contractor and owner as required in contract).

<sup>19</sup> *McCarthy v. Azure*, 22 F.3d 351 (1st Cir. 1994). The FAA itself does not provide subject matter jurisdiction for federal courts.

<sup>20</sup> *Moses*, 460 U.S. at 24–25.

By the same token, because arbitration is a matter of contract, a party cannot be required to submit to arbitration any dispute which that party has not agreed to submit to arbitration.<sup>21</sup> These competing principles often define the outcome when there are differing contentions as to the “scope” of the arbitration agreement and whether or not the parties intended that a particular dispute must be referred to arbitration, that is, whether a particular dispute is “arbitrable.” However, since the ruling in *Moses H. Cone*, the overwhelming trend of cases addressing disputes regarding arbitrability has resulted in decisions finding that the parties agreed to arbitrate the dispute.

**[C] A Major Exception to Arbitration of Insurance Disputes:  
“Reverse Preemption” by McCarran-Ferguson**

As discussed in the preceding subsection, judicial hostility to arbitration no longer exists. Congress and the legislatures of most states have enacted statutes sanctioning and in some cases mandating ADR, including arbitration, as a preferred means to resolve commercial disputes. Nevertheless, perhaps as an outgrowth of the historical hostility to private arbitration and perhaps in recognition that insurance policies are often contracts of adhesion, several states do have statutes that expressly prohibit arbitration of insurance disputes. These statutes may be invoked to curb the increasing judicial enthusiasm for binding arbitration of insurance-related issues.<sup>22</sup>

Ordinarily, state law that precludes or restricts the enforcement of arbitration provisions in contracts touching upon interstate commerce are preempted by the FAA, by virtue of the Supremacy Clause in the Constitution.<sup>23</sup> The McCarran-Ferguson Act, however, expressly provides that “[n]o 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 . . . unless such Act specifically relates to the business of insurance. . . .”<sup>24</sup> Applying McCarran-Ferguson, several courts have ruled that state laws restricting the arbitration of insurance disputes supersede the mandatory arbitration provisions of the FAA, thereby allowing for

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<sup>21</sup> *AT&T Techs., Inc. v. Communications Workers of Am.*, 475 U.S. 643, 648 (1986).

<sup>22</sup> *See, e.g.*, Ark. Code Ann. § 16-108-201(b) (Michie 1997); O.C.G.A. § 9-9-2(c)(3) (Michie 1997); Kan. Stat. Ann. § 5-401(c) (1991); Ky. Rev. Stat. Ann. § 417.050(2) (Michie 1996); La. Rev. Stat. Ann. § 22:629a (West 1986); Mo. Ann. Stat. § 435.350 (West 1992); Mont. Code Ann. § 27-5-114(2)(c) (1998); Neb. Rev. Stat. Ann. § 25-2602(f)(4) (Michie 1997); Okla. Stat. Ann. tit. 15, § 802 (West 1993); S.D. Codified Laws § 21-25a-3 (Michie 1998). *See also* R.I. Gen. Laws § 10-3-2 (1996) (providing for arbitration at option of insured).

<sup>23</sup> *See, e.g.*, *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984) (“Congress [through the FAA] intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements.”).

<sup>24</sup> 15 U.S.C. § 1012(b).

litigation of insurance coverage disputes in accordance with applicable state law, despite the carrier's arguments that all such disputes must be arbitrated in accordance with arbitration clauses in a policy or other applicable side agreement.

For instance, in *Standard Security Life Insurance Co. v. West*,<sup>25</sup> the U.S. Court of Appeals for the Eighth Circuit articulated a three-part analysis for determining whether Missouri law<sup>26</sup> prohibited a federal court from compelling arbitration of an insurance dispute involving claims for breach of an insurance contract and "vexatious refusal to pay": (1) Does the FAA specifically relate to the business of insurance (if so, it would fall under the saving provision of McCarran-Ferguson providing for the supremacy of federal laws enacted with a particular view to regulate insurance); (2) does the FAA "invalidate, impair, or supersede" the Missouri statute; and (3) was the Missouri statute enacted for the purpose of regulating the business of insurance?<sup>27</sup> There was no controversy regarding the first two issues, as the FAA had clearly not been enacted for the express purpose of regulating the business of insurance, and application of the FAA to compel arbitration of the coverage dispute clearly would conflict with the Missouri statute. Following the precedent of *United States Department of Treasury v. Fabe*,<sup>28</sup> the *West* court held that "[the statute] does regulate the business of insurance because it applies to the processing of disputed claims. This processing, in turn, has a substantial effect upon the insurer-insured relationship and the policy's interpretation and enforcement, both of which are 'core' components of the business of insurance." Accordingly, the Eighth Circuit held in *West* that the Missouri statute prohibited arbitration of insurance disputes and "reverse preempted" the FAA.

A recent decision by the Georgia Court of Appeals, *Continental Ins. Co. v. Equity Residential Properties Trust*, echoed *West*, holding that:

[b]y invalidating arbitration agreements in insurance contracts, [O.C.G.A. § 9-9-2(c)(3)] is aimed, if not directly then indirectly, at regulating the relationship between the insured and the insurer in disputed insurance

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<sup>25</sup> 267 F.3d 821 (8th Cir. 2001).

<sup>26</sup> Mo. Ann. Stat. § 435.350. The Missouri statute, which is typical of similar statutes enacted in several states, provides in relevant part as follows: "A written agreement to submit any existing controversy to arbitration or a provision in a written contract, *except contracts of insurance and contracts of adhesion*, to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract." (emphasis added). See also statutes cited in note 22, *supra*.

<sup>27</sup> *West*, 267 F.3d at 823. See also *In re Arbitration of Mutual Reins. Bureau v. Great Plains Mut. Ins. Co., Inc.*, 969 F.2d 931 (10th Cir. 1992); *Continental Ins. Co. v. Equity Residential Props. Trust*, 565 S.E.2d 603 (Ga. App. 2002).

<sup>28</sup> 508 U.S. 491 (1993) (recognizing that central to the business of insurance is the insurer-insured relationship and policy interpretation and enforcement).

claims. In so doing, it is limited to the insurance industry, integral to the policy relationship between the insured and the insurer, and has the effect of transferring or spreading risk by preserving the possibility of a jury verdict (as opposed to compelled arbitration) to resolve the claim.<sup>29</sup>

The Georgia court also ruled that a choice-of-law clause in the policy, which picked Illinois law that allowed arbitration of insurance disputes, could not be enforced to bar application of the Georgia anti-arbitration statute.

As illustrated by the ruling in *Continental Insurance*, determining whether a state's statutory bar to arbitration of insurance disputes is applicable may depend on which state's laws govern the claim. A "race to the courthouse" to determine which state's law governs may be outcome determinative of the question of whether or not the dispute over coverage will be arbitrated or litigated. Accordingly, choosing *where* a case is filed can have a dispositive effect on the outcome of a dispute over arbitrability.

### § 5.03 ANATOMY OF AN ARBITRATION CLAUSE

It is important to understand the basic anatomy of an arbitration clause because the wide variety of wording of such clauses can create confusion and uncertainty. The specific elements of such a clause ultimately define whether a particular dispute is subject to arbitration, the form of the arbitration process, the issues to be decided, and any potential recovery. Arbitration clauses in insurance contracts may run the gamut from a limited clause in a property policy requiring arbitration of disputes regarding appraisal and valuation of damaged or destroyed property to a broad clause requiring arbitration of "any and all" controversies arising under this policy, "including but not limited to, disputes regarding coverage." In this section, therefore, we examine a hypothetical arbitration clause in an insurance policy. The sample arbitration clause reproduced below includes a wide variety of elements that might not appear in every arbitration clause, as such clauses often are quite short and sometimes appear to be added to a contract almost as an afterthought. Nonetheless, each element of the clause below, or some variety of it, is "typical" in the sense that the language used ultimately will determine the scope of the issues to be arbitrated. Familiarity with each of the typical elements of an arbitration clause will aid the insurance professional in understanding and perhaps in negotiating favorable changes to an arbitration clause proposed by an insurer.

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<sup>29</sup> *Continental Ins. Co.*, 565 S.E.2d at 605. See also *McKnight v. Chicago Title Ins. Co.*, 358 F.3d 854 (11th Cir. 2004). But see *Buck Run Baptist Church v. Cumberland Sur. Ins. Co., Inc.*, 983 S.W.2d 501 (Ky. 1998) (holding that a surety bond was not "insurance" in the ordinary sense, and hence did not fall within the Kentucky anti-arbitration statute nor within the policy purview of the McCarran-Ferguson Act).

**[A] A “Sample” Arbitration Clause**

The following is a sample arbitration clause:

If there is any disagreement or dispute between us regarding this Policy, it is mutually agreed that any and all such disagreements and disputes shall be submitted to binding arbitration before a panel of three (3) arbitrators as the sole and exclusive remedy. The party desiring arbitration of such disagreement shall notify the other party, said notice including the identity of the Arbitrator nominated by the demanding party. The other party shall within 30 days following receipt of the demand, notify in writing the demanding party of the identity of the Arbitrator nominated by it. The two (2) Arbitrators so selected shall within 30 days of the appointment of the second Arbitrator, select a third Arbitrator to act as “Umpire.” If the Arbitrators are unable to agree upon an Umpire, each Arbitrator shall submit to the other Arbitrator a list of three (3) proposed individuals, from which list each Arbitrator shall choose one (1) individual. The names of the two (2) individuals so chosen shall be subject to a draw, whereby the individual drawn shall serve as Umpire.

Each Arbitrator and the Umpire must be an officer or former officer of a property or casualty insurance or reinsurance company, insurance brokerage company or risk management official engaged in the construction industry; provided, however, that such risk management official must have had no less than ten years previous experience as an employee of an insurance company or insurance brokerage.

The dispute shall be submitted to the arbitration panel by written and oral evidence at a hearing time and place selected by the umpire. Said hearings shall be held within 30 days of the selection of the Umpire. The panel shall be relieved of all judicial formality, shall not be obligated to adhere to the strict rules of law or of evidence, shall seek to enforce the intent of the parties hereto and may refer to, but is not limited to, relevant legal principles. The panel will have exclusive jurisdiction of the entire matter in dispute, including any question as to its arbitrability. The panel may award compensatory damages, but will not have the power to award exemplary damages or punitive damages. The decision of at least two (2) of the three (3) panel members shall be binding and final and not subject to appeal except for grounds of fraud and gross misconduct by the Arbitrators. The award will be issued within 30 days of the close of the hearings. Each party shall bear the expenses of its designated Arbitrator and shall jointly and equally share with the other the expense of the Umpire and of the arbitration.

The arbitration proceeding shall take place in Chicago, Illinois.

The preceding hypothetical arbitration clause presents the following questions, which are addressed in the remaining sections of this chapter:

1. Who decides what issues are encompassed by the arbitration clause, *i.e.*, is “arbitrability” for the arbitrators?

2. What issues are proper subjects for arbitration, *i.e.*, what is the scope of the agreement?
3. What law (if any) governs the arbitration and where should the arbitration be conducted?
4. What procedure will be employed regarding (a) selection of the arbitrators, and (b) the procedures the arbitrators must follow in deciding the issues?
5. Once an arbitration demand for matters that are arbitrable is received, what defenses, if any, may be invoked to avoid arbitration?
6. What remedies may the arbitrators award and how are these remedies enforced or challenged?

### [B] Scope of the Arbitration: Who Decides?

Following the lead of the Supreme Court, many courts have ruled that a party cannot be required to arbitrate any dispute that the party has not agreed to submit to arbitration.<sup>30</sup> While the judicial presumption in favor of arbitrability is undeniable, there also is a competing presumption that the determination of arbitrability is for the courts: “The question whether the parties had submitted a particular dispute to arbitration, *i.e.*, the question of arbitrability, is an issue for judicial determination unless the parties clearly and unmistakably provide otherwise.”<sup>31</sup> The scope of an arbitration agreement “is undeniably a judicial determination,” so that “a party will not be coerced to arbitrate an issue unless he has so agreed.”<sup>32</sup> Moreover, the question of arbitrability is usually a “dispositive gateway question” applicable, for example, “where reference of the gateway dispute to the court avoids the risk of forcing parties to arbitrate a matter that they may well not have agreed to arbitrate.”<sup>33</sup>

The authorities cited above suggest that where a clause providing for arbitration is vague or ambiguous, questions of intent regarding the parties’ understandings about the scope of arbitration should be resolved in a judicial forum, perhaps by a jury. In reality, however, the outcome in most courts today is very different. For example, if a court considering a dispute over arbitrability concludes that an arbitration clause, such as the hypothetical clause quoted above, is

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<sup>30</sup> *AT&T Techs., Inc. v. Communications Workers of Am.*, 475 U.S. 643, 648 (1986).

<sup>31</sup> *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 101, 123 (2003) (internal citation and punctuation omitted).

<sup>32</sup> *Painewebber v. Elahi*, 87 F.3d 589, 594-95 (1st Cir. 1996) (citing *First Options of Chicago v. Kaplan*, 514 U.S. 938 (1995)).

<sup>33</sup> *Id.* at 592. *See also* *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995) (“Courts should not assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they did so.”). Thus, federal courts have recognized that the presumption in favor of arbitration accorded by the FAA and similar statutes should not be a “mindless mantra.” *Rudolph v. Alamo Rental Car*, 952 F. Supp. 311, 317 (E.D. Va. 1997).

broad in scope, virtually any dispute arising between the parties to the contract will be deemed to be within the scope of the arbitration clause. Clauses using the words “any” or “all” when referring to disputes or controversies subject to arbitration almost always will be deemed broad enough to refer virtually any dispute arising under the contract to arbitration.<sup>34</sup> As a result, absent specific language (or a controlling statute) limiting arbitration of insurance coverage disputes, such disputes are almost certain to be deemed encompassed within a broad-ranging arbitration clause. This is true even if the broadly worded agreement to arbitrate is incorporated in a separate, collateral agreement to the policy, such as a retrospective premium or other separate form of premium payment agreement or perhaps even in a claims handling agreement, if the dispute arising under the separate agreement is dependent on resolution of underlying coverage issues.

For example, assume that a separate retrospective premium arrangement is keyed to one or more liability policies and that the amount of premium charged is measured by “incurred losses,” including claims payments, settlements, and claims reserves for claims arising under those policies. Assume further that the agreement has a disputes clause providing that all disputes regarding payments due under the agreement shall be arbitrated. If the carrier settles a claim that arguably is uninsured, either because it accrued before the applicable policy period or because an exclusion applies, and then bills the policyholder for the retrospective premium generated by the settlement, is the controversy over coverage arbitrable?<sup>35</sup>

In a recent, as yet unpublished, case decided in New York, a federal court judge addressed a somewhat similar issue dealing with a separate “Payment Agreement” that the parties had executed to address questions regarding payment of premiums, the amount of security required, and related questions regarding allocated loss adjustment expenses and related claims costs in connection with a series of commercial general liability policies issued over an eight-year

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<sup>34</sup> See, e.g., *Highlands Wellmont Health Network, Inc. v. John Deere Health Plan, Inc.*, 350 F.3d 568 (6th Cir. 2003); *Battaglia v. McKendry*, 233 F.3d 770 (3d Cir. 2000); *Valentine Sugars, Inc. v. Dona Corp.*, 981 F.2d 210, n.2 (5th Cir. 1993) (noting that by including clause calling for arbitration of any dispute “relating to or arising out of” an agreement, the parties “intend the clause to reach all aspects of the relationship”), *cert. denied*, 509 U.S. 923 (1993).

<sup>35</sup> The same issue could arise if the carrier settles a questionable claim and then bills the policyholder for the portion of the settlement covered by a deductible or self-insured retention. Several courts have ruled that a carrier must obtain its policyholder’s consent to settle a claim (especially when coverage is questionable), if the carrier intends to charge the amount of the settlement back to the policyholder. See *Medical Malpractice Joint Underwriting Ass’n of Mass. v. Goldberg*, 680 N.E.2d 1121, 1129 (Mass. 1997) (holding that “[w]here an insurer defends under a reservation of rights to later disclaim coverage . . . it may later seek reimbursement for an amount paid to settle the underlying tort action only if the insured has agreed that the insurer may commit the insured’s own funds to a reasonable settlement”). Is this type of dispute arbitrable?

period. The agreement in question contained an arbitration clause that did not mention coverage. However, because the agreement referenced the underlying insurance policies and otherwise was broad in scope, that is, it did not exclude coverage issues from being arbitrated, the court ruled in effect that any questions of coverage that were intertwined with the dispute regarding who should pay what for the underlying claims should be resolved by the arbitrators.<sup>36</sup> The court's ruling on this point was not definitive, as the trial judge, in granting the insurance carrier's motion to compel arbitration, concluded that the language of the arbitration clause deferred all questions of arbitrability to the arbitrators. Thus, in that case, the court determined that the question of the intent of the parties regarding the scope of the issues to be arbitrated had to be resolved by the arbitrators and was not an issue for judicial determination.

As noted above, the Supreme Court has ruled that questions regarding the scope of an arbitration clause present issues for judicial resolution.<sup>37</sup> Nevertheless, most lower courts have modified this rule where, as in the hypothetical clause quoted above,<sup>38</sup> the drafter desiring to arbitrate coverage disputes includes talismanic wording to the effect that all issues and questions regarding the scope of the agreement are to be resolved by the arbitrators. Once a court concludes that issues of "arbitrability are for the arbitrators," virtually any attack on the scope of the clause must be resolved during the arbitration proceedings and will not be resolved in court. Thus, it is uncertain whether a subsequent arbitration award that disregards arbitrability and scope issues or other arguably "jurisdictional" questions could be subject to collateral attack as beyond the power or jurisdiction of the arbitrators to enter.

## [C] Choice of Law and Forum

Arbitration clauses in insurance contracts rarely contain choice-of-law and forum selection clauses that are pro-policyholder. Rather, the law chosen, and the place for arbitration, usually is the "home base" of the carrier, thereby requiring the policyholder and its witnesses to travel potentially great distances and to incur expenses for "local" counsel that would not be necessary if the matter were litigated or arbitrated where the policyholder is located or where the claim arose. However, a general choice-of-law provision in a contract that also contains an arbitration clause may not govern the question of arbitrability.<sup>39</sup> When deciding whether

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<sup>36</sup> See *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Raytheon Co.*, 2004 WL 34443 (S.D.N.Y., Jan. 7, 2004) (Scheidlin, J.).

<sup>37</sup> See notes 30-33 and accompanying text, *supra*.

<sup>38</sup> The pertinent language in the hypothetical clause reads, "[t]he panel will have exclusive jurisdiction of the entire matter in dispute, including any question as to its arbitrability."

<sup>39</sup> See *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 64 (1995) ("the choice-of-law provision covers the rights and duties of the parties, while the arbitration clause covers

parties agreed to arbitrate a certain matter, courts should apply ordinary state law principles that govern the formation of contracts.<sup>40</sup> The question remains, when state law principles are applied, which state's law will govern? This issue may be critically important when the law chosen in the arbitration clause incorporates remedies that differ significantly from and are more narrow than the remedies available under the law that otherwise would govern the coverage dispute.

The FAA, specifically 9 U.S.C. § 4, provides that a court may only order an arbitration to take place within the district in which it sits. Some courts, notably the Seventh Circuit, have held that this aspect of the FAA should be read as a limitation on a court's ability to adjudicate the merits of a dispute over arbitrability, where the arbitration clause at issue calls for the arbitration to take place in a different district.<sup>41</sup> There is a split of authority on this issue, however, with the Ninth and Fifth Circuits taking the opposite view, holding that the FAA does not limit a court's authority to adjudicate arbitrability, notwithstanding a choice-of-forum clause providing for a different jurisdiction.<sup>42</sup>

In *Texaco, Inc. v. American Trading Transportation Co., Inc.*,<sup>43</sup> the Fifth Circuit issued a ruling (also controlling precedent in the Eleventh Circuit) expressly rejecting the argument that a choice-of-forum provision in an arbitration clause divested the district court of the authority to enjoin parties from proceeding with an arbitration in another district.<sup>44</sup> This ruling is consistent with the Ninth Circuit's ruling in *Textile Unlimited, Inc. v. A. BMH & Co., Inc.*, holding that "injunction actions [seeking to forestall arbitration] . . . are properly considered under general venue provisions."<sup>45</sup> Accordingly, where an arbitration clause is challenged can have a material and sometimes dispositive effect on the outcome of the challenge, given the differences among various jurisdictions as to substantive arbitrability issues regarding scope and waiver.

### [D] Procedure: Selection of the Panel and Course of Proceedings

As noted above, arbitration is often touted as a dispute resolution mechanism that is more efficient and expeditious than litigation. Although this

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arbitration"). As noted above, courts in some jurisdictions may refuse to enforce a choice-of-law clause if the chosen law is contrary to the statutory law and policy of the state where the court sits. See *Continental Insurance*, discussed at text accompanying note 29, *supra*.

<sup>40</sup> *First Options of Chicago v. Kaplan*, 514 U.S. 938, 944 (1995). However, when the arbitration agreement is subject to the FAA, that statute and "federal common law" thereunder will determine the scope of the arbitrable issues. *Painwebber v. Landay*, 903 F. Supp. 193, 198 (D. Mass. 1995) ("to the degree that this state court view reflects a determination regarding arbitrability inconsistent with the FAA, I must decline to follow it.").

<sup>41</sup> See, e.g., *Merrill Lynch v. Lauer*, 49 F.3d 323, 327 (7th Cir. 1995).

<sup>42</sup> See *Textile Unlimited, Inc. v. A. BMH & Co., Inc.*, 240 F.3d 781, 785-86 (9th Cir. 2001).

<sup>43</sup> 644 F.2d 1152, 1154 (5th Cir. 1981).

<sup>44</sup> *Id.* at 1154.

<sup>45</sup> 240 F.3d at 785 (citing *First of Michigan Corp. v. Bramlet*, 141 F.3d 260 (6th Cir. 1998)).

may be true in many instances, the goals of economy and efficiency are not the overriding purpose of the FAA.<sup>46</sup> Moreover, speed, economy, and efficiency may not be in the best interest of parties engaged in a potentially complex insurance-related dispute. Indeed, it may be particularly troublesome to a policyholder resisting arbitration to be faced with a situation in which the insurance carrier cannot be compelled to produce witnesses or documents explaining its “case” or even setting forth in advance of the arbitration hearing the position it proposes to expound or the basis for its decision not to provide coverage for the construction-related claim(s) at issue.

The problems of uncertainty and “trial by ambush” resulting from this uncertain process may be remedied; for as a matter of contract, an arbitration provision may dictate the rules and procedures to be used at the arbitration. It is not uncommon for arbitration clauses to refer to or incorporate by reference the arbitration rules of a third party, such as the American Arbitration Association,<sup>47</sup> which establishes a procedural protocol without having to address in detail a whole host of issues, *e.g.*, the number of arbitrators, the process of their selection, the venue for the arbitration and applicable law, and rules dealing with discovery and the form of submissions to the panel.

As one commentator notes, “the more detailed and formal the procedures become, the more court-like the arbitration proceeding becomes and the less valuable it is as an alternative to traditional litigation.”<sup>48</sup> While this may be deemed inconsistent with speed and economy, as noted above, such principles cannot be used to trump the parties’ agreement regarding the arbitration process. Thus, an insured is well advised to insist on a minimum degree of process, including the right to request documents from the insurance carrier explaining the basis for the coverage decision at issue and the right to conduct at least a few “discovery” depositions of the decision makers.

Another consideration is whether the panel will be required to issue a written rationale for its award, which can have important consequences with respect to a party’s ability to challenge an adverse award, as discussed more fully in § 5.05, below.

## § 5.04 DEFENSES TO AN ARBITRATION DEMAND

Arbitration is strongly favored and courts will apply almost every presumption in favor of arbitration in addressing a motion to stay litigation and/or a motion to compel arbitration under the FAA. However, the right to arbitrate (and

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<sup>46</sup> See note 2, *supra*, and accompanying text.

<sup>47</sup> The full text of the AAA Commercial Arbitration Rules, as well as the text of specialized rules applicable to a wide variety of disputes, can be found at <<http://www.adr.org/index2.1.jsp>>.

<sup>48</sup> Martin Domke, *Commercial Arbitration* § 8:18 (2003).

the scope of the resulting arbitration) is not guaranteed. For example, there may be conditions precedent that must be satisfied; courts have repeatedly recognized that “[t]he FAA’s pro arbitration policy does not operate without regard to the wishes of the contracting parties.”<sup>49</sup> Thus, in *HIM Portland v. Devito Builders*, in which the contract at issue stated that mediation was a condition precedent to arbitration, the court decided that the plaintiff’s failure to request mediation precluded enforcement of the contract’s arbitration clause.

In addition to contractual conditions precedent, other procedural and substantive defenses to arbitration should not be overlooked in opposing a demand for arbitration of an insurance dispute. For example, when should an arbitration clause added to an insuring program after several years of coverage be applied retroactively to compel arbitration of claims arising from the inception of the program? Under what circumstances will a party to an arbitration clause be deemed to have waived its right to arbitration where the party litigates issues that it later seeks to arbitrate? Are there circumstances in which the remedies provided in the arbitration clause may be so restrictive as to be contrary to public policy, thereby rendering the clause unenforceable? While these defenses are not the exclusive means of resisting arbitration, they should not be overlooked in deciding whether or not to contest arbitration of an insurance dispute.

### **[A] Retroactivity of the Arbitration Clause**

Often, a particular organization will continue with a particular insurer for many years, resulting in issuance of several consecutive policies covering essentially the same risks. Although renewals or extensions of coverage are sometimes accomplished by a single endorsement to an existing policy extending the expiration date, it is not at all unusual for a renewal policy to be issued as a completely new policy form. In such situations, the renewal policy is often presented as being “essentially” the same as the expiring policy in all material aspects—type of coverage, limits, deductibles, or retentions—with only a few “minor” changes, including those sometimes incorporated with changes in policy wording approved by the Insurance Services Office (ISO). ISO does not include a form of arbitration clause as part of its “standard” liability policy forms. The addition of such a clause should be deemed a major change in renewal terms, which should be carefully considered and negotiated, perhaps by insisting on a reduction in premium and/or addition of specific language that carefully delineates the issues that are subject to arbitration. One issue that should be considered and could arise implicitly, if not addressed explicitly during the negotiation process, is whether the arbitration clause added to the renewal program applies retroactively to coverage disputes that arise after renewal but are based on the policies in effect during previous policy

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<sup>49</sup> *HIM Portland v. Devito Builders*, 317 F.3d 41, 43 (1st Cir. 2003).

periods. Certainly, when faced with an arbitration demand based on an arbitration clause in a renewal policy, the policyholder should not concede that the “prior” dispute is arbitrable unless the clause specifically addresses such disputes.

Many federal courts hold that an arbitration clause that does not specifically address retroactivity will not be applied retroactively.<sup>50</sup> Not all courts, however, require such crystal-clear language.<sup>51</sup> Despite this uncertainty, and even when a clause otherwise contains broad arbitration language, a policyholder opposing arbitration of “prior” coverage disputes should not concede that such disputes are arbitrable. The absence of wording requiring that the clause be applied to prior policy years, coupled with the absence of any arbitration clause in the previous policy or policies, may be a complete defense to the demand for arbitration of claims arising under those policies.

### **[B] Litigation of a Dispute as a Bar to Arbitration: Waiver Principles**

Another viable defense to arbitration may arise in the not uncommon situation when one party (or both) to an arbitration agreement initiates litigation in federal or state court regarding a dispute that either is or may be within the scope of a broadly worded arbitration clause. The FAA and many state arbitration statutes permit the defendant in such a case to move the court for an order staying the litigation and compelling arbitration.<sup>52</sup> However, what happens if instead of seeking immediately to compel arbitration, the defendant insurance carrier first litigates with its policyholder and then seeks to compel arbitration later? In some instances, the parties to the case may have overlooked the availability of the arbitration remedy or may not have realized that the dispute that is the subject of

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<sup>50</sup> *Peerless Importers Inc. v. Wine, Liquors & Distillery Workers Union Local 1*, 903 F.2d 924, 928 (2d Cir. 1990) (“the arbitration clause of a new agreement may not be used to reach back to cover disputes arising before the agreement was executed, unless such preexisting disputes are brought within the scope of the clause”); *Hendrick v. Brown & Root, Inc.*, 50 F. Supp. 2d 527 (E.D. Va. 1999) (finding that although arbitration agreement was very broad, it would not be applied retroactively because arbitration agreement did not address retroactivity).

<sup>51</sup> *Beneficial Nat’l Bank v. Payton*, 214 F. Supp. 2d 679 (S.D. Miss. 2001) (finding that broad arbitration clause applied retroactively even though it contained no retroactive language); *B.G. Balmer & Co. v. United States Fid. & Guar. Co.*, 1998 WL 764669, \*5 (E.D. Pa., 1998) (reasoning that “when an arbitration clause speaks in terms of relationships and not timing, a dispute arising from the relationship between the parties is arbitrable even if the dispute arose before the agreement was signed”); *Merrill Lynch v. King*, 804 F. Supp. 1512, 1514 (M.D. Fla. 1992) (holding arbitration agreement applied retroactively because it stated it applied to all transactions “whether entered into prior, on, or subsequent to the date hereof”); *Zink v. Merrill Lynch*, 13 F.3d 330, 332 (10th Cir. 1993) (finding retroactive application in arbitration agreement that stated “any controversy between the parties arising out of plaintiff’s business or this agreement shall be submitted to arbitration”).

<sup>52</sup> See 9 U.S.C. § 3 (motion to stay), and 9 U.S.C. § 4 (motion to compel).

litigation also is or may be within the scope of the arbitration clause. Often, such “realization” occurs after one or more adverse rulings in the case and perhaps on the eve of trial. In such cases, several courts have applied the doctrine of waiver to bar the belated enforcement of an arbitration clause, after significant delay or conduct inconsistent with the intent to arbitrate a dispute.<sup>53</sup>

The inquiry in most jurisdictions—when one party to a case moves belatedly to compel arbitration—is highly fact-specific. Courts look to the circumstances in the aggregate to determine whether the length of delay (and reasons for such delay) in demanding arbitration, coupled with any actions contrary to an intent to assert a right to arbitration, such as litigation of the “merits” and/or substantial participation in discovery, warrant a finding of waiver.<sup>54</sup> Consistent with federal and most cases state law policies to encourage ADR, and consistent with what is now an almost irrebuttable presumption in federal court in favor of arbitration, when the wording of the applicable clause is broad enough to encompass the dispute being litigated, even eleventh-hour demands for arbitration—after considerable discovery and not long before a scheduled trial—may be granted if the party opposing arbitration has not been prejudiced by the ensuing delay.

The prejudice necessary to support a finding of waiver

can be substantive, such as when a party loses a motion on the merits and then attempts, in effect, to relitigate the issue by invoking arbitration, or it can be found when a party too long postpones his invocation of his contractual right to arbitration, and thereby causes his adversary to incur unnecessary delay or expense.<sup>55</sup>

However, the approach of the various federal circuit courts to this issue varies; in some circuits, very little “substantive” prejudice need be shown. For example, in the Seventh Circuit, the courts do not require a showing of prejudice “beyond what is inherent in an effort to change forums in the middle . . . of a litigation.”<sup>56</sup> Elsewhere, it may be necessary to show actual prejudice in the form of substantive judicial rulings, or perhaps a change in the position of the party based on

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<sup>53</sup> See, e.g., *O.J. Distrib., Inc. v. Hornell Brewing Co., Inc.*, 340 F.3d 345 (6th Cir. 2003); *PPG Indus., Inc. v. Webster Auto Parts, Inc.*, 128 F.3d 103 (2d Cir. 1997); *Cabinetree of Wisconsin, Inc. v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388 (7th Cir. 1995); *Stone v. E.F. Hutton & Co., Inc.*, 898 F.2d 1542 (11th Cir. 1990).

<sup>54</sup> For example, the Second Circuit ruled in *PPG Indus., Inc.*, that “[t]here is no bright-line rule . . . for determining when a party has waived its right to arbitration: the determination of waiver depends on the particular facts of each case.” 128 F.3d at 107-08. The Second Circuit also has ruled that a party waives its right to arbitration when it engages in protracted litigation that is relevant to “substantial issues going to the merits” of the issues sought to be arbitrated and that results in prejudice to the opposing party. See *S & R Co. of Kingston v. Latona Trucking, Inc.*, 159 F.3d 80, 83-84 (2d Cir. 1998).

<sup>55</sup> *Kramer v. Hammond*, 943 F.2d 176, 179 (2d Cir. 1991).

<sup>56</sup> *Cabinetree*, 50 F.3d at 390.

the ongoing litigation, to establish prejudice sufficient to avoid a belated arbitration demand.

Complex insurance coverage disputes often involve a protracted process of investigation, as well as many exchanges of correspondence, often resulting in a relatively long period from submission of a claim, through investigation of the claim, to the issuance of a determination by the carrier or adjuster regarding whether or not the loss is covered and if so, for how much. The sometimes extended period of negotiation before a “final” coverage position is issued can arguably prejudice the policyholder, especially where the policyholder, whether a project owner, contractor, or subcontractor, may have changed its position. For example, based on the expectation that the loss is insured, the insured may not have negotiated as vigorously over a change order or agreement modifying the completion date to avoid liquidated damages. Can such extra-judicial “prejudice” be sufficient to support a finding of waiver, or is actual delay in invoking a claimed right to arbitrate until well into the litigation process necessary to support a waiver finding? There is no reported case on point;<sup>57</sup> however, where, for example, the underlying, potentially insured dispute has been the subject of litigation (or arbitration) under the construction contract and where the insurer either has knowledge of the claim or actually participates in some fashion in the underlying litigation, it is possible that a waiver argument may be successful.

For instance, the U.S. Court of Appeals for the Second Circuit has ruled expressly that a company may be barred from seeking arbitration if it or its “alter ego” previously litigated the same dispute, noting that a court’s “ability to reach the question of waiver as a defense to arbitration is not grounded solely in its ability to control litigation practices before it . . . [as] a district court may reach the question of waiver whenever a party [or alter ego] seeking arbitration has engaged in any prior litigation.”<sup>58</sup> While *Doctor’s Associates, Inc. v. Distajo* and other similar cases have not addressed insurance coverage disputes, it is certainly possible that a court might conclude that previous litigation of coverage issues by an insurer, either on its own behalf or on behalf of a coinsured company under the

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<sup>57</sup> Cases addressing waiver of the right to arbitrate may be found in a thorough annotation on the subject. See Joel E. Smith, Annotation, *Defendant’s Participation in Action As Waiver of Right to Arbitration of Dispute Involved Therein*, 98 A.L.R.3d 767 (1980). However, given the relatively few cases addressing waiver in the context of a demand for arbitration of an insurance dispute, it is not surprising that none of them address the question of whether or not “extra-judicial” prejudice of the sort generated by sometimes lengthy delay in resolving a questioned claim for insurance proceeds may cause sufficient prejudice to bar a belated arbitration demand.

<sup>58</sup> *Doctor’s Assocs., Inc. v. Distajo*, 66 F.3d 438, 454, 456 n.12 (2d Cir.1995) (citing among other authorities, *Kramer v. Hammond*, 943 F.2d 176 (2d Cir. 1991)). The Second Circuit also noted that “[p]rior to *Kramer*, all of the cases in which we reached the issue of waiver involved substantial litigation on the merits in the district court which was asked to grant the . . . stay [pending arbitration], not in other state or federal courts.” 66 F.3d at 456 n.12.

same policy, could support an argument for waiver in the event of a subsequent demand by the carrier for arbitration of a related coverage dispute arising under the same policy.

To support a waiver argument based on prejudice flowing from prior litigation by a party (or alter ego of the party) later seeking arbitration, it is necessary to show that the issue previously litigated was essentially the same as the issue that is the subject of the arbitration demand. Thus, following remand in the *Doctor's Associates* case, the Second Circuit revisited the issues presented and affirmed the trial court's ruling that the right to demand arbitration had not been waived. The court noted that consistent with "the strong federal policy favoring arbitration, courts resolve doubts as to whether waiver occurred in favor of arbitration."<sup>59</sup> Consistent with this principle, the Second Circuit decided that "only prior litigation of the *same legal and factual issues* as those the party now wants to arbitrate results in waiver of the rights to arbitrate."<sup>60</sup> Otherwise, a finding of waiver "where a party has previously litigated an unrelated yet arbitrable dispute would effectively abrogate an arbitration clause once a party had litigated *any* issue relating to the underlying contract containing the arbitration clause."<sup>61</sup>

While a party opposing arbitration of a coverage issue on the basis of waiver may face considerable difficulty in overcoming the strong presumption favoring arbitration, the possibility of success on a waiver argument should not be overlooked. Indeed, even in a situation in which the controlling clause contains the talismanic language supporting the proposition that "arbitrability is for the arbitrators," the question of waiver may be an exception to that rule. In its first opinion in *Doctor's Associates*, the Second Circuit devoted substantial attention to the question of whether or not the issue of waiver presented a question to be resolved by the arbitrators or a question to be resolved in federal court, perhaps with the aid of a jury. Noting that there was a split of authority on the subject, based in part on the question of the procedural context in which the question arose, the Second Circuit decided that "where the waiver defense was based on prior litigation by the party [later] seeking arbitration . . . the [district] court should decide the issue of waiver. . . ."<sup>62</sup> Thus, if the insurance carrier files an action for declaratory relief and then later seeks arbitration of a subsequent coverage lawsuit initiated by the policyholder alleging damages for bad faith, or if the carrier previously litigated coverage with a coinsured or other "alter ego" of the policyholder, the court, rather than the arbitration panel, should decide whether or not the right to arbitrate the dispute has been waived.

In sum, a policyholder seeking to avoid arbitration on the grounds of waiver faces an uphill battle if the arbitration clause is broadly worded and assigns

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<sup>59</sup> *Doctor's Assocs., Inc. v. Distajo*, 107 F.3d 126, 130 (2d Cir. 1997).

<sup>60</sup> *Id.* at 133 (emphasis added).

<sup>61</sup> *Id.* (emphasis added).

<sup>62</sup> *Doctor's Assocs.*, 66 F.3d at 456.

“arbitrability” issues to the panel. Nevertheless, in appropriate circumstances waiver is a viable defense to a belated demand for arbitration. Accordingly, policyholders should be aware of continuing developments regarding the doctrine of waiver and the circumstances, including any participation by the carrier in the judicial process, that may be used to support waiver defenses to the carrier’s belated demand for arbitration.

### [C] Limitation of Remedies as a Defense to Arbitration

In a complex coverage dispute, the outcome is often determined by the degree of leverage an insured may bring to bear with respect to a judicial resolution of the dispute. When damages for bad faith and other statutory remedies that have punitive aspects are waived, an arbitration clause can drastically reduce such leverage. Is this an issue for the court or for the arbitrators? An insurance carrier’s motivation in including arbitration clauses in policies typically would be to avoid juries, which historically are hostile to insurance companies, and to avoid “extra-contractual” damages allowed by numerous state statutes, including those states that permit claims for unfair and deceptive trade practices to be pursued against insurers.

As noted above, many states provide statutory remedies for an insurer’s bad faith and/or unfair and deceptive trade practices. A number of these statutory remedies provide for the recovery of attorneys’ fees and/or penalties, including treble damages. In some jurisdictions, courts allow claims for punitive damages to be presented to a jury if the evidence shows that a carrier has acted in conscious or at least “reckless” disregard of its policyholder’s rights.<sup>63</sup> In such situations, if the applicable arbitration provision expressly prohibits any award of punitive damages or other penalties, as does the hypothetical clause above, case authorities suggest that a policyholder may be able to argue that the arbitration clause is unenforceable, as its strict enforcement would deprive the policyholder of “meaningful relief” under applicable statutory remedies and accordingly violate public policy.

Several courts have refused to enforce an arbitration provision that bars a statutory remedy because “arbitrability of [statutory] claims rests on the assumption that the arbitration clause permits relief equivalent to court remedies.”<sup>64</sup> In *Paladino v. Avnet Computer Technologies, Inc.*, the Eleventh Circuit addressed enforceability of an arbitration agreement that limited the arbitrator to an award of damages for breach of employment contract and prohibited any other remedy, such as an award of damages for employment discrimination. In a special concurrence, two judges concluded that because the arbitration agreement did

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<sup>63</sup> See commentary cited in note 6, *supra*.

<sup>64</sup> *Paladino v. Avnet Computer Techs., Inc.*, 134 F.3d 1054, 1062 (11th Cir. 1998) (citing *Gilmer v. Interstate/ Johnson Lane Corp.*, 500 U.S. 20, 28 (1991)).

not encompass the plaintiff's statutory claims for employment discrimination, the clause deprived the plaintiff of "meaningful relief" and hence was unenforceable.

Similarly, in *Graham Oil Co. v. Arco Products Co.*,<sup>65</sup> the Ninth Circuit held that an arbitration clause purporting to forfeit certain statutorily mandated rights or benefits afforded the plaintiff under the Petroleum Marketing Practices Act (PMPA), 15 U.S.C. §§ 2801-2806, was unlawful and invalid. The clause at issue barred the plaintiff's right to recover exemplary damages, the right to obtain statutorily mandated attorneys' fees if successful, and the right to a one-year statute of limitations on its claims under the PMPA. Reasoning that "each of the three statutory rights is important to the effectuation of the [PMPA's] policies," the court refused to enforce the arbitration agreement because it frustrated the essential purpose of the statute.

Under the *Paladino/Graham Oil* analysis, if the arbitration agreement precludes vindication of a statutory right serving an important remedial and/or deterrent function that embodies an important public interest, the arbitration clause cannot be enforced to nullify the statutory guarantee.<sup>66</sup>

The proposition that an arbitration clause barring an essential remedy may be unenforceable was the subject of a more recent decision of the Supreme Court. In *PacifiCare v. Book*,<sup>67</sup> the Court addressed a situation in which the plaintiff sought to avoid arbitration based on the proposition that the arbitration clause barred meaningful relief because claims for multiple damages under the Racketeer-Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961 *et seq.*, were punitive in nature and hence were barred by the language of the arbitration clause prohibiting the arbitrator from awarding punitive damages.<sup>68</sup> The Court reviewed the RICO case law to determine whether or not the treble damages provisions of RICO were considered "punitive" in nature, concluding that, "in light of our case law's treatment of statutory treble damages and given the uncertainties surrounding the party's intent with respect to the contractual term 'punitive,' the application of the disputed language [in the arbitration agreement]

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<sup>65</sup> 43 F.3d 1244 (9th Cir. 1994).

<sup>66</sup> *Paladino* and *Graham Oil* relied on the Supreme Court's opinion in *Mitsubishi Motor Corp. v. Soler Chrysler Plymouth, Inc.*, 473 U.S. 614 (1985). In *Soler*, the Court was faced with the issue of whether an arbitration agreement that arguably did not provide an adequate procedure or forum for pursuing the plaintiff's statutory causes of action under federal antitrust laws, including the treble damages provision of the Clayton Act, was per se invalid. *Id.* at 635. The Court ruled that there was nothing inherent in the arbitration agreement suggesting that the arbitration panel would not give credence and effect to the federal antitrust causes of action being asserted, noting, however, "in the event the choice of forum and choice-of-law clauses [in the arbitration agreement] operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy." *Id.* at 637 n.19.

<sup>67</sup> 123 S. Ct. 1531 (2003).

<sup>68</sup> *See id.* at 1535.

to [the plaintiff's] RICO claims is, to say the least, in doubt."<sup>69</sup> Because it was not certain that the arbitration clause precluded the treble damages remedy sought by the plaintiff, the Court determined that the *arbitrator* should first address the question of whether the RICO treble damages remedy was available, noting that the clause at issue assigned all questions of "arbitrability" to the arbitrator.

While the *PacifiCare* Court stopped short of holding that an arbitration clause that deprived a claimant of an essential, statutory remedy should not be enforced, the Court's analysis seems fully consistent with the rulings on that subject by the *Palladino* and *Graham Oil* courts. Accordingly, given the language in the *Soler Chrysler* case and *PacifiCare*, the Supreme Court appears to endorse the proposition that an arbitration clause that deprives a plaintiff of a statutory remedy intended to punish or deter conduct is at odds with public policy and should not be enforced.

### § 5.05 ENFORCEMENT OF THE ARBITRATION AWARD

The hypothetical arbitration clause set forth above does not specifically state whether the panel shall issue an explanation or justification for any resulting award. In the absence of such language, arbitrators have no obligation to explain or justify, either in law or fact, the reasons behind their award.<sup>70</sup> "If parties to an arbitration agreement wish a more detailed arbitral opinion, they should clearly state in the agreement the degree of specificity required."<sup>71</sup> As will be discussed below, even when an award is accompanied by a memorandum decision explaining the outcome, it is exceedingly difficult to overturn an arbitration decision. Nevertheless, because the absence of a record or written decision explaining the reasoning behind the award contributes to this difficulty,<sup>72</sup> a risk manager negotiating an arbitration clause in an insurance policy should insist on wording requiring the arbitration panel to issue an explanation of its award.

If an arbitration award is challenged, it is usually during the "confirmation" process. Standing alone, an award by an arbitration panel is not enforceable. Rather, the prevailing party must first seek to "confirm" the award and have a

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<sup>69</sup> *Id.*

<sup>70</sup> *Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198, 203 (1956). An arbitration agreement may incorporate by reference arbitration rules created by third parties. One of the most commonly so incorporated is the Commercial Arbitration Rules and Mediation Procedures of the American Arbitration Association. Even those rules, however, provide that "[t]he arbitrator need not render a reasoned award unless the parties request such an award in writing prior to appointment of the arbitrator or unless the arbitrator determines that a reasoned award is appropriate." *Id.* R-42(b).

<sup>71</sup> *Green v. Ameritech Corp.*, 200 F.3d 967 (6th Cir. 2000).

<sup>72</sup> *Bernhardt*, 350 U.S. at 203-04 (recognizing that the "change from a court of law to an arbitration panel may make a radical difference in ultimate result" and suggesting that lack of record and written decision contribute).

judgment entered by a court enforcing the award. This procedure is dictated by statute in most states and by the FAA.<sup>73</sup> Post-arbitration disputes often arise during the process of confirmation, when the losing party seeks to vacate the award in the same proceeding.<sup>74</sup> Under the FAA, an arbitration award may be vacated on very limited grounds, including where the award was procured by fraud, where there was “evident partiality” by the arbitrators, or “where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual final and definite award upon the subject matters submitted was not made.”<sup>75</sup>

As ruled by the Supreme Court in *Wilco v. Swan*, a court’s “[p]ower to vacate an award is limited.”<sup>76</sup> Indeed, it has even been said that an arbitration award has a presumption of validity.<sup>77</sup> Based on *Wilco v. Swan*, courts have vacated arbitration awards that demonstrate “manifest disregard” for the law.<sup>78</sup> Most federal courts have interpreted the manifest disregard standard to mean that an arbitration panel that interprets the law incorrectly, applies the law incorrectly, or incorrectly applies the facts to the law will not necessarily be overturned.<sup>79</sup> Rather, in most courts, a party challenging an award based on manifest disregard for the law must show that (1) the relevant law was clearly defined, and (2) that the arbitrators consciously choose not to apply it.<sup>80</sup>

A court may also vacate an arbitration award when an arbitration panel exceeds its powers.<sup>81</sup> Whether an arbitrator has exceeded its powers under the FAA is largely a matter of contract law, in that the power of the arbitrators is

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<sup>73</sup> See 9 U.S.C. § 9 (addressing time limits, venue and jurisdictional issues, some of which may be altered by the parties in the arbitration agreement); 9 U.S.C. § 10 (grounds for vacating award); 9 U.S.C. § 11 (modification or correction); 9 U.S.C. § 12 (addressing notice and time limits with respect to vacation and modification).

<sup>74</sup> See *id.*

<sup>75</sup> 9 U.S.C. § 10 (listing other grounds not herein discussed).

<sup>76</sup> *Wilco v. Swan*, 346 U.S. 427, 436 (1953) (noting that an arbitration award would not necessarily be overturned even if a reviewing court could not know whether arbitrators understood or properly applied concepts like “burden of proof” or “reasonable care”).

<sup>77</sup> *Flexible Mfg. Sys. Ltd. v. Super Prods. Corp.*, 86 F.3d 96 (7th Cir. 1996).

<sup>78</sup> *Wilco*, 346 U.S. at 436-37. The manifest disregard standard has been reaffirmed, though not applied, in dicta in *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995) (stating that an arbitrator’s decision may be set aside “only in very unusual circumstances” and citing *Wilco v. Swan*).

<sup>79</sup> See, e.g., *Hoffman v. Cargill, Inc.*, 236 F.3d 458, 461 (8th Cir. 2001) (“We may not set an award aside simply because we might have interpreted the agreement differently or because the arbitrators erred in interpreting the law or determining the facts.”); *Brown v. ITT Consumer Fin. Corp.*, 211 F.3d 1217, 1223 (11th Cir. 2000) (“arbitration awards will not be reversed due to an erroneous interpretation of the law by the arbitrator”).

<sup>80</sup> *Dawahare v. Spencer*, 210 F.3d 666, 669 (6th Cir. 2000) (noting that “inadvertent” mistake in applying the law does not constitute manifest disregard); *Brown*, 211 F.3d at 1223 (“To manifestly disregard the law, one must be conscious of the law and deliberately ignore it.”).

<sup>81</sup> 9 U.S.C. § 10(a)(4).

defined by the agreement to arbitrate and the parties' submissions.<sup>82</sup> If the scope of the arbitration agreement broadly refers to disputes "relating to or arising out of" an agreement, the parties have contractually agreed to give the arbitrators jurisdiction over almost "anything under the sun."<sup>83</sup> Thus, in *Valentine Sugars, Inc. v. Donau Corp.*, the arbitration panel did not exceed its authority in awarding title to certain manufacturing equipment to one of the parties, even though the issue of ownership of the equipment was not raised specifically in the notice of arbitration. Such a broad reading derives from the same authority under which courts construe the agreement to arbitrate as a contract and "resolve all doubts in favor of arbitration."<sup>84</sup> Because the scope is contractually based, if an arbitrator fails to take steps specifically required in the agreement to arbitrate, the award is subject to attack.

If an arbitration agreement states "any award in arbitration shall be accompanied by a statement of the arbitrators outlining their findings of fact and conclusions of law," failure to do so subjects the award to being overturned. In *Western Employers Insurance Co. v. Jefferies & Co.*,<sup>85</sup> before executing a standard agreement to arbitrate under the rules of the National Association of Securities Dealers (NASD), the parties inserted a requirement that the arbitrators issue findings of fact and conclusions of law. The arbitration panel eventually failed to do so, apparently reasoning that under NASD rules and procedures the parties could not bind the panel with their own agreement.<sup>86</sup> The award was challenged and the Ninth Circuit Court of Appeals ordered the award vacated. Analyzing the issue as one involving "traditional principles of contract law," each party "had a right to receive what it bargained for—arbitration according to the terms of its contract."<sup>87</sup> Accordingly, because the arbitrators had failed to meet their obligations, the award was vacated.

Although not necessary to the basic holding, the court in *Jefferies* specifically rejected the notion that including findings of fact and conclusions of law would have increased the challenger's chances on review by triggering some "higher level of judicial review."<sup>88</sup> "The fact that a court has access to detailed findings of fact and conclusions of law does not alter this [manifest disregard]

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<sup>82</sup> *Delta Queen Steamboat Co. v. District II Marine Eng'rs Benefits Ass'n, AFL-CIO*, 889 F.2d 599 (5th Cir. 1989), *cert. denied*, 498 U.S. 853 (1990).

<sup>83</sup> *Valentine Sugars, Inc. v. Donau Corp.*, 981 F.2d 210, 213 and n.2 (5th Cir. 1993), *cert. denied*, 509 U.S. 923 (1993).

<sup>84</sup> *Id.* at 213 (*citing* *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983)).

<sup>85</sup> 958 F.2d 258 (9th Cir. 1992).

<sup>86</sup> The record does not reveal whether the panel issued a reason for the refusal, but the panel chairman had said as much during discussion on the topic at the arbitration. *Id.* at 260.

<sup>87</sup> *Id.* at 260.

<sup>88</sup> *Id.* at 261.

deferential review.”<sup>89</sup> This comment raises the issue as to whether parties may add language to an arbitration agreement that would alter the normally deferential standard of judicial review of an arbitral award.

Presently, the federal courts of appeal are split on the issue of whether parties to arbitration agreements can expand the scope of judicial review by stating so in the agreement to arbitrate. For example, the Seventh Circuit has disapproved the practice, stating in dicta that “federal jurisdiction cannot be created by contract.”<sup>90</sup> The Third Circuit, however, has held that parties may “opt out of the FAA’s off-the-rack vacatur standards and fashion their own.”<sup>91</sup> The Eighth Circuit avoided a direct holding on the topic, but made clear that “if parties could contract for heightened judicial review, the parties’ intent to do so must be clearly and unmistakably expressed.”<sup>92</sup> The Ninth Circuit has issued contradictory rulings on the issue, but presently holds that parties may not contract for an expanded judicial review.<sup>93</sup>

As noted above, there are several defenses to arbitrability that may be invoked to resist arbitration of coverage disputes; however, there remains a wide split of authority on the question of whether or not some or all of those defenses and other “gateway” issues are for resolution by the courts or by the arbitration panel. Where the gateway principles are decided by the arbitrators, it is by no means certain that their determination—for example, that a clause should be applied retroactively, that a clause barring statutory remedies is unenforceable as contrary to public policy, and/or that certain issues are beyond the scope of the agreement and hence arguably beyond the “power” of the arbitrators to address—present issues that may later subject a final award to collateral attack. These uncertainties must await judicial resolution in subsequent cases. However, pending the outcome of these issues and to add some level of certainty and predictability to the process, it may be essential to insist that a written decision accompany an award explaining the basis for the outcome. Such an award may

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<sup>89</sup> *Id.*

<sup>90</sup> *Chicago Typographical Union v. Chicago Sun-Times, Inc.*, 935 F.2d 1501, 1505 (7th Cir. 1991) (but recognizing that parties can contract for appellate arbitration panel to review arbitral award). *See also* *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 937 (10th Cir. 2001) (disallowing parties to contract for heightened judicial review).

<sup>91</sup> *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 293 (3d Cir. 2001), *cert. denied*, 534 U.S. 1020. *See also* *Gateway Tech., Inc. v. MCI Telecom Corp.*, 64 F.3d 993, 997 (5th Cir. 1995) (allowing parties to decide in advance that arbitral award will be subject to *de novo* review by court).

<sup>92</sup> *Schoch v. InfoUSA, Inc.*, 341 F.3d 785, 789 (8th Cir. 2003), *cert. denied*, 2004 WL 323269 (2004).

<sup>93</sup> *LaPine Tech. Corp. v. Kyocera*, 130 F.3d 884 (9th Cir. 1997) (allowing parties to contractually heighten scope of judicial review), *overruled by* *Kyocera Corp. v. Prudential-Bache Trade Servs. Inc.*, 341 F.3d 987 (9th Cir. 2003) (reversing itself and holding that parties may not expand scope of judicial review beyond FAA standards), *cert. dismissed*, 124 S. Ct. 980 (2004).

provide more bases for judicial review than otherwise would be available to the party disappointed by the final outcome.

## § 5.06 CONCLUSION

When considering questions of arbitration of insurance-related disputes, the playing field is not level. Rather, the advantages of arbitration almost invariably, if not exclusively, favor the insurance carrier. At a minimum, arbitration of a coverage dispute, often before a panel of “insurance professionals,” will eliminate the advantages to a policyholder gained by litigating such disputes before a jury. Most insurance carriers have the perception, correct or not, that juries are hostile to them and will identify with and most often favor the interests of the policyholder, even when the policyholder is a large construction company, developer, or project owner. Perhaps more importantly, it is rare indeed for an arbitration clause to permit the full panoply of remedies, including statutory damages, penalties, punitive damages, and attorneys’ fees, that can be awarded by juries when carriers are found to have acted in bad faith in failing to pay a covered claim. Whatever the advantages gained by economy and perhaps speed in arbitrating the dispute, the alacrity with which a carrier faced with the possibility of a claim for “bad faith” may decide to pay an otherwise controverted claim, thereby avoiding the bad faith claim, should not be underestimated.

The authorities that address arbitration of insurance coverage disputes are much more limited than those that address other types of disputes; however, except in those jurisdictions with statutes prohibiting arbitration of insurance disputes, the cases to date have applied the same pro-arbitration principles that normally govern other matters, including typical construction-related disputes. Thus, as explained in this chapter, the party seeking to avoid arbitration of an insurance coverage dispute, if faced with a broad arbitration clause, faces an uphill battle when the governing law allows such disputes to be arbitrated, especially if the arbitration clause at issue also assigns issues of “arbitrability” to the arbitrators. Nevertheless, the informed construction manager responsible for insuring construction risks needs to be aware of the principles summarized above in considering whether, and under what circumstances, to agree to include an arbitration clause in the policy or policies covering the risk. Knowledge of the impact of the clause on the ability to litigate or arbitrate coverage issues in a meaningful fashion may be the difference between a favorable outcome, resulting in prompt reimbursement of an insured loss, and one that is inconsistent with the coverage expectations of the parties engaged in the construction work.

