Arbitration vs. Litigation: Key Factors for Policyholders

Although disputes between US policyholders and US-based insurers relating to claims submitted under commercial general and excess liability insurance policies often are litigated in US courts, policies issued by foreign insurers often contain provisions requiring that arbitration be used to resolve disputes. How disputes are resolved in an insurance policy can have a significant effect on claims outcomes, but assessing mandatory arbitration provisions is not always simple. Policyholders should consider several factors and work with their legal and insurance advisors before making this choice.

HOW DISPUTES ARE HANDLED IN DIFFERENT JURISDICTIONS

In US-only coverage disputes, litigation is typically the default approach to resolution. In fact, in certain states, mandatory arbitration provisions in insurance contracts may be unenforceable. However, policies issued by insurers located outside the US often contain mandatory arbitration provisions. Bermuda-based insurers, for example, almost always issue insurance policies with mandatory arbitration provisions because of tax and regulatory reasons.

When considering insurance policies subject to a mandatory arbitration provision, policyholders may have questions about which dispute resolution method — litigation in the US or a private arbitration proceeding — better serves their interests. But answering those questions can be complicated.

THE RULES FOR DECIDING THE DISPUTE

Some insurance policies — regardless of whether they have mandatory arbitration provisions — contain governing law provisions that specify which

state's or country's laws will apply to any dispute under the policy. The applicable law in a choice-of-law provision may be different than the law that would have been applied by a court in litigation.

Even if the same law is applied, it does not mean that a court or arbitration panel would view and apply the law the same way and reach the same result. The interaction between the substantive law to be applied, on the one hand, and a court's procedures or arbitration's rules, on the other, may not be straightforward. Among the factors that will govern the resolution of a coverage dispute by a court as compared with arbitration panel are the rules for construing policy wording and the available remedies.

For example, under the law in many US jurisdictions, an ambiguity in an insurance policy is construed against the drafter of the policy wording. As the insurer is often responsible for the policy wording, the rule can benefit policyholders. Some policies and mandatory arbitration provisions, however, attempt to avoid application of that rule. For example, the occurrence-reported XL 004 form specifies that the arbitration panel must interpret the policy in an "even handed fashion."

Further, in US courts, policyholders can sometimes seek compensatory and punitive damages against an insurer for bad faith and/or unfair claims handling practices. The potential for those remedies are often viewed as providing a disincentive for insurers to take unsupported positions. In some cases, a policyholder may not be able to seek or be awarded those remedies in an arbitration proceeding. The rules regarding whether the prevailing party can be awarded its attorneys' fees can also vary in litigation and arbitration, depending on the jurisdiction and/or the applicable arbitration rules.

CONFIDENTIALITY

Typically, arbitrations are confidential proceedings in which information about the substance of the dispute and the result is not available to non-parties. An arbitration proceeding is therefore unlikely to attract additional attention to the matter or affect the litigation of underlying claims.

In contrast, for insurance coverage litigation in US courts, filings and proceedings — including trials — are open to the public, including the media and plaintiffs' attorneys pursuing any remaining underlying

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claims against the policyholder. Policyholders can seek and sometimes obtain confidentiality protection for sensitive information in US litigation, but the protection will be limited and the outcome of the lawsuit will be public. Meanwhile, the public nature of litigation may be viewed by policyholders as beneficial to their insurance recovery efforts since the lack of confidentiality may cause the insurer to be more careful about taking inconsistent positions or positons that might reflect negatively on it if made public.

TIMING AND EXPENSE

Conventional wisdom suggests that arbitration is quicker and less expensive than litigation in US courts. But litigation timelines can vary significantly by court and by judge. This means that whether arbitration actually is speedier and less costly to the parties depends on where the litigation proceeds or would have proceeded.

As a general matter, the availability of discovery is more limited in arbitration than in litigation, and there are often restrictions on depositions in arbitration proceedings. The ability to appeal the outcome of litigation also potentially lengthens the litigation timeline, sometimes by years.

In contrast, an arbitration award is usually final, with little or no ability to appeal. Further, arbitration outside the United States may increase certain costs because of international travel, the costs of arbitrators, and higher hourly legal fees in some jurisdictions.

Whether a future dispute is likely to involve more than one insurer is also an important consideration. Because the agreement to arbitrate is a part of each policy issued, a policyholder may need to commence separate arbitrations against each of the insurers, resulting in multiple proceedings and potentially varying outcomes and increasing costs. In US litigation, depending on the circumstances, the policyholder may be able to join all insurers whose policies do not have arbitration provisions to a single proceeding.

DECIDING WHETHER TO ARBITRATE OR LITIGATE

The choice of dispute resolution mechanisms can have significant implications for disputed claims. But the question of whether to litigate or to arbitrate any future disputes under an insurance contract cannot be addressed in isolation. In purchasing excess casualty or general liability insurance, policyholders often must evaluate competing insurer proposals with different terms and conditions. The presence or absence of a mandatory arbitration provision is just one potential difference in these proposals, which are rarely identical in all other respects.

In building effective casualty insurance programs, policyholders should consider all of these differences — including those governing dispute resolution — carefully. Throughout this process, policyholders can benefit from support from insurance and legal advisors, who can help them decide how best to appropriately address their risks and position them to more quickly and effectively resolve disputes.

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