Invoking a Policy's Arbitral Provisions When a Third Party Sues the Insurer

By Edward K. Lenci

The Supreme Court has extended the validity and expanded the scope of arbitral provisions in consumer and employment contracts. Now, last year's decision in *GE Energy Power Conversion Fr. SAS, Corp. v. Outokumpu Stainless USA, LLC* [1] may pave the way for an insurer to successfully invoke a policy's arbitral provisions when a non-party to the policy sues the insurer (e.g., an injured plaintiff sues for bad faith) if (1) the arbitral provisions fall under either the New York [2] or the Panama Convention [3] and (2) applicable state law permits binding a non-signatory to a contract to its arbitral provisions.

In fact, construction is already underway. Although *Outokumpu* involved a business dispute, the U.S. Court of Appeals for the Eleventh Circuit, in *McCullough v. AIG Ins. H.K. Ltd.* [4], instructed a district court to consider *Outokumpu* in a case where an American woman, injured during a shore excursion from a Caribbean cruise ship, and her husband sued an insurer of one of the excursion's owners for bad faith, and the policy required arbitration in Hong Kong.

Application of the Conventions, and Procedures

As to *Outokumpu's* first requirement, a district court should conduct "a very limited inquiry" [5] and decide that one

of the Conventions applies if: the parties' contract has arbitral provisions; those provisions require arbitration in the territory of a signatory to the relevant Convention; and either one party to the contract is not a U.S. citizen [6] or all parties to it are U.S. citizens and their "relationship involves property located abroad, envisages performance or enforcement abroad, or has some other reasonable relation with one or more foreign states" [7].

The Conventions are treaties, so federal courts have "federal question" jurisdiction over disputes falling under them [8]. Moreover, for purposes of removal to a federal court, the enabling legislation of the Conventions permits removal "at any time before the trial" [9] and "[t]he procedure for removal of causes otherwise provided by law shall apply, ... the ground for removal provided in this section need not appear on the face of the complaint but may be shown in the petition for removal" [10]. If a court denies a motion to compel arbitration, the movant has the right to an interlocutory appeal to the Circuit Court of Appeals [11], an advantage the other party does not have [12].

"The Conventions are treaties, so federal courts have 'federal question' jurisdiction over disputes falling under them"

Outokumpu

Article II(2) of the New York Convention requires "an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams" [13]. In *Outokumpu*, however, the Supreme Court explained that, in cases involving the Federal Arbitration Act, it had "recognize[d] that arbitration agreements may be enforced by nonsignatories [sic] through 'assumption, piercing the corporate veil, alter ego, incorporation by reference, third-party beneficiary theories, waiver and estoppel[,]'" [14] and it held simply that the same principle applies in cases falling under the New York Convention because the Convention did not prohibit it [15].

McCullough

The facts in *McCullough* were straightforward [16]. Lynn and William McCullough were passengers on a Royal Caribbean cruise ship. At their shore excursion in St. Lucia, they participated in a zip-line course, during which Lynn McCullough fell and sustained terrible injuries. The McCulloughs sued Royal Caribbean, various insurance companies, and the shore excursion's three owners in federal court in Florida. After the court denied the owners' motion for summary judgment, the owners and the McCulloughs arbitrated their dispute, the arbitrator entered an award in favor of the McCulloughs, and the court entered a final judgment against the excursion's owners, jointly and severally.

AIG Insurance Hong Kong Ltd. ("AIG HK") insured one of the excursion's owners. The policy had liability coverage of up to $5.15 million, but limited AIG HK's liability for "Bodily Injury and Property Damage." Based on the policy's exclusions, AIG HK disputed coverage, though it offered to fund a settlement for $350,000 based on its evaluation of its policyholder's exposure. In their Third Amended Complaint, the McCulloughs alleged, under Florida law [17], that AIG HK had acted in bad faith by failing to settle the McCulloughs' claims within the policy's limits. AIG HK moved to dismiss and compel arbitration based on the policy's dispute resolution provision:

Except as otherwise specifically provided, any dispute regarding any aspect of this policy or any matter relating to cover thereunder which cannot be resolved by agreement within six (6) months, shall first be referred to mediation at the Hong Kong International Arbitration Centre and in accordance with its Mediation Rules. If the mediation is abandoned by the mediator or is otherwise concluded without the dispute or difference being resolved, then such dispute or difference shall be referred

to and determined by arbitration at HKIAC and in accordance with its Domestic Arbitration Rules.

The McCulloughs argued that they were not subject to that provision because their claim was for common law bad faith and they were not signatories to the policy. With respect to their first argument, the McCulloughs had not sought verification of coverage through litigation, so the district court held that, because there was no determination of coverage but merely a final judgment against the excursion's owners, a bad faith claim was premature. As to their second argument, AIG HK responded that the McCulloughs stood in the shoes of its policyholder, so their bad faith claim was subject to the dispute resolution provision. The court held that the New York Convention binds only a signatory to a contract. The decision the court followed was the Eleventh Circuit's in *Outokumpu Stainless USA, LLC v. Converteam SAS* [18], which the Supreme Court vacated and remanded, so the Eleventh Circuit vacated the court's order and remanded the case:

As noted above, the district court relied entirely on our decision in Outokumpu *in declining to grant AIG's motion to compel arbitration. ... However, after the district court decision in this case and after the briefing on appeal, the Supreme Court in* [Outokumpu]*, reversed our decision. ... Contrary to the Eleventh Circuit decision, the Supreme Court held that nothing in the New York Convention conflicts with the application of relevant equitable doctrines. ... Consistent with that Supreme Court ruling, we also vacate the judgment of the district court and remand for further proceedings not inconsistent with this opinion or the opinion of the Supreme Court in* Outokumpu *[19].*

Drafting an Enforceable Arbitral Provision

Various considerations apply when drafting arbitral provisions or deciding whether to include such provisions at all. Assuming that arbitral provisions will be in the policy, the following are some drafting tips in view of the Fifth Circuit's decision in *McCullough*.

It is worth reiterating that the insurer must choose an arbitral forum in one of the nations that is a signatory to either the New York or Panama Convention. Fortunately, there are many.

While the arbitral provision in *McCullough* is, of course, an excellent place to start, the drafter's work does not end there. As a practical matter, some judges go to great lengths to find a way, despite the Supreme Court's decisions of the last decade, not to enforce arbitral provisions against a party the judge perceives as "the little guy." The scope of the arbitral provision is, therefore, of utmost importance, because a judge inclined not to grant a motion to compel arbitration of a claim akin to the McCulloughs' will have a harder task if the arbitral provision is, within the bounds of applicable law, broad. The provision in *McCullough*, while broad, could be broader—for example, it could state as follows: "any dispute, controversy, claim, or difference, including one in tort or under a statute, regarding any aspect whatsoever of this policy, or arising out of or relating in any way to this policy, shall be resolved by binding arbitration."

"Arbitrability" is whether the dispute in question is subject to the arbitral provision in question. Given the chance that the lawsuit may be assigned to a judge hostile to enforcing the arbitral provision, it is a good practice to take the decision of arbitrability out of judicial hands altogether. However, to put the issue of arbitrability into the hands of the arbitrators—called "competence-competence" in some lands—there must be "clear and unmistakable evidence" that the parties intended that the arbitrators will decide arbitrability [20].

Fortunately, the rules of arbitral institutions around the world typically provide that the arbitrators decide arbitrability. Eleven federal Circuit Courts of Appeal—the Seventh Circuit has not yet addressed the issue—have held that an arbitral provision requiring arbitration before an arbitral institution whose rules provide that the arbitrators decide arbitrability is clear and unmistakable evidence that the parties agreed to arbitrate arbitrability [21]. The arbitral provision in *McCullough* is a good template: any such dispute, controversy, claim, or difference "shall be referred to and determined by arbitration at [name of institution] and in accordance with [the institution's] [r]ules."

In fact, apropos of claims akin to those in *McCullough*, choosing to arbitrate before an arbitral institution, such as the HKIAC, would seem a much better approach than an ad hoc arbitration. A good arbitral institution provides the parties to the arbitration with a set of detailed rules and procedures that are well known to attorneys who practice in the area of international arbitration. This restricts an attorney's

ability to create procedural mischief in the hope that the cost of dealing with the mischief will elicit a settlement. Additionally, a good arbitral institution assigns a case manager and has an administrator to help ensure that the arbitration proceeds smoothly and predictably, from soup to nuts.

Furthermore, while it is exceedingly difficult to overturn any international arbitral award, experience has shown that an award by a panel of an arbitration administered by a well-known, reputable arbitral institution stands a better chance of enforcement. Moreover, as readers of the ARIAS·U.S. *Quarterly* know, ad hoc arbitration of reinsurance disputes works (at least much of the time) because there are certain procedural customs and practices that, for the most part, the parties and counsel follow. Such would not likely be the situation in an ad hoc arbitration of a claim akin to that of the McCulloughs.

“While it is exceedingly difficult to overturn any international arbitral award, experience has shown that an award by a panel of an arbitration administered by a well-known, reputable arbitral institution stands a better chance of enforcement.”

Of course, the drafter must work with or around (as the case may be) the following:

(1) about one-third of states prohibit or restrict the arbitration of insurance disputes or the inclusion of arbitral provisions in insurance policies;

(2) despite the Supremacy Clause [22], in the Second and Eighth Circuits, the Conventions do not preempt those laws or the McCarran-Ferguson Act;

(3) the Fourth and Fifth Circuits have reached a contrary conclusion; and

(4) district court decisions elsewhere go either way [23].

A review of more drafting considerations would be better presented in a webinar or at the next ARIAS·U.S. conference. Suffice to say, the canny drafter knows the applicable legal requirements and carefully tailors the language of the arbitral provisions to achieve the desired result: an enforceable agreement to arbitrate that binds certain third parties in an international context to arbitrate. The canny drafter does not rely on off-the-shelf arbitral provisions that may be decades old. In fact, given the pro-arbitration decisions of the U.S. Supreme Court in the last decade, old arbitral provisions are likely woefully outdated and may not afford the insurer the benefits of recent jurisprudence, including *Outokumpu*.

NOTES

1 *GE Energy Power Conversion Fr. SAS, Corp. v. Outokumpu Stainless USA, LLC,* __U.S. __, 140, S. Ct. 1637, 207 L. Ed. 2d 1 (2020).

2 The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, June 10, 1958). The Convention is implemented at 9 U.S.C. §§ 201, et seq., as Chapter 2 of the U.S. Federal Arbitration Act (FAA).

3 The Inter-American Convention on International Commercial Arbitration (Panama City, January 30, 1975). The Panama Convention is implemented at 9 U.S.C. §§ 301, et seq., Chapter 3 of the FAA. The Convention was promulgated at the conclusion of the First Specialized Inter-American Conference on Private International Law

sponsored by the Organization of American States.

4 *McCullough v. AIG Ins. H.K. Ltd.*, 828 Fed. Appx. 704; 2020 U.S. App. LEXIS 33907, 2020 WL 6301357 (11th Cir. Oct. 28, 2020).

5 E.g., *Francisco v. Stolt Achievement MT*, 293 F.3d 270, 273 (5th Cir. 2002).

6 E.g., *id.*

7 9 U.S.C. § 202; 9 U.S.C. § 302 (the Panama Convention incorporates, inter alia, 9 U.S.C. § 202 "as if specifically set forth herein, except that for the purposes of this chapter [9 USCS §§ 301 et seq.] 'the Convention' shall mean the [Panama Convention]."

8 28 U.S.C. § 1331 states that, "[t]he district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States."

9 9 U.S.C. § 205; 9 U.S.C. § 302 (the Panama Convention incorporates, inter alia, 9 U.S.C. § 205 "as if specifically set forth herein").

10 9 U.S.C. § 205.

11 9 U.S.C. § 16(a)(1)(c) ("an [interlocutory] appeal may be taken from … an order … denying an application under section 206 of this title to compel arbitration"). Interlocutory appeals in cases involving the Panama Convention are a bit convoluted because 9 U.S.C. § 16(a)(1) deals only with motions to compel under the New York Convention but not the Panama Convention. An interlocutory appeal for denial of a motion to compel arbitration under the Panama Convention can be founded under 9 U.S.C. §307, the residual provision of the enabling legislation. "Because Chapter 3 provides essentially no guidance to the district court with respect to the conduct of enforcement proceedings, a district court must turn to [9 U.S.C.] §4 for vital procedures, and §307 permits this borrowing [so] the application of §16 follows, because §16(a)(1)(B) is linked to §4." *Pine Top Receivables of Ill., LLC v. Banco de Seguros del Estado*, 771 F.3d 980, 989-90 (7th Cir. 2014), cert. denied, 576 U.S. 1055 (2015).

12 9 U.S.C. § 16(a).

13 Article 1 of the Panama Convention states that "[t]he agreement shall be set forth in an instrument signed by the parties, or in the form of an exchange of letters, telegrams, or telex communications."

14 140 S. Ct. at 1643-44, 207 L. Ed. 2d at 10 (citations omitted).

15 140 S. Ct. at 1645, 207 L. Ed. 2d at 12.

16 *McCullough v. Royal Caribbean Cruises, Ltd., et al.*, Case No. 16-cv-20194, 2019 U.S. Dist. LEXIS 79338, 2019 WL 2076192 (S.D. Fl. May 10, 2019).

17 "In Florida, a bad faith action against an insurance company may be brought … by a third party whose claim against the insurance policy was the subject of alleged bad faith. … A bad faith claim may be brought by a third party absent an assignment from the insured. See id." *Id.*, 2019 U.S. Dist. LEXIS 79338 at *6 (citation omitted).

18 *Outokumpu Stainless USA, LLC v. Converteam SAS*, 902 F.3d 1316, 1325 (11th Cir. 2018), vacated and remanded, *Outokumpu*, __ U.S. __, 140 S. Ct. 1637, 207 L. Ed. 2d 1.

19 *McCullough.*, 828 Fed. App'x. 705-06, 2020 U.S. App. LEXIS 33907 at *2-4.

20 *Henry Schein, Inc. v. Archer & White Sales, Inc.*, __ U.S. __, 139 S. Ct. 524, 202 L. Ed. 2d 480 (2019). The U.S. Court of Appeals for the Seventh Circuit has not yet addressed the issue. *Grabowski v. Platepass, L.L.C.*, 2021 U.S. Dist. LEXIS 92859 at *7, 2021 WL 1962379 (N.D. Ill. May 21, 2021) (following the consensus of the eleven other circuits).

21 *Blanton v. Domino's Pizza Franchising LLC*, 962 F.3d 842, 846 (6th Cir. 2020) (citing cases and so holding), cert. denied sub. nom., *Piersing v. Domino's Pizza Franchising LLC*, __ U.S. __, 41 S. Ct. 1268, 209 L. Ed. 2d 8 (2021).

22 The U.S. Const., Art. VI, cl. 2; treaties are "the supreme Law of the Land; and the Judges in every State shall be bound thereby, any thing [sic] in the Constitution or Laws of any State to the Contrary notwithstanding."

23 E. Cygal, et al., "State Law Restrictions on Arbitration of Insurance Coverage Disputes," ARIAS·U.S. *Quarterly*, 2nd Qtr. 2018; B. Briz, et al., "Which Law Is Supreme? The Interplay Between the New York Convention and The McCarran-Ferguson Act," *Univ. of Miami Law Rev.*, Vo. 74, No. 4, Art. 7 (June 23, 2020). The Ninth Circuit joined the Fourth and Fifth Circuits in August 2021 in *CLMS Mgmt. Servs. Limited P'ship, et al. v. Amwins Brokerage of Georgia LLC, et al.*, 9th Cir. Doc. No. 20-354282021, U.S. App. LEXIS 23996 (9th Cir. August 12, 2021).

Ed Lenci is a partner at Hinshaw & Culbertson LLP in New York. He litigates and arbitrates business disputes, including reinsurance disputes, and chairs the Reinsurance Section of Hinshaw & Culbertson's global Insurance Services Practice Group.