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REPRINTED FROM:
CORPORATE DISPUTES MAGAZINE
OCT-DEC 2019 ISSUE

www.corporatedisputesmagazine.com

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Published by Financier Worldwide Ltd
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www.corporatedisputesmagazine.com

PERSPECTIVES

THERE'S LIFE IN THE OLD DOG YET – THE USE OF ADR IN INSURANCE PRACTICE

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Both insurance/reinsurance and alternative dispute resolution (ADR) are founded in the same old tradition; namely, to further commerce through informality, speed, low cost and commercial realism. Historically, confidential binding arbitration has been used in the insurance arena to resolve disputes among insurers in the reinsurance context and between insureds and insurers under high excess catastrophic liability policies. In recent years, it has been resorted to more frequently in all types of insurance disputes involving coverage of first-party property claims and third-party claims, including claims under professional indemnity (PI) and directors and officers (D&O) policies.

The mechanics for dealing with and resolving disputes are increasingly provided for in well-drafted policy clauses that not only oblige the parties to pursue alternative means of dispute resolution (arbitration and mediation) but also ensure that such proceedings remain entirely confidential to

the parties for the protection of brand image or reputation.

In the insurance coverage context, arbitrations typically proceed under either: (i) the standard commercial arbitration model in which the parties nominate a single arbitrator or a tripartite panel of arbitrators; or (ii) a modified reinsurance model where the parties each select an arbitrator with insurance industry expertise or experience who in turn selects a neutral umpire, most likely a professional arbitrator (and frequently someone with a background in insurance).

There are several advantages to arbitrating insurance coverage disputes, including first-party and third-party claims. In international legal transactions, a prominent factor is that the international enforcement of arbitral awards under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 is often easier than enforcing state court judgments. Another advantage of arbitration is that obtaining a ruling on an issue of contract interpretation, which will affect each layer of insurance, is likely to occur far more expeditiously than in civil litigation. In terms of procedure, the parties can 'mix and match' in order to narrow the issues in dispute and make the fact-finding process more efficient. For instance, the parties to an arbitration can limit the scope of the oral hearing to deal with discrete factual issues, as opposed to a full-blown trial.

Especially in the coverage context, hearings are frequently streamlined and used for the purpose of oral argument or expert testimony rather than fact witnesses.

Arbitration may be advantageous, but getting agreement on an efficient arbitration process does require some work. Insureds – particularly large commercial entities – typically enter into separate policies with insurers organised in a tower of insurance with no direct contract between the insurers. Towers of insurance provide following-form coverage, meaning that a policy may stand alone for certain exclusions, conditions, etc., while relating back to the underlying coverage for most provisions. In terms of dispute resolution, sophisticated following-form constructions often require that the conditions for coverage for a particular exposure must be established vis-à-vis the primary insurer with binding effect for all other insurers. To an increasing degree, 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 also include the threshold issue of coverage.

As arbitration clauses are intrinsically linked to the reinsurance treaty, the reinsurance industry has created a number of specialised centres, such as, for example, the Insurance and Reinsurance Arbitration Society (ARIAS) and the French Reinsurance and Insurance Arbitration Center (CEFAREA). Those organisations provide standard arbitration clauses to facilitate and improve conflict management. In practice, essential provisions will have to be supplemented in those standard clauses. Whether they are included as part of the insurance policy or agreed to after a dispute has arisen, parties drafting arbitration agreements governing primary and excess policies should consider issues relating to scope, forum, governing rules (including with respect to document production), the number of arbitrators and how those arbitrators are appointed, consolidation, confidentiality, and the form of the award. Provisions of this kind are only indicative. The more precise the clause, however, the less problematic its applicability will be.

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Until recently, arbitration proceedings have been an infrequent occurrence in D&O insurance, at least for disputes regarding coverage. With respect to D&O, the main factor that has spurred the use of arbitration as a tool of dispute resolution is the policyholders' wish to speed up the settlement of claims in D&O insurance. This has also led to increased recourse to 'integrated' arbitration proceedings where the aim is to settle liability and coverage matters in one and the same process. A few new sets of terms and conditions already contain provisions providing for such kinds of proceedings. The intention is that the loss event and all the liability, as well as coverage aspects, are resolved exclusively by the policy holder and the D&O insurer. This is to be achieved by assigning the insured's indemnification entitlement to the company. In the direct action between the company and the D&O insurer, the matter of liability will be dealt with as an ancillary matter that is a requirement for the indemnification entitlement.

Mediation as an ADR tool is regularly used in professional indemnity disputes. ADR forums are written into policies as a step which must be taken before the parties can resort to litigation or arbitration. Against this background, the use of so-called 'escalation' provisions in the dispute resolution clauses of insurance policies is on the rise. Typically, provisions of this kind require a dispute to be referred to senior management within a company with a time period built in to allow the parties to try to negotiate before taking recourse to more formal processes of dispute resolution. Again, careful drafting at the outset is essential.

Settling even high value and complex disputes without recourse to litigation or arbitration may, however, not necessarily involve a formal ADR process, where standardised procedures are adopted. Besides providing a professional framework for settlement discussions, mediation can encourage the parties to focus their minds on the strengths and weaknesses of their case at an early stage. That by itself can help lead to an earlier settlement and is the primary reason why cases may settle soon after the mediation, even if the mediation itself was not successful. This is a positive development, although on occasion it can simply introduce an extra layer of costs and delay if either of the parties is not open to finding a consensual solution. However, if both parties are genuinely committed to trying to resolve their differences, mediation can offer a quicker and more cost-effective solution with the very real benefit that it leaves the parties' commercial relationship unscathed.

In the international insurance and reinsurance sector, the number of ADR proceedings has steadily increased over the past decade. While it cannot be denied that the threat of arbitration is often used to 'motivate' a contractual party to make certain claims payments, the times when disputes were exclusively settled without the intervention of a third party – be it an arbitrator or a mediator – have

long passed. Market developments, and especially significant higher loss values, have created a climate in which disagreements are more common. Driven by the pressures of profit expectations, large direct insurance groups adopt policies of aggressive claims management tactics, including dispute resolution. At least for the insurance of substantial risks, such as large industrial companies or significant individual risks, ADR is indeed a significant alternative to effectively resolve disputes in a reasonable and quick manner. CD

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