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INSURANCE LAW

For Insureds and Insurers, Complex Disputes Are Best Left to the Courts

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While binding arbitration can provide a convenient forum for specific types of claims, within the ambit of insurance coverage litigation, there are significant pitfalls to both insureds and insurers when arbitration is chosen as the dispute resolution forum as opposed to nonbinding mediation or court proceedings. In this article, it is assumed that the parties have unsuccessfully attempted nonbinding mediation and are now faced with the decision of where to prosecute their claims. At least with respect to complex insurance coverage disputes, courts typically represent a superior choice in four key respects: lower comparative total costs; uncompromised resolution on the merits; predictability; and guaranteed appellate review.

Cost

Save for filing fees or the unlikely discovery sanction, courts do no charge litigants to resolve their disputes. Aside from each party's respective litigation costs (e.g., attorneys and consultants fees), there is no added cost imposed upon litigants that correlates to the intensity with which they avail themselves of the court's services. On the other hand, arbitration inherently has the potential to impose significant costs that are in addition to the insurer and insured's legal fees depending on the litigants' use of the arbitration panel. The typical arbitration panel routinely consists of between one and three members; each is being compensated for services at a substantial hourly billable rate that is split between the parties. It is not unusual for even an ordinary discovery dispute to cost the parties thousands of dollars of arbitrators' fees. In a contentious or complex proceeding, the costs grow quickly

as panel members spend additional time to resolve ongoing interlocutory disputes. Further, arbitration has a substantial initial filing fee that in some instances is derived from the amount at issue; the greater the amount at issue correlates to a larger the filing fee. Additionally, in the event a party wishes to file a counterclaim or amend its complaint to include an additional claim, each of these actions carries with it another filing fee to be paid before the new claims will be considered.

While there is no argument that courts are overburdened, which can prolong litigation and potentially increase expense, courts still strive to efficiently, expeditiously and fairly resolve disputes. On the other hand, commercial arbitration is a service provided at a considerable hourly rate separately charged by each arbitrator who, whether fair or not, benefits directly from an increase in his involvement in the proceeding. From a cost/benefit analysis standpoint, when an insured challenges a coverage determination, an underlying event has taken place that the insured believes triggered its insurance policy. From the insured's perspective, this has the potential to be an uncovered loss. This loss must be considered in conjunction with the legal fees and with the expense of arbitration. Conversely, an insurer seeks to resolve a coverage dispute as efficiently as possible to minimize costs. In either event, in and of itself, the selection of arbitration as the forum to resolve the coverage dispute, more likely than not, will cost both parties thousands of dollars, in addition to legal expenses, before the coverage question is resolved.

Compromised Resolutions

The binary nature of an insurance contract dispute does not lend itself to express or informal compromise in the ultimate adjudication. Where courts are restricted by the text of the policy and application of relevant legal precedent, arbitration panels are not. Furthermore, arbitration panels, for fear of appearing sympathetic to one side, tend to take a "compromise" approach to preliminary disputes. This aversion to "hurting" either party during arbitration by way of engineered compromise in the end hurts one or both parties through a "half a loaf" methodology. Courts, on the other hand, have no such reservations about handing down one-sided determinations, even if the adverse consequences fall primarily or exclusively on one party, if stare decisis mandates such an outcome. While there is never a guarantee that a court will arrive at the "correct conclusion" as viewed from either side; nonetheless, there is an accountability to such decisions, which provides a degree of certainty that is absent in arbitration. In the context of coverage actions, where the final outcome is more often black and white or a zero sum game, the inherent interest of an arbitration panel compromising a claim seems to prevail, even when there is no policy language or legal authority to justify parsing out or withholding some measure coverage as opposed to fully granting or denying coverage.

While compromise of discovery disputes or the ultimate adjudication may seem attractive on its face, compromise also means either an insured is not getting as much coverage as it paid for or an insurer is paying for an uncovered loss. When this outcome is added to the inherent cost of arbitration, neither party truly prevails. When juxtaposing this comparatively losing proposition with the relative economy and uncompromised resolution provided by courts, arbitration is a less attractive option for the majority of complex coverage disputes.

Predictability

For both an insured and its insurer, accurately assessing the strength of one's position is of paramount importance. An insured can gauge the amount of legal fees it is willing to invest in pursuit of coverage. An insurer can make the business decision of how to handle a questionable claim. Courts provide an environment where, based on existing legal precedent, this can be accomplished with greater accuracy. Also, coverage disputes customarily constitute pure questions of law that are left for a court to decide, thereby removing the uncertainty

of a jury and significantly reducing discovery costs. On the other hand, arbitration panels hearing commercial disputes are governed by canons requiring, inter alia, just, independent and deliberate decisions, yet do not bind arbitration panels to a strict adherence to policy language or applicable precedent. This can make arbitrating a coverage dispute, even with a clear policy provision and well-settled point of law seemingly in your favor, an uncertain proposition.

Discovery is another unpredictable aspect of arbitration. Arbitration's rules of discovery are informal and ultimately governed by the respective panel making it difficult to predict which permutation of the rules will be in play. Although courts and arbitrations both approach discovery from the common starting point of a broad and liberal exchange of potentially relevant information, courts are constrained by the rules of discovery and case law interpreting those rules, each of which has been developed and refined over decades. Arbitrations do not share the same constraints. The result can be an insured not getting all of the information necessary to pursue a bad faith claim, or an insurer compelled to produce confidential and protected claims handling information that has little relevance to a coverage dispute. This lack of predictability obfuscates resolution and usually adds costs.

Absence of Review

After a court reaches a decision, it provides its findings of fact and its rationale. An aggrieved litigant has an opportunity to scrutinize the court's opinion and is entitled by right to challenge the decision. On the other hand, unless a specific request is made for a written opinion (which can create additional expense), arbitration panels may issue a final order without informing either of the participants as to how it reached the decision. This makes it extremely difficult to articulate how that decision fits into the narrowly defined criteria of when an arbitration award should be vacated.

In both Pennsylvania and New Jersey, the vacation of an arbitration award is governed, in part, by statute. These statutes primarily deal with an unlikely occurrence of a compromised arbitration process, such as a demonstrable lack of neutrality by a panel member. A mistake of law is not one of the stated grounds for vacating an award, which is an imperative consideration when the interpretation of an insurance policy is a pure question of law. The absence of a clear path to appellate review creates a risk of finality that is exclusive to arbitration.

There is an appellate arbitration process to review a panel's decision, yet this process includes an administrative fee of thousands of dollars for each party appealing an outcome that is exclusive of the additional hourly rates to be charged by the appellate arbitration panel. In addition to the substantial cost of an appellate arbitration, many of the aforementioned points favoring judicial resolution of a coverage dispute at the trial level are equivalently germane and show judicial appellate review to be a more attractive choice.

Conclusion

Arbitration may find a beneficial application in a number of specialized circumstances, especially those that are relatively simple in nature and lend themselves to a compromised resolution. However, any complex dispute between insureds and their insurers requires the predictable, economic and tested manner of resolution provided by the courts. •

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