State Law Restrictions on Arbitration of Insurance Coverage Disputes

By Everett J. Cygal and Robert Murphy

The reinsurance community has consistently supported arbitration as a means of resolving disputes. Indeed, a portion of the recent 2017 ARIAS-U.S. Fall Conference was devoted to the issue of arbitration of direct insurance disputes. The consensus of most of those presentations was that, in many contexts involving sophisticated insureds, arbitration of coverage disputes before panels of industry experts can provide benefits to both insurer and insured.

Many of the conference participants urged the insurance industry to expand the use of arbitration clauses in at least some of the policies it issues. This article considers whether arbitration clauses, when included in a policy of insurance, are enforceable. We conclude that, in many states, arbitration clauses are not enforceable.

Statutory Exclusions

A significant number of states, including those that have enacted one of the prevailing versions of the Uniform Arbitration Act (UAA), have restricted binding arbitration clauses in insurance contracts. These restrictions are typically found in one of two places: general laws governing arbitration and state insurance codes.

States with valid insurance contract exclusions in their general arbitration laws include Georgia, Kansas, Kentucky, Louisiana, Maryland, Missouri, Montana, Nebraska, Oklahoma, South Carolina, and South Dakota. States with arbitration exclusions in their insurance codes include Hawaii, Virginia, and Washington.

A few states have exclusions for particular types of insurance contracts: Illinois (imposing additional requirements to arbitrate health care negligence claims); Iowa (voiding arbitration clauses in adhesion contracts); Mississippi (voiding arbitration clauses in uninsured motorist policies); Rhode Island (voiding arbitration clauses in uninsured motorist policies); West Virginia (voiding clauses in uninsured and underinsured motorist policies); and Wyoming (barring the inclusion of arbitration clauses, when included in a policy of insurance, are enforceable. We conclude that, in many states, arbitration clauses are not enforceable.

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clauses in uninsured motorist coverage, but allowing such terms if contained in a separate written agreement). In Rhode Island, arbitration is allowed only at the option of the insured.

A small number of states also impose explicit opt-out or disclosure requirements on arbitration clauses in insurance contracts: California (imposing disclosure requirements for arbitration clauses in health care service plans); Nevada (imposing arbitration clause opt-out requirements in health care insurance contracts); and Tennessee (requiring insureds to sign or initial arbitration clauses in some specific contexts, including insurance policies relating to residential or farm properties). This is in addition to the general regulatory requirement in many states that an insurer specifically notify insureds at the time of renewal about changes in policy terms.

Sometimes these limited or special restrictions apply only to certain kinds of personal lines coverages. For example, Maryland’s statute voids arbitration clauses in contracts where the insured is an individual, Oklahoma only allows insurance arbitration clauses when the insurance is “between insurance companies,” and Iowa refuses to enforce arbitration clauses in “contracts of adhesion.”

Arbitration of disputes involving reinsurance and other forms of risk transfer between insurance companies is usually not restricted, presumably on that theory that it constitutes “insurance between consenting adults.”

But some state’s exemptions are not so circumscribed and at least arguably apply to reinsurance contracts as well: South Carolina, Virginia, and Washington all feature language voiding any arbitration clause in any contract for insurance.

Interplay Between the FAA and McCarran-Ferguson

Under the Federal Arbitration Act (FAA), an arbitration clause in a contract involved in interstate commerce is “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract,” and the FAA pre-empts state laws requiring a judicial forum for resolution of claims. This language reflects a “liberal federal policy favoring arbitration” and pre-empts state laws “prohibit[ing] outright the arbitration of a particular type of claim.”

The McCarran-Ferguson Act, on the other hand, was enacted to limit congressional pre-emption of state regulation of insurance. Under McCarran-Ferguson, “[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.”

Thus, in certain circumstances, McCarran-Ferguson exempts state laws from FAA pre-emption. Briefly, McCarran-Ferguson would reverse pre-empt the FAA only if “(1) the FAA does not specifically relate to insurance; (2) the state law invalidating the arbitration agreement was enacted to regulate the business of insurance; and (3) the FAA would invalidate, impair, or supersede that state law.”

In the great majority of circumstances, a narrowly directed state statute invalidating arbitration of coverage disputes will meet the above tests and be sustained. To better understand the limits of McCarran-Ferguson reverse pre-emption, it may be useful to review a handful of cases in which arbitration bans were not sustained by the state courts, notwithstanding a state law prohibiting arbitration of coverage disputes.

The Alabama Supreme Court, in Central Reserve Life Insurance Co. v. Fox (Hon. Roy Moore dissenting), invalidated a law that on its face banned arbitration of coverage disputes, but the court never referenced McCarran-Ferguson in its decision. There is a good reason it
didn’t: the anti-arbitration statute applied to all contracts, not just contracts of insurance. Thus, the statute was not part of an overall scheme of insurance regulation and did not fall within the scope of McCarran-Ferguson.

In Courville v. Allied Professionals Insurance Co., the court held that, as a general matter, McCarran-Ferguson does pre-empt the FAA. In the unique circumstances before the court, however, the state law prohibiting arbitration was itself pre-empted by an obscure federal statute, the Liability Risk Retention Act of 1986 (LRRA), thus rendering the McCarran-Ferguson reverse pre-emption inapplicable.16

Towe Hester & Erwin, Inc. v. Kansas City Fire & Marine Insurance Co. and Bixler v. Next Fin. Grp., Inc. involved suits against an insurance agency (Towe Hester) and a broker selling a variable annuity insurance contract (Bixler).17 As the courts properly pointed out, however, an insurance agency is not involved in the “business of insurance” as the Supreme Court has defined the term in its decisions involving the McCarran-Ferguson Act. McCarran-Ferguson only reaches activity constituting the narrowly defined “business of insurance,” which in turn usually involves the regulation of insurer-insured relationships.

Finally, Little v. Allstate Insurance Co. involved the not-uncommon situation of the state arbitration act (in this case, Vermont’s) excluding arbitration of insurance coverage disputes from the scope of the act.18 The court reasoned that this exclusion meant that the validity of agreements to arbitrate coverage disputes were thus determined by reference to Vermont common law. While Vermont common law apparently rendered arbitrations unenforce-
able, the court held that the common law was not “enacted” for the purpose of regulating insurance and thus was not subject to the protection of the McCarran-Ferguson Act. In the absence of McCarran-Ferguson protection, Vermont’s common law prohibition on arbitration was pre-empted by the FAA.

While Little appears to be the only state court case of its kind, many state arbitration acts similarly exclude arbitration of insurance from the scope of the act. These state statutes are commonly thought to prohibit arbitration of coverage disputes, but Little demonstrates there is another way to interpret these statutes.

**Conclusion**

There are a number of reasons why many insurance coverage lawyers believe that arbitration could be made more generally available for resolution of coverage disputes. After all, coverage arbitration is not generally prohibited under the laws of many of the most important commercial states, like New York, California, Texas, Illinois, Ohio, and New Jersey. The prevalence of Bermuda Form arbitrations is another factor encouraging those who advocate arbitration of coverage disputes. Even so, coverage arbitration is arguably prohibited in about a dozen and a half states (including Georgia, Maryland, Virginia, and Washington), and that fact alone places real constraints on the viability of including arbitration clauses in insurance policies.

While there is little case law interpreting the reach of state arbitration coverage exclusions, it is only prudent to expect litigation regarding the enforceability of an arbitration clause if one is included. A resolution of that issue will depend on many factors, including where a risk or insured is determined to be located. In an age where commercial insurers routinely conduct their businesses in numerous jurisdictions, it is impractical to expect that an underwriter could determine, at the time of policy issuance, whether an arbitration clause is appropriate in a particular case, especially when even a demand for arbitration might give rise in some states to a claim for extra-contractual damages.

**NOTES**

1. Many states, either in their insurance codes or in their specific version of the Uniform Arbitration Act, have expressly prohibited the arbitration of insurance coverage disputes. States have liberally altered the supposedly “uniform” UAA so that it does not compel arbitration of insurance contracts. See, e.g., Neb. Rev. Stat. § 25-2602.01(l)(4) (binding arbitration provision in UAA does not apply to insurance policies in most cases). So, while the UAA provides a common foundation for many states’ arbitration laws, it does not create actual uniformity.

2. Furthermore, there are two different UAA— the 1955 version (amended in 1956) and the 2000 version—and both are called the Uniform Arbitration Act. In fact, there are some states that have enacted both the 1955 UAA and the 2000 UAA. In Arizona, a court used the 1955 form of the UAA to work around a provision in the revised UAA stating that the 2000 UAA did not apply to arbitration clauses in insurance contracts. Tessler v. Progressive Preferred Insurance Co., 2015 WL 5612123, at *3 n.6 (Ariz. Ct. App. Sept. 24, 2015).

3. GA. CODE ANN. § 9-9-2(c)(3); KAN. STAT. ANN. § 5-401(c)(1) (although there have been attempts to amend this, such as 2017 Kansas House Bill 2186); KY. REV. STAT. ANN. § 417.050(2); LA. STAT. ANN. § 22:866; MD CODE ANN., (CTS. & JUD. PROC.) § 3-206.1; MO. REV. STAT. § 433-350, MONT. CODE ANN. § 27-5-114(2c); NEB. REV. STAT. § 25-2602.01(l)(4); OK. STAT. tit. 12, § 1855; S. C. CODE ANN. § 15-48-10(b)(4); S.D. CODIFIED LAWS § 21-25A-3 (does not apply to insurance policies).

4. 710 ILL. COMP. STAT 15/3 et seq; IOWA CODE § 679A.1(2)(a); MISS. CODE ANN. § 83-11-109; N.J. GEN. LAWS § 37:4-13; N.M. CODE ANN. § 38-3-6-31(g); WYO. ADMIN. CODE INS. Ch. 23, § 7.

5. See R.I. GEN. LAWS § 10-3-2 (allowing arbitration at the option of the insured).


7. See, e.g., ILL. ADMIN. CODE tit. 50, § 753.10; WASH. ADMIN. CODE § 284-44A-050.

8. MD CODE ANN., (CTS. & JUD. PROC.) § 3-206.1; OKLA. STAT. tit. 12 § 1855; IOWA CODE § 679A.1(2a).

9. GA. CODE ANN. § 9-9-2(c)(3); K.Y. REV. STAT. ANN. § 417.050(2); NEB. REV. STAT. § 25-2602.01(l)(4).


19. See GA. CODE ANN. § 9-9-2(c)(3) (arbitration provisions “shall not apply” to “any contract of insurance”); KAN. STAT. ANN. § 5-401(c) (provisions of arbitration act “shall not apply to ... [c]ontracts of insurance”); NEB REV. STAT. § 25-2602.01(l)(4) (“does not apply to ... any agreement relating to an insurance policy other than a contract between insurance companies including a reinsurance contract”); OK. STAT. tit. 12, § 1855 (“shall not apply to ... contracts with reference to insurance except for those contracts between insurance companies”); S.D. CODIFIED LAWS § 21-25A-3 (“does not apply to insurance policies”).

20. There are very few cases construing the scope of the various state statutes restricting arbitration of coverage disputes. That is a little surprising, since the statutes are frequently ambiguously drafted and there are numerous circumstances in which the statute might or might not apply. Take, for example, GA. CODE ANN. § 9-9-2(c)(3), which provides in pertinent part: “this part shall not apply to: (f) Any contract of insurance, as defined in paragraph (1) of Code Section 33-1-2; provided, however, that nothing in this paragraph shall impair or prohibit the enforcement of or in any way invalidate an arbitration clause or provision in a contract between insurance companies.” Read literally, all the Georgia statute provides is that the Georgia Arbitration Code does not apply to arbitration of coverage disputes, not that such arbitration is restricted. That might be a question to be resolved under Georgia common law, as was a similar issue in Vermont, Little v. Allstate Insurance Co., 705 A.2d 538, 539 (Vt. 1997). Even if the Georgia statute and others like it are construed to prohibit coverage arbitration, the question remains: What is the scope of that prohibition? Would it apply to all policies written by an insurer domiciled in Georgia, or just to risks and insureds located in Georgia? Is the scope of the prohibition coextensive with the application of Georgia law to the insurance policy, or is it broader or narrower? Those are good and unresolved questions, but are the proper subject of another article.