Introduction:

Form contracts for consumer goods and services increasingly contain provisions either allowing the company to require that disputes be arbitrated rather than litigated in open court, or making it permissive if both sides agree. Arbitration is often championed as being both cheaper and faster than litigation, but this is often not the case, and since arbitration is usually confidential, it reduces the scrutiny of state and federal regulatory and law enforcement officials over the practices of financial services and consumer products providers. Government agencies, the media, consumer groups and academics are investigating the use of these provisions and they are leading the growing chorus of criticism over consumer arbitration provisions (selected references are at the end of this memo). Last fall the New York Time conducted an in-depth investigation on this issue and the first of three articles is attached.

Insurance and Arbitration Clauses:

Commercial insurance policies frequently contain arbitration clauses, especially in professional liability lines. While personal lines policies typically do not (yet) contain arbitration clauses, a few do, and without state regulatory or legislative intervention, this anti-consumer trend will likely grow. Here are several examples:

- **ALTA Homeowners Policy of Title Insurance (2013)**
  Arbitration
  a. If permitted in the state where the Land is located, You or We may demand arbitration.
  b. The law used in the arbitration is the law of the state where the Land is located.
  c. The arbitration shall be under the Title Insurance Arbitration Rules of the American Land Title Association (“Rules”). You can get a copy of the Rules from Us.
  d. Except as provided in the Rules, You cannot join or consolidate Your claim or controversy with claims or controversies of other persons.
  e. The arbitration shall be binding on both You and Us. The arbitration shall decide any matter in dispute between You and Us.
  f. The arbitration award may be entered as a judgment in the proper court.

- **Farmers Next Generation Homeowners Policy (Nevada, Missouri)**
  Allstate Homeowners Policy (Missouri)
  Arbitration
  Any claim or dispute related to this policy, by an insured against us or us against an insured, may be resolved by arbitration only upon mutual consent of us and the other party subject to:
  a. no arbitrator has the authority to award punitive damages, exemplary damages or attorney’s fees;
  b. neither of the parties are entitled to arbitrate any claims or disputes in a representative capacity or as a member of a class; and
c. No arbitrator has the authority, without the mutual consent of the parties, to consolidate claims or disputes in arbitration.

Note: the Farmers’ and Allstate policies do not mandate arbitration but require both the insurer and policyholder to agree to use it.

- **American United Life Insurance Company, Group Disability Policy**  
  Section 7A-Claim Procedures

  ARBITRATION: Any controversy or claim arising out of or relating to the Group Policy, the sale or solicitation of the Group Policy, or its breach thereof whether in tort, contract, breach of duty (including but not limited to) any alleged fiduciary, good faith and fair dealing duties, shall be decided by arbitration in accordance with the Federal Arbitration Act ...

States have traditionally regulated both insurer conduct (e.g. Unfair Trade Practices Acts) and the content of insurance policy forms (financial responsibility laws, the New York Standard Fire Policy Form). While states often vary in how they do so - such as the penalties for an insurer’s breach of contract – state insurance statutes and regulations have the same central philosophy: that policyholder and consumer protection is paramount. Arbitration provisions jeopardize these goals and threaten a state’s ability to protect insurance consumers. Problems include:

- Consumers are usually unaware that the contracts they have signed contain arbitration provisions, are even less likely to understand the rights they are giving up even if they read the provisions, and often have no realistic opportunity to do anything other than consent - especially if market competitors employ similar practices. Courts have long recognized the “fiction” that consumers have freely (knowingly) agreed to such terms.

- Prohibiting policyholder remedies available under state law, such as recoupment of attorney’s fees, damages for “bad faith” (statutory or common law), and similar laws allowing policyholders who are successful in litigation against their insurers to obtain full compensation, and when applicable under state law, obtain exemplary damages as a method of deterring improper insurer conduct. The Farmers and Allstate policies cited above purport to eliminate these remedies.

- Requiring the consumer to pay 50% of the arbitrators’ fees, which diminishes the ability to initiate or participate in arbitration, and if only one party (i.e., the insurer) can enforce the arbitration provision, these costs can in effect strip the policyholder of her rights under state law, since she has “agreed” not to go to court.

- Arbitration decisions are typically confidential and cannot be appealed to the courts, except under limited circumstances (e.g. fraud). This practice hinders state oversight over insurer conduct and its ability to respond to consumer complaints.
Arbitration clauses usually ban consumers from aggregating claims with other consumers in the arbitration action (no class actions), further reducing a consumer’s financial ability to pursue a claim, and making it difficult for an individual policyholder to demonstrate, for example, a pattern or practice of wrongful conduct, which is required under some state insurance laws.

Approximately half the states have statutes or regulations prohibiting or restricting the use of arbitration provisions in various lines of insurance. State efforts to limit (or eliminate) arbitration clauses have been restricted by a series of recent U.S. Supreme Court decisions interpreting the 1925 Federal Arbitration Act (FAA) as preempting state laws affecting a company’s ability to enforce pre-dispute arbitration clauses. Fortunately, however, because the FAA is silent on its application to insurance contracts, states have strong legal arguments under the McCarran-Ferguson Act that they can regulate the use of arbitration provisions in insurance, including forbidding their use outright. This issue has been litigated in a number of jurisdictions, with most (but not all) decisions supporting a state’s regulatory authority, though the U.S. Supreme Court has not ruled on this issue.

What can States Do?

- Determine which insurers are currently using arbitration clauses in your jurisdiction, in what lines, and the arbitration restrictions and requirements.

- Review applicable state laws and regulations and propose legislation or promulgate rules to allow the insurance department to ban or limit the use of arbitration provisions as appropriate. Make explicit that these laws apply to the “business of insurance” or otherwise acknowledge the intent to bring them within McCarran-Ferguson.

- Obtain data from each insurer utilizing arbitration clauses on the number of arbitrations actually entered into, which party initiated the arbitration, damages sought and awarded (if any), the length of time to conclude the arbitration, final allocation of arbitrator fees and costs, and percentage of arbitrations resolved prior to a decision. If insurers are not collecting this information then we have a double problem – no one knows how arbitration clauses are affecting policyholders and insurance regulations.

- While arbitration provisions requiring mutual consent may be less problematic, regulators still need to understand how they operate in practice, including how the arbitration option is presented to the policyholder during a dispute, and information on arbitration results described above.
Selected References

- Consumer Financial Protection Bureau
  - Remarks of CFPB Director Cordray (February 18, 2016)

- Federal Trade Commission: retains ban on binding arbitration clauses in warranty contracts,


- Consumers Union: “Forcing Consumers into Arbitration,” November 6, 2015
  http://consumersunion.org/2015/11/forcing-consumers-into-arbitration/

  http://www.citizen.org/congress/article_redirect.cfm?ID=6560
  (good state-by-state resource, but not necessarily up to date)


