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The International Comparative Legal Guide to:

# Insurance & Reinsurance 2013

**2nd Edition**

A practical cross-border insight into insurance and reinsurance law

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# The International Comparative Legal Guide to: Insurance & Reinsurance 2013

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## General Chapters:



## Country Question and Answer Chapters:

# USA

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## 1 Regulatory

### 1.1 Which government bodies/agencies regulate insurance (and reinsurance) companies?

With limited exceptions, the insurance industry in the United States is regulated by state governments. Individual state legislatures set policy and fund state insurance departments, which establish rules and regulations and enforce them. State regulators coordinate their insurance activities through participation in the National Association of Insurance Commissioners ("NAIC"), an organisation that provides state commissioners with a forum to address issues of common concern and to promote policies. The NAIC drafts model laws and regulations which often form the basis for statutes and regulations enacted by individual states.

The U.S. Congress has historically restricted the federal government's role in the regulation of insurance. The 2010 passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act might indicate a change. The Act created a Financial Stability Oversight Council, which is not a regulator but a 15-member body designed to monitor the stability of the U.S. financial system (including the insurance industry), identify risks, and coordinate responses to them. The Act also created a Federal Insurance Office, another monitoring body that collects information and advises federal agencies and state regulators on systemic risks to the financial stability of the insurance sector. Other areas of federal oversight are limited and do not significantly affect regulation of the insurance industry by the individual states.

### 1.2 What are the requirements/procedures for setting up a new insurance (or reinsurance) company?

The formation of a new insurance company is governed by the laws of the state where the company will be licensed. The company can expect requirements relating to capital and surplus levels, rates, the type and size of risks to be written, and the policy forms to be used. Both insurance and reinsurance companies are subject to posting some form of collateral based upon the size of their U.S. risks, whether in the form of deposits or the formation of a trust fund, and/or participation in state-run guaranty programme to protect policyholders should the company become insolvent. There may be differences in the applicable formation rules depending on the type of entity being created (e.g., a joint stock company vs. a mutual corporation).

An insurance entity can avoid some state requirements by purchasing a shell company (one with the required licences but no insurance liabilities) that is domiciled in the desired jurisdiction. Shell companies in more populated states and those with multiple state licences are likely to be more costly to acquire. Further, although purchasing a shell allows a new company to circumvent some costly or time-consuming regulatory requirements, the acquisition of the shell will not by itself be sufficient. Among other things, the new company will still have to meet capital and surplus requirements and obtain required ratings and licences for a new owner. Nonetheless, acquisition of a shell can provide a significant head start for a new owner and may be a viable option to consider.

### 1.3 Are foreign insurers able to write business directly or must they write reinsurance of a domestic insurer?

A foreign insurer can be licensed in a state and write insurance directly as an "admitted insurer". To do this the insurer must establish a U.S. branch, appoint a local manager, and obtain a licence from the state insurance department. As described in the response to question 1.2 above, obtaining a licence requires compliance with state regulations governing such matters as the insurer's solvency, rates, forms, conduct, leverage, affiliate relationships, and establishment of a trust fund to satisfy projected liabilities. An admitted insurer also will likely be required to participate in a government-mandated programme to protect policyholders against possible insolvency.

A foreign insurer may write business in a state as a "non-admitted" insurer through surplus lines laws, which allow unlicensed companies to place certain risks not generally available from admitted companies. Surplus lines business is typically placed through a licensed surplus lines broker. States have their own rules regarding which type of business may be written as surplus lines, with some requiring a determination that the required coverage is unavailable in the admitted market, and others maintaining "export lists" – pre-approved lists of the types of risks that may be placed as surplus lines business. In many states, certain categories of risks or policyholders are exempt from surplus lines requirements, such as certain industrial, ocean marine, and transportation risks.

Another way a non-admitted foreign insurer may obtain business in a state is through direct placement by an insured who seeks insurance directly from a carrier located outside the insured's home state. This type of placement typically requires that the insured have no access to the insurer through an agent or broker in the state where the risk is located. It also requires that the insurer not make or perform the contract in the state where the risk is located.

### 1.4 Are there any legal rules that restrict the parties' freedom of contract by implying extraneous terms into (all or some) contracts of insurance?

Yes. U.S. law dictates the terms of insurance contracts in two principal ways: (i) legislation or administrative regulations may mandate or prohibit certain terms in insurance contracts; and (ii) judicially-developed doctrines may imply certain terms into insurance contracts.

As noted above, regulation of insurance companies is a state responsibility. State legislatures delegate to departments of insurance the authority to promulgate rules requiring certain terms that must – or must not – be included in particular types of insurance contracts. For instance, a state regulation might require insurance policies to provide that an insurer cannot cancel coverage without a specific period of advance notice to the insured, or that the insurer must offer the insured an opportunity to purchase transitional coverage in the event of cancellation. In addition, a state insurance department may forbid insurers from using particular forms or incorporating particular terms unless those provisions are submitted to and approved by the department. The purposes of such regulations vary, but often a principal goal is to protect public welfare by ensuring that unsophisticated purchasers of insurance understand the products they are buying and are not misled or exploited by an unscrupulous or careless insurer or rogue insurance agent. Another objective of mandatory terms is to ensure that insurance coverage of a certain type or scope is available to the public. Terms may also be required in policies issued by non-admitted insurers (such as a "service of suit" clause) to ensure that the local courts have jurisdiction over them – and can enforce possible judgments against them – in the event of a dispute over coverage.

A key term implied by courts in every contract is the duty of good faith and fair dealing. In the insurance realm, this implied duty of good faith is often litigated in the context of alleged insurer bad faith, such as a policyholder's contention that its primary insurer committed bad faith by refusing to pay to settle a claim within policy limits, thus exposing the policyholder to a judgment above the limits of its insurance. Alternatively, a policyholder may allege that its insurer denied its insurance claim in bad faith, i.e., without a reasonable basis for the denial.

Related to the duty of good faith and fair dealing is the doctrine of *uberrima fidei*, or "utmost good faith". In the U.S., this doctrine is an element of reinsurance relationships, but is also applied in the direct insurance context, particularly in disputes about marine insurance or business placed in the London Insurance Market. Utmost good faith is not, strictly speaking, limited to a contractual duty because it arises even before a contract is formed – for instance, the duty of utmost good faith requires an insured seeking to insure a risk to disclose to the prospective insurer all material circumstances regarding the risk, whether or not the insurer specifically inquires into such circumstances.

Another term implied in insurance contracts is the requirement of fortuity. U.S. courts recognise the principle that, in general, insurance contracts are intended to cover fortuitous losses and not those that are substantially probable to occur at the time an insurance policy incepts. The requirement of fortuity is sometimes referred to as the "known loss" doctrine.

In addition to implying or mandating terms in insurance contracts, the law also provides certain rules of construction to determine the meaning of particular insurance contract terms, as discussed in the response to question 2.1 below.

### 1.5 Are companies permitted to indemnify directors and officers under local company law?

Yes. Every state allows corporate indemnification. The relevant statutes generally allow companies to indemnify any person serving as a director or officer of the company if the person's actions are taken in good faith and with the reasonable belief that the conduct is in the company's best interest. However, the statutes also typically allow indemnification only if disinterested directors, independent legal counsel, or a court determine that an individual's conduct warrants it.

Most indemnification statutes give corporations the discretion to include terms and conditions in the company bylaws regarding indemnification and advancement of expenses, so long as the terms and conditions do not violate the statutes. Courts typically enforce the terms of the bylaws as if enforcing the terms of a contract. It is important to note that courts tend to view "indemnification" and "advancement" as discrete concepts, so if an indemnification provision does not specifically provide for advancement of defence costs, directors and officers likely will not be entitled to advancement. They instead would have the right to reimbursement of costs only after the investigation or litigation is complete.

### 1.6 Are there any forms of compulsory insurance?

Yes. Government entities most often provide for compulsory insurance of three classes of risk. One class includes risks that are considered inherently dangerous, such as manufacturing of hazardous chemicals or explosives. Another includes risks in which a single event could cause harm to large numbers of people or extensive property damage, such as the operation of a nuclear energy facility. The third includes risks in which frequent accidents are likely across a large population, such as the operation of automobiles and other heavy machinery.

There are other types of compulsory insurance, including worker's compensation insurance and the recently-enacted federal law requiring individuals to obtain health insurance. The purpose of worker's compensation insurance is to provide benefits to employees injured while on the job (usually in the form of medical benefits and compensation for lost wages). In most states this insurance is only available in the private market, but a few states operate their own worker's compensation systems. The requirement to purchase health insurance is provided in the 2010 Patient Protection and Affordable Care Act, which requires that individuals not otherwise covered by public insurance purchase an approved health insurance policy or pay a penalty.

## 2 (Re)insurance Claims

### 2.1 In general terms, is the substantive law relating to insurance more favourable to insurers or insureds?

In a federal government structure with dozens of federal courts and fifty autonomous state court systems, it is impossible to make sweeping generalisations about whether the substantive law or the judiciary favours insureds or insurers. However, a number of American jurisdictions, and individual judges, have reputations of being biased toward insureds, and one would be hard-pressed to identify courts or jurists with the opposite reputation of being biased in favour of insurers. Moreover, individual jurors may take anti-insurer biases with them into deliberations, and pro-insurer bias among jurors is essentially unheard of. Nonetheless, in coverage disputes many important questions – such as the meaning

of insurance policy provisions – are decided by courts not jurors, and many judges can be expected to apply the governing law to coverage issues in a fair-minded manner.

It may be more instructive to evaluate the "pro-insured vs. pro-insurer" question in the context of specific insurance principles. For instance, a fundamental tenet of insurance law that can work to the benefit of insurers is the ubiquitous rule that the insured has the initial burden of proving that a claim falls within the terms of insurance coverage. If the facts necessary to establish coverage are difficult or impossible to ascertain, this principle may be dispositive of a coverage dispute. On the other hand, coverage disputes often turn on contract interpretation, and many interpretive rules favour insureds. For instance, courts typically will construe exclusions to coverage narrowly. (Insurers also generally have the burden of proving that an exclusion to coverage applies to a particular claim.) An important principle applied by many courts that can favour insureds is the doctrine of *contra preferentem*, an interpretive rule that provides that ambiguous terms in an insurance contract should be construed against the drafter, often found to be the insurer.

The law may also favour insureds by imposing certain requirements that are not expressly stated in an insurance contract. For example, a typical condition in an occurrence-based policy is that the insured provide the insurer with timely notice of claims. Most courts interpret this provision to preclude coverage only if the insurer has been prejudiced by untimely notice, even though a requirement that the insurer show prejudice is not found in the express terms of the notice provision.

### 2.2 Can a third party bring a direct action against an insurer?

Only parties in privity of contract have the right to sue on the contract. In the insurance context, this means that generally only the insured (and not a third-party claimant against the insured) may sue an insurer on a liability policy. However, if a third party is assigned the insured's rights under the policy then it may directly sue an insurer. Because of the general restrictions imposed by the "privity" rule, some states have "direct action" statutes on their books, which allow injured parties to directly sue a tortfeasor's liability insurer. These statutes typically require the injured party to obtain a judgment against the tortfeasor before filing a separate suit against the insurer. Exceptions to this rule are the laws of Louisiana, Wisconsin, and Puerto Rico, which permit a claimant to sue the alleged tortfeasor's insurer without first obtaining a judgment. A few other jurisdictions allow direct actions in certain limited circumstances, such as where the alleged tortfeasor cannot be found.

### 2.3 Can an insured bring a direct action against a reinsurer?

An insured generally cannot bring a direct action against a reinsurer in a U.S. court. The main reason for this is again the "privity" rule – the insured typically has no contractual relationship with the reinsurer. Courts have largely rejected arguments by policyholders that they are third-party beneficiaries of reinsurance contracts (absent express provisions in the contract), or that an insolvent direct insurer was effectively an agent of the reinsurer.

There are exceptions to the general rule which are applied in some circumstances. For instance, a reinsurer and direct insurer may include a "cut through" clause in the reinsurance agreement, providing that if the direct insurer is insolvent or otherwise fails to pay, the insured may take direct action against the reinsurer. In addition, a reinsurer might agree to a novation of the direct policy and thereby assume the direct insurer's liabilities.

Additionally, courts have allowed direct actions by insureds against reinsurers in fronting or other similar arrangements where a reinsurer was viewed as effectively acting as a direct insurer, e.g., where the reinsurer was handling direct claims made to the insurer. Moreover, a direct action has been permitted against a reinsurer where the insured is found to be a third party beneficiary under the reinsurance contract.

### 2.4 What remedies does an insurer have in cases of either misrepresentation or non-disclosure by the insured?

If an insured (or reinsured) misrepresents or fails to disclose a material fact concerning the risk to be insured when the coverage is placed, the insurer or reinsurer may be able to rescind the contract. Alternatively, the insurer may be able to sue for damages based on fraud or negligent misrepresentation. A fact concerning a risk is "material" if it may have influenced the insurer's decision to accept the risk, or the premium or other terms upon which the risk would be insured. In some courts, rescission may be available for even "innocent" misrepresentations; in others, some degree of culpability by the insured may be required. Reformation of the contract is another potential remedy for misrepresentation or non-disclosure, but it is less often pursued.

Some courts have imposed restrictions on the types of misrepresentations that can justify rescission or fraud/negligence damages. For instance, a court might refuse to grant relief where the misrepresentation strictly concerns a matter of opinion. Insureds may argue, for example, that projections of future events are matters of opinion and not facts on which a claim of rescission or fraud damages can be based. (Courts have disagreed, although the bases for such determinations may be fact-specific.) In addition, the insurer must demonstrate that it relied to its detriment on the misrepresentation. (The facts that will establish "materiality" and reliance often overlap.) Many courts require such reliance to be reasonable or justifiable in the circumstances.

In particular situations, a rescission claim may have advantages over an action for damages, and *vice versa*. Damages for misrepresentation or nondisclosure generally require proof of culpable conduct by the policyholder – at least negligence and, in some jurisdictions, fraud. As noted above, some courts permit rescission as an equitable remedy even if the misrepresentation was "innocent." On the other hand, rescission is subject to procedural requirements that do not apply to a damages claim. For instance, some jurisdictions may require an insurer seeking rescission to return to the policyholder, at the outset of a rescission action, all premium (plus interest) that the insurer received in connection with the insurance contract. A rescission claim also might be waived if it is not asserted within a reasonable period of time, or if an insurer engages in conduct that is inconsistent with its position that the contract is void (such as accepting additional premium under the contract after discovering grounds for rescission). Because the requirements of each form of relief are different, an insurer seeking relief may initially plead entitlement to both rescission and damages in the alternative, although generally only one form of remedy ultimately may be obtained.

### 2.5 Is there a positive duty on an insured to disclose to insurers all matters material to a risk, irrespective of whether the insurer has specifically asked about them?

Whether relief is available for non-disclosure of a material fact (as opposed to an affirmative misstatement) depends on the jurisdiction, as well as the circumstances of the placement of coverage. While some courts have declined to recognise a general

duty of full disclosure for contracting parties, most jurisdictions apply principles regarding disclosure which can be significant in the insurance and reinsurance context. Courts have found that a duty of full disclosure exists where there is a relationship of trust and confidence between the parties to a transaction; where, based on the circumstances of a transaction, such as applicable custom and practice, the contracting parties or their representatives recognise a requirement of full disclosure; or where a party has made a partial disclosure of information that requires full disclosure to prevent the partial disclosure from creating a misleading impression. A duty of full disclosure can also arise where one party possesses superior knowledge, not readily available to the other, and knows that the other is acting on the basis of mistaken knowledge. Courts may apply a duty of full disclosure where the failure to disclose amounts to a knowing concealment.

Courts addressing reinsurance disputes have found a duty of full disclosure based on the "duty of utmost good faith" that exists between a reinsured and reinsurer. Such a duty also exists with respect to marine insurance placements, and applies as a matter of custom and practice to risks placed in the London Insurance Market. U.S. courts have also found a duty of full disclosure in other insurance contexts on the basis of the duty of utmost good faith or other relationship of trust and confidence.

### 2.6 Is there an automatic right of subrogation upon payment of an indemnity by the insurer or does an insurer need a separate clause entitling subrogation?

For the most part, an insurer paying a third-party claim has a right of subrogation under statutory or common law, and an express contractual provision providing for subrogation rights typically is not required. The right is not automatic in all situations, however. Subrogation is based on the equitable principle that fairness requires a loss be borne by the party responsible, and an indemnifying insurer therefore should have a right of recovery against that party. In practice, the existence and scope of the right depends on the relevant state law and the facts of the case. Therefore, while subrogation is usually available to an indemnifying insurer, the insurer and insured will often include an express provision in the insurance contract to further protect and delineate the right.

## 3 Litigation - Overview

### 3.1 Which courts are appropriate for commercial insurance disputes? Does this depend on the value of the dispute? Is there any right to a hearing before a jury?

In the United States, insurance disputes primarily involve issues of state law and thus those disputes are most often litigated in state courts. The amount at issue in the dispute may determine which state court hears the case; a "small claims" court might hear cases with a small dollar value. The federal trial courts (U.S. district courts) have concurrent jurisdiction with state courts over insurance disputes where $75,000 or more is in controversy and there is complete "diversity of citizenship" between the adverse parties, meaning all of the plaintiffs are domiciled in different states (or different countries) than all of the defendants. The federal courts also have jurisdiction where federal statutes confer it (such as admiralty cases).

There is no right to a jury trial for every type of civil (non-criminal) case. The U.S. Constitution and most state constitutions generally ensure a right to a jury trial for "legal" claims, i.e., claims for money damages. However, claims for "equitable" relief – such as rescission – are not required to be heard by a jury. Moreover, in some courts no right to a jury is afforded in cases that largely involve the legal interpretation of the meaning of an insurance contract. For instance, declaratory judgment actions in New Jersey are generally not subject to a right to a jury trial. In such cases the trial judge resolves disputed issues of fact as well as issues of law.

### 3.2 How long does a commercial case commonly take to bring to court once it has been initiated?

The answer to this question depends on the presiding judge and the particular court procedures in place. In cases that are brought in "rocket dockets" (courts with rules designed to move cases quickly), it may be less than a year from filing the complaint until trial. Nevertheless, studies over the past two decades have shown that civil (i.e., non-criminal) cases in federal and state courts take an average of roughly one and a half to two and a half years to proceed from the filing of a complaint to trial. While it is possible that a relatively simple, two-party insurance dispute can be litigated to conclusion in that general time frame, complex, multi-party coverage litigation involving mass torts or other high-value claims will typically take longer to resolve. The most complicated, high-stakes insurance coverage disputes can be in litigation for 10 years or more.

## 4 Litigation - Procedure

### 4.1 What powers do the courts have to order the disclosure/discovery and inspection of documents in respect of (a) parties to the action and (b) non-parties to the action?

U.S. courts are known for the broad discovery they allow. This reflects a policy decision to avoid "trial by surprise." The authority of a court to order discovery (testimony, production of documents, and inspection of property) is typically provided in its procedural rules. Although there are differences among jurisdictions, discovery of information in the possession, custody or control of litigants is generally expansive in scope – potentially extending to all matters that are not privileged and that may lead to the discovery of admissible evidence (even if the information itself is not admissible). Discovery is intended to be managed through cooperation of the parties without the court's involvement, but most often disputes arise that the parties cannot resolve without court intervention. Discovery disputes may arise out of a party's assertion that materials sought are not relevant, that materials are subject to a privilege, that their disclosure could compromise commercial secrets, or that collecting and producing the materials would be unduly burdensome. Although the general scope of discovery is broad, courts may narrow its scope if the cost of full compliance would be high in relation to the amount in dispute.

Discovery of non-parties tends to be more restrictive because non-parties are likely to have no direct stake in the litigation, in which case discovery compliance represents an expenditure of a non-party's time and resources with no corresponding benefit. Absent informal cooperation, a subpoena authorised by the court is required to obtain discovery from a non-party. Obtaining a subpoena is not difficult and many courts authorise an attorney to issue them without seeking advance approval. Courts will also liberally issue requests to tribunals in other states to issue subpoenas for witnesses located outside the forum state. However, the recipient of a subpoena may move to quash it on the basis that

the discovery demanded is improper, such as if the subpoena seeks privileged or irrelevant information, or if compliance would be unduly expensive or onerous.

### 4.2 Can a party withhold from disclosure documents (a) relating to advice given by lawyers or (b) prepared in contemplation of litigation or (c) produced in the course of settlement negotiations/attempts?

Communications reflecting or in some cases relating to legal advice given by lawyers are protected from disclosure pursuant to the "attorney-client privilege." Although there are a few narrow exceptions to this privilege (e.g., the crime/fraud exception), it is generally considered to be absolute. In the insurance and reinsurance context, most disputes over attorney-client communications relate to: (i) whether the information sought is in fact privileged (not all communications between a lawyer and client are necessarily privileged); (ii) whether the party resisting disclosure has done something to waive the privilege; or (iii) whether, because of the insurer-insured relationship, the insurer may review privileged communications relating to the parties' "common interest" in having the insured succeed in its defence of the underlying claim. In addition, policyholders sometimes argue that an attorney's involvement in claims-handling issues is not subject to privilege, or that the attorney-client privilege is vitiated in cases involving allegations of bad faith claims handling.

Materials prepared in anticipation of litigation or in preparation for trial, whether prepared by lawyers or by non-lawyer party representatives, may also be immune from disclosure pursuant to the "work product doctrine." In contrast to the attorney-client privilege, work product immunity is "qualified." A party may overcome the immunity and obtain discovery of work product materials upon a showing that the party has a substantial need for the materials and cannot obtain the equivalent information through other means without undue hardship. However, heightened work product protection applies to materials that contain the "mental impressions" of counsel. Such "core" or "opinion" work product is almost never discoverable.

There also is protection for documents prepared for or reflecting settlement negotiations. This protection is not, technically speaking, a "privilege," but arises from an evidentiary rule that settlement communications are inadmissible to prove or disprove a party's liability on a claim. Nonetheless, parties often assert that documents relating to settlement communications are "privileged" from disclosure in discovery, and courts sometimes agree on the basis that, because of the evidentiary rule, settlement materials are not likely to lead to admissible evidence.

### 4.3 Do the courts have powers to require witnesses to give evidence either before or at the final hearing?

Courts have the power to compel both party and non-party witnesses to give testimony before or during a trial, although there are differences in nature and scope of such authority among state and federal courts. The scope of such power also depends on whether the testimony is sought for pre-trial discovery or for trial, and whether it is being sought from a party or non-party witness.

In both state and federal litigation a party's officers, directors or managing agents may be compelled to appear for deposition (the provision of sworn testimony in response to questioning) based on notice from another party in the case. The court has jurisdiction over the parties appearing before it, and no subpoena is required. With regard to non-parties, federal trial courts have nationwide subpoena power to command witnesses to appear for pre-trial depositions. State courts lack nationwide subpoena power, but equivalent national deposition discovery can be obtained in a state court by asking the court to make a formal request to other state courts to issue subpoenas for out-of-state witnesses.

In contrast to discovery, the power of federal and state courts to compel the appearance of witnesses ***for trial*** is limited geographically. As discussed in response to question 4.4 below, if a witness is not subject to being subpoenaed for trial by a court, the court may permit that witness's evidence to be presented through deposition testimony taken before trial.

### 4.4 Is evidence from witnesses allowed even if they are not present?

Courts may receive evidence from witnesses through deposition testimony taken before trial. Typically, a court will allow deposition testimony to be submitted *in lieu* of live testimony if the witness (i) is a non-party, and (ii) is located outside of the trial subpoena authority of the court. In addition, a party witness's deposition testimony may be offered by an adversary as an admission of a party-opponent.

If deposition testimony is permitted, a litigant may present it by reading questions and answers into the record during the trial (with an "actor" – often another member of the trial team – reading the witness's transcribed answers) or, if the deposition has been videotaped, by playing the video in court. Alternatively, in a non-jury trial, the trial judge may simply accept the deposition transcript (or designated portions) into evidence and read the testimony outside of the courtroom.

In recent years courts have allowed absent witnesses to testify by video link. At this time, most court rules do not officially authorise this method of receiving trial evidence, and trial testimony by live video link typically requires the consent of all parties and the court.

### 4.5 Are there any restrictions on calling expert witnesses? Is it common to have a court-appointed expert in addition or in place of party-appointed experts?

It is common in insurance coverage disputes for parties to use expert witnesses, particularly in cases where disputed facts of a claim involve complex scientific or technical issues, or where insurance custom and practice are relevant to an issue in dispute. Litigants have wide latitude to call expert witnesses at trial if their testimony regarding specialised knowledge will assist the trier of fact to understand the evidence or to determine a disputed fact. A court typically will allow a timely designated expert to testify unless the court determines that the evidence will not be relevant or helpful, or that expert's opinions are not based on reliable principles or methods ordinarily used by others in the expert's field.

Other restrictions on the use of experts arise from pre-trial procedures designed to ensure that each party has a fair opportunity to prepare for trial. In most cases a court will establish deadlines for parties to identify experts, to submit reports with the experts' opinions, and to make the experts available for deposition. Disputes often arise if a party attempts to designate an expert after a deadline, or proffers additional or amended opinions of an expert that was already deposed. In deciding whether to allow late-identified experts or opinions, courts will weigh the proffered reasons for the untimely designation and the purported value of the testimony against the potential prejudice to the other side from the untimely designation.

Both federal and state courts have the power to appoint their own experts. Courts rarely exercise this authority, however, typically reserving the use of court-appointed experts for the most complex cases, such as those involving highly-specialised and difficult scientific or technical matters. Most often, courts hear evidence from the party-sponsored experts and weigh the credibility of each expert's testimony when there is disagreement.

Another option available to courts in complex or specialised matters is to appoint a "master' or "special master," a person with relevant expertise who serves in a *quasi*-judicial role to assist a judge in developing the record and in decision-making. The costs of masters are typically charged to the litigants.

### 4.6 What sort of interim remedies are available from the courts?

A party may seek interim relief through a temporary restraining order or preliminary injunction if the party can show it is likely to succeed on the merits of its case and that it will suffer irreparable harm if interim relief is not granted. This relief typically is not available where an insurer breaches a duty to indemnify because a policyholder has an adequate remedy at law (money damages) and an injunction is not required to protect this right.

However, courts may order interim relief to ensure that a money judgment can be satisfied, particularly if a non-admitted insurer is involved. A significant number of states have "pre-answer security" statutes which permit a court to require a non-admitted insurer to post security – unless the insurer satisfies an exemption – before it may answer a policyholder's complaint.

Other interim relief may be awarded that is strictly procedural in nature. Because the law on key insurance issues can vary from state to state, an insurer and a policyholder may engage in a "forum fight" – i.e., the filing of competing lawsuits in each party's preferred jurisdiction. A court may issue an "anti-suit injunction" forbidding a party from pursuing a lawsuit regarding the same subject matter in another jurisdiction. Of course, another form of procedural interim relief is the pre-trial discovery order which may require – or prohibit – certain types of discovery.

### 4.7 Is there any right of appeal from the decisions of the courts of first instance? If so, on what general grounds? How many stages of appeal are there?

The right to appeal a trial court's ruling is widespread (but not universal) among the federal and state courts, as long as the challenge to the ruling has properly been preserved for appeal under the forum's procedural rules. Both substantive and procedural issues, as well a trial court's or a jury's fact-finding, may be appealed if properly preserved. Virginia is one jurisdiction where the right of appeal from a trial court decision is not automatic. In non-criminal cases permission to appeal must be granted by the Virginia Supreme Court, the only appellate court in that state.

Each of the state and federal court systems has at least one appellate level. The federal system and most states have three tiers of courts – the courts of first instance, or trial courts; intermediate appellate courts; and the court of last resort (the highest court, often but not always called the "supreme court"). Some states have two tiers – a trial court and an appellate ("supreme") court. In the vast majority of jurisdictions a party is entitled to one level of appeal as a matter of right, before the intermediate appellate court in a three-tiered system or the highest court in a two-tiered system. In three-tiered systems, a second level of appeal – a petition to the highest court – is also possible. However, in such systems the highest state court typically has the discretion whether or not to hear the case, and most petitions to the highest court are not accepted for review.

Appellate courts typically will undertake plenary (*de novo*) review of a trial court's rulings on issues of law. Issues of insurance contract interpretation are considered issues of law and thus are subject to *de novo* review on appeal. Appellate review of factual determinations of a jury or trial court is more deferential to the trial court. Findings of fact will generally not be overturned on appeal unless they are clearly erroneous or are unsupported by the record evidence in the proceedings below. In addition, a trial court's application of procedural rules to the circumstances before it is typically considered to be a matter reserved to its discretion, which will not be disturbed on appeal absent a determination that the trial court abused its discretion.

### 4.8 Is interest generally recoverable in respect of claims? If so, what is the current rate?

Most jurisdictions provide by court rule or by statute that a prevailing litigant may recover prejudgment and/or post-judgment interest. The interest rate varies by jurisdiction. In some states the rate is fixed by statute; in other states it is indexed to another rate measure, and varies over time as the economic rate of interest rises or falls.

In some states the rules providing for pre- or post-judgment interest are essentially mandatory, but in others a court has significant discretion as to whether to assess interest and, if so, in what amount. While the nominal rate of interest is typically prescribed by rule or statute, the court may, as a practical matter, have latitude to determine (subject to review for abuse of discretion) the actual amount of the interest award through factual determinations such as when interest begins to accrue, or the amount of principal subject to interest at particular points in time.

### 4.9 What are the standard rules regarding costs? Are there any potential costs advantages in making an offer to settle prior to trial?

Although the "American rule" observed in most federal and state courts is that, win or lose, each litigant bears its own attorney's fees and most other litigation costs, special "fee shifting" rules may apply to insurance coverage litigation. Some states have rules providing that a policyholder who prevails in coverage litigation may recover attorneys' fees and costs from the insurer. In practice, courts in these jurisdictions have latitude in determining whether to assess fees and costs against an insurer and, if so, in what amount. In some circumstances a court may in its discretion order a party to pay its adversary's attorney's fees or expenses if the party has asserted frivolous claims or defences, or pursued or resisted a particular type of pre-trial discovery without a reasonable basis for doing so. Such orders are not common, however.

Because the trial is often the most expensive phase of litigation, significant cost advantages can be realised by making a pre-trial settlement offer based on an objective assessment of a party's case. The drafters of the Federal Rules of Civil Procedure, and of some state court rules, have devised mechanisms in the rules aimed at giving a cost advantage to parties that offer to settle before trial. Such "offer of judgment" rules require a party to pay its adversary's costs if a defendant makes an offer before trial, the offer is refused, and the judgment ultimately obtained is less than the amount offered. However, the rules have not been particularly effective in promoting settlement. A number of court decisions have interpreted them to shift only court costs and not the more substantial expenditures associated with attorneys' fees and "non-court" costs.

**4.10 Can the courts compel the parties to mediate disputes? If so, do they exercise such powers?**

Federal and state courts have the authority to order parties to mediate their disputes, and frequently do so. In the U.S. there is a strong public policy to promote settlement so as to manage burdens on overcrowded courts and reduce parties' litigation costs. For that reason, mandatory mediation programs are very common in both the federal and state courts. In many states there are statutes or court rules that require litigants to engage in mediation of certain categories of disputes or cases within a certain range of values, or that authorise a court to order mediation at its discretion. Though a party ordered to mediate might have little or no interest in settlement at the time, a directive to mediate typically incorporates a requirement that parties do so in "good faith." A court might construe the good faith obligation to require a litigant to cooperate in scheduling the mediation, to reasonably prepare to participate in it, to submit a pre-mediation statement if requested by the court or mediator, to make available a representative with settlement authority, or otherwise to conduct itself in a way that gives the mediation some prospect of success. Statutory or judicial authority to compel mediation does not empower a court to force parties to settle their differences, only to require parties to make a *bona fide* effort to do so through mediation.

**4.11 If a party refuses a request to mediate, what consequences may follow?**

If a party requests mediation of a dispute, its adversary generally is not required to comply with the request. However, if a party refuses to engage in good faith mediation ordered by a court – pursuant to statute, rule, the court's own initiative, or on motion of another litigant – then the court may impose sanctions on the recalcitrant party. For instance, if a party fails to appear for a mediation scheduled by the court, or disobeys an order requiring attendance of a representative with settlement authority, the court might sanction the offender by requiring it to pay the mediator's fees and its opponent's costs of attendance. Sanctions for failure to mediate in good faith typically involve an assessment of costs or fees incurred by others involved in the process, but in particularly egregious cases a court's authority to punish violations of its orders might include more severe sanctions such as the dismissal of claims or the striking of defences.

## 5 Arbitration

**5.1 What approach do the courts take in relation to arbitration and how far is the principle of party autonomy adopted by the courts? Are the courts able to intervene in the conduct of an arbitration? If so, on what grounds and does this happen in many cases?**

In the U.S. there is a strong public policy recognising the validity of private agreements to arbitrate and favouring the enforcement of such agreements by the courts. The Federal Arbitration Act embodies this public policy in federal law; it applies to arbitrations concerning any transaction in interstate commerce. Arbitrations involving foreign commerce are subject to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, to which the United States is a party. Most states have their own arbitration acts. However, for the very broad range of insurance and reinsurance relationships that affect interstate or foreign commerce, federal arbitration law pre-empts any conflicting provision in state law.

Consistent with the public policy to enforce agreements of parties to arbitrate, federal courts are extremely reluctant to interfere with on-going arbitrations. The courts generally limit their role to compelling a party to abide by an agreement to arbitrate and, post-arbitration, to confirm or vacate an arbitral award. Courts occasionally will appoint an arbitrator and may do so if the agreement does not specify an alternative appointment process, or may intervene where a disagreement arises over the arbitrator selection process. Courts may enforce arbitrator-issued subpoenas to non-parties. Otherwise, courts broadly defer to the procedural and substantive decisions of arbitrators – particularly while the arbitration remains on-going – so long as the controversy is within the scope of the parties' agreement to arbitrate. The courts typically will refrain from considering questions about arbitrator conduct or decision-making until after the arbitration has concluded.

**5.2 Is it necessary for a form of words to be put into contract of (re)insurance to ensure that an arbitration clause will be enforceable? If so, what form of words is required?**

It is essential that parties who intend to arbitrate disputes expressly articulate that intent in their contracts, but no particular form of words is required to create an enforceable agreement to arbitrate. A very broad arbitration clause (e.g., one requiring arbitration of "any and all disputes arising out of or relating to this contract") is likely to be construed to require arbitration of all disputes regarding the contractual relationship, including those relating to the formation of the contract (such as a claim that the contract was induced by fraud). A more narrowly drafted arbitration clause (e.g., "should an irreconcilable difference of opinion arise as to the interpretation of this agreement, such difference shall be submitted to arbitration") is less likely to be construed to provide for arbitration of contract formation issues. However, upon finding an enforceable agreement to arbitrate, courts will generally resolve doubts regarding the scope of arbitrable matters in favour of arbitration.

**5.3 Notwithstanding the inclusion of an express arbitration clause, is there any possibility that the courts will refuse to enforce such a clause?**

The Federal Arbitration Act provides that a written agreement to arbitrate "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract". Given the strong public policy in the U.S favouring arbitration where the parties have agreed to it, it is highly unlikely that a court would invalidate an arbitration clause in an insurance or reinsurance contract unless the court determined that the arbitration clause itself (as opposed to the formation of the contract generally) was the product of fraud, duress, or mistake. Arbitration clauses are very commonly found in reinsurance contracts, and it would be very unusual for a court to find that a sophisticated insurer or reinsurer had accepted an arbitration clause in such a contract as a result of deceit or undue pressure.

**5.4 What interim forms of relief can be obtained in support of arbitration from the courts? Please give examples.**

If a party refuses to abide by an agreement to arbitrate, its adversary may petition a federal court to compel arbitration. In addition, a federal court may compel parties to follow a previously agreed method for choosing arbitrators, in the event a dispute over arbitrator selection arises. Arbitrators are authorised to subpoena non-party witnesses to give testimony and/or produce documents at a hearing, and federal courts may issue orders compelling witnesses to comply with such subpoenas.

Courts also may grant preliminary injunctive relief to preserve the *status quo* if a party can demonstrate that, among other things, it will be irreparably harmed absent interim relief. One example is where the adverse party is engaged in a fraudulent transfer of assets – endangering its ability to satisfy a later award – and the arbitration panel has not yet been constituted. Even if the panel is constituted, there may be a circumstance where time is of the essence and judicial relief is warranted without prior resort to the panel.

Other interim relief, if allowed, would typically be determined by arbitrators rather than the courts. For instance, a cedant may demand that its reinsurer post a letter of credit or provide some other form of security in advance of a hearing; a panel (not a court in most instances) may decide based on the contract and the circumstances whether such relief is authorised, and whether to award it. Even if a court has authority to grant such relief, it might defer to the arbitration panel absent a showing of imminent, irreparable harm. A party may seek to confirm or vacate an interim form of relief awarded by a panel if the interim award is sufficiently "final" for purposes of judicial review. Confirmation of an interim award would permit the prevailing party to use judicial mechanisms to enforce compliance with the interim award.

### 5.5 Is the arbitral tribunal legally bound to give detailed reasons for its award? If not, can the parties agree (in the arbitration clause or subsequently) that a reasoned award is required?

Unless the arbitration clause specifies that an award be accompanied by a statement of reasons, arbitrators are not legally bound to give a "reasoned award" – an award based on a detailed statement of its legal and factual basis. However, either party to an arbitration can ask the arbitral panel to render a reasoned award. If the arbitration agreement requires a reasoned award, or both sides request one, the arbitrators will be required to provide a reasoned award. If one side favours a reasoned award and the other does not (and the contract is silent on the question), the arbitrators have the discretion whether or not to render one. In deciding whether to do so, the arbitrators may consider factors such as whether a reasoned award is likely to provide guidance to the parties in future dealings on similar issues.

### 5.6 Is there any right of appeal to the courts from the decision of an arbitral tribunal? If so, in what circumstances does the right arise?

Under the Federal Arbitration Act, a party aggrieved by an arbitral award has the right to "appeal" (i.e., petition to vacate) the award in federal district court, and may also appeal the decision of the district court on the petition to a federal appeals court. The grounds for such an "appeal" are extremely limited, and petitions to vacate are rarely granted. Under Section 10 of the Federal Arbitration Act, the grounds to vacate an award are restricted to those where: (1) the award was procured by corruption, fraud, or undue means; (2) there was evident partiality or corruption in one or more arbitrators; (3) the arbitrators were guilty of misconduct in refusing a postponement for sufficient cause shown, in refusing to hear pertinent and material evidence, or other prejudicial misbehaviour; or (4) the arbitrators exceeded their powers (such as by deciding an issue that was not arbitrable or by straying from interpretation and application of the parties' contract). While these grounds collectively may appear broad, in practice the courts construe them very narrowly. Some courts have also recognised an arbitrator's "manifest disregard" of applicable law as another basis for *vacatur*, but the continuing viability of that approach, either as an independent ground or emanating from the statutory bases, is an open question. Even the courts that recognise the "manifest disregard" doctrine construe it narrowly, and rarely overturn an arbitration award on that basis. The doctrine has been applied only where the arbitrators knew of, but still refused to apply, controlling legal principles. Misapplication or misinterpretation of the law alone does not suffice.

## Acknowledgment

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Lewis Baach's insurance and reinsurance practice encompasses litigation, arbitration, and ADR involving specific disputes; strategic planning on important claims issues and bad faith; audits, investigations, and monitoring of high-value claims; and legislative and regulatory representation. The firm has successfully represented insurers and reinsurers in accident and health, antitrust, asbestos, bad faith, broker misconduct, construction, D&O, energy, environmental, lead paint and other health hazard, misrepresentation and nondisclosure, patent and trademark, pharmaceutical, political risk, professional liability, property, and workers' compensation matters.

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