

Bermuda Form arbitration: a policyholder perspective

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Introduction

With the globalisation of the world economy, private arbitration is fast becoming the favoured forum to resolve international business disputes, with London being a primary venue. While most decisions to arbitrate as well as the terms of the arbitration are negotiated by the parties, there is one contract that requires a party to arbitrate and sets forth the terms without negotiation – that contract is a Bermuda Form excess insurance policy.

In today's insurance market, most multinational and US Fortune 500 companies purchase high-level excess insurance in the Bermuda market, primarily because the market has substantial capacity. The purpose of this article is to comment briefly on several aspects of this arbitration process that by design favours the insurer, and how a policyholder can secure a more level playing field.

There are a number of Bermuda forms covering different risks.¹ They all, however, have one feature in common – the dispute resolution provision.² Briefly, that provision provides for an arbitration seated in London and procedurally governed by the (British) 1996 Arbitration Act.

It is widely acknowledged that the Bermuda Form and its arbitration provision resulted from the insurance industry's dissatisfaction with insurance coverage decisions in United States courts³ and, more broadly, with an American judicial system that insurers believe favours policyholders. The Bermuda Form arbitration provision somewhat alleviates the insurers' perceived mistreatment at the hands of the American judicial system by featuring several pro-insurer procedural mechanisms.

London venue

Seating the arbitrations in London presents several advantages to insurers. First, for most American companies it will greatly increase costs and complexity to bring company and third-party witnesses to London. Second, many of the evidence-gathering tools available in US court proceedings (eg, third-party document subpoenas, depositions *de bene esse*) are not available to litigants. Since the presentation of factual evidence is almost the sole burden of policyholders in coverage disputes, the absence of these tools adds further difficulties to the prosecution of the claim.

English procedural rules

Particularly distressing and burdensome to the insurers is the American discovery process, especially when insurer underwriters are asked probing questions at depositions about the meaning of the policies the insurers are selling. While the Bermuda Form dictates the substantive law of New York should apply, British law governs procedural issues. Thus, the procedural rules governing a Bermuda Form arbitration do not allow depositions and restrict written discovery. Practically speaking, the policyholder has no means to test the document productions of Bermuda insurers, nor is there any threat of sanctions or penalties to compel the complete and ethical production of documents.

The abrogation of *contra proferentem*

The substantive law of almost every jurisdiction in the United States, including New York, provides that if a policy term is ambiguous and subject to two reasonable interpretations, the one favouring the policyholder will be used. The Bermuda Form expressly abrogates New York's *contra proferentem* rule – a major advantage for the insurers who drafted the contract. Many 'policyholder friendly' court decisions in New York rely at least in part upon this doctrine; its abrogation provides a means for Bermuda insurers to distinguish these cases.

Payment of punitive damages

The threat of punitive damages is a useful lever to prevent an insurer from refusing to pay a claim even though there is no credible basis to deny it. The Bermuda Form expressly prohibits the award of any punitive damages. The result is that a Bermuda insurer has little or no incentive to resolve a large claim quickly – the longer the insurer holds the money, the more it will earn, ultimately reducing the insurer's net payout.

Confidentiality

In the insurance context, confidentiality acts as a sword rather than a shield. The purpose of confidentiality in most business arbitrations is to protect sensitive business data from being publicly disclosed. In the insurance context, confidentiality (in tandem with the unavailability of punitive damages) permits insurers to advance specious defenses with no accountability. Arbitral decisions are not reported, so there is no way for an insured to investigate an insurer's position or to root out whether the same insurer has taken a contrary position in a prior proceeding.

Confidentiality also allows insurers to work together while leaving the policyholder to fend for itself. Most insurance is purchased in layers, with no one insurer providing the totality of the limits. When a coverage dispute occurs, separate arbitrations must be brought against each insurer.⁴ In a situation where, for example, a policyholder commences simultaneous arbitrations against two insurers, the insurers – even though they are in separate arbitrations – are permitted to work together under the guise of a joint defence agreement, while the policyholder cannot seek assistance from either, similarly situated, policyholders because such a request would violate the confidentiality of the arbitration.

Another way in which confidentiality tilts the playing field against the policyholder is that insurers are repeat players in Bermuda Form arbitrations. Hence, because the same issues arise in multiple arbitrations over time, insurers are able to fine-tune their arguments and, as discussed below, they know which arbitrators have ruled in their favour in the past and are disposed to be swayed by such arguments in a pending arbitration. On the other hand, it is unusual for a policyholder to be a repeat player in insurance arbitrations in the same way that insurers are.

Selection of arbitrators

As explained above, Bermuda Form arbitrations create unique circumstances that set them apart from more traditional international business arbitrations. In most business disputes, the players have never been involved in prior arbitrations; namely, an arbitration is a unique event for most businesses. Bermuda insurers, on the other hand, may be involved in multiple arbitrations each year. This gives the Bermuda insurers an unparalleled advantage in choosing an arbitrator. Because it arbitrates year in and year out, a Bermuda insurer can winnow its arbitrator choices to those few who share its interpretation of the Bermuda Form in connection with similar issues that have arisen in the past. The policyholder, on the other hand, does not have access to this same information because, more likely than not, the instant arbitration is the only one the policyholder has experienced. Hence, it cannot determine the track record of any potential arbitrator. Moreover, given the confidential nature of arbitrations, the policyholder cannot make a general inquiry to uncover the experience of potential arbitrators.

Finally, the process for selecting arbitrators provides that each party selects an arbitrator and those two arbitrators, in turn, select the third arbitrator. If the two arbitrators cannot agree on the selection of the third arbitrator, either party can petition the High Court of Justice of England and Wales to appoint the third arbitrator. This process means that, more often than not, the third arbitrator will be a British barrister or former British jurist. Further, the third arbitrator, who is not appointed by either party unilaterally, is the chair of the tribunal.

While this process does not appear to provide either side with an advantage, the likely result is a majority British panel that will apply New York law through an English law ‘prism’. On most insurance issues, English law is more favourable to insurer positions than the law of most American jurisdictions, including New York. Insurers rely on this prism (and the abrogation of *contra proferentem*) to advance aggressive, pro-insurer interpretations of New York law and arguments that can lack the commercial sense American courts require.

Levelling the playing field

While there is no doubt that the playing field is tilted toward the insurer at the outset of a Bermuda Form arbitration, there are steps the policyholder can take that even the odds. In our experience the following steps can certainly assist in the successful outcome described at the outset.

Assemble the right team

A Bermuda Form arbitration requires an international team of lawyers. The events that are the subject of disputed coverage more than likely took place in the United States or, at the very least, did not take place in the United Kingdom. In addition, New York is the governing law. Hence, American lawyers are needed to develop the facts and evidence under New York law. In our experience, however, it would be a mistake for an American lawyer to be the lead trial counsel. George Bernard Shaw was reputed to have said that ‘England and America are two countries separated by a common language.’ That statement is amplified in how trials are conducted on either side of the Atlantic.

British counsel have a unique style that American attorneys cannot replicate, and, given that the chair of the arbitration tribunal is invariably from the United Kingdom, the wise policyholder chooses a British barrister, who will speak the same language as the chair. The search does not end there, however. While the UK is modern in almost all respects, legal representation remains determinedly less so. Barristers are the lead trial lawyers, who are ‘instructed’ by solicitors. Traditionally, barristers seldom meet clients, do not interview witnesses, and become deeply involved in the case only in the last few months before the hearing. Given today’s complex disputes, with key decisions made during the many months of preparation, it

is imperative that the chosen barrister has a ‘modern’ view of practice, and will engage with the client and the American lawyers as a full participant from the outset.

Many experienced practitioners believe that one of the most important decisions in an arbitration is the selection of the tribunal. As discussed above, the policyholder has the right to choose an arbitrator, and has input through that arbitrator in the selection of the chair. Given that the chair will most probably be from the UK, an accessible and experienced barrister will be an invaluable resource in the selection process.

Prepare the case early and carefully

US practice permits American litigators to often sue first and develop the facts and theories later. Most American jurisdictions permit notice pleading, namely, describing generally what the dispute is about. The specific facts and theories can be and are developed almost up to the first day of trial. The pleadings can be freely amended and the legal arguments can change daily. Your case is told through direct testimony of the witnesses during trial. Because they are governed by British procedural rules, the arbitrations have come to replicate in large part British court trials and therefore this approach will not work in a Bermuda Form arbitration.

The first major difference compared with the American judicial system is that pleadings take a central role in a Bermuda Form arbitration. Rather than simply give notice in general of the dispute, the pleadings, which are exchanged shortly after the commencement of the arbitration, set forth in detail each party’s legal and factual position. If an argument is not laid out in these pleadings – which consist of a statement of claim by the claimant, a statement of defence by the respondent, and a reply by the claimant – the tribunal will be reluctant to allow amendments as the date of hearing approaches. Additionally, a ‘directions order’ is negotiated among the tribunal and the parties early in the proceedings. This order, similar to a case management order, sets forth the case calendar working backward from the hearing date, which is set in stone along with the length of the hearing; a contrast to the often multiple changes in the trial calendar one sees in American courts.

Another major difference between an American judicial proceeding and a Bermuda Form arbitration that requires a party to prepare the case early and carefully is the manner in which witnesses are presented to the tribunal. The direct testimony of all witnesses is submitted to the tribunal and the opposing party months before the hearing in the form of written witness statements or expert reports.⁵ Live testimony of both fact witnesses and experts is conducted only as cross-examination. This allows the insurer at the final hearing, who will often have far fewer witnesses than the policyholder, the benefit of weeks of challenging the policyholder’s case before the tribunal – without the benefits that accrue from presenting direct testimony.

Hence, the policyholder must make the tactical and strategic investment necessary to develop the legal theories and facts before invoking the arbitration provision in order to avoid being straitjacketed later by the contents of its early pleadings and direct testimony. Given the absence of direct testimony, the policyholder must also take great care in selecting which witnesses to present.

Prepare and maintain a claim-cost analysis

By prohibiting recovery for punitive damages against insurers in their insurance policies, the insurers removed any financial incentive to settle early or for a reasonable amount. If an insurer loses an arbitration, however, one recovery element remains for the policyholder – attorneys’ fees, which can be significant. The losing party in a Bermuda Form arbitration is liable for the winning party’s costs, which include legal fees and expenses, expert witness fees, the arbitrators’ fees and expenses, and any other expenses associated with the conduct of the arbitration. The tribunal has almost unlimited discretion to award costs as well as in the matter of the amount.

In order to maximise an arbitration award, it is imperative that meticulous records be kept of all expenditures, especially if the policyholder is engaged in multiple arbitrations with different Bermuda insurers involving the same occurrence. In that situation, the policyholder can expect each insurer to attempt to pass its award burden on to one of the other insurers or argue for an equal division of the award. To counter this argument and maximise the cost award, the policyholder should maintain separate expense records for each arbitration to the extent possible.

Conclusion

As should be obvious from the foregoing, Bermuda Form arbitrations are very different from both American trials and arbitrations. Many of the differences are designed to give the insurer an advantage. What we have tried to do in this chapter is to provide some ideas about how policyholders can counter those inbuilt advantages. These ideas are by no means the totality of steps a policyholder can take to insure a fair hearing, but they should give policyholders an appreciation that they can vindicate their rights in spite of playing on the insurers' custom-made playing field.

Notes

- 1 For example, for most North American utilities the Bermuda policy purchased follows the form of the AEGIS primary policy, AEGIS being the industry mutual that provides much of the North American utility industry's primary liability coverage.
- 2 The Bermuda Form contains an arbitration provision, which replaces any underlying dispute resolution provision with a lengthy provision specifying, among other things, that:

Any dispute, controversy or claim arising out of or relating to this Policy or the breach, termination or invalidity thereof shall be finally and fully determined in London, England under the provisions of the Arbitration Act of 1996 . . . by a Board composed of three arbitrators...

 An additional provision specifies that '...any dispute, controversy or claim arising out of or relating to this Policy shall be governed by and construed in accordance with the internal laws of the State of New York.' See, for example, FORM-AE02 Ed 9/08 ('Excess Liability Insurance Policy Follow Form Claims Made Policy Insuring Agreements').
- 3 Richard Jacobs, Lorelie Masters and Paul Stanley, *Liability Insurance in International Arbitration: the Bermuda Form* (Second edition, January 2011), paragraph 1 at 1-21; David Scorey, Richard Geddes and Chris Harris, *The Bermuda Form: Interpretation and Dispute Resolution of Excess Liability Insurance* (December 2011), paragraph 1 at 3-6.
- 4 Consolidation of the disputes is only by consent of the insurers, which seldom happens.
- 5 For example, the authors submitted 21 fact witness statement and seven expert reports in a current arbitration, as well as submitting supplemental statements in rebuttal of the respondent's witness statements and expert reports, several months before the actual hearing.



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