

Understanding the Bermuda Excess Liability Form

MITCHELL F. DOLIN and ETHAN M. POSNER

Mitchell F. Dolin and Ethan M. Posner are partners at Covington & Burling in Washington, D.C. The views expressed in this article are those of the authors and not of their firm or its clients.*

A substantial portion of the current excess liability coverage of many large US companies consists of policies written by the handful of major Bermuda-based insurers. In only a dozen years, “island” insurers such as ACE Insurance Company, Ltd. and X.L. Insurance Company, Ltd. have grown into major enterprises insuring hundreds of large American companies, many of which operate in the pharmaceutical, chemical, and major manufacturing industries.¹ While additional Bermuda-based insurers have emerged more recently, including Starr Excess Liability Insurance Company, Ltd., European excess insurers utilizing policy forms similar to those pioneered by ACE and XL also have become potent competitive forces.

With so much excess coverage available on terms originating in the Bermuda market, it is critical for policyholders to understand the coverage forms that were crafted by the major Bermuda-based insurers. There is a surprising lack of interpretive and explanatory materials regarding these Bermuda forms. This is largely because the Bermuda-based insurers do not have long claims-paying histories, and their policies have not been subject to judicial interpretation.

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1. *Best's Insurance Reports: International* at 191 (1998 ed.) (reporting that ACE insures more than half of the companies in the top half of the Fortune 500).

This article reflects a modest and preliminary effort to fill this gap in the available literature. In Part I, the article reviews the recent history of the Bermuda general liability insurance market, with particular attention to the two largest concerns, ACE and XL. In Part II, some key provisions in the Bermuda forms are described with an emphasis on the coverage provided for mass-tort claims. And in Part III, arbitration under the Bermuda forms is discussed.

I. THE BERMUDA EXCESS MARKET

Just over a dozen years ago, the Bermuda insurance market consisted largely of reinsurers and captive insurers. In 1985, as a direct response to the liability insurance crisis and the attendant shortage of underwriting capacity for major US risks, Marsh & McLennan and J.P. Morgan organized the formation of ACE, which “provided excess liability coverages and limits that were largely unavailable [at the time] for difficult risks such as pharmaceuticals and chemical firms.”² XL, which was formed in 1986, entered the same basic market niche, but offered smaller limits at lower coverage layers.

ACE and XL were initially funded by large American companies that together contributed hundreds of millions of dollars of capital and became shareholders. At first, the policyholders consisted only of those companies that contributed capital and become shareholders. That soon changed as XL and ACE rapidly grew.

The original XL coverage provided \$50 million in limits excess of a \$50 million retention, and the original ACE coverage provided \$100 million in limits excess of at least \$100 million, with a requirement that the ACE layer sit atop a policyholder’s excess program. Since the 1980s, XL has lowered its minimum attachment point to \$25 million and raised its available limits to \$150 million.³ For its part, ACE has remained a higher level excess carrier and now offers as much as \$200 million in limits.⁴

Bermuda excess insurers typically claim three principal benefits from their off-shore location—tax minimization, lack of a strict regulatory climate, and avoidance of US courts. Blessed with these “advantages,” ACE and XL have expanded to serve hundreds of policyholders and

2. James V. Davis, “ACE and XL are Held Captive in the Critical Spotlight,” *Risk Management* at 37-38 (Sept. 7, 1988).

3. *Best’s Insurance Reports*, *supra* note 1, at 235.

4. *Id.* at 191.

collect billions of dollars in premiums. Through its parent, EXEL Limited, XL went public in 1991, and ACE, through its parent ACE Limited, followed in 1993. Today, each company has billions of dollars in shareholder equity, insures several hundred policyholders, and collects more than \$500 million in premiums each year. As a result of recent acquisitions of UK and US affiliates, ACE now has a substantial direct presence in the London and US markets.⁵

During their first five years, ACE and XL apparently paid few, if any, claims. There was some criticism of their claims-paying practices,⁶ but over the past several years both companies have begun paying sizable claims. It has been reported that XL and/or ACE have paid numerous claims, including claims relating to oil platform losses, plant explosions, crop damage, medical devices, and mass-tort litigation. Significantly, ACE and XL have paid or reserved hundreds of millions of dollars to cover breast implant liabilities.⁷

Despite the similarity of their histories and forms and the close proximity of their present (and future) headquarters buildings in Hamilton, Bermuda, it would be a mistake to treat ACE and XL as a single monolith. They are separate companies with distinct underwriting and claims-paying philosophies, practices, and reputations.

Today, the ACE and XL offerings compete with other Bermuda forms, such as those of Starr, that provide coverage on substantially similar terms at varying levels for personal injury, property damage, advertising liability, and some types of environmental liability.⁸ In the past few years, ACE and XL have apparently begun to confront significant competition in the excess liability market from London-based underwriters and various European insurers, many of which use a substantially similar policy form.

II. KEY PROVISIONS IN THE BERMUDA FORMS

The original ACE and XL excess liability forms debuted in 1985 and 1986. ACE forms 002 and 003 were issued in the 1980s, while ACE form 004 is dated November 1991. The most recent ACE excess liability policy, Form A.C.E. No. 005-3/96, remains in use today. The most recent XL

5. See *Lloyd's List: Insurance Day* at 6-7 (July 15, 1998) (reporting that ACE UK is the largest managing agency at Lloyd's and commands nearly 10 percent of the capacity at Lloyd's).

6. See, e.g., "Attorney Bashes Off-Shore Domiciles," *Nat'l Underwriter* at 1 (July 25, 1994).

7. See ACE Limited Form 10-K for 1997 at 11 (reporting that ACE paid "approximately \$250 million" for breast implant claims in 1997 alone).

8. ACE and XL also provide property insurance, directors and officers coverage, and other specialty cover such as political risk, aviation, employment, and satellite insurance. See "Bermuda: Soft Rates Bring New Products In Bermuda," *Business Insurance* at 16 (Apr. 14, 1997).

policy, known as Form XL XS-004, is dated January 1996. This article focuses mostly on the current ACE form, although it also discusses how the 1996 XL and 1997 Starr forms deal with related issues.

A. The Occurrence Concept

The most important feature of the Bermuda policy form is that it is triggered by giving notice of an “occurrence” either during the policy period or before the end of an extended discovery period if the insured purchases a discovery option. In this regard, the Bermuda form is neither a pure claims-made policy, which typically requires that claims be asserted against the insured during the policy period, nor a traditional occurrence policy, which usually requires only that bodily injury take place during the policy period. Perhaps the most apt shorthand label for the Bermuda form is an “occurrence-reported” policy.

In the current XL and ACE forms, an “occurrence” is defined, for purposes of products liability coverage, to include “actual or alleged Personal Injury to any individual person . . . arising from the Insured’s Products [that] takes place on or subsequent to the Inception Date and before the Termination Date of Coverage A.”⁹ The inception date for original ACE or XL insureds is normally November 1, 1985. The termination date is usually the end of the policy period.¹⁰

Aside from generally providing that injuries should occur between the inception date and the termination date, the Bermuda policies further define an “occurrence” to require that where alleged injuries are “attributable directly, indirectly or allegedly to the same actual or alleged event, condition, cause, defect, hazard and/or failure to warn of such,” all such injuries “shall be added together and treated as one Occurrence irrespective of the period . . . or area over which the actual or alleged [injuries] occur or the number of such actual or alleged Personal Injuries”¹¹ For injuries that are sufficiently related and occur over time, the Bermuda forms use the term “Integrated Occurrence.” An integrated occurrence means “actual or alleged” injury “to two or more persons . . . which

9. See 1996 ACE Form, Art. III.V(1)(b); 1996 XL Form, Art. III.V(1)(b).

10. The early versions of the ACE and XL policies provided coverage for injury from the use of products “taking place entirely at or subsequent to the Inception Date,” which led some to wonder whether coverage was limited for long-tail claims where injuries were alleged to have occurred over a long period of time, including prior to the Inception Date. The more recent forms delete the word “entirely” and thus confirm the insurers’ intent to cover claims where injuries may span either side of the Inception Date line. An ACE “Executive Summary” issued when ACE’s 1991 form was released stated that, by deleting the language “taking place entirely at or subsequent to the Inception Date,” the new policy “extends coverage to personal injury or property damage taking place during the ACE coverage period regardless of whether the same product caused personal injury or property damage before the ACE coverage period.”

11. 1996 ACE Form, Art. III.V(2).

commences over a period longer than thirty (30) consecutive days which is attributable . . . to the same actual or alleged event, condition, cause, defect, hazard, and/or failure to warn of such.”¹² Thus, an integrated occurrence—which is a type of an occurrence—is distinguished by the time period over which injuries commence.

According to XL, not all mass-tort situations should be characterized as an integrated occurrence. For example, XL has advised its policyholders regarding the following hypothetical scenario: “[A]ssume an explosion at the Insured’s plant results in a release of a toxic gas which floats into inhabited areas and is inhaled by residents for five days before it dissipates. Further assume that this causes both immediate acute injuries and long-term chronic injuries. This would not be an Integrated Occurrence because all of the injuries would have commenced in the five day exposure period.”¹³ On the other hand, multiple claims involving similar alleged injuries arising out of a product that is alleged to cause bodily injury over a period of years—such as long-tail or delayed-manifestation claims—would appear subject to characterization as an integrated occurrence.

The occurrence and integrated occurrence concepts have several ramifications. First, once the insured provides notice of an occurrence or integrated occurrence, all past and future claims involving similar alleged injuries typically will be covered only under the policy (and the applicable limits) in effect at the time notice is given. Thus, the insurer may be able to telescope the policyholder’s recovery to a single policy limit for a large loss arising out of a mass-tort, product defect, or other catastrophe that plays out over several years. Second, and of benefit to the policyholder, if the insured “batches” related claims into a single occurrence, then the insured can more easily exhaust the underlying per-occurrence retention.

To date, ACE and XL appear to have advocated the batching of related product liability claims.¹⁴ In late 1994, after incurring significant losses from the breast implant litigation, ACE implemented an “Integrated Occurrence Sublimit,” which became a feature of the 1996 form policy. We understand that ACE frequently imposes a “sublimit” of \$100 million even on policies that otherwise contain \$150 or \$200 million limits for occurrences generally. According to a leading trade journal, “[t]his underwriting reform is designed to reduce the company’s exposure to the aggregation of risk resulting from multiple ‘batch’ claims originating from one event.”¹⁵

12. 1996 ACE Form, Art. III.R; 1996 XL Form, Art. III.R.

13. See Memorandum to All X.L. Excess Liability Insureds Under Form XS-004 at 2-3 (Dec. 1, 1995).

14. In an early arbitration involving crop-damage claims, ACE successfully resisted a policyholder’s attempt to claim that its product’s adverse effects on two different types of crops should be deemed two separate occurrences.

15. “ACE Limiting its Exposure,” *Business Insurance* at 1 (Sept. 26, 1994).

B. Notice

By definition, notice of an occurrence is the triggering event for coverage under an occurrence-reported policy. Notice is also a condition precedent to coverage. Thus, the decision of whether and when to give notice often has implications far more profound than it does in the case of ordinary occurrence policies.

Under the 1996 ACE and XL forms, if an “Executive Officer” (defined as a senior officer of the company or “any manager in the Risk Management or Law Department”) shall “become aware of an Occurrence likely to involve this Policy,” the policyholder shall, “as a condition precedent” to coverage, “give written notice” to the insurer. Such notice “shall be given as soon as practicable” during the policy period or the discovery period.¹⁶ Failure to provide proper notice “shall result in a forfeiture” of rights.

Applied to excess policies, the “as soon as practicable” language has been construed to require notice at the point at which a reasonable person (or, in the case of the ACE and XL policies, a reasonable senior officer of the insured) should have known that underlying claims stemming from the same occurrence were likely to exceed the policy’s underlying limits.¹⁷ The fact that underlying complaints may have large *ad damnum*s exceeding the insured’s retention, for example, would not by itself require the company to give notice. Rather, the insured’s actual experience with prior claims involving the allegedly defective product, with respect to both settlement amounts and verdict amounts, has been identified as the touchstone for assessing when an excess policy is reasonably likely to be reached.¹⁸

Over the years, XL has provided its insureds with a series of “Notice Guidelines” that in large part reflect an emphasis on reasonable attention to actual claims experience. The December 1995 version of these guidelines states that “[i]t serves no one’s interest to have Insureds submit notice of Occurrences which have no reasonable probability of impacting X.L.” Thus, the insureds are advised that it is “not necessary to give notice of every Occurrence or claim to protect the Insured’s rights” where the

16. 1996 ACE Form, Art. V.A.; 1996 XL Form, Art. V.A.

17. *See, e.g., CSX Transp., Inc. v. Commercial Union Ins. Co.*, 82 F.3d 478, 480-81 (D.C. Cir. 1996) (test for giving notice under excess policy is when, “viewed objectively, the facts and circumstances known to the insured would have suggested to a reasonable person the possibility of a claim likely to trigger the excess insurer’s coverage”); *Paramount Communications, Inc. v. Gibraltar Casualty Co.*, 612 N.Y.S.2d 156, 156 (App. Div. 1994) (three-year delay in notifying excess insurer justified because it took that long for insured to determine that damages would reach high excess layers).

18. *See CSX*, 82 F.3d at 481.

insured "in good faith determines its exposure to be less than its Per Occurrence Retention Amount," frequently \$25 million in the XL policies. In determining exposure, XL advises its insureds to "give more weight to the potential damages than to the risk of liability being imposed." Thus, XL seeks notice "where, even though the risk of liability is low, the potential damages are high (e.g., a seemingly frivolous class action for personal injuries). Of course, the mere fact that a plaintiff's attorney adds several zeros to the prayer for relief should not be controlling in evaluating exposure."¹⁹

C. The Expected or Intended Clause

Like many standard occurrence policies, the ACE and XL policies seek to exclude coverage for intentional injuries by defining an occurrence to exclude any injury that "is Expected or Intended by any Insured." In contrast to standard CGL policies, however, the ACE and XL forms contain an additional clause that further defines the term "expected or intended" in connection with integrated occurrences. The clause provides that injury to underlying claimants "as respects an Integrated Occurrence" may be "expected or intended" if: (a) the insured "has historically experienced a level or rate of actual or alleged Personal Injury," and (b) the insured "expects or intends a level or rate of actual or alleged Personal Injury."²⁰ Neither the ACE nor the XL policy defines the terms "historical experience" or "level or rate."

This clause may be of concern to the insured. There may be few instances in which an insured's decision to provide notice of an integrated occurrence for products liability will not have been preceded by at least some level of claim activity. For example, the breast implant manufacturers received relatively routine product liability claims long before an explosion of lawsuits, quite different in character, emerged in the early 1990s. If an insured's mere awareness of prior claims, or anticipation of additional claims in the future, were alone sufficient to vitiate coverage for an integrated occurrence, the ACE and XL coverage for mass tort claims could be largely illusory.

Indeed, the balance of the "expected or intended" definition makes clear that the policies are not so limiting. The ACE and XL policies provide that injuries caused by an integrated occurrence will not be deemed expected or intended to the extent that they are "fundamentally different in nature or at a level or rate vastly greater in order of magnitude" than expected injury. This language, often referred to by the insurers as

19. Memorandum to All X.L. Excess Liability Insureds Under Form XS-004 at 2-3 (Dec. 1, 1995).

20. 1996 ACE Form, Art. III.M(1); 1996 XL Form, Art. III.M(1).

imposing a “maintenance deductible,” preserves coverage when the insured experiences a significant increase or change in character in certain types of claims. However, neither the ACE nor the XL policy offers guidance on how to determine when injuries should be considered “fundamentally different” from prior injuries involving the same product or when an increase in the number or rate of claims involving that product should be viewed as “vastly greater in order of magnitude” than the historical claims experience. For example, if the insured historically experienced 100 claims per year from a given product, would a doubling of the claims to 200 per year be sufficient to avoid application of the expected or intended exclusion?²¹

There is one additional feature of the ACE and XL expected or intended clause—first added in 1996—that merits discussion. The policies state that once the insured provides notice of an integrated occurrence, any actual or alleged personal injuries that arise out of products sold *after* the date of notice will be deemed expected or intended and thus excluded from coverage if “similar to, and not vastly greater in order of magnitude” than prior injuries.²² This language seemingly could require the insured to consider halting product sales whenever it decides to treat a series of claims based on that product as an integrated occurrence. If the insured does not withdraw from the market, the company could be faced with the extraordinary argument that injuries arising from sales of the product *after* the date of notice of an integrated occurrence are automatically deemed to be expected or intended.

This should not be acceptable to the insured. To be sure, there may be a situation in which an increase in claims that is serious enough to warrant notice of an integrated occurrence could be serious enough to justify a costly product recall. But the fact that product liability claims have been asserted does not necessarily mean that the claims are meritorious, or that the product is in any way defective. It is certainly possible that a spate of claims involving a particular product will be groundless, and in those circumstances the insured may appropriately decide to defend the integrity of the product line and to resist any wide-ranging product recall. The insured may also decide that a product recall will only generate additional publicity, which in turn will lead to an even sharper increase in claims. Either way, the insured should have the right to make these kinds of product integrity decisions without sacrificing its insurance coverage in the process. By suggesting that injuries are expected or intended if they

21. While in ordinary lay usage “vastly greater in order of magnitude” may simply mean “a significant increase,” some insurers may assert that a technical mathematical meaning of “ten times” may apply.

22. 1996 ACE Form, Art. III.M(3).

arise from sales of a product *after* notice of an integrated occurrence, ACE and XL may be seeking to force insureds into product recalls as a matter of course. Such an interpretation of the expected or intended language would not only be unfair to the insured, but bad public policy as well.²³

D. Choice of Law and Interpretive Principles

The ACE, XL, and Starr forms all provide that their policies "shall be governed by and construed in accordance" with the "internal" or "substantive" laws of the State of New York.²⁴ Presumably, the insurers selected New York law because New York courts traditionally have treated compliance with notice requirements as a strict condition precedent to coverage. For example, the New York Court of Appeals held last year that an insured's unexcused delay in providing notice of a covered occurrence could vitiate coverage regardless of whether the excess insurer was prejudiced by the delay.²⁵

Despite this adoption of New York law generally, the policies seek to eliminate application of certain aspects of New York law. On the one hand, the ACE and XL forms eliminate application of a part of New York law that is potentially adverse to policyholders—the prohibition on indemnification of punitive damages.²⁶ On the other hand, the ACE and XL forms attempt to eliminate certain traditional contract law principles that are often favorable to policyholders.

Like other jurisdictions, New York courts have long recognized the doctrine of *contra proferentum*, which provides that ambiguous or uncertain policy language will be strictly construed against the insurer-drafter and in favor of coverage.²⁷ The ACE, XL, and Starr forms seek to prohibit resort to such rules of construction by providing that the policy language must be "construed in an evenhanded fashion as between the Insured and the Insurer" and where the language of the policy "is deemed to be ambiguous or otherwise unclear," the issue shall be resolved in the manner

23. Exclusion P to the most recent Starr form also raises the product recall issue. The Starr form excludes "any Occurrence which is included in an Integrated Occurrence, and which takes place after the Insured has given Notice of Integrated Occurrence." 1997 Starr Form, Art. III.P. However, the policy adds that "this exclusion shall not apply to Occurrences" arising from products "over which the Insured has relinquished possession by selling, distributing, giving away or abandoning . . . prior to giving Notice of Integrated Occurrence."

24. 1996 ACE Form, Art. VI.O; 1996 XL Form, Art. VI.O.

25. *American Home Assur. Co. v. International Ins. Co.*, 684 N.E.2d 14, 17-18 (N.Y. 1997).

26. See 1996 ACE Form, Art. VI.O; 1996 XL Form, Art. VI.O; see also *Home Ins. Co. v. American Home Prods. Corp.*, 550 N.E.2d 930, 932 (N.Y. 1990) (punitive damages not insurable); Barry S. Ostrager & Thomas R. Newman, *Handbook on Insurance Coverage Disputes* at 769 (9th ed. 1998) (punitive damages non-insurable; undecided whether vicarious liability awards are insurable).

27. See, e.g., *Continental Cas. Co. v. Rapid-American Corp.*, 609 N.E.2d 506, 511-512 (N.Y. 1993).

most consistent with the relevant provisions, stipulations, exclusions and conditions (without regard to authorship of the language, *without any presumption or arbitrary interpretation or construction in favor of either the Insured or the Insurer* or reference to the ‘reasonable expectations’ of either . . . *or to contra proferentum* and without reference to parol or other extrinsic evidence.²⁸

Not only is this provision of questionable fairness to the insured, but it may not be consistent with New York law itself. A major premise of rules of construction like *contra proferentum* in New York and elsewhere is that they should be applied in the context of standard-form policies drafted by the insurer. Since the Bermuda policies consist almost entirely of form language, the traditional rules of construction should apply. It is far from clear that the insurers can unilaterally prevent courts or arbitrators from resorting to these rules if substantive provisions of the policies are ambiguous or imprecise.

E. Defense Costs

The ACE and XL policies require indemnification of “Ultimate Net Loss,” which includes “Damages,” which in turn is defined to include “Defense Costs.” “Defense Costs” is broadly defined to include “reasonable legal costs and other expenses incurred by or on behalf of the Insured in connection with the defense of any actual or anticipated Claim.”²⁹ In addition, the policies make clear that the insured may count these defense costs towards exhaustion of the underlying retention.

Just as defense costs serve to erode underlying retentions, defense costs also count against upper limits. The coverage of defense costs within limits rather than in addition to limits is a potentially significant limitation on an insured’s available protection against a catastrophic exposure. Assuming the insured spent several years contesting a flood of lawsuits relating to a mass-tort situation, it could find itself in the unenviable position of having exhausted a substantial portion of liability insurance coverage before sustaining large damage awards or entering into a settlement.

F. Key Exclusions

1. **Injuries Prior to Inception Date.** A new exclusion has been inserted in the most recent ACE, XL, and Starr forms that purports to exclude coverage for personal injury “which takes place prior to the

28. 1996 ACE Form, Art. VI.O (emphasis added); *see also* 1996 XL Form, Art. VI.O; 1997 Starr Form, Art. IV.O. Prior forms were less sweeping in carving out legal doctrines helpful to policyholders.

29. 1996 ACE Form, Art. III.I.

Inception Date” of the policy.³⁰ Like other clauses in these policies, this exclusion is potentially subject to varying interpretations. For example, the insurer might try to deny coverage for part of an integrated occurrence if some of the injuries or damages occurred prior to the inception date, which for most original ACE and XL insureds would be 1985. The more plausible reading, which the insurers appear to share, is that only those claims alleging injury or damage that occurred *entirely* before the inception date might be subject to the exclusion.

2. Known Occurrences. The 1997 Starr form contains an exclusion that purports to bar coverage for any liability arising from an occurrence that was known to any executive officer or management-level employee prior to the inception date of the policy.³¹ The exclusion applies “irrespective of whether that person believed or expected such Occurrence would involve this policy.” Theoretically, this exclusion could foreclose coverage of *any* mass-tort exposure whenever the insured had any pre-inception claim activity involving alleged defects in the same product. Since many products generate at least *de minimis* claim activity, the products coverage might be illusory if the insurer could assert that even modest pre-inception claim activity meant that an insured’s senior employee “was aware” of the occurrence.

Similar problems exist with another exclusion in the 1997 Starr form, which seems to bar coverage of any occurrence “included within an Integrated Occurrence” if an executive officer or management-level employee “first became aware” of the occurrence more than five years before an insured gave notice of an integrated occurrence.³² For example, if an insured had five claims alleging injury from a product in 1996, followed by a dramatic increase in similar claims resulting from the publication of a “junk science” study about the product in 2002, Starr might try to argue that all such claims are barred by the exclusion.

3. Product and Other Exclusions. The most recent ACE, XL, and Starr forms all have exclusions directed at particular products and types of injuries. One exclusion, for example, is entitled “Toxic Substances,” and it purports to exclude coverage for alleged injuries from the manufacture, distribution, or sale of, or exposure to: “asbestos-containing materials”; “tobacco or any tobacco products”; DES; dioxin and dioxin component products; IUDs; and “any product containing silicone which is

30. 1996 ACE Form, Art. IV.A; 1996 XL Form, Art. IV.A.

31. See 1997 Starr Form, Art. III.O (“Known Occurrences”).

32. See 1997 Starr Form, Art. III.Q.

in any form implanted or injected in the body.”³³ And an exclusion for “Repetitive Stress” seeks to prevent coverage for certain liabilities “arising out of any repetitive motion, repetitive stress, repetitive strain or cumulative trauma disorder.”³⁴ Although the 1996 ACE policy contains a pollution exclusion, it does not apply to “Product Pollution Liability” or to certain discharges that are immediately reported to the insurer.³⁵

III. ARBITRATION UNDER THE BERMUDA FORMS

One of the most significant aspects of the Bermuda form is its elaborate arbitration provision designed to keep coverage disputes with US-based companies out of American courts. Consistent with this goal, the principal Bermuda carriers designate either Bermuda or England as the arbitral situs and provide for the application of local arbitration laws. Although it is widely recognized that arbitral tribunals are free to conduct proceedings at places other than the arbitral situs,³⁶ it is likely that most American insureds will find the foreign arbitration process cumbersome, complex, and extremely expensive, bringing to mind one scholar’s comment that “[i]nternational commercial arbitration is sometimes referred to as ‘Rolls Royce’ justice.”³⁷

A. Situs

The current ACE and XL forms provide that “any and all disputes arising out of or relating to this Policy” shall be subject to binding arbitration in London, England.³⁸ The original ACE policy also designated London as the arbitral seat, but the 1991 ACE form switched to Bermuda because, according to an “Executive Summary” to the 1991 ACE form, Bermuda was “more convenient for most ACE insureds.” ACE’s stated concern for policyholder convenience was short lived, however, because in 1996, ACE restored London as the arbitral situs, the situs XL consistently has used. By contrast, the current Starr form provides for a Bermuda-based arbitration.³⁹

33. See 1996 ACE Form, Art. IV.H; 1996 XL Form, Art. Comment IV.H; 1997 Starr Form, Art. III.G.

34. See 1996 ACE Form, Art. IV.O; 1996 XL Form, Art. IV.O.

35. See 1996 ACE Form, Art. IV.K; 1996 XL Form, Art. IV. K.

36. See Reply Brief of Defendant-Appellant ACE Insurance Co. at 25 (June 29, 1998), filed in *Ieyoub v. American Tobacco Co.*, No. 97-31222 (5th Cir.), reprinted in *Mealey’s Ins. Supp.* (July 23, 1998).

37. Russell J. Weintraub, *International Litigation and Arbitration* at 455 (1994).

38. 1996 ACE Form, Art. VI.N; 1996 XL Form, Art. VI.N.

39. See 1997 Starr Form, Art. IV.B.

B. Validity of the Arbitration Clause

The insured should not automatically assume that these foreign-situs arbitration clauses are valid and enforceable. There are at least 10 states, for example, that have statutes precluding the arbitration of insurance disputes.⁴⁰ There may be a question as to whether these "anti-insurance arbitration" statutes are preempted by the Federal Arbitration Act (FAA),⁴¹ but federal courts recently have concluded that state statutes precluding insurance arbitration are immunized from FAA preemption by the McCarran-Ferguson Act's delegation of insurance regulation to the States.⁴² Thus, if the insured resides in one of the states that has an anti-insurance arbitration statute, *and* can obtain personal jurisdiction over the Bermuda (or European) insurer in that forum, then the state statute may permit the insured to sue the insurer in a US court rather than arbitrate in Bermuda or London.

A policyholder seeking to avoid arbitration might also consider lodging a systemic challenge to the entire concept of forced arbitration of insurance coverage disputes. For example, many employment discrimination claimants working in the securities industry have argued that the established securities industry arbitration system is inherently unfair. At least one court has agreed.⁴³ There are indications that some insureds feel the same way about insurance arbitrations,⁴⁴ which suggests that future public policy challenges are likely.

40. See Ark. Code Ann. 16-108-201(b) (Michie 1997) (arbitration "shall have no application to . . . any insured or beneficiary under any insurance policy"); Ga. Code Ann. § 9-9-2(c)(3) (Michie 1997) (arbitration provisions "shall not apply" to "any contract of insurance"); Kan. Stat. Ann. § 5-401(c) (1991) (provisions of arbitration act "shall not apply to . . . [c]ontracts of insurance"); Ky. Rev. Stat. Ann. § 417.050(2) (Michie 1996) ("insurance contracts" excluded from arbitration); La. Rev. Stat. Ann. § 22:629a (West 1986) ("[n]o insurance contract . . . shall contain any . . . agreement . . . depriving the courts . . . of the jurisdiction of action against the insurer"); Mo. Ann. Stat. § 435.350 (West 1992) ("except contracts of insurance"); Mont. Code Ann. § 27-5-114(2)(c) (1998) (arbitration not applicable to insurance contracts); Neb. Rev. Stat. § 25-2602(f)(4) (Michie 1997) ("does not apply to . . . any agreement . . . relating to an insurance policy other than a contract between insurance companies including a reinsurance contract"); Ok. Stat. Ann. tit. 15, § 802 (West 1993) ("shall not apply to . . . contracts with reference to insurance except for those contracts between insurance companies"); S.D. Laws Ann. § 21-25A-3 (Michie 1998) ("does not apply to insurance policies"); Vt. Stat. Ann. tit. 12, § 5653 (Michie 1997) ("does not apply . . . to arbitration agreements contained in a contract of insurance"). See also R.I. Stat. Ann. § 10-3-2 (Michie 1996) ("allowing arbitration at the option of the insured").

41. 9 U.S.C. § 2.

42. See *e.g.*, *Transit Cas. Co. v. Certain Underwriters at Lloyd's of London*, 119 F.3d 619, 622 (8th Cir. 1997) (Missouri's Uniform Arbitration Act was not preempted by the FAA and thus precluded enforcement of an arbitration clause in a reinsurance policy); *Stephens v. American Int'l Ins. Co.*, 66 F.3d 41, 45 (2d Cir. 1995) (neither the FAA nor the New York Convention preempts the Kentucky Liquidation Act, which bars arbitration clauses against insolvent insurance companies); *but see Little v. Allstate Ins. Co.*, 705 A.2d 538, 539-41 (Vt. 1993) (FAA preempts application of the anti-insurance arbitration clause of the Vermont Arbitration Act).

43. *Rosenberg v. Merrill Lynch*, 995 F. Supp. 190, 206-208 (D. Mass. 1998).

44. See Brief of Amicus Curiae United Policyholders in Support of the State of Louisiana's Original Brief at 17-25 (Mar. 13, 1998), *filed in Ieyoub v. American Tobacco Co.*, Nos. 97-31279, 97-31222

C. Third-Party Claims

Even if the policyholder cannot obtain access to a US court directly, two recent cases suggest that ACE and XL's carefully crafted strategy to stay out of court in America may not work when these foreign insurers are confronted with other insurers' claims for contribution or a tort victim's direct action.⁴⁵

In *X.L. Insurance Co. v. Hartford Accident & Indemnity Co.*,⁴⁶ Hartford filed an action against XL for contribution and indemnity in regard to Bristol Myers Squibb breast implant claims. XL sought dismissal, contending that the arbitration clause in effect with Bristol Myers should be enforced against other insurers because "privity is not required in order to bind a party to arbitration under New York law."⁴⁷ Affirming the trial court's denial of the XL motion, the court of appeals concluded that insurer contribution claims "are independent of, rather than derivative of, any alleged third-party beneficiary, agency, or assignee/subrogee relationship. There is no litigation pending between X.L. and [Bristol Myers]; the only claim X.L. seeks to have dismissed is that of a non-party to the arbitration agreement."⁴⁸

More recently, ACE was confronted with Louisiana's "direct action" statute in the State of Louisiana's lawsuit against the tobacco industry. There, the Attorney General of Louisiana sued a number of tobacco manufacturers and then, one year later, sued their liability insurers (including ACE) under the Louisiana Direct Action Statute, which provides that the "injured person . . . shall have the right of direct action against the insurer within the terms of the policy."⁴⁹ In response, ACE instituted arbitration proceedings in London against its insureds and removed the State's lawsuit to federal court pursuant to the FAA's provisions covering international arbitration.⁵⁰ The federal district court denied the State's motion to remand to state court, but also refused to permit ACE to proceed

(5th Cir.), reprinted in *Mealey's Ins. Supp.* (May 1, 1998). The United Policyholders brief contends that arbitration of insurance coverage disputes undermines a state's ability to regulate the insurance industry, prevents public dissemination of interpretive rulings, and places the policyholder "in the hands of an insurance industry dominated process." United Policyholders Brief at 19.

45. The ACE and XL policies address the indemnity/contribution issue, providing that "in the event that claims for indemnity or contribution are asserted in any action or proceeding against [ACE] by any of the Insured's other insurers in any jurisdiction [other than London], the Insured will in good faith take all reasonable steps requested . . . to assist [ACE or XL] in obtaining a dismissal of these claims[.]" 1996 ACE Form, Art. VI.N(5); see also 1996 XL Form, Art. VI.N(5).

46. 918 S.W.2d 687 (Tex. App.-Beaumont 1996, no writ).

47. 918 S.W.2d at 689.

48. *Id.*

49. See La. Rev. Stat. 22:655 (West 1986).

50. See 9 U.S.C. § 205.

with its arbitrations until the Fifth Circuit could rule on the remand issue.⁵¹ ACE has appealed the district court's order staying the arbitrations to the Fifth Circuit,⁵² but for the time being, ACE remains a party in this highly visible litigation between the State of Louisiana and the tobacco industry.

These recent developments may have great significance for the Bermuda excess market. The arbitration clause still may apply to direct disputes with insureds, but in large omnibus coverage cases with numerous insurer defendants, a policyholder might refrain from naming XL or ACE, only to have the named insurers bring a third-party claim for contribution against ACE and/or XL. This could result in American courts ruling on coverage defenses and interpreting these Bermuda forms, a scenario that the island carriers have gone to great lengths to avoid.

D. Three Key Arbitration Issues

1. **Selection of Arbitrators.** Under the ACE and XL policies, either the insured or the insurer may initiate the arbitral process by notifying the other of its intention to arbitrate and by nominating its party-appointed arbitrator. The other party then has 30 days in which to nominate its party-appointed arbitrator.⁵³ Bermuda insurers arbitrating in London have typically appointed English barristers as their party-appointed arbitrators, often using the same party-appointed arbitrator on multiple occasions. This practice likely will continue now that London is again the arbitral situs for both ACE and XL.

Some American insureds will begin with a decided preference for an American lawyer or jurist to serve as party-appointed arbitrator. Given that New York law controls and that most arbitrations will involve US-based facts and underlying claims, an American arbitrator likely will be better able to understand the relevant laws and facts. As a London-based solicitor has put it, if the American policyholder is the claimant and appoints an American lawyer as its arbitrator, the foreign insurer is faced with these choices:

- (a) does he appoint another US lawyer so as not to feel disadvantaged in any deliberations about issues of substantive law; or
- (b) does he appoint an English lawyer with greater familiarity with procedural matters which might be relevant to the arbitration; or

51. See *Ieyoub v. American Tobacco Company*, No. 97-1174, slip op. at 18 (W.D. La. Sept. 11, 1997), reprinted in *Mealey's Litig. Rep. Insurance* (Sept. 16, 1997); see also Amended Order, Oct. 28, 1997.

52. See Brief of Defendant-Appellant A.C.E. Insurance Company, Ltd. On Appeal of Order Staying Arbitration (May 12, 1998), filed in *Ieyoub v. American Tobacco Company*, Nos. 97-31279, 97-31222 (5th Cir.), reprinted in *Mealey's Ins. Supp.* (July 23, 1998).

53. See 1996 ACE Form, Art. VI.N(1); 1996 XL Form, Art. VI.N(1); see also 1997 Starr Form, Art. IV.B (either party may initiate arbitration "once a claim or demand on his part has been denied or remains unsatisfied" for at least 20 days).

- (c) does he appoint an industry expert who is not legally qualified but who may have greater experience of how the insurance market actually works?⁵⁴

Any enthusiasm by a US policyholder for an American party-appointed arbitrator might be tempered, however, if it appears that the other two members of an arbitral panel will be English.

Alternatively, the US policyholder could appoint an Englishman on the assumption that the Bermuda insurer likewise will do the same, and then press for appointment of an American as the third arbitrator. There is no right way to approach the appointment process other than to insist on arbitrators of strong intellectual caliber, high integrity, extensive arbitration experience, and a genuinely international perspective.

Under the ACE, XL, and Starr policies, the two party-appointed arbitrators have a defined period (usually 30 days) in which to agree on the selection of the third arbitrator. In the event that the arbitrators chosen by the parties cannot agree, the third arbitrator is to be selected by the English High Court under the ACE and XL policies, and by “a judge of a court of competent jurisdiction in Bermuda” under the Starr policy. The conventional wisdom—largely untested—is that these courts would select a local practitioner or retired judge to serve as the third arbitrator. Given the undoubted importance of US law and practice and the large number of Americans with stature in international arbitration circles, an English or Bermudan judge should be expected seriously to consider the appointment of an American as the third arbitrator.

2. Transnational Legal Teams. The ACE and XL policies are governed by New York substantive law, but the arbitration procedures are fixed by English law. The applicability of different bodies of substantive and procedural law typically prompts American insureds to retain a multinational legal team, including: (a) American counsel who are knowledgeable concerning the policies, the underlying claims, and US law; and (b) a London-based solicitor and/or barrister who is versed in English procedural rules and arbitration practices. For an American insured, the need to employ multiple counsel will inevitably result in an expensive proceeding.

3. Arbitration Practice. The idealized view of arbitration in the United States is that it offers an economical, speedy, and confidential

54. Nigel Rawding, “Can a US Policyholder Expect to Receive a Fair Hearing in an Arbitration against Lloyd’s Underwriters in London or Bermudan Companies in Bermuda?,” at 10 (Feb. 1994), reprinted in A.B.A. Litig. Sec., Ins. Coverage Litig. Comm. Annual Midyear Meeting (March 1994).

method of dispute resolution. There is no reason why a foreign arbitration cannot live up to that ideal, and modern practice should be moving in that direction. That said, some London arbitrations have been known to get bogged down and become creatures of overly formalistic practices.⁵⁵ The challenge of counsel is to press vigorously for the desirable and more efficient features of arbitration, which presumably motivated the insurers to mandate the arbitral process in the first place.

CONCLUSION

As we begin the twenty-first century, the Bermuda form policy—whether used by the Bermuda carriers or their European competitors—will play an increasingly important role in the insurance market. The next mass-tort disaster or products catastrophe, for example, almost certainly will involve these Bermuda policies. At a minimum, over the next few years, numerous policyholders that to date have never made a claim under these policies likely will be filing their first claim, or at least putting these insurers on notice of losses that are reasonably expected to exceed the underlying retentions. Thus, it is critical for policyholders, even those who have been insureds for a decade or more, to pay close attention to these policies, which include some new key concepts and terms in their most recent iteration. These policies are in some respects both dense and complex, far more so than this article's general overview can suggest.

55. See, e.g., Eugene Wollan, "A View From the Colonies," *The John Liner Review* at 61 (Summer 1997) (referring to filing of "Re-Re-Re-Re-Amended Points of Claim" in recent London arbitration).