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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Compelling Arbitration — Sans Arbitration Clause

Law360, New York (April 25, 2012, 5:58 PM ET) -- Can a life insurance company compel arbitration even though its policy does not contain an arbitration clause? Of course not, you might say at first. But, as a recent decision by the California Court of Appeal reminds us, sometimes an insurer may do just that. When the situation is right, motions to compel arbitration by insurers often catch plaintiffs off guard and have the potential to change the dynamics—and maybe the outcome—of a case.

Insurers most often have the opportunity to consider a motion to compel arbitration in financial planning cases that involve insurance as part of an overall estate or tax planning strategy and that do not work out according to plan. The advisers or lawyers involved in creating the financial plan, and the broker-dealers through whom any securities in the plan were sold, sometimes have customer contracts requiring FINRA or AAA arbitration.

If things fall apart, and one of the parties to the contract files suit, the insurance company is frequently a defendant — and often the only defendant. Is the insurer stuck in the forum the plaintiff chose? Not necessarily. Although not a party to the plaintiff's contract with the broker or planner, the insurer may still be able to invoke the contract's arbitration clause.

Estoppel is the most commonly cited rationale. When moving to compel arbitration, insurers argue that a plaintiff who agreed to arbitrate particular types of claims should not be allowed to avoid arbitration by casting the dispute a certain way or by carefully selecting a lineup of defendants that excludes the other parties to the agreement. Insurers also often point to contract law on third-party beneficiaries.

In response, plaintiffs frequently argue that "I didn't agree to arbitrate this type of claim, and I certainly didn't agree to arbitrate it with you." Other times, they turn the estoppel argument on its head, arguing that the insurer could have included an arbitration provision in its policy but did not and should not be allowed to, in effect, add an arbitration clause after the fact. Plaintiffs also argue that trying to invoke a provision in someone else's contract is too clever by half and that the insurer is really just forum shopping.

No matter the precise grounds for the motion or the plaintiff's response, courts have substantial leeway in defining the analysis. Often, courts look past the legal arguments to see whether it is the plaintiff or the insurer that is doing the forum shopping.

When can this be done? As with most things, the answer is, “it depends on the facts.” As discussed below, an insurer may invoke another party’s agreement to arbitrate only in certain circumstances. While courts frame the issue somewhat differently, the key is linking the pleadings in litigation to a contract with an arbitration clause.

When Can an Insurer Without an Arbitration Clause Invoke Arbitration?

Broadly speaking, there are three scenarios in which a defendant that is not a party to an arbitration agreement might still be able to compel arbitration.

In the first scenario, the plaintiff’s case involves the type of claim the plaintiff agreed to arbitrate with another party.[1] In the financial services context, plaintiffs often challenge whether the insurance serves their ultimate financial planning purposes, not whether the insurer breached the policy.

The plaintiff argues that the insurer is responsible nonetheless because the financial plan into which the policy fit has not performed as well as the plaintiff’s broker or tax specialist originally represented. If the plaintiff’s contract with the broker or tax planner requires arbitration of all claims relating to the broker’s or planner’s services or products, the insurer — though not a party to the contract — can argue that the dispute falls within the scope of the arbitration provision and, therefore, must be arbitrated.

The second situation in which a non-signatory may compel arbitration arises where an agreement containing an arbitration clause will be a focal point of the litigation. If a plaintiff sues to recover benefits under a contract requiring arbitration, for example, courts routinely hold that the plaintiff may not simply ignore its agreement to arbitrate all disputes concerning the contract.[2]

In a securities or other financial services case, the plaintiff often seeks what amounts to the benefit of the bargain it made with a broker or financial planner — investment growth or tax savings. In these circumstances, the insurer can argue that the court should still compel arbitration because the plaintiff effectively is pursuing benefits under a contract with an arbitration provision.

The third scenario arises where the plaintiff alleges a conspiracy or agency relationship between a party with which it agreed to arbitrate and the party that wishes to compel arbitration. As the California court recently demonstrated in Thomas v. Westlake[3], a plaintiff, in effect, pleads itself into arbitration.

In Thomas, a court of appeals in California held that the defendant-insurer could invoke the plaintiff’s arbitration agreement with a broker-dealer because the plaintiff claimed that the insurer and broker were each other’s agents.[4] The court reasoned that the plaintiff, by alleging the existence of such an agency relationship, was estopped from arguing that the insurer could not invoke the broker-dealer’s contractual right to arbitrate.[5]

Is Seeking to Compel Arbitration a Good Idea for an Insurer?

Ultimately, just because a nonparty insurer may compel arbitration does not always mean it should. The pros and cons of arbitration are well-known. In arbitration, the rules of procedure and evidence are less formal, which can be good or bad. There is no right of appeal, and dispositive motions — if not prohibited — are rarely granted. And, depending on the relevant issues and the court venues, an arbitration panel might be better or worse than a judge or jury. All these factors will bear on whether an insurer might want to compel arbitration.

Moving to compel can be advantageous even if the court denies the motion, however, as the threat of arbitration often creates early settlement leverage. The motion can result in the best of both worlds for the insurer: an order staying the state court case and compelling the other parties to arbitrate.

This might seem a little like a double-bank shot, but it has happened before, the rationale being that a court can avoid the risk of inconsistent rulings on overlapping claims by awaiting the results of the arbitration before allowing the litigation to proceed. Down the road, this can have its own benefits, as the result of the arbitration can provide res judicata or collateral estoppel against a plaintiff.

Of course, moving to compel will not always be an available option. In most life insurance cases, for instance, the plaintiff will not have agreed to arbitrate anything with anyone. Invoking arbitration may also be impossible in a traditional insurance dispute involving coverage, claims handling or bad faith.

As FINRA Rule 12200 puts it, arbitration is not an appropriate forum for "inherently insurance" or "insurance-only" disputes. Where there is a hook, however, motions to compel arbitration can be a valuable strategic option. Insurance companies should consider this often-overlooked issue at the start of any case. It might prove to be a difference-maker.

--By David Jones, Akin Gump Strauss Hauer & Feld LLP

David Jones is a partner in Akin Gump's San Antonio, Texas, office.

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[1] See Sea Bowld Marine Group, LDC v. Oceanfast PTY, Ltd., 432 F. Supp. 2d 1305, 1314 (S.D. Fla. 2006) (stressing that the "lack of a written arbitration agreement is not an impediment to arbitration" where the plaintiff's claims fall "within the scope of" an arbitration agreement between the plaintiff and another party) (quoting Sunkist Soft Drinks Inc. v. Sunkist Growers Inc., 10 F.3d 753, 755-58 (11th Cir. 1993)).

[2] See Int'l Paper Co. v. Schwabedissen Maschinen & Analgen GMBH, 206 F.3d 411, 418, 416-18 (4th Cir. 2000) (holding that the plaintiff — the buyer of an industrial saw whose breach-of-contract and breach-of-warranty claims against the saw's manufacturer and distributor were based in part on a contract between the two defendants — could not "seek to enforce those contractual rights and avoid the contract's requirement that 'any dispute arising out of' the contract be arbitrated").

[3] -- Cal. Rptr. 3d --, (Cal. Ct. App. Mar. 23, 2012).

[4] Id. at *5.

[5] Id.