Westlaw Journal
INSURANCE COVERAGE
Litigation News and Analysis • Legislation • Regulation • Expert Commentary
VOLUME 25, ISSUE 32 / MAY 14, 2015

EXPERT ANALYSIS

Navigating Cross-Border Coverage in the Bermuda 'Choice Of Law' Triangle

By Walter J. Andrews, Esq., and Paul T. Moura, Esq.
Hunton & Williams

Because American courts have interpreted insurance policies in some unexpected ways over the past several decades, many insurance carriers and policyholders have shied away from U.S.-based insurance coverage and have flocked to Bermuda to use what are commonly referred to as "Bermuda Form" policies. The idea is that the use of these foreign policies can mitigate some of the perceived risks posed by the American court system.

Originally, Bermuda Form policies required disputes to be subject to arbitration governed by U.S. substantive law, but with procedural and arbitration rules governed by English law. The view was that this would, in theory, make coverage litigation less expensive or unwieldy.

As the Bermuda insurance market has developed, however, more insurance and reinsurance agreements are now designating Bermuda substantive law. Bermuda law is largely modeled after English common law, but it has a few of its own quirks. Thus, in considering whether to purchase these policies, policyholders will need to demystify this tripartite governing law, and they should keep in mind several potential key differences between U.S. insurance law and Bermuda's developing insurance framework.

COVERAGE FOR 'PROPERTY DAMAGE'

Policy language under U.S. law may result in broader coverage for certain liabilities than would similar language governed by Bermudian law. For example, jurisdictions can vary as to what constitutes physical damage to property. In the American legal system, incorporating a defective product or commodity within another product can amount to physical damage.[1]

Courts in the English system have gone the other way, holding that such incorporation does not, by itself, result in physical damage to property.[2] Depending on the language of the form used, Bermuda courts may be expected to follow that precedent, giving policyholders a narrower scope of coverage.

COVERAGE FOR SETTLEMENT COSTS

A Bermudian court guided by English law also probably would follow the principle that an insurer is not required to indemnify its insured for settlement costs unless there is "actual legal liability," absent any language to the contrary.

Recently, in *AstraZeneca Insurance Co. v. XL Insurance (Bermuda) Ltd.*, the English Court of Appeal held that there must be a demonstration of actual legal liability on a balance of probabilities, as opposed to an "arguable liability," for the insured to be entitled to an indemnity.[3]

Many insurance carriers and policyholders have shied away from U.S.-based insurance coverage and have flocked to Bermuda.

In contrast, the rule in many U.S. jurisdictions is that the insured need only show that it made a reasonable, good-faith settlement of a potential liability.[4] Thus, a Bermudian choice-of-law provision can significantly affect a strategy in considering whether a settlement would be commercially sensible. A well-informed strategy is particularly important when a Bermuda Form policy-holder participates in coverage litigation in a U.S. court, which is comparatively more expensive than Bermuda-based litigation but still governed by Bermuda's limitations on coverage for settlement costs.

QUESTIONS OF ARBITRABILITY

The general rule in the United States is that courts should decide whether claims fall within the scope of the arbitration agreement, unless the parties "clearly and unmistakably" intend that the arbitrators should decide arbitrability.[5]

Bermuda law, however, leaves "arbitrability" to be decided by an arbitrator.[6] In fact, the arbitral tribunal has authority to rule on whether there is an arbitration agreement at all. Furthermore, under the English common-law doctrine of "separability," an arbitration provision is treated as a separate agreement independent of the overall agreement in which it is found, which means that a challenge to the enforceability of the parties' overall agreement does not necessarily preclude the arbitral tribunal from ruling on its own jurisdiction.[7]

ARBITRATION PROCEDURES AND DAMAGES

Generally, Bermuda arbitrations will adopt procedures influenced by Bermudian and English civil procedure. For example, the parties will typically first exchange statements of the case and documentary discovery, followed by an exchange of fact and expert-witness statements.[8] The tribunal may also appoint its own expert.[9]

In addition, there can be differences in what is or is not considered privileged in a Bermuda Form arbitration. Bermuda law recognizes only two types of privilege: the legal professional privilege and the litigation privilege. An arbitral tribunal in Bermuda may not uphold a claim of privilege if it does not fall within these two categories.[10]

Notably, U.S. states vary in whether arbitrators are permitted to award punitive damages, and arbitrations governed by the rules of the Federal Arbitration Association have allowed such damages.[11] However, under Bermuda law, it is unlikely that the arbitral tribunal would have power to award punitive damages without a clear agreement authorizing such a remedy.

VACATING ARBITRATION AWARDS

Grounds for challenging an award under Bermuda law also differ from the U.S. approach. Under Bermuda law, an award can be set aside if:

- A party to the arbitration agreement was incapacitated.
- The arbitration agreement was invalid.
- A party was not given proper notice of the appointment of an arbitrator or of the proceedings, or was otherwise unable to present its case.
- The award deals with a dispute outside the scope of the arbitration agreement.
- The arbitral tribunal, or the procedure it adopted, was not in accordance with the agreement of the parties.
- The court finds that the subject matter of the dispute is not capable of settlement in arbitration by the law of Bermuda or
- The award offends public policy.[12]

Under the U.S. Federal Arbitration Act, however, an award may be vacated only if the award was procured by corruption, fraud or undue means; there was evident partiality in the arbitrators; the arbitrators were guilty of any misconduct that caused prejudice; or the arbitrators exceeded their powers.[13]

AVOIDING BERMUDA LAW?

Even with a Bermuda choice-of-law provision, it may be possible to avoid application of unfavorable Bermuda law. In *Ghose v. CNA Reinsurance Co.*, a New York state court considered a choice-of-law clause in an insurance policy providing that "this policy shall be interpreted under, governed by and construed in accordance with the laws of the jurisdiction of [Bermuda]."[14] In that case, the defendant directors and officers liability insurers had given notice to rescind a D&O policy, and given the favorable Bermuda law relating to rescission as compared with New York law, the insurers argued that Bermuda law should apply.

The court acknowledged that the choice-of-law clause must apply to the parties' "contractual" causes of action. However, the court did not consider the clause to be encompassing enough to include "non-contractual" causes of action or affirmative defenses, such as the insurer's claim of rescission based on fraudulent inducement. The court therefore applied New York law, rather than Bermuda law, to the insurer's claim.[15]

CONCLUSION

As Bermuda Form policies become increasingly common, policyholders will need to keep these jurisdictional differences in mind, since the choice-of-law clause has the potential to significantly increase or decrease the scope of coverage. As explained above, application of Bermuda law can have a significant effect on insurance coverage litigation, arbitration and settlement strategies. Coverage counsel can assist policyholders in demystifying unfamiliar coverage types in order to evaluate their particular risk profiles in an increasingly international insurance marketplace.

NOTES

[1] *See, e.g., Shade Foods Inc. v. Innovative Prod. Sales & Mktg.*, 78 Cal. App. 4th 847 (Cal. Ct. App., 1st Dist. 2000); *Eljer Mfg. v. Liberty Mut. Ins. Co.*, 972 F.2d 805, 814 (7th Cir. 1992).

[2] Matthew Smith & John Sylvester, *Coming to Grips with the Bermuda Form,* StrategicRISK (February 2006), http://bit.ly/1HZMbJU.

[3] *AstraZeneca Ins. Co. v XL Ins. (Bermuda) Ltd. & Anor* [2013] EWCA Civ. 1660, *available at* http://www.bailii.org/ew/cases/EWCA/Civ/2013/1660.html.

[4] *See, e.g., Tokio Marine & Nichido Fire Ins. Co. v. Calabrese*, No. 07-CV-2514, 2013 WL 752259, at *8 (E.D.N.Y. Feb. 26, 2013).

[5] *AT&T Tech. v. Commc'n Workers of Am.*, 475 U.S. 643, 649 (1986).

[6] UNCITRAL Model Law on International Commercial Arbitration, Article 23; *see also Oracle Am. Inc. v. Myriad Group A.G.*, 724 F.3d 1069, 1075 (9th Cir. 2013) (holding that UNCITRAL arbitration rules delegate questions of arbitrability to arbitrators).

[7] *Cf. Contec Corp. v. Remote Solution Co.*, 398 F.3d 205, 208 (2d Cir. 2005) ("Under the [U.S. Federal Arbitration Act], there is a general presumption that the issue of arbitrability should be resolved by the courts.").

[8] *See* UNCITRAL, *supra* note 6.

[9] *Id.* at Article 26.

[10] *See IRS & Minister of Fin. v. Braswell* [2001] Bda LR 41, [2002] Bda LR 51 (adopting English law on privilege); *Three Rivers Dist. Council v. Bank of England* (No. 5), [2003] EWCA 2565 (Comm.), appeal dismissed [2004] EWCA Civ. 218 (discussing scope of privilege under English common law).

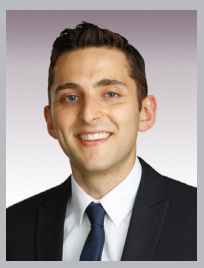
[11] *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52, 58 (1995); *Sperry Int'l Trade v Gov't of Israel*, 689 F2d 301 (2d Cir. 1982).

[12] *See* Bermuda International Conciliation and Arbitration Act 1993, Article 23; UNCITRAL Model Law on International Commercial Arbitration, Article 34. An award is in conflict with the public policy of Bermuda if, *inter alia*, the making of the award was induced or affected by fraud or corruption. *See* Bermuda International Conciliation and Arbitration Act 1993, Article 27.

[13] Federal Arbitration Act, § 10(a).

[14] *Ghose v. CNA Reinsurance Co. Ltd.*, Index No. 108121/04, at p. 9 (N.Y. Sup. Ct., N.Y. Cnty. Jan. 26, 2006).

[15] *See also Imaging Holdings I LP v. Israel Aerospace Indus. Ltd.*, 26 Misc. 3d 1226(A), 907 N.Y.S.2d 437, 2009 WL 5895337 (N.Y. Sup. Ct., N.Y. Cnty. 2009) (finding that Israeli law applied to non-contractual fraud causes of action, despite the presence of a New York choice-of-law provision in the agreement).



Walter J. Andrews (L), a partner in the McLean, Va., and Miami offices of **Hunton & Williams**, heads the firm's insurance coverage counseling and litigation practice. He focuses on complex insurance litigation and reinsurance arbitrations, including cross-border insurance disputes. He can be reached at wandrews@hunton.com. **Paul T. Moura** (R), an associate in the firm's Los Angeles office, focuses his practice on insurance coverage counseling and litigation. He can be reached at pmoura@hunton.com. This article presents the views of the authors and does not necessarily reflect those of Hunton & Williams or its clients. The information presented is for general information and education purposes. No legal advice is intended to be conveyed; readers should consult with legal counsel with respect to any legal advice they require related to the subject matter of the article.