



July 31, 2017

Katie Johnson
Virginia Bureau of Insurance

VIA EMAIL: Katie.Johnson@scc.virginia.gov

Dear Ms. Johnson:

United Policyholders (“UP”), a 25 year-old non-profit insurance consumer organization, and the Center for Economic Justice (“CEJ”), respectfully and strongly oppose any change in your agency’s position on binding arbitration in homeowner’s insurance policies. The prohibition in Virginia Code § 38.2-312 and related statutes are essential consumer protection measures¹ that will continue to serve your resident businesses and individuals well if left intact. The inherent imbalance in resources and leverage between a one-time versus a repeat, institutional user of arbitration proceedings is particularly acute in the insurer-insured context.

We absolutely support consensual arbitration where appropriate procedural safeguards are in place to ensure fairness in the outcome. Arbitration can be a sound dispute resolution process where both parties evaluate the pros and cons and decide it is in their best interests to arbitrate rather than litigate.² But mandatory pre-dispute arbitration provisions don’t belong in insurance

¹ § 38.2-312 reads as follows: **Provisions limiting jurisdiction, or requiring construction of contracts by law of other states, prohibited.** No insurance contract delivered or issued for delivery in this Commonwealth and covering subjects which are located or residing in this Commonwealth, or which are performed in this Commonwealth shall contain any condition, stipulation or agreement: 1. Requiring the contract to be construed according to the laws of any other state or country, except as may be necessary to meet the requirements of the motor vehicle financial responsibility laws of the other state or country; or 2. **Depriving the courts of this Commonwealth of jurisdiction in actions against the insurer.** Any such condition, stipulation or agreement shall be void, but such voiding shall not affect the validity of the remainder of the contract. 952, c. 317, § 38.1-339; 1986, c. 562. (emphasis added).

² Charles L. Knapp, Taking Contracts Private: The Quiet Revolution in Contract Law, 71 Fordham L. Rev. 761, 781–82 (2002) (“Arbitration is, first of all, not free. Commercial arbitrators are paid for their services, as, of course, are judges. However, judges’ remuneration comes out of everyone’s taxes while arbitrators’ fees must come out of the pockets of the parties. **Two disputants with equally deep pockets may gladly pay the cost of arbitrators’ fees as a trade-off for speedier resolution of their dispute.** There are many reasons why time is money, particularly to those who have plenty of the latter and never enough of the former. **But where**

contracts. They deprive the purchaser of the ability and right to make that evaluation *when a dispute has arisen*, and based on specific information about arbitration's pros and cons in their situation. The right to litigate is the most powerful leverage a consumer has when a dispute arises between them and an insurance entity. Allowing insurers to deprive their customers of that right at the time they purchase a policy is blatantly unfair and unsound from a public policy perspective.

Opposition to mandatory arbitration in contracts of adhesion continues to build

The National Association of Insurance Commissioners now has a working group specifically charged with acting on consumer opposition to allowing insurers to gain an unfair advantage in resolving disputes with their insureds. The Group is examining whether pre-dispute mandatory arbitration, choice of venue and choice of law provisions should be further limited or outright banned in insurance policy contracts.

The Consumer Financial Protection Bureau (CFPB) issued its final arbitration rule on July 10, 2017, which, *inter alia*, prohibits covered providers (*e.g.*, debt servicers, credit lenders) from using pre-dispute mandatory arbitration to bar class action lawsuits. It also requires providers to report arbitral records to the CFPB.³

The CFPB's background study found that "pre-dispute arbitration agreements are being widely used to prevent consumers from seeking relief from legal violations on a class basis, and that consumers rarely file individual lawsuits or arbitration cases to obtain such relief." *Id.* The CFPB also recognized that arbitration outcome data is sparse and thus the new rule requires that such data be provided to the CFPB for ongoing analysis. That is all to say that the use of pre-dispute mandatory arbitration clauses raises serious concerns about the ability of consumers to enforce their contractual rights and that we do not have the data necessary to analyze outcomes.

While arbitration clauses are prevalent in consumer contracts, and with regard to uninsured and underinsured motorist portions of auto policies, they have not appeared in home policies with a few notable exceptions. An insurer's proposal in Texas which would have offered policyholders a discount in exchange for agreeing to arbitrate rather than litigate claim disputes was vigorously opposed by policyholder advocates and ultimately withdrawn.⁴

From a macro-perspective, the arbitration process for an individual consumer is a stacked deck. Insurers have years of experience as favored, high-paying customers of the dominant provider,

the claimant is an individual buyer of goods or services, an employee, a health-care patient, a bank customer, or even a small business attempting to pursue a claim against a much larger one, the cost of arbitrators' fees may be prohibitive (emphasis added).

³ See: <https://www.consumerfinance.gov/policy-compliance/rulemaking/final-rules/arbitration-agreements>;
https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201707_cfpb_Arbitration-Agreements-Rule.pdf.

⁴ See: <https://www.tdi.texas.gov/rules/financial/documents/dkt2788s614358.pdf>;
<http://www.uphelp.org/texas-insurer-drops-push-let-homeowners-forgo-right-sue>

the American Arbitration Association. Individual consumers have no similar leverage when submitting to their jurisdiction.

The Texas proposal referenced above would have given the policyholder only two choices of vendors and would prohibited the arbitrator from awarding attorney's fees or extra-contractual damages. The later is significant because it would effectively require a policyholder to front pay for the costs of an attorney for the arbitration with no hope of recouping those fees.⁵ This has a deterrent effect and in fact very few consumers pursue arbitration.⁶ Even when they do, it is a closed-door process that tends to favor corporations over consumers.⁷

Arbitration is billed as a cost-saving measure, but the jury is still out. At least one micro-study, which followed one company through 19 employment discrimination cases, some which went to litigation and some that went to arbitration, showed that attorney fees for arbitration *exceed* fees for litigation.⁸ Arbitrator bias is also a significant concern given the incentives for arbitrators to please corporations to get repeat business.⁹

⁵ See, e.g., Mark E. Budnitz, *The High Cost of Mandatory Consumer Arbitration*, 67 Duke L. Rev. 133. (discussing the high costs consumers face to participate in mandatory arbitration).

⁶ See also: Jean R. Sternlight, *Disarming Employees How American Employers Are Using Mandatory Arbitration to Deprive Workers of Legal Protection*, 80 Brook. L. Rev. 1309, 1338–39 (2015) (...a survey of plaintiff-side employment attorneys conducted by Alexander Colvin and Mark Gough found that the presence of an arbitration clause would discourage the attorneys from taking the case on a contingent fee basis. Specifically, they found that whereas the surveyed attorneys reported accepting 10% of the potential clients who sought representation in litigation, they accepted only 5% of potential clients who were covered by a mandatory arbitration clause.)

⁷ Jessica Silver-Greenberg and Robert Gebeloff, *Arbitration Everywhere, Stacking the Deck of Justice*, The New York Times (October 31, 2015)

⁸ See: <http://www.insidecounsel.com/2012/12/06/which-costs-less-arbitration-or-litigation> (The nine cases resolved through arbitration incurred a total of \$710,323.50 in outside counsel fees, with an average outside counsel bill of \$78,924.84 while the ten cases in litigation cost an aggregate \$631,443.28 in outside counsel fees but averaged roughly \$63,144.33 per case - \$15,000 less per case than arbitration. The arbitration cases incurred \$921,042.22 in *total costs* and outside counsel fees, with an average per-case expenditure of \$102,338.02. But in the litigation cases, total costs and outside counsel fees were \$704,908.20, with an average per-case expenditure of \$70,490.82—a difference of more than \$30,000 per case. Interestingly, arbitrations lasted 19 months on average, while litigation cases lasted 21 months per case).

⁹ See, e.g., *Ontiveros v. DHL Express (USA), Inc.* (2008) 164 CA4th 494, 505, 79 CR3d 471, 480-481 (noting that [the] arbitrator may have self-interest in deciding that dispute is arbitrable because employer may be a “repeat player” in arbitration); See also, *Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 C4th 83, 115, 99 CR2d 745, 768—“Various studies show that arbitration is advantageous to employers not only because it reduces the costs of litigation, but also because it reduces the size of the award that an employee is likely to get, particularly if the employer is a ‘repeat player’ in the arbitration system”].

Arbitration in the insurance context

The CFPB's background report found that consumers were not aware of the existence of arbitration clauses in many of the contracts they had signed.¹⁰ They were also not aware of how they operated or how arbitration was different from a typical lawsuit. Consumers also rarely know what is in their insurance policy. They do not typically read them, and if they wanted to, they are written in legalese for lawyers. Not to mention, consumers are rarely provided a copy of their insurance policy before they purchase it.¹¹ In light of this reality, asking a consumer to agree to give an important right, to litigate claim disputes that may arise months or years later, at the time the policy is sold, invites unfair surprise and may incentivize insurer misconduct.

As discussed above proposals for arbitrating insurance disputes would significantly limit the remedies available to aggrieved policyholders. If a policyholder, as in the Texas example, went to arbitration to resolve a failure to pay case, the best he or she could hope for is to be paid the actual policy benefits and would be left to pay the attorneys fees out of pocket. It is unlikely an individual policyholder would attend arbitration without counsel, so even in the best-case scenario in which they "prevail" on their claim, they are worse off at the end of the process.

It is also important to note that state law governs insurance contracts. In almost every state, including Virginia, if an insurance company breaches its duty of good faith of fair dealing, which could include failure to pay benefits owed, the policyholder can recover attorney's fees and double damages.¹² If the Texas example is any indication, it is unlikely that arbitration clauses would provide a forum that would be anywhere equal to a court of law, with respect to the damages that could be awarded to a policyholder. Again, as stated above, the incentives for insurer good faith (attorneys fees and punitive damages) all but disappear in arbitration. It is also common for choice of law and forum selection clauses to be coupled with arbitration.

About United Policyholders and the Center for Economic Justice

While much of UP's work is aimed at helping individuals and businesses purchase appropriate insurance and repair, rebuild, and recover after disasters through its Roadmap to Preparedness and Roadmap to Recovery Programs, through its Advocacy and Action Program, UP engages

¹⁰ See also Victor D. Quintanilla & Alexander B. Avtgis, The Public Believes Pre-dispute Binding Arbitration Clauses Are Unjust: Ethical Implications for Dispute-System Design in the Time of Vanishing Trials, 85 Fordham L. Rev. 2119, 2121 (2017) (Legal scholars have empirically examined...whether consumers meaningfully consent to pre-dispute binding consumer arbitration...a body of literature examines consumers' general understanding of standard-form contracts and included contract terms. This research reveals both that consumers rarely read the fine print in adhesion contracts and even in the rare instances when they do, they seldom understand the meaning and effect of binding arbitration clauses).

¹¹ Maine, Missouri, Nevada, Oklahoma, and Texas regulators post policies online. However, only the Texas Office of Public Insurance Counsel compares policy terms: <http://www.opic.texas.gov/resources/compare-policies>.

¹² Va. Code Ann. § 32.2-209(A); Virginia Code § § 8.01-66.1(A) and (B).

with regulators, including the Virginia Bureau of Insurance and other public officials, academics, and various stakeholders in connection with legal and marketplace developments relevant to all policyholders and all lines of insurance.

CEJ is a 501(c)(3) advocacy and education center dedicated to representing the interests of low-income and minority consumers as a class on economic justice issues. Most of its work is in administrative advocacy on insurance, utilities, and credit; the tools necessary for the poor to pull themselves out of poverty.

UP and CEJ's Executive Directors are official consumer representatives to the National Association of Insurance Commissioners where the use of mandatory arbitration in insurance policies is currently being debated by a working group of which we are both members, along with our other colleagues who write in opposition.¹³

Thank you for your time and consideration of these comments and this very important issue.

Sincerely,

Handwritten signature of Amy Bach in black ink.

Amy Bach, Esq.
Executive Director
United Policyholders

Handwritten signature of Birny Birnbaum in black ink.

Birny Birnbaum
Executive Director
Center for Economic Justice

¹³ See: http://www.naic.org/cmte_d_predispute_arbitration_wg.htm.