FIFTH CIRCUIT COURT OF APPEALS ISSUES OPINION HOLDING THAT FEDERAL LAW TRUMPS STATE ANTI-ARBITRATION INSURANCE STATUTE

On November 9, 2009, after en banc rehearing, the United States Court of Appeals for the Fifth Circuit issued a decision that should be of interest to foreign insurance companies that enter into contracts with U.S. insureds. In *Safety Nat'l Cas. Corp. v. Certain Underwriters at Lloyd's, London, et al.*, 2009 WL 3722727 (5th Cir. Nov. 9, 2009), the Fifth Circuit considered whether the McCarran-Ferguson Act authorizes states to preclude the enforcement of agreements to arbitrate that are covered by the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "Convention") or its implementing legislation, Chapter Two of the Federal Arbitration Act (the "FAA"). The en banc majority held that a Louisiana statute[1] prohibiting the enforcement of arbitration provisions in insurance contracts did not reverse-preempt the Convention under the McCarran-Ferguson Act.

The en banc panel's decision will have major implications for foreign insurance companies that seek to enforce arbitration provisions in their policies. The Fifth Circuit affirmed that the Convention requires each signatory nation's courts to compel arbitration when requested by a party to an international arbitration agreement. Hence, foreign companies whose insurance contracts with U.S. insureds call for disputes to be submitted to arbitration before the London Court of International Arbitration, the Arbitration Chamber of Paris, the Swiss Arbitration Association, and the like, may now find support in the Fifth Circuit's decision for the enforceability of such arbitration provisions even in the face of state statutes that purport to preclude the enforcement of arbitration provisions in insurance contracts.[2] With the Fifth Circuit's decision there is now a split among the Circuits on this issue.

Factual Background and the Procedural Background

The plaintiff-appellee, the Louisiana Safety Association of Timbermen-Self Insurers Fund ("LSAT"), provides workers' compensation insurance for its members. Certain Underwriters at Lloyd's, London (the "Underwriters") provided excess insurance to LSAT by reinsuring claims for occupational-injury occurrences. Each reinsurance agreement contained an arbitration provision. Safety National Casualty Corporation ("Safety National") also provided excess workers' compensation coverage and alleged that in a loss portfolio transfer agreement, LSAT assigned its rights under the reinsurance agreements with the Underwriters to Safety National.

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1 Louisiana Revised Statutes § 22:868: "No insurance contract delivered or issued for delivery in this state . . . shall contain any condition, stipulation, or agreement: . . . (2) Depriving the courts of this state of the jurisdiction of action against the insurer."

2 The court made no distinction regarding the enforceability of arbitration provisions based on whether the agreement called for the arbitration to be held in the United States or abroad.

The Underwriters refused to recognize the assignment and Safety National sued the Underwriters in the U.S. District Court for the Middle District of Louisiana for allegedly failing to reimburse it under the reinsurance agreements. The Underwriters subsequently filed a motion to compel arbitration.

On December 5, 2005, the district court denied the Underwriters' motion to compel arbitration, ruling that Louisiana Revised Statute Annotated Section 22:69, which was interpreted to prohibit arbitration agreements in insurance contracts, reverse-preempted the Convention through the McCarran-Ferguson Act, which prohibits Congress from enacting legislation that supersedes the states' regulation of insurance.

The Fifth Circuit granted leave to appeal the district court decision and held that treaties such as the Convention, whether self-executing or not, do not constitute an "Act of Congress" as that term was used within the McCarran-Ferguson Act, and therefore the Act did not cause the Louisiana statute to reverse-preempt the Convention. The court therefore reversed the district court's denial of the motion to compel arbitration and remanded for further proceedings.

LSAT filed an application for rehearing en banc on October 14, 2008, arguing that the case merited reconsideration because of its "exceptional importance," and stated that the court's decision conflicted with the only other appellate decision to directly address the issue, *Stephens v. American Int'l Ins. Co.*, 66 F.3d 45 (2d Cir. 1995).

The Fifth Circuit's En Banc Decision

A. The Majority Opinion

In its en banc brief, LSAT contended that the Convention was not self-executing and that its implementing legislation, the FAA, was the relevant federal law because the Convention has no effect independent of the FAA. LSAT argued that because the implementing legislation was an "Act of Congress" within the meaning of the McCarran-Ferguson Act, it was reverse-preempted by the Louisiana statute. In response, the Underwriters argued that even if the Convention were not self-executing, once implemented, it remained a treaty and was therefore not an "Act of Congress" subject to the reverse-preemption effect of the McCarran-Ferguson Act.

The majority of the en banc panel held that the McCarran-Ferguson Act did not empower the Louisiana statute to reverse-preempt the Convention. The panel was persuaded that the state law did not reverse-preempt the Convention for two main reasons: (1) Congress did not intend to include a treaty within the scope of an "Act of Congress" when it used the term in the McCarran-Ferguson Act, and (2) it is the Convention, rather than the FAA, that determines the parties' respective rights and obligations, and whether the state law at issue is superseded.

The majority stated that it was "unclear . . . whether the Convention is self-executing" but regardless, even "if the Convention required legislation to implement some or all of its provisions in United States courts, that "d[id] not mean that Congress intended an 'Act of Congress,' as that phrase is used in the McCarran-Ferguson Act, to encompass a non-self-

executing treaty that has been implemented by congressional legislation." The en banc majority went on to note that "[i]mplementing legislation that does not conflict with or override a treaty does not replace or displace that treaty" and that a "treaty remains an international agreement or contract negotiated by the Executive Branch and ratified by the Senate, not by Congress. The fact that a treaty is implemented by Congress does not mean that it ceases to be a treaty and becomes an 'Act of Congress.'"

The majority acknowledged that its decision conflicted with the Second Circuit Court of Appeals' decision in *Stephens v. American International Insurance Co.*, 66 F.3d 41 (2d Cir. 1995), which held that the Convention is not self-executing. The panel stated that this finding by the Second Circuit "d[id] not answer the question of what Congress intended when it used the terms '[n]o Act of Congress' and 'such Act' in the McCarran-Ferguson Act or why Congress would have addressed only treaties that required implementation by Congress." The panel stated that because it gave the phrases "Act of Congress" and "such Act" their usual, commonly understood meanings, it concluded that "implemented treaty provisions, self-executing or not, are not reverse-preempted by state law pursuant to the McCarran-Ferguson Act." The majority also noted that the *Stephens* decision was at least in tension with the same court's subsequent decision in *Stephens v. National Distillers & Chemical Corp.*, 69 F.3d 1226 (2d Cir. 1995), where the Second Circuit stated that it had to "apply federal law to the insurance industry, in spite of the McCarran-Ferguson Act, whenever federal law clearly intends to displace all state laws to the contrary."

The en banc panel vacated the district court's order denying the Underwriters' motion to compel arbitration and remanded for further proceedings consistent with its opinion.

B. The Concurring and Dissenting Opinions

Circuit Judge Edith Brown Clement wrote a concurring opinion stating that Article II of the Convention is self-executing and therefore preempted the Louisiana statute by virtue of the Supremacy Clause. Judge Clement found that "the plain text of Article II of the Convention compels a finding of self-execution" and that the Convention therefore was "fully enforceable in domestic courts by its own operation."

Circuit Judge Jennifer Walker Elrod dissented in an opinion joined by Circuit Judges Jerry E. Smith and Emilio M. Garza. She stated that the Convention is non-self-executing and "[b]ecause a non-self-executing treaty cannot itself provide a rule of decision in U.S. courts, the only candidate for a source of federal law with preemptive force under the Supremacy Clause is the statute that implements the treaty." Judge Elrod therefore concluded that "there can be no preemption in this case without construing an Act of Congress—the [FAA] rather than the treaty" and that the McCarran-Ferguson Act rendered the implementing legislation "powerless to preempt state law."

Implications of the Fifth Circuit's Decision

The Fifth Circuit's decision is now the first Circuit court decision providing direct support for the argument that a state statute cannot deprive foreign insurance companies of the remedy of arbitration when such a remedy is set out in an insurance policy covered by the Convention. As many states in addition to Louisiana have enacted statutes prohibiting the enforcement of arbitration provisions in insurance policies, this decision may have far-reaching implications. [3] Foreign insurance companies should be aware of the *Safety National* decision when confronted with a state statute prohibiting the enforcement of arbitration provisions or in deciding whether to include such a provision in their contracts. Since the Fifth Circuit's decision conflicts with the Second Circuit's *Stephens* decision, the United States Supreme Court may decide to hear the appeal of the Fifth Circuit's decision.[4]

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If you have any questions concerning the foregoing or would like additional information, please contact Richard Mancino (212-728-8243, rmancino@willkie.com) or the Willkie Farr & Gallagher attorney with whom you regularly work.

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[3] Alabama Code § 8-1-41(3); Arkansas Code § 16-108-201; Georgia Code § 9-9-2(c)(3); Missouri Statutes § 435.350; South Carolina Code § 15-48-10(b)(4); South Dakota Codified Laws § 21-25A-3.

[4] On November 12, 2009, LSAT asked the Fifth Circuit Court of Appeals to stay the issuance of its mandate pending LSAT's application to the U.S. Supreme Court for Writ of Certiorari.