HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 837 Insurance
SPONSOR(S): Hays
TIED BILLS: IDEN./SIM. BILLS: SB 1598

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) Insurance Committee		Freire	Cooper
2) Civil Justice Committee			
3) Commerce Council			
4)			
5)			

SUMMARY ANALYSIS

Arbitration is a method of dispute resolution in which a neutral third party makes decisions in order for parties to obtain a fair resolution of disputes. The object of arbitration is to resolve disputes in an efficient and timely manner without the interference of courts. Whereas the common law found arbitration contrary to public policy, today's legal system, at both the Federal and State levels, consider arbitration a favored practice.

In 1967, Florida enacted s. 682.02, F.S., providing that: "two or more parties may agree in writing to submit to arbitration any controversy existing between them…" The Florida Supreme Court, in *Roe v. Amica Mutual Insurance Co.*, indicated that "arbitration is a favored means of dispute resolutions and courts indulge every reasonable presumption to uphold proceedings resulting in an award." Florida courts find arbitration to be an efficient and less expensive alternative to litigation.

Florida courts also hold that freedom of contract is a fundamental policy, and an agreement to arbitrate is an exercise of that policy. However, courts may find that contracts are unenforceable as against public policy or unenforceable if it is unconscionable. In order for a contract to be unenforceable as against public policy, it must be "clearly injurious to the public good" or "contravene some established interest of society." This is often seen where a contractual provision contravenes a previously enacted remedial statute.

In order for a contract to be found unconscionable, it must be both substantively and procedurally unconscionable. A contract is substantively unconscionable when its terms are "outrageously unfair". A contract is procedurally unconscionable when important terms are "hidden in a maze of fine print."

This bill creates s. 627.4141, F.S., which allows insurers to include a mandatory arbitration provision in life insurance contracts. This bill requires the arbitration provision to be set forth in the policy or a separate endorsement and provide: a description of the arbitration process, the method of selecting an arbitrator, that the insurer will pay for arbitration costs, and that the hearing will occur where the insured resides. The bill also requires insurers to disclose at the time of the application for a policy, in a separate document, the arbitration requirement to the life insurance to the applicant.

This bill may have a fiscal impact on the Office of Insurance Regulation. It does not have a fiscal impact on local government.

This bill will take effect upon becoming a law.

FULL ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

Provide limited government- This bill allows private parties to contract for an alternative means to resolve disputes.

B. EFFECT OF PROPOSED CHANGES:

Arbitration Generally

Arbitration is a method of dispute resolution involving one or more neutral parties who are usually agreed to by the disputing parties and whose decision is binding.[1] General principles of arbitration are as follows:

- The object of arbitration is to obtain a fair resolution of disputes by an impartial third party without unnecessary expense or delay.
- Parties should be free to agree how their disputes are resolved, subject only to such safeguards as are necessary in the public interest.
- Courts should not interfere.[2]

Supporters of arbitration find it has a multitude of advantages over court action. These advantages include: the ability to choose a neutral decision maker; an efficient and timely proceeding; protection of privacy (as arbitration hearings are confidential whereas court proceedings are often public); the convenience of choosing the time and place of arbitration meetings; and finality, as there is generally no right of appeal in arbitration.[3]

Those opposed to arbitration argue that other than a speedy resolution, the benefits of arbitration are likely to benefit insurance companies at the expense of the policyholder.[4] They claim that whereas the policyholder has little to gain from private arbitration proceedings, confidentiality is critical for insurance companies in order to avoid bad publicity.[5] They also argue that the simpler and shorter proceedings may prevent a policyholder from obtaining crucial information about the policyholder's specific claim, as well as information about a company's procedures and policies.[6] Opponents also question the neutrality of arbiters that have industry expertise (and feel that arbiters may be predisposed to favor an industry), and find that even if there is manifest disregard of the law by the arbitrator, the result is virtually unreviewable.[7]

The common law traditionally found that arbitration was a deprivation of the jurisdiction of the courts and therefore contrary to public policy.[8] Over time, the legal system has embraced arbitration, and in 1925, Congress enacted the Federal Arbitration Act (FAA).[9] The United States Supreme Court has decided that the FAA preempts state laws which prohibit or limit arbitration[10] and is grounded on Congress's full commerce power.[11] The mechanism for avoiding the preemptive effect of the FAA in insurance is the McCarran-Ferguson Act.

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[1] Black's Law Dictionary, *Arbitration*, 4th ed. 2004.
[2] Leslie Grant, *What Is Arbitration*, available at http://www.mediate.com/articles/grant.cfm, viewed on February 27, 2006.
[3] *Id.*
[4] Susan Randall, *Mandatory Arbitration in Insurance Disputes: Inverse Preemption of the Federal Arbitration Act*, 11 Conn. Ins. L. J. 253 (2004-2005).
[5] *Id.* At 257.
[6] *Id.*
[7] *Id.* at 262.
[8] *Id.*
[9] *Id.* at 253-254.
[10] *See Bernhardt v, Polygraphic Co. of Am.*, 350 U.S. 198, 200-201.
[11] *See Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265 (1995).

The McCarran Ferguson Act provides that: "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance… unless such Act specifically relates to the business of insurance.[12] State laws preempt the FAA when 1)the federal statute at issue does not specifically relate to the business of insurance; 2) the state law was enacted for the purpose of regulating the business of insurance; and 3) application of the federal statute will invalidate, impair, or supersede state law. Because no federal statute regulates the business of life insurance arbitration, Florida may enact statutes governing life insurance policies.

Arbitration in Florida

In Florida, the Legislature and the Judiciary consider arbitration a favored practice. In 1967, Florida codified this principle under s. 682.02, F.S., which provides that: "Two or more parties may agree in writing to submit to arbitration any controversy existing between them at the time of agreement, or they may include in a written contract a provision for the settlement by arbitration of any controversy thereafter arising between them relating to such contract or the failure or refusal to perform the whole of any part thereof." The Florida Supreme Court also emphasized this principle on several occasions, including in *Roe v. Amica Mutual Insurance Co.*[13], where it proffered "arbitration is a favored means of dispute resolution and courts indulge every reasonable presumption to uphold proceedings resulting in an award."[14]

Florida holds arbitration in high esteem for a couple of reasons. First, public policy favors arbitration as an efficient means of settling disputes, because it avoids the delays and expenses of litigation.[15] Second, freedom of contract is a fundamental policy and an agreement to arbitrate is the exercise of that freedom.

Freedom of Contract

Because Florida favors freedom of contract as a fundamental policy, courts are reluctant to disregard contractual provisions. However, in some circumstances, Florida courts have found that contracts were unenforceable as void against public policy or unconscionable.

Void as against public policy

In *Bituminous Casualty Corp. v. Williams,* the Florida Supreme Court proclaimed that "Courts… should be guided by the rule of extreme caution when called upon to declare transactions as contrary to public policy and should refuse to strike down contracts involving private relationships on this ground, unless it is made clearly to appear that there has been some great prejudice to the dominant public interest sufficient to overthrow the fundamental policy of the right to freedom of contract between parties [privately]."[16] For this reason, when a particular contract is not prohibited under any constitutional provision, statutory provision, or prior judicial decision, it should not be struck down on public policy grounds unless it is "clearly injurious to the public good" or "contravenes some established interest of society."[17]

Florida courts find that a contractual provision violates dominant public interest where it contravenes a previously enacted remedial statute. A remedial statute is designed to correct an existing law, redress

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12 15 U.S.C. s.1012(b)(2004).
13 *Roe v. Amica Mutual Insurance Co.*, 533 So. 2d 279 (Fla. 1988).
14 *See also Ronbeck Const. Co., Inc. v. Savanna Club*, 592 So. 2d 344 (Fla. 4th DCA 1992); *Orkin Exterminating Co. v. Petsch*, 872 so. 2d 259 (Fla. 2d DCA 2004); *KFC Nat. Mngt. Co. v. Beauregard*, 739 So. 2d 630 (Fla. 5th DCA 1999); *Boston Bank of Commerce v. Morejon*, 786 So. 2d 1245 (Fla. 3rd DCA 2001).
15 *KFC Nat. Mngt. Co,* 739 So. 2d at 631.
16 *Bituminous Casualty Corp. v. Williams*, 154 Fla. 191, 197 (Fla. 1944).
17 *See Florida Windstorm Underwriting v. Gajwani*, 2005 WL 1109465 (Fla. 3rd DCA 2005); *Banfield v. Louis*, 589 So. 2d 441 (Fla. 4th DCA 1991).

an existing grievance, or introduce regulations conducive to the public good. It is also defined as a statute giving a party a mode of remedy for a wrong, where he either no remedy or a different remedy existed.[18] For example, in *Mullis*, the Supreme Court found that an arbitration provision signed by a nursing home resident was void because it substantially eliminated some of the remedies provided in the legislation for nursing home negligence.[19] In *Holt*, the court found that a contract providing for arbitration limited the remedies provided by Florida Deceptive and Unfair Trade Practices and was void as contrary to public policy.[20] From these examples, it appears that Florida courts will find that some contracts violate public policy where it contravenes remedial action taken by the legislature.

Void because of unconscionability

In order for a contract to be unenforceable due to unconscionability, it must be both substantively and procedurally unconscionable. The substantive component of unconscionability relates to the terms of the contract. The test for substantive unconscionability is whether the terms of the contract are so "outrageously unfair" as to "shock the judicial conscience."[21]

The procedural component of unconscionability relates to the manner in which the contract was entered, and it involves consideration of such issues as the relative bargaining power of the parties and their ability to know and understand the disputed contract terms.[22] For example, the court might find that a contract is procedurally unconscionable if important terms were "hidden in a maze of fine print and minimized by deceptive sales practices."[23] A court might also find procedurally unconscionability if a contract is written on a "take it or leave it" basis.[24] Courts have stated that a contract of adhesion Is often procedurally unconscionable because it suggests an absence of "meaningful choice".[25] However, courts have also noted that this is not entirely true because the purchaser of services has the ability to obtain such services elsewhere.[26]

Florida and Access to Courts:

Article I, section 21 of the Florida Constitution provides that "The courts shall be open to every person for redress of any injury, and justice shall be administered without sale, denial or delay." In the seminal case *Kluger v. White*, the Florida Supreme Court held that the Legislature cannot abolish the right to seek redress of injury in court unless the Legislature provides a reasonable alternative to protect the rights of the people of the State to redress injuries, or the Legislature can show an overpowering public necessity for the abolishment of such right and no alternative method of meeting such public necessity can be show.[27]
The Florida Supreme Court has invalidated statutes requiring binding arbitration agreements. In *Nationwide Mutual. Fire Ins.*, the Florida Supreme Court held that a statute requiring every automobile insurance policy for personal injury protection coverage to mandate arbitration of claims disputes involving an assignee of benefits violated medical providers' access to courts under article 1, section 21 of the Florida Constitution.[28] There, the Florida Supreme Court concluded that, unlike cases in which it

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18 *See Fonte v. AT&T Wireless Services, Inc.*, 903 So. 2d 1019 (Fla. 4th DCA 2005) *citing Adams v. Wright*, 403 So. 2d 391, 394 (Fla. 1981).
19 *Mullis v. State Farm Mut. Auto. Ins. Co.,* 252 So. 2d 229, 235 (Fla. 1971).
20 *Holt v. O'Brien Imps. of Fort Meyers, Inc.*, 862 So. 2d 87 (Fla. 2nd DCA 2003).
21 *VoiceStream Wireless Corp. v. U.S. Communications, Inc.*, 912 So. 2d 34, 40 (Fla. 4th DCA 2005).
22 *Nationwide Mutual Fire Insurance Company v. Pinnacle Medical, Inc.*, 753 So.2d 55 (Fla. 2000).
23 *Blankfeld v. Richmond Helath Care*, 902 So. 2d 29, 6 (Fla. 4th DCA 2005).
24 *VoiceStream Wireless Corp.*, 912 So. 2d at 34.
25 *See VoiceStream Wireless*, 912 So. 2d at 40; *see also Gainesville Healthcare Ctr. Inc. v. Weston*, 857 So. 2d 278, 285 (Fla. 1st DCA 2003).
26 *See VoiceStream Wireless*, 912 So. 2d at 41, *citing Gainsville Healthcare Ctr.*, 857 So. 2d at 285.
27 *Kluger v. White*, 281 So.2d 1 (Fla. 1973); *see also University of Miami v. Echarte*, 618 So. 2d 189 (Fla. 1993)(Holding that ss. 766.207 and 766.209, F.S., which provide a monetary cap on noneconomic damages in medical malpractice claims when a party requests arbitration, did not violate a claimant's right of access to the courts because by compelling arbitration, the statutes provided a commensurate benefit to the plaintiff in exchange for the monetary cap.)
28 *See Nationwide Mutual Fire Insurance Co., v. Pinnacle Medical, Inc.*, 753 So.2d 55, 57 (Fla. 2000).

had upheld mandatory arbitration legislation, the medical providers' ability to pursue a remedy in court was not replaced with rights of equal or greater value.[29]

Unlike the statutes in these cases, this bill does not require mandatory arbitration clauses in life insurance policies. Agreements to arbitrate are treated differently from statutes compelling arbitration. The difference arises because the rights of access to courts and trial by jury may be contractually relinquished, subject to defenses to contract enforcement including voidness for violation of the law or public policy, unconscionability, or lack of consideration.[30]

Changes provided by the bill

Currently, there is no law in Florida governing mandatory arbitration clauses in life insurance policies. This bill creates s. 627.4141, F.S., and it provides that an insurer may require mandatory arbitration for life insurance policies providing a death benefit of $50,000 or less. The statute requires the life insurance policy to include:

- a description of the arbitration process,
- the method used for selecting an impartial arbitrator,
- that the insurance company will pay for the arbitrator and arbitration fees,
- that arbitration will be conducted where the insured resides,
- that the arbiter will apply applicable arbitration rules, and
- that the insurer provide the rules of arbitration to the insured.

The bill also requires that the insurance company provide applicants a separate disclosure statement explaining, in clear and prominent language, that their policy contains a binding arbitration agreement. Finally, the bill clarifies that "this section does not prohibit the use of mandatory binding arbitration in insurance policies not described in this section." By adding this section, this bill does not limit mandatory arbitration proceedings to life insurance policies providing a death benefit of $50,000 or less; instead, it leaves those policies providing death benefits above $50,000 unregulated.

Currently, s. 627.428(1), F.S., provides for the payment of a reasonable attorney's fee when a judgment is entered against the insurer. According to the court in *Nationwide Mutual Fire Insurance Company*, that statute was enacted to discourage insurers from contesting valid claims and to reimburse successful insureds for their attorney fees when they are compelled to sue to enforce their insurance contracts.[31] This bill does not provide reimbursement of attorney's fess to a successful insured.

C. SECTION DIRECTORY:

Section 1. Creates s. 627.4141, F.S., permitting insurance companies to issue life insurance policies containing mandatory binding arbitration provisions in specific circumstances; creating parameters for the arbitration; requiring disclosure of the mandatory arbitration at the time of the application for a policy; and specifying the absence of prohibition against arbitration in other types of insurance policies.

Section 2. Provides that the bill will be effective July 1, 2006.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

[29] *See Nationwide Mutual Fire Insurance*, 753 So.2d at 59.
[30] *See Global Marketing, Inc. v. Shea*, 908 So. 2d 392 (Fla. 2005).
[31] *Nationwide Mutual Fire Insurance,* 753 So. 2d at 59.

None.

2. Expenditures:

The Office of Insurance Regulation reported it anticipates a significant influx of policy form filings which should be accompanied with corresponding rate reduction filings. For FY 2005-2005, the OIR completed approximately 1317 form filings in the Life and Health Product Review business unit. In order to assure timely processing of form and rate filings associated with this bill, OPIR requests OPS funding in the amount of $250,000 for consultant services.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

This bill allows insurance companies to save, at a minimum, attorney fees associated with life insurance claims taken to court.

D. FISCAL COMMENTS:

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

This bill does not require counties or municipalities to spend funds or to take action requiring the expenditure of funds. The bill does not reduce the percentage of a state tax shared with counties or municipalities. The bill does not reduce the authority that municipalities have to raise revenue.

2. Other:

B. RULE-MAKING AUTHORITY:

C. DRAFTING ISSUES OR OTHER COMMENTS:

Currently, the bill is unclear as to where arbitration proceedings will take place. It currently reads: (e) "that the arbitration hearing will be conducted in the county of residence of the person demanding arbitration unless the parties agree to a different location." In response to this concern, the sponsor has filed an amendment requiring that arbitration take place in the county of residence of the insured unless the parties agree to a different location.

In its legislative analysis of the bill, the Office of Insurance Regulation noted a few concerns. First, it stated that this legislation would remove a policyholder's right to dispute a life insurance claim in court and the recovery of any attorney fees associated with such litigation. OIR posits this would have a disproportionate impact for lower income policyholders. They are also concerned: that it is unclear which arbitration rules will be used; that the legislation has no "roll back" provision for rate deduction (thus providing a potential for windfall profits and/or excessive premium rates over time); and that the arbitration proceeding "may contain other reasonable provisions consistent with the fair, prompt,

economical and efficient resolution of disputes" – a set of ambiguous standards against which the OIR would be unable to determine grounds for approval or disapproval of the contract form. [32]

Proponents of the bill state that they would have no problems clarifying that the process would use the American Arbitration Association process. The AAA is a not-for-profit, public service organization committed to the fair resolution of disputes through the use of arbitration, mediation and other voluntary procedures. Proponents also state that there are two entities, other than the AAA, providing similar arbitration services.[33]

IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES

[32] Office of Insurance Regulation Legislative Analysis, dated Jan. 6, 2006, on file with Insurance Committee.
[33] Communications with proponents of the bill, dated March 7, 2006, on file with Insurance Committee.