RECENT DEVELOPMENT, *STATE OF WASHINGTON, DEPARTMENT OF TRANSPORTATION V. JAMES RIVER INSURANCE COMPANY*[1]

I. INTRODUCTION

In January, the Supreme Court of Washington invalidated a mandatory arbitration clause in a James River Insurance Company policy.[2] The decision was groundbreaking in that it resolved a conflict between the Federal Arbitration Act ("FAA")[3] and the McCarran-Ferguson Act[4] and determined that McCarran-Ferguson specifically exempted a Washington statute from FAA preemption.[5] The Washington statutes at issue were Revised Code of Washington ("RCW") §§ 48.18.200(1)(b), which prohibits insurance contracts from "depriving the courts of this state of the jurisdiction of action against the insurer,"[6] and 48.15.150(1), which requires that "an unauthorized insurer must be sued in the superior court of the county in which the cause of action arose."[7] James River Insurance Company ("James River") sought to compel arbitration under the Federal Arbitration Act but the trial court held—and the Supreme Court of Washington affirmed—that the McCarran-Ferguson Act shielded the Washington statutes from FAA preemption and guaranteed a policyholder's right to bring an action in state court to enforce an insurance contract.[8]

II. FACTS AND PROCEDURAL HISTORY

The facts and procedure of this case overlap slightly in that the facts leading up to the suit and the disagreements between the parties concern procedural aspects of the insurance policies. The facts below are, thus, those leading to the procedural disputes, which later rolled into the lawsuit.

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[1] State of Washington, Department of Transportation V. James River Insurance Company, 176 Wash.2d 390 (2013) (hereinafter "James River Ins.").

[2] *Id.* at 392.

[3] 9 U.S.C. §§ 1–14.

[4] 15 U.S.C. § 1012.

[5] James River Ins., *supra* note 1, at 402.

[6] WASH. REV. CODE § 48.18.200(1)(b).

[7] WASH. REV. CODE § 48.15.150(1).

[8] James River Ins., *supra* note 1, at 402–03.

A. *Facts*

James River issued two insurance policies to Scarcella Brothers, Inc. ("Scarcella"), which provided liability coverage for work done by Scarcella on a highway project for the Washington State Department of Transportation ("WSDOT") from 2008 to 2011.[9] Scarcella requested that James River include WSDOT as a co-insured under the surplus line policies, which was done and led to WSDOT's claim of coverage.[10]

The claims against WSDOT underlying this case arose from an accident at the scene of the Scarcella project that occurred in 2009.[11] Representatives of those injured or killed later added Scarcella as a defendant and Scarcella forwarded WSDOT's request for a defense under the insurance policies to James River.[12] James River accepted WSDOT's tender for representation under a reservation of all rights under the insurance policies and reminded WSDOT of the mandatory arbitration clause[13] contained within the contract, demanding acquiescence to the arbitration of coverage disputes.[14] However, WSDOT did not acquiesce and, when James River sought to enforce the arbitration provisions of the insurance policies, this lawsuit was initiated.

B. *Procedural History*

In September of 2010, James River sought to initiate arbitration of a coverage dispute, to which WSDOT objected and then filed a declaratory judgment action against James River, seeking a declaration that the arbitration clauses contained in the policies were void.[15] In response, James River filed a counterclaim for declaratory judgment, seeking a determination by the trial court that the arbitration clauses were binding and enforceable.[16]

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[9] *Id.* at 392.

[10] *Id.*

[11] *Id.* at 393.

[12] *Id.*

[13] *Id.* (the arbitration clause, labeled "BINDING ARBITRATION," read in pertinent part as follows: "Should we and the insured disagree as to the rights and obligations owed by us under this policy, including the effect of any applicable statutes or common law upon the contractual obligations otherwise owed, either party may make a written demand that the dispute be subjected to binding arbitration.").

[14] James River Ins., *supra* note 1, at 393.

[15] *Id.*

[16] *Id.*

James River then filed a motion for summary judgment to compel arbitration on January 28, 2011, while, on the same day, WSDOT filed a motion to bar the initiation of arbitration proceedings.[17] The trial court heard oral arguments on May 20, 2011 and issued an order denying James River's motion to compel arbitration, holding that the arbitration clauses were barred by RCW 48.18.200 and RCW 48.15.150.[18] Under the McCarran-Ferguson Act, the Washington statutes were shielded from FAA preemption due to McCarran-Ferguson's reverse-preemption effect.[19] James River Appealed the trial court's order and the Supreme Court of Washington granted direct review.[20]

III. THE COURT'S HOLDING AND REASONING

In order to determine whether the arbitration clauses in the James River insurance policies were binding and enforceable, the Court had to answer the following questions: (1) Do RCW 48.18.200 and RCW 48.15.150 prohibit binding arbitration clauses in surplus line insurance contracts?; and (2) If so, does the McCarran-Ferguson Act shield RCW 48.18.200 and RCW 48.15.150 from preemption by the FAA?[21] The Court found that the binding arbitration clauses were prohibited by the Washington statutes and held that the FAA was reverse-preempted by the McCarran-Ferguson Act, meaning James River could not compel arbitration where WSDOT sought to pursue its insurance claims in court.[22]

A. *Arbitration Clauses are Prohibited in Washington Insurance Contracts*

The Court, gathered en banc, reviewed the issue of statutory interpretation regarding RCW 48.18.200 de novo[23] and held that the Washington statute does, in fact, prohibit the inclusion of arbitration clauses

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17 *Id.*

18 *Id.* at 393–94.

19 *Id.* at 394.

20 James River Ins., *supra* note 1, at 394.

21 *Id.*

22 *Id.* at 402–03.

23 *Id.* at 394 (citing Kruger Clinic Orthopaedics, LLC v. Regence BlueShield, 138 P.3d 936, 939 (2006)).

in insurance contracts.[24] James River sought to convince the Court that RCW 48.18.200 does not invalidate arbitration agreements where the law prohibits any language in insurance contracts "depriving the courts of this state of the jurisdiction of action against the insurer" and, thus, does not implicate the FAA or McCarran-Ferguson.[25] WSDOT argued that the arbitration clause violates the Washington statute because it "deprives the court of full jurisdiction to determine the merits of the parties' claims." WSDOT further argued that the FAA's and federal government's policies in favor of arbitration did not preempt the Washington statutes because the McCarran-Ferguson Act shielded state laws that regulate "the business of insurance" from federal preemption under the FAA.[26]

In order to ascertain the intent of the legislature in drafting RCW 48.18.200(1)(b), the Court first looked at the plain meaning of the statute.[27] Both parties agreed with the Court that the terms "jurisdiction" and "action" are susceptible to multiple ' meanings and interpretations.[28] One interpretation, as advocated by James River, is that the statute was meant to prohibit forum selection and the designation of jurisdictions outside the State of Washington as the sole venue for actions against the insurer "because such agreements deprive Washington policyholders of the right to bring an action against the insurer in the courts of this state."[29] A second and competing interpretation of the statute, advocated by WSDOT, is that the statute was meant to prohibit mandatory arbitration clauses "because such agreements deprive Washington policyholders of the right to bring an original action against the insurer in the courts of this state."[30] Due to the mutual agreement on the statute's vagueness, the Court moved on to determine if case law surrounding RCW 48.18.200's enactment would shine light on its meaning but, unfortunately, it was "not particularly helpful."[31]

James River claimed WSDOT's position that arbitration deprives the court of jurisdiction harkens back to common law arbitration, as opposed to the statutory arbitration that the State of Washington's legislature enacted in

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[24] James River Ins., *supra* note 1, at 400.

[25] *Id.* at 394–95; WASH. REV. CODE § 48.18.200(1)(b).

[26] James River Ins., *supra* note 1, at 395; 15 U.S.C. § 1012(b).

[27] James River Ins., *supra* note 1, at 396.

[28] *Id.*

[29] *Id.*

[30] *Id.*

[31] *Id.* at 396–97.

1911 through RCW 48.18.200.[32] James River referenced the Supreme Court of Washington's decision in *Dickie Manufacturing Co. v. Sound Construction & Engineering Co.*, where the Court found RCW 48.18.200 contained "positive provisions *giving the court jurisdiction* to adopt, modify, and enforce the award."[33] Reliance upon the current and former views of arbitration were "not particularly helpful" to the Court, which recognized that the full phrase "*jurisdiction of action* against the insurer" was operative—and the phrase "jurisdiction of action" does not mean the same thing as the term "jurisdiction"—in ascertaining the legislature's intent in RCW 48.18.200.[34] The full phrasing of RCW 48.18.200, WSDOT argued, suggests that the legislature sought to give parties the right to bring an original action in the state courts of Washington, not just to maintain the courts' jurisdiction over the enforcement of awards.[35]

In a special proceeding to confirm an arbitration award, the jurisdiction of the court is, in fact, limited as compared to its jurisdiction in an original action.[36] Specifically, arbitration provisions in contracts between insurers and health care providers deprive the health care providers of the "judicial remedies" guaranteed by regulation, which grants parties the right to initiate "an action to litigate the dispute" and does not simply secure the right to judicial review.[37] To accept James River's argument that the limited "jurisdiction" to review arbitration awards satisfies RCW 48.18.200 would "frustrate the legislature's intent because . . . binding arbitration agreements deprive our state's courts of the jurisdiction they would normally possess in an original action by depriving them of the jurisdiction to review the

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[32] *Id.* at 397.

[33] James River Ins., *supra* note 1, at 397 (citing Dickie Manufacturing Co. v. Sound Construction & Engineering Co., 159 P. 129, 131 (1916) (hereinafter "Dickie Manufacturing")) (emphasis added in James River Ins. decision).

[34] James River Ins., *supra* note 1, at 397–98. *See* WASH. REV. CODE § 48.18.200(1)(b) (emphasis added).

[35] James River Ins., *supra* note 1, at 397–98.

[36] *Id.* (citing Price v. Farmers Ins. Co. of Wash., 946 P.2d 388, 391 (1997) in which the Supreme Court of Washington stated, "[a]lthough a party may apply to the court to confirm an arbitration award, that is not the same as bringing an original action to obtain a monetary judgment. A confirmation action is no more than a motion for an order to render judgment on the award previously made by the arbitrators pursuant to contract. If the court does not modify, vacate, or correct the award, the court exercises a mere ministerial duty to reduce the award to judgment.").

[37] *Id.* at 398–99 (citing Kruger Clinic Orthopaedics, LLC v. Regence BlueShield, 138 P.3d 936, 942–43 (2006) (referring to WASH. ADMIN. CODE § 284–43–322(4) (2005))).

substance of the dispute between the parties."[38] Guaranteeing the courts' ability to analyze and review the substance of disputes ensures the protection of the laws of Washington as provided in RCW 48.18.200(1)(a).[39]

Thus, unless the legislature specifically provides otherwise, the Court held that RCW 48.18.200 prohibits binding arbitration agreements in insurance contracts; because the agreements in this case were pre-dispute binding arbitration agreements, the agreements are unenforceable.[40] The Court did not need to address the provisions of RCW 48.15.150 because it determined that RCW 48.18.200, in itself, prohibited binding arbitration agreements.[41]

B. *McCarran-Ferguson Reverse-Preempted the FAA*

After determining that RCW 48.18.200 prohibited binding arbitration agreements, the Court turned its attention to whether the McCarran-Ferguson Act shielded the state law from FAA preemption. Generally, where a state enacts a law of "general applicability" that prohibits arbitration agreements, the FAA's pro-arbitration provisions preempt the state law.[42] One exception to the general rule, however, is where a state law is enacted "for the purpose of regulating the business of insurance" pursuant to the McCarran-Ferguson Act.[43]

A statute "aimed at protecting or regulating the performance of an insurance contract . . . is a law enacted for the purpose of regulating the business of insurance, within the meaning of the first clause of § 2(b) [of the

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38 *Id.* at 399.

39 *Id.* at 399. *See* RCW 48.18.200(1)(a) (prohibiting insurance contract provisions that "requiring it to be construed according to the laws of any other state or country except as necessary to meet the requirements of the motor vehicle financial responsibility laws of such other state or country.").

40 James River Ins., *supra* note 1, at 400.

41 *Id.*

42 *Id.* (citing AT&T Mobility LLC v. Concepcion, 131 S.Ct. 1740, 1753 (2011)).

43 *Id.* at 400–01. *See* the McCarran-Ferguson Act, 15 U.S.C. § 1012(b) (providing in part: "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: Provided, That [the federal antitrust statutes] shall be applicable to the business of insurance to the extent that such business is not regulated by State law."

FAA]."[44] Here, WSDOT argued that the provisions of RCW 48.18.200 regulate the business of insurance because they directly relate to the content of the insurance contract itself.[45] James River responded with the argument that the statutory provisions do not regulate the insurance industry because they are merely choice of forum provisions but, as the Court ruled in the first section of its analysis, the provisions were not merely regarding choice of forum.[46]

The Court, therefore, denied James River's motion to compel arbitration as it held that the provisions of RCW 48.18.200 regulate the industry of insurance and are, thus, "shielded from preemption by the FAA under the McCarran-Ferguson Act."[47]

IV. CONCLUSION AND IMPACT OF THE COURT'S RULING

The Court's ruling is one of several recent rulings that resolve a conflict between the FAA and another federal statute.[48] Since its ruling in *AT&T Mobility LLC v. Concepcion*,[49] the Supreme Court has yet to rule on a case involving a conflict between the FAA and a federal law. If the Supreme Court decides to take this case or one like it—either from a Federal Court of Appeals or a state's highest court—it will have the opportunity to clarify and resolve the question of just how expansive are the reach and policy implications of the FAA. A ruling resolving an FAA conflict with a federal

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[44] James River Ins., *supra* note 1, at 401 (quoting Kruger Clinic Orthopaedics, LLC v. Regence BlueShield, 138 P.3d 936, 940 (quoting United States Department of Treasury v. Fabe, 508 U.S. 491, 501 (1993))) (internal quotations removed).

[45] *Id.* at 402. The Court compared the statutory provisions at issue in this case to the statutes and regulations involved in *Kruger*, which concerned the contracts between insurers and health care providers and were found to be shielded from FAA preemption via McCarran-Ferguson. *See* Kruger, 138 P.3d at 940.

[46] James River Ins., *supra* note 1, at 402.

[47] *Id.* at 402–03.

[48] *Id.* at note 4 (In particular, the Court referenced the First Circuit's decision in *DiMercurio v. Sphere Drake Ins. PLC*, 202 F.3d 71, 76 (1st Cir.2000) (referring to the historical perspective regarding arbitration as supporting the notion that mandatory arbitration is not contrary to a court's jurisdiction) and a Louisiana Appeals Court's decision in *Macaluso v. Watson*, 171 So.2d 755, 757 (La. Ct. App.1965) (holding the statutory language "depriving the courts of this state of the jurisdiction of action against the insurer" prohibits binding arbitration agreements). Both cases concerned statutory language similar to the provisions in this case but those courts took different approaches and each resolved the issue differently.).

[49] AT&T Mobility LLC v. Concepcion, 131 S.Ct. 1740 (2011)

statute would potentially have significant implications for many heavily-regulated industries, such as insurance, energy, or the financial securities industry.[50]

With the current disagreement among courts as to just how the FAA must interact with the McCarran-Ferguson Act specifically, and with other federal laws generally, the Supreme Court docket is ripe for another significant arbitration-related decision. Although multiple courts have acknowledged the interaction between the reverse-preempting McCarran-Ferguson Act and the FAA, the underlying question of whether the relevant state law regulates the insurance industry seems to be the key question. If the U.S. Supreme Court chooses to review such a case, it would be interesting to also note any guidance as to what specific inquiries or determinations must be made in order to establish whether the reverse-preempting federal law applies to the specific state law at issue in any future cases.

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[50] *See generally, e.g.*, Department of Enforcement v. Charles Schwab & Co., Inc., FINRA Disciplinary Proceeding No. 2011029760201 (Feb. 21, 2013) (demonstrating the morass of securities regulations and their interaction with the FAA).