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Insurers and Reinsurers, Here and Abroad, Should Pay Attention: The Second Circuit May Well Reconsider Reverse-Preemption of The New York Convention by the McCarran-Ferguson Act

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Insights for Insurers

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A significant number of states prohibit or restrict the arbitration of disputes between an insurer and its policyholder and/or preclude the inclusion of arbitral provisions in insurance policies. The McCarran-Ferguson Act ("MFA") is a federal statute that generally precludes an "Act of Congress" from preempting state statutes involving the business of insurance. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958, commonly known as the New York Convention (the "Convention"), is a treaty of the United States and the foundation of the international system of arbitration. Its enabling legislation is Chapter 2 of the Federal Arbitration Act ("FAA Chapter 2"). However, the federal Circuit Courts of Appeals are split about whether MFA reverse-preempts the Convention. The First, Fourth, Fifth, and Ninth Circuits have held that the Convention preempts MFA while the Second and Eighth Circuits have held that the MFA reverse-preempts the Convention. The Supreme Court may decide to resolve this split of authority in the future, but that is a discussion for another day.

Today's discussion arises from the decision of the U.S. District Court for the Southern District of New York, on August 15, 2023, in *Certain Underwriters at Lloyds, et al. v. 3131 Veterans Blvd LLC*. There, the court followed, as it must, the Second Circuit's holding in *Stephens v. American Int’l Ins. Co*. that the MFA reverse-preempts the Convention. If the insurers appeal, it will be interesting to see whether the Second Circuit changes its mind on reverse preemption.

By way of background, MFA exempts insurance from most federal regulations. Congress enacted the MFA in 1945 after the U.S. Supreme Court overruled a long-standing precedent in *U.S. v. South-Eastern Underwriters Association*, holding that the Commerce Clause of the U.S. Constitution allowed Congress to regulate the business of insurance. The MFA provides in pertinent part as follows:

5 U.S.C. § 1012. Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948.

1. State regulation. The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

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2. Federal regulation. 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, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance[.]

According to the National Association of Insurance Commissioners ("NAIC"), "[t]he fundamental reason for government regulation of insurance is to protect American consumers," and state regulation of insurance is preferable because "[s]tate insurance regulatory systems are accessible and accountable to the public and sensitive to local social and economic conditions[,] [and] [s]tate regulation has proven that it effectively protects consumers and ensures that promises made by insurers are kept." It should be well noted, though, that in response to the financial crisis of 2007-08, Congress broadly expanded the federal government's involvement in the regulation of the business of insurance with the enactment of the Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), including the establishment of a Federal Insurance Office, as part of the Treasury Department, with authority over most areas of insurance, the major exceptions being health, long-term care, and crop insurance. As an "Act specifically relate[d] to the business of insurance, " Title V of Dodd-Frank is not subject to the MFA.

Turning back to *Stephens*, the Second Circuit held that the MFA preempts the Convention despite the Supremacy Clause of the U.S. Constitution, thus permitting reverse-preemption of the Convention by Kentucky's Liquidation Act in that case. The Second Circuit reasoned that "the Convention is not self-executing, and therefore, relies upon an Act of Congress for its implementation[,]" *viz.*, FAA Chapter 2. In support of this holding, the Second Circuit quoted an 1829 decision of the U.S. Supreme Court penned by Chief Justice John Marshall:

A treaty is, in its nature, a contract between two nations, not a legislative act. It does not generally effect, of itself, the object to be accomplished; especially, so far as its operation is infra-territorial; but is carried into execution by the sovereign power of the respective parties to the instrument. In the United States, a different principle is established. Our constitution declares a treaty to be the law of the land. It is, consequently, to be regarded in courts of justice as equivalent to an act of the legislature, whenever it operates of itself, without the aid of any legislative provision. But when the terms of the stipulation import a contract -- when either of the parties engages to perform a particular act, the treaty addresses itself to the political, not the judicial department; and the legislature must execute the contract, before it can become a rule for the court.

The Second Circuit then added that, "McCarran-Ferguson states' no Act of Congress shall be construed to … supersede any law … regulating the business of insurance.' 15 U.S.C. § 1012(b) (1994). Accordingly, the implementing legislation does not preempt the Kentucky Liquidation Act[.] …The Convention itself is simply inapplicable in this instance."

In May, the First Circuit, in *Green Enters., LLC v. Hiscox Syndicates Ltd.*, became the latest Circuit Court to disagree with *Stephens*. Based on the Supreme Court's 2008 decision in *Medellín v. Texas*, the First Circuit held that "the text of the Convention makes plain that Article II(3) provides a clear 'directive to domestic courts.' *Medellín*, 552 U.S. at 508. Article II (3), by its express terms, directly commands courts to channel arbitrable disputes to arbitration: 'The court … shall … refer the parties to arbitration….'" In other words, the Convention is a self-executing treaty. In so deciding, the First Circuit followed the Ninth Circuit's 2021 holding in *CLMS Mgmt. Servs. Ltd. P'ship v. Amwins Brokerage of Ga., LLC*, which in turn relied on a concurrence in the Fifth Circuit's 2009 *en banc* decision in *Safety Nat'l Cas. Corp. v. Certain Underwriters*. Additionally, the *en banc* Fifth Circuit, over the dissent of three judges, held in *Safety Nat'l* that the text of the MFA applies to an "Act of Congress" and not "a treaty implemented by an Act of Congress," and the Fourth Circuit agreed in 2012, in *ESAB Group, Inc. v. Zurich Ins. PLC*.

Furthermore, the First, Fifth, Fourth, and Ninth Circuits all called into question the Second Circuit's reasoning. The First Circuit observed as follows: "…*Stephens* predated *Medellín*, offered no analysis of the text of Article II(3), and contained little explanation for why it concluded that the Convention was in relevant part non-self-executing." The Ninth Circuit made the same point in 2021.

The *en banc* Fifth Circuit, in *Safety Nat'l*, offered an additional criticism of *Stephens* based on a footnote in a subsequent decision of the Second Circuit:

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We also note that the reasoning of the Second Circuit in *Stephens v. American International Insurance Co.* is at least in tension with that of its subsequent decision in *Stephens v. National Distillers & Chemical Corp.* [69 F.3d 1226 (2d Cir. 1995)], in which the Second Circuit held that the McCarran-Ferguson Act did not cause a state law requiring out-of-state insurers to post security before participating in court proceedings to preempt the Foreign Sovereign Immunities Act. In support of its first alternative ground for that holding, the Second Circuit reasoned that it must "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 McCarran-Ferguson Act does not "force a federal law that clearly intends to preempt all other state laws to give way simply because the insurance industry is involved." In a footnote appended to this statement, the court concluded that because an additional, alternate ground (that international law preempted the state insurance law before the passage of both the McCarran-Ferguson Act and the Federal Sovereign Immunities Act) supported its holding, it "need not consider whether [its decision to apply federal law when it was clearly intended to displace all state law] is in conflict with the holding in [*Stephens v.*] *American [International Insurance Co.*]."

The Fourth Circuit agreed with the Fifth Circuit on this point in *ESAB Group*.

All of the foregoing points, and assuredly more from the detailed discussions in the decisions of the First, Fourth, Fifth and Ninth Circuits, will undoubtedly be made in the event of an appeal from *3131 Veterans Blvd LLC*. If there is an appeal, the states that prohibit or restrict the arbitration of insurance disputes will be watching closely and, so too, insurers and reinsurers in the United States and the world-over should be watching closely.

Edward K. Lenci, “Drafting an Enforceable Arbitral Provision” in “Invoking a Policy’s Arbhttps://www.hinshawlaw.com/professionals-edward-lenci.htmlitral Provisions When a Third Party Sues the Insurer,” ARIAS-U.S. Quarterly, Q3-2021, at 6-10.

15 U.S.C. §§ 1011-15.

15 U.S.C. § 1012(b), titled “Federal regulation,” states that, “[n]o 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.…”

9 U.S.C. §§ 201-208.

Reverse-preemption occurs when a state statute supersedes a federal statute.

Edward K. Lenci, “Another Circuit Court Holds That the New York Convention Pre-empts State Laws Prohibiting Arbitration of Insurance Disputes” in “The Continued Rise Of The New York Convention And The Fall Of The ‘Bellefonte Cap,’” *Arbitrate.com*, September 8, 2021, https://arbitrate.com/the-continued-rise-of-the-new-york-convention-and-the-fall-of-the-bellefonte-cap/. Since publication of this article, the First Circuit has sided with the Fourth, Fifth, and Ninth Circuits. *Green Enters., LLC v. Hiscox Syndicates Ltd.*, 68 F.4th 662 (1st Cir. 2023).

Certain Underwriters at Lloyds, et al. v. 3131 Veterans Blvd LLC, No. 22-CV-9849 (LAP), 2023 U.S. Dist. LEXIS 144956 (S.D.N.Y. August 15, 2023).

Stephens v. American Int’l Ins. Co., 66 F.3d 41, 43 (2d Cir. 1995)),

U.S. v. South-Eastern Underwriters Assoc., 322 U.S. 533 (1944).

U.S. Const., Art. I, Sec. 8, Cl. 3 (“The Congress shall have Power … [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes[.]).

“State Insurance Regulation,” NAIC Center for Insurance Policy and Research, at 2

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See generally, “Dodd-Frank: Title V – Insurance,” Cornell Law School Legal Information Institute, https://www.law.cornell.edu/wex/dodd-frank_title_V.

U.S. Const., Art. VI, cl. 2 (“all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any State to the contrary notwithstanding.”).

Id., *quoting Foster v. Neilson*, 27 U.S. (2 Pet.) 253, 313-14 (1829).

Id.

Medellin v. Texas, 552 U.S. 491, 505 (2008).

Green Enters., 68 F.4th at 667-68.

CLMS Mgmt. Servs. Ltd. P'ship v. Amwins Brokerage of Ga., LLC, 8 F.4th 1007, 1015-16 (9th Cir. 2021), *cert. denied*, 142 S. Ct. 862, 211 L. Ed. 2d 569, 2022 U.S. LEXIS 545 (2022)

Safety Nat'l Cas. Corp. v. Certain Underwriters, 587 F.3d 714, 735 (5th Cir. 2009) (*en banc*) (Clement, J., concurring).

Id., 587 F.3d at 731.

ESAB Group, Inc. v. Zurich Ins. PLC, 685 F.3d 376, 388-89 (4th Cir. 2012).

Green Enters., 68 F.4th at 667-68

ESAB Group, 685 F.3d at 1015-16.

Safety Nat'l, 587 F.3d at 731-32.

ESAB Group, 685 F.3d at 385.

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