Service of Suit Clauses: Do They Also Dictate the Applicable Law in Reinsurance Disputes?

What effect (if any) do SOS clauses have on the law governing contracts?

By Pieter Van Tol

As insurance and reinsurance professionals, we frequently run across contracts with "Service of Suit" (SOS) clauses stating that, in the event of a failure to pay amounts claimed under the policy, the insurer/reinsurer submits to the jurisdiction of any U.S. court of competent jurisdiction. These provisions have been the subject of litigation involving several important issues, such as whether SOS clauses preclude removal of a case from state court, constitute mandatory choices of forum or affect arbitral rights.[1] One contentious and often overlooked question is what effect—if any—SOS clauses have on the law governing contracts.

Many courts have adopted the view that SOS clauses do not include choice-of-law provisions. However, a few decisions from federal district courts sitting in New York (among others) are to the contrary and they have held that bringing an action in New York under an SOS clause results in the application of New York substantive law. This minority approach has major implications for companies and their advisors because claimants often resort to the New York courts as their forum of choice, especially for contracts involving foreign insurers or reinsurers.

Background on SOS Clauses

SOS clauses have been around since at least the 1940s.[2] The London market developed the provision as a response to "competitors' arguments that Lloyd's [of London] was not amenable to process in the United States and that

potential customers thus should place their business with a domestic company."[3] There are also various regulatory reasons for including SOS clauses in contracts. For example, state laws and regulations provide that ceding insurers cannot take credit on their financial statements for reinsurance issued by unlicensed or unauthorized reinsurers unless (among other things) the reinsurers consent to service of suit.[4]

In one of its earlier iterations, the typical SOS clause states as follows:

It is agreed that in the event of the failure of [the insurer/reinsurer] hereon to pay any amount claimed to be due hereunder, [the insurer/reinsurer] hereon, at the request of the [insured/reinsured], will submit to the jurisdiction of any Court of competent jurisdiction within the United States and will comply with all requirements necessary to give such Court jurisdiction and all matters arising hereunder shall be determined in accordance with the law and practice of such Court.[5]

The underlined portion of the above SOS clause has given rise to the choice-of-law debate. As discussed below, the courts and commentators disagree about whether the reference to the "law and practice of such Court" mandates the use of a particular state's substantive law.

In order to address questions under the old SOS clauses concerning removal or transfer, the London market developed the NMA 1998 form.[6] The NMA 1998 form states as follows:

It is agreed that in the event of the failure of the Underwriters hereon to pay any amount claimed to be due hereunder, the Underwriters hereon, at the request of the Insured (or Reinsured), will submit to the jurisdiction of a Court of competent jurisdiction within the United States. Nothing in this Clause constitutes or should be understood to constitute a waiver of Underwriters' rights to commence an action in any Court of competent jurisdiction in the United States, to remove an action to a United States District Court, or to seek a transfer of a case to another Court as permitted by the laws of the United States or of any State in the United States.[7]

The NMA 1998 form omits the phrase from the earlier clause stating that "all matters arising hereunder shall be determined in accordance with the law and practice of such Court." However, the NMA 1998 form does not resolve the choice-of-law issues under contracts with the older clause and, in recent years, the courts have continued to face those questions.

Majority Approach on Choice of Law in SOS Clauses

The majority of courts have held that SOS clauses are not choice-of-law provisions and do not dictate the substantive law applicable to the contract.[8] Collectively, these courts have relied on three main arguments in reaching their conclusion.

First, they point out the overarching purpose of SOS clauses, noting that the provisions are designed to provide the insurer's or reinsurer's consent to the chosen forum. The *Allianz Insurance* court stated that: "The plain language of the clause shows a consent to jurisdiction of any court of plaintiff's choice; it does not address the law to be applied."[9] Both the *Singer* and *Chesapeake* courts stated that the parties would have more clearly provided for a choice of law in the SOS clauses (or elsewhere in the agreements) if they had intended to select a particular law.[10]

Second, in response to the argument that SOS clauses do in fact reflect a choice of the forum law as the substantive law governing the contract because they state that "all matters arising hereunder shall be determined in accordance with the law and practice of such Court," the courts have focused on the precise language in that phrase. In *Singer*, the court stated that the phrase "the law and practice of such Court" refers only to the *choice-of-law principles* of the forum court and thus it means that the forum court will apply those principles to determine the substantive law applicable to the contract.[11] The *Chesapeake* court expanded on this argument: "The clause alludes to the 'law and practice of such *Court*.' It does not say 'such *state*' or 'such *forum*.' The law and practice of this Court, in diversity cases, is to apply the law (*including the choice of law rules*) of the forum state."[12] Therefore, in *Chesapeake*, the court did not apply the substantive law of Delaware because the suit had been brought there; instead, it applied the Delaware choice-of-law principles and held that the applicable law depended on the location of the insured risk, here the pollution site involved.[13]

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The *Chesapeake* decision has been very influential, and other courts have likewise construed the reference to the "law and practice of such Court" to mean the choice-of-law principles, not the substantive law, of the forum. In *Carrier*, for example, the court stated: "The court treats the expression 'such court' as meaning this court for the purposes of this analysis. This court does not have any substantive law. The state of Connecticut has substantive law. All this court may do is apply the law of this state to the choice of law question."[14]

Third, the courts have supported their findings with public policy considerations. The primary concern is forum-shopping. As the Supreme Judicial Court of Massachusetts stated in *W.R. Grace*, the application of the forum's substantive law would mean that "an insured seeking a declaration of its rights to indemnity and defense could select any United States jurisdiction in which service could be obtained on the insurer and compel it to decide the case [under the forum's law], even though the insured, the risk covered, the injured underlying claimant, the alleged wrongful act and resulting harm, and all witnesses had no connection whatsoever with the selected jurisdiction."[15] The *James River* court added that relying on the forum's choice-of-law principles—rather than applying the substantive law of the forum under the SOS clause—"promotes clarity and certainty in contracting" because Florida (like many other states) follows the *lex loci contractus* rule that focuses on where the contract was negotiated and concluded.[16]

New York Courts Choose a Different Path

The courts in New York, along with a few courts in other jurisdictions, interpret SOS clauses differently. In two cases (both of which are federal cases from the Southern District of New York), the courts held that SOS clauses include choice-of-law provisions mandating that the substantive law of the forum will apply to the contract.[17] Neither decision contains an extensive analysis on the choice-of-law issue. In *Lexington*, the court cited the language in the SOS clause stating that "all matters arising hereunder shall be determined in accordance with the law and practice of such Court" and described it as a "valid choice of law provision" making New York law applicable.[18] In the other case, *Core-Mark*, the court relied on the same language and the Lexington decision.[19]

Other courts have reached the same result as in *Core-Mark* and *Lexington*.[20] In *Century Indemnity* (which is a reinsurance case), the Third Circuit raised the choice-of-law issue *sua sponte*. After noting that both parties cited Pennsylvania state court cases (without explicitly arguing that Pennsylvania law applied), the court noted that "the retrocessional agreements' service-of-suit clause contains a choice-of-law provision stating that 'all matters arising [from disputes brought pursuant to the service-of-suit clause] shall be determined in accordance with the law and practice of [the] Court' where the action is brought."[21] The Third Circuit then stated: "This provision suggests that to the extent that federal law does not control this action, we should resolve this dispute over payments under the retrocessional agreements in accordance with the substantive law of Pennsylvania, the state in which Century filed suit."[22]

As in *Core-Mark*, *Lexington*, and *Century Indemnity*, the other cases following the minority approach do not engage in a detailed discussion of the choice-of-law issues. However, in two of those cases (*Fossil Creek* and ISLIC), the courts found that the language in the SOS clauses is clear. The *Fossil Creek* court cited the phrase "all matters arising hereunder shall be determined in accordance with the law and practice of such Court" and concluded:

Cook's argues that pursuant to this language in the insurance contract, "Admiral has agreed for this matter to be determined in accordance with the laws of and practice of Oklahoma." Giving effect to this language according to its ordinary and popular meaning, we agree. We find that these words clearly and definitely express the parties' intent to have this case determined in accordance with the law of any court of competent jurisdiction including the District Court of Cimarron County, Oklahoma, chosen by Cook's. Therefore, pursuant to the agreement of the parties, we find that Oklahoma law governs this dispute.[23]

In *ISLIC*, the court construed a similar SOS clause and found that "[i]t is clear from this section that ISLIC anticipated suits in courts of States other than Illinois, and that ISLIC agreed that all matters relative to the disputes concerning the policy were to be interpreted within the law and practice of the courts of those States."[24]

There are also several unpublished

(and not readily available) decisions to the same effect that the California and Washington courts issued in the late 1980s and early 1990s. These decisions are discussed in the well-known *Insurance Coverage Litigation* treatise.[25] The treatise refers to those cases (along with *Lexington* and others) as the "better-reasoned decisions" because the courts considered evidence on the drafting history of SOS clauses and the intent of the London market in adding the reference to the "law and practice of such Court." [26]

The extrinsic evidence cited by the *Insurance Coverage Litigation* treatise includes, among other things: (1) a 1944 circular from the NMA to the London market noting that the amendment to the SOS clause adding the phrase "all matters arising hereunder shall be determined in accordance with the law and practice of such Court" was necessary because the previous version of the SOS clause did not state that the underwriters were prepared to be governed by "American law"; (2) a 1944 letter from Lloyd's U.S. counsel similarly noting that the new clause specifically provides for "the application of American law"; (3) a 1971 letter from the NMA explaining that the SOS clause enables insureds in the U.S. "to pursue their remedies against Underwriters in a local court under local law"; and (4) expert testimony from Julian M. Flaux (then a QC and now a judge on the High Court of England and Wales) in which he stated that the SOS clause allows the policyholder to choose the substantive law of the forum.[27] In general, the treatise is an excellent source for those who wish to argue that the intent of the parties supports the minority approach on choice-of-law under an SOS clause.

As a note of caution, however, a few courts have not been persuaded by extrinsic evidence regarding the SOS clauses and choice-of-law.[28] In *Hoechst*, the court considered expert evidence from Michael Jackson, the 1944 NMA circular and letter from Lloyd's counsel noted above, and the 1971 letter from the NMA. With regard to the 1944 materials, the *Hoechst* court found that their reference to "American law" includes "American choice of law principles" and "the drafters' intent that American law apply would still be upheld even in a situation where a state's application of choice of law principles leads to an application of British law."[29] The *Hoechst* court also rejected the reliance on the 1971 NMA letter referring to "local law." One of the parties in *Hoechst* argued that the letter supports the proposition that SOS clauses are choice-of-law provisions because, pursuant to the RESTATEMENT (SECOND) CONFLICT OF LAWS § 187 cmt. h, "the reference to local law is a term of art which means substantive law of a jurisdiction, not its conflict-of-laws principles." The court stated, however, that Section 187 only applies where the parties have agreed at the time of contracting which state's law will apply; "[s]uch a situation is not presented here where the insurance contracts at issue were void of any indication of the state in which litigation would be pursued."[30] Thus, *Hoechst* and other cases demonstrate that the citation to extrinsic evidence is not a guarantee of success.[31]

Other commentators have offered a rebuttal to the majority view that is based on the plain language of the SOS clauses as opposed to extrinsic evidence regarding intent. In a 1994 article, for example, the authors criticized the holdings in *Chesapeake* and similar cases that the "law and practice" portion of the SOS clause is a reference to the forum's choice-of-law principles, but not its substantive law.[32] They noted that "[a] construction of the language as excluding the application of the *substantive* law of the forum would render that language surplusage since the court always will apply its own procedural law and choice-of-law principles to all actions before it."[33] The authors further pointed out that "the provision plainly states that 'all matters' arising under the contract will be governed by the forum court's law."[34]

Why Does It Matter and What Is Next?

New York is often a forum for insurance and reinsurance disputes, and the presence of an older SOS clause in the contract(s) may provide an opportunity for a party to urge the arbitrators or

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court to apply the substantive law of the forum. As noted above, there are several arguments for and against the interpretation of such SOS clauses as choice-of-law provisions. It appears, however, that the case law is still developing and counsel should keep an eye out for new cases on this issue, especially any decision from the Second Circuit or the New York Court of Appeals. In addition, given the less restrictive nature of evidence in arbitration, panels may be more amenable to considering extrinsic evidence—particularly from new sources with knowledge of the history or market practice—regarding the interpretation of SOS clauses. •

ENDNOTES

1. In a 1997 case, the court listed the issues that had arisen in connection with SOS clauses. *Allendale Mutual Insurance Co. v. Excess Insurance Co.*, 970 F. Supp. 265, 273-74 (S.D.N.Y. 1997) (citing cases), vacated on other grounds, 172 F.3d 37 (2d Cir. 1999). The controversy over SOS clauses has persisted, and parties are still debating the effects of such a provision on a variety of legal issues. *See, e.g., Pine Top Receivables of Illinois, LLC. v. Transfercom, Ltd.*, No. 15-CV-8908, 2015 WL 8780611 (N.D. Ill. Dec. 14, 2015) (determining whether an SOS clause is a waiver of the right to remove).
2. *See Travelers Insurance Co. v. Keeling*, 91 CIV. 7753 (JFK), 1993 WL 18909, at *1 (S.D.N.Y. Jan. 19, 1993) (noting that casualty excess reinsurance treaties dating back to 1947 contained SOS clauses); *General Phoenix Corp. v. Malyon*, 88 F. Supp. 502, 502 (S.D.N.Y. 1949) (construing SOS clause). *See generally* L. Masters, J. Stanzler & E. Anderson, INSURANCE COVERAGE LITIG., § 6.03[B][1] at 6-27 (2d ed. 2013 Supp.) (describing pre-1944 SOS clauses).
3. *Chubb Custom Insurance Co. v. Prudential Insurance Co. of America*, 948 A.2d 1285, 1290 (N.J. 2008); see also *Columbia Cas. Co. v. Bristol-Myers Squibb Co.*, 635 N.Y.S.2d 173, 176 (N.Y. App. Div. 1995); *Appalachian Insurance Co. v. Union Carbide Corp.*, 208 Cal.Rptr. 627, 629 (Cal. Ct. App. 1984).
4. *See, e.g.*, R. Hall, Does a Service of Suit Clause in a Reinsurance Contract Bar Removal of a Dispute to Federal Court?, available at: http://www.robertmhall.com/articles/ServiceSuitRemovalArt.pdf.
5. *See, e.g., Dinallo v. Dunav Insurance Co.*, 672 F. Supp. 2d 368, 370 (S.D.N.Y. 2009) (SOS clause in reinsurance context) (emphasis added); L. Masters, *et al.*, INSURANCE COVERAGE LITIG., § 6.03[B] at 6-25 (SOS clause in excess insurance context). The phrase "all matters arising hereunder shall be determined in accordance with the law and practice of such Court" was added to the SOS clause in 1944. *See Hoechst Celanese Corp. v. Nat'l Union Fire Insurance Corp. of Pittsburgh, Pa.*, Civ. A. No. 89C-SE-35, 1994 WL 721651, at *2 (Del. Super. Ct., Mar. 28, 1994). *See generally* L. Masters, *et al.*, INSURANCE COVERAGE LITIG., § 6.03[B][1] at 6-27 to 6-28.
6. See Lloyd's Market Bulletin, June 7, 2004, Y3327, available at: http://www.lloyds.com/~/media/files/the%20market/communications/market%20bulletins/market%20bulletins%20pre%2005%202010/2004/y3327.pdf. "NMA" refers to the "Non-Marine Association."
7. *See* https://ebview.com/pdfgenerator/ViewPdf/EPLI/SERVICEOFSUITCLAUSE.pdf. NMA 1998 was also cited in *Ario v. Underwriting Members of Syndicate 53 at Lloyds for the 1998 Year of Account*, 618 F.3d 277, 284-85 (3d Cir. 2010).
8. *See James River Insurance Co. v. Fortress Sys., LLC*, No. 11-60558-CIV., 2012 WL 760773, at *3-6 (S.D. Fla. Mar. 8, 2012); *In re FEMA Trailer Formaldehyde Prods. Liab. Litig.*, 780 F. Supp. 2d 514, 523 (E.D. La. 2011); *Weitz Co., LLC v. Lloyd's of London*, Civil No. 4:04-CV-90353-TJS, 2008 WL 7796651, at *5-6 (S.D. Iowa, Mar. 31, 2008), *rev'd on other grounds*, 574 F.3d 885 (8th Cir. 2009); *Norfolk Southern Corp. v. California Union Insurance Co.*, 859 So. 2d 167, 182-83 (La. Ct. App. 2003); *Allianz Insurance Co. v. SSR Realty Advisors, Inc.*, No. CIV.A. 02-7253, 2003 WL 21321430, at *6 (E.D. Pa. June 5, 2003); *Burlington Northern Railroad Co. v. Allianz Underwriters Insurance Co.*, Civ. A. No. 90C-07-108, 1994 WL 637011, at *2-4 (Del. Super. Ct. Aug. 25, 1994); *Carrier Corp. v. Home Insurance Co.*, 648 A.2d 665, 668 (Conn. Super. Ct. 1994); *Hoechst*, 1994 WL 721651, at *1-3; *Revco Drug Stores, Inc. v. Government Employees Insurance Co.*, 791 F. Supp. 1254, 1262 (N.D. Ohio 1991), aff'd, 984 F.2d 154 (6th Cir. 1992) (per curiam); *W.R. Grace & Co. v. Hartford Accident & Indemnity Co.*, 555 N.E.2d 214, 218-19 (Mass. 1994); *Monsanto Co. v. Aetna Casualty & Surety Co.*, 1990 WL 9496, at *3-4 (Del. Super. Ct. Jan. 19, 1990); *Chesapeake Utilities Corp. v. American Home Assurance Co.*, 704 F. Supp. 551, 557-58 (D. Del. 1989); *Singer v. Lexington Insurance Co.*, 658 F. Supp. 341, 344 (N.D. Tex. 1986); *Edinburgh Assurance Co. v. R.L. Burns Corp.*, 479 F. Supp. 138, 148 (C.D. Cal. 1979), *aff'd in part and rev'd in part on other grounds*, 669 F.2d 1259 (9th Cir. 1982).
9. 2003 WL 21321430, at *6 (citing *Singer*, 658 F. Supp. at 344); see also *James River*, 2012 WL 760773, at *4; *Chesapeake*, 704 F. Supp. at 557.
10. *Chesapeake*, 704 F. Supp. at 557; *Singer*, 658 F. Supp. at 344.
11. *Singer*, 658 F. Supp. at 344.
12. *Chesapeake*, 704 F. Supp. at 557 (emphasis in original).
13. *Id.* at 557-58.
14. 648 A.2d at 668; *see also* James River, 2012 WL 760773, at *4 ("Nothing in the Service of Suit provision directs the application of the 'law of this *State*'; the provision merely specifies the 'law and practice of such *Court*.'") (emphasis in original).
15. 555 N.E.2d at 582 n.14; *see also James River*, 2012 WL 760773, at *5; *Norfolk*, 859 So. 2d at 182; *Burlington*, 1994 WL 637011, at *4.
16. 2012 WL 760773, at *6.
17. *Core-Mark International Corp. v. Commonwealth Insurance Co.*, No. 05 Civ. 183 (WHP), 2005 WL 1676704, at *3 (S.D.N.Y. July 19, 2005); *Lexington Insurance Co. v. Unionamerica Insurance Co.*, No. 85 Civ. 9181 (MJL), 1987 WL 11684, at *4 (S.D.N.Y. May 28, 1987).
18. 1987 WL 11684, at *4. The *Lexington* court cited two cases, *General Phoenix* and *Perini Corp. v. Orion Insurance Co.*, 331 F. Supp. 453 (E.D. Cal. 1971), but those decisions involved removal and did not discuss whether SOS clauses are also choice-of-law provisions.
19. 2005 WL 1676704, at *3.
20. See *Fossil Creek Energy Corp. v. Cook's Oilfield Servs.*, 242 P.3d 537, 542 (Okla. 2010); *Century Indemnity Co. v. Certain Underwriters at Lloyd's, London*, 584 F.3d 513, 533 (3d Cir. 2009); *TH Agriculture & Nutrition, LLC v. ACE European Group Ltd.*, 488 F.3d 1282, 1293-94 (10th Cir. 2007); *International Surplus Lines Insurance Co. v. Pioneer Life Insurance Co. of Ill.*, 568 N.E.2d 9, 12 (Ill. Ct. App. 1991) (*"ISLIC"*); *Capital Bank & Trust Co. v. Associated International Insurance Co.*, 576 F. Supp. 1522, 1525 (M.D. La. 1984). As noted in *James River*, *TH Agriculture* presents an unusual situation because, in that case, the SOS clause explicitly provided the application of the law of The Netherlands as opposed to just the "law and practice of such Court." *James River*, 2012 WL 760773, n.2. *Capital Bank* is also problematic because the court, in dicta, seems to have misconstrued two other cases (*General Phoenix* and *Perini*) as relating to the choice-of-law issue when it fact they dealt with removal. Norfolk, 859 So. 2d at 183.
21. 584 F.3d at 533 (alterations in original).
22. *Id.*
23. 242 P.3d at 542 (internal citations omitted). *Fossil Creek* also cited *TH Agriculture*, but its holding is based on the language in the SOS clause.
24. 568 N.E.2d at 12 (emphasis in original). In dicta, the *Chubb* court also stated that the SOS clause "essentially guarantees the application of United States law." 948 A.2d at 1291.
25. *See* L. Masters, *et al.*, INSURANCE COVERAGE LITIG., § 6.03[B] at 6-25, 6-32 to 6-34. Some of the California decisions are also discussed in another treatise, J. Oshinsky & T. Howard, PRACTITIONER'S GUIDE TO LITIGATING INSURANCE COVERAGE ACTIONS.
26. *See* L. Masters, *et al.*, INSURANCE COVERAGE LITIG., § 6.03[B] at 6-25 to 6-26.
27. *See id.*, § 6.03[B][1] at 6-27 to 6-30, 6-33.
28. See *Hoechst*, 1994 WL 721651, at *2; *Burlington Northern*, 1994 WL 637011, at *3-4; *Edinburgh*, 479 F. Supp. at 148.
29. 1994 WL 721651, at *2 (emphasis in original).
30. *Id*. The *Burlington Northern* decision (which came after *Hoechst*) took a different approach on the "local law" issue. The court stated that "had the parties intended to apply the local law of the forum state chosen by the insured, the parties would have said 'local law,' not 'law,' in the SOS clause." 1994 WL 637011, at *4. In other words, the *Burlington Northern* court believed that the parties would have not left such an issue to implication and would have expressly referred to "local law" in the SOS clause itself.
31. Another issue is that extrinsic evidence often involves expert testimony, which can be expensive, time-consuming and contradictory. *Compare* Expert Report of Robert N. Hughes in *Newmont U.S.A. Ltd v. American Home Assurance Co.*, No. CV-09-033-JLQ (E.D. Wash. July 2, 2010), 2010 WL 4392835 (stating that SOS clauses "serve a dual purpose" in that they allow for the selection of a forum and "also provide that the law of that court shall apply") *with* Expert Report and Opinion of John Holford in *Teck Metals Ltd. v. Certain Underwriters at Lloyd's*, No. CV-05-0411-LRS (E.D. Wash. Sept. 7, 2010), 2010 WL 8981708, ¶ 35(2) (stating that ("[t]he Service of Suit Clause is not a Choice of Law Clause").
32. P. Kalis, J. Segerdahl, and J. Waldron, The Choice-of-Law Dispute in Comprehensive Environmental Coverage Litigation: Has Help Arrived from the American Law Institute Complex Litigation Project?, 54 *Louisiana Law Review* 925, 927 n.6 (1994).
33. *Id*. (emphasis in original).
34. *Id.*