

Former Subsidiary Has Right to Enforce ADR Clause in Policy

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The United States Court of Appeals for the Seventh Circuit has held that a former subsidiary was entitled to arbitration under the parent company's professional liability policy, but that the insurer had not waived its right to object to such arbitration. *Am. Int'l. Spec. Lines Ins. Co. v. Elec. Data Sys. Corp.*, 347 F.3d 665 (7th Cir. 2003).

An insurer issued a professional liability policy that provided specified coverage to a company and to certain past Subsidiaries of the Named Insured. The policy covered "claims of liability that are first made against the Insureds during the Policy Period" arising out of "wrongful acts" committed by the Insureds. "Insureds" was defined as "any subsidiary of the Named Insured, but only with respect to wrongful acts which occur while it is a subsidiary and are otherwise covered by this policy." The policy also stated that disputes under the policy "shall be subject to the alternative dispute resolution process (ADR) set forth in" the policy, and "the Named Insured shall act on behalf of all Insureds in selection of the ADR in accordance with this clause."

A former subsidiary of the policyholder was sued in connection with work that it did for the New York Police Department. The subsidiary had been a subsidiary of the policyholder company at the time it completed the work for the police department, but it was sold before the department made its claim for damages. The subsidiary tendered a claim to the policyholder's insurer for the suit against it and invoked the ADR clause of the policy, demanding arbitration. The insurer filed suit to enjoin the arbitration and to obtain a declaration that the subsidiary's claim had no merit. The trial court ordered arbitration. After the arbitrator awarded a judgment of \$14 million against the insurer, the insurer appealed, arguing that the subsidiary was not entitled to arbitration.

The court first rejected the subsidiary's procedural argument that the insurer had waived its right to object to the arbitration because it had willingly participated therein. The court reasoned that the insurer had not waived its objection because it had initially objected to ADR and participated in the arbitration only after the district court ordered it to do so.

On the merits, the court held in favor of the subsidiary, explaining that since it "did not cease to be an Insured under the policy by reason of being a former subsidiary of [the Named Insured], it seems very odd that it should be unable to invoke a dispute resolution mechanism, namely arbitration, that the policy authorizes—at

the Insured's election—for resolving such disputes." The court also rejected the insurer's argument that only the named policyholder should be able to invoke the ADR mechanism, explaining that because the policyholder no longer had any stake in the former subsidiary, "an interpretation that places the sole power to invoke arbitration in an entity that has no stake in the arbitration makes no commercial sense."

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