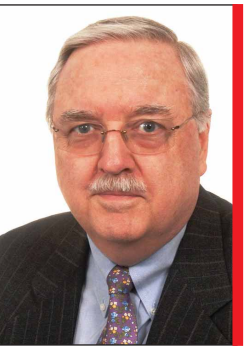
[INSIGHT] By Peter H. Bickford

A Primer For Agencies: Understanding the Arbitration Clause

Arbitration has been the preferred method of dispute resolution in the reinsurance arena for decades and has grown into quite its own industry, including the development and standardization of forms and procedures, and a proliferation of law firms, consultants and other service providers specializing in reinsurance arbitrations, and of "certified" or "qualified" arbitrators (I confess to being one of those "certified" reinsurance arbitrators!). Although the process has had to deal with issues raised by its own growth, the reinsurance arbitration process has proven over the years to be a successful alternative to litigation. In part because of this success, insurers have been including arbitration clauses in their standard agency and program management contracts as the exclusive method of resolving contractual disputes. However, while arbitration can be an effective dispute resolution process for reinsurance disputes, it can be fraught with danger for unsuspecting agencies, MGAs, MGUs and other program managers.



Peter H. Bickford

The most obvious disparity between the insurance agency/manager and the insurance company is economic. With few exceptions, the company has far greater resources to bring to bear on a dispute than its appointed agencies and managers.

In an excellent 2004 article on the history of arbitration, "Arbitration and Insurance Without the Common Law," economist and former NY superintendent of insurance Dick Stewart points out that arbitration works best between parties of the same merchant class, such as insurance company versus reinsurance company. However, arbitration does not work as well between parties of a different class, such as insurance company versus agency or program manager. In reinsurance disputes, where the parties are considered to be of the same merchant class, the process generally protects both sides equally. It is this level playing field that has provided the basis for the success of arbitration between insurers and reinsurers. However, arbitration as a means of resolving disputes between insurers and agencies/managers is an imperfect solution tilted decidedly toward the insurer.

The most obvious disparity between the insurance agency/manager and the insurance company is economic. With few exceptions, the company has far greater resources to bring to bear on a dispute than its appointed agencies and managers. This economic disparity, however, would be present in any forum for resolving disputes, including litigation, so it is understandable that most agencies or managers would consider arbitration the smarter and safer alternative to litigation because of the perceived benefits of time and cost of arbitration over litigation. But there are other more subtle differences and prejudices in the system as it exists today, and these differences should be recognized and considered by the agency/manager community. Among these differences are:

- Arbitration clauses in use today are, for the most part, recycled reinsurance forms that do not recognize the differences between reinsurance and agency/manager relationships;
- The rules of conduct of arbitration proceedings -- including such things as audits, discovery, confidentiality, and the like -- have evolved substantially from reinsurance disputes;
- The available community of arbitrators is composed primarily of insurance and reinsurance company experts with very little experience with or knowledge of agency/manager operations, practices and expectations; and
- The lawyers, consultants and other service providers supporting the arbitration process are substantially insurer or reinsurer oriented because that is where the work is found.

Given this background, the main issue for agencies asked or required to accept an arbitration clause is to make sure that it provides a reasonable method for the selection of a panel with knowledge of and experience with agency business, and that the process called for in the clause will not be unduly burdensome.

The arbitration clauses found in most agency/manager agreements are modeled on clauses that have evolved in the reinsurance business over the past several decades, and the vast majority of them provide that arbitrators must be current or retired executives of insurance or reinsurance companies. The boilerplate from the reinsurance world, including the arbitrator qualification provision, keeps appearing unchanged in carriers' standard agency, MGA or similar agreements.

The selection of arbitrators qualified to consider the unique issues involved in agency/manager disputes with carriers is one of -- if not the most -- crucial events in the process. While most experienced arbitrators will decline to serve as an arbitrator on issues for which they have limited experience or pre-set positions, the danger is with the "expert" arbitrators who – through ignorance or hubris, or both – believe they know everything about everything. Because panel awards generally do not have to be reasoned, and because the grounds for overturning arbitration awards in court are very limited, it is remarkably easy for a panel to hide a prejudicial or improper award behind the screen of "unreasoned" awards, limited ability to challenge, and confidentiality.

Typical reinsurance disputes, even where

continued on page 8

continued from page 6

large sums are at stake, are generally not a life or death proposition for companies or their reinsurers. For agencies or program managers, however, the loss of a dispute with a carrier can be far more consequential, and often can mean the difference between success and failure of its business.

At the very least, agencies/managers need to make sure that the arbitration provision in their agreements with insurers allows for the appointment of active or former executives of brokerage firms, agencies, managing general agents and program managers as well as insurers. But until there is a substantial pool of potential arbitrators with knowledge and understanding of agency/manager operations, agencies and managers remain at a distinct disadvantage even with a change in the boilerplate.

In the meantime, agencies/managers, separately and through their trade organizations, need to educate their brethren on the shortcomings of the arbitration process; to take joint and concerted actions to expand the pool of qualified and available arbitrators knowledgeable on agency and program management issues; and to make sure that this pool is known and accessible to the agency/manager community. If the agency/manager community can develop a significant alternative pool to the predominantly reinsurance oriented pools, this development could also spur a change in attitude about the process by carriers, and increase the expertise of the supporting groups on agency issues -- including law firms, consultants and other service providers looking to the arbitration process as a significant source of their business – and go a long way in helping to change the playing field from a steep slope to at least a gentler incline. [IA]

…agencies/managers need to make sure that the arbitration provision in their agreements with insurers allows for the appointment of active or former executives of brokerage firms, agencies, managing general agents and program managers as well as insurers.

[LETTERS]

continued from page 4

I always like to see the work being performed and engaged "Prada" in conversation. When he heard that I was a lawyer he told me that his brother was a lawyer – who turned out to be Fred.

Such humble beginnings to such outstanding fame.

I am saddened by Fred's passing.

I did not know his partner Michael Killorin and I would appreciate it if you could pass on to him my condolences on Fred's passing and my thoughts of how great Fred was to everyone.

Don Gabay