

California Employers Win Arbitration Dispute

The New York Supreme Court is refusing to enforce the arbitration provision that an American International Group company is trying to impose on a California employer after finding that it failed to show the agreement is valid. The decision is good news for California employers who have been chafing at carriers' use of side agreements in workers' comp policies to compel arbitration in far-off locales and under other states' insurance laws.

The timing of the decision is prescient given that legislation in the California Legislature addressing this very issue is on its way to the governor's desk. The Department of Insurance isn't sitting back either, and is reminding carriers that the insurance code doesn't accept side agreements not attached to the insurance policy.

The central question in the case, which pits Source One Staffing against National Union Fire Insurance Company of Pittsburgh, is whether a side agreement never filed with, nor approved by, the California insurance commissioner is valid and enforceable. The court ruled that it isn't but gave National Union, an AIG/Chartis company, the opportunity to file an amended petition to show that the form did not need to be filed and approved to be enforceable.

AIG officials declined to comment on the decision. But others were not so circumspect.

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"It's a good decision," says attorney Nick Roxborough, who has been a vocal critic of the policies and the way they're foisted on employers, often weeks or months after a policy incepts. "The issue is a huge one for California employers because they're being [dragged] all over the country to arbitrate these disputes."

The case at hand involved a dispute over unpaid reimbursements, premiums and collateral on Source One's 2004 large-deductible policy. Under such policies, employers pay on a claim from the first dollar up to an agreed-upon amount — the specific deductible point. But disputes often arise over claims-handling practices, which then trigger the arbitration clause.

Roxborough points out that arbitration is a costly proposition,

with arbitrators' rates running about \$500 per hour. "So you're looking at \$1,500 per hour for three arbitrators. You split the fee, but you're still paying \$750 an hour for an arbitrator, plus your lawyers, and then you have to move your witnesses," he maintains. "The insurance carriers just beat you up."

Beyond the cost is the way the arbitration provisions are added and enforced. The court noted in Source One's case that the arbitration provision was in a side agreement detailing how premiums were to be paid. Source One argued, and the court ultimately agreed, that the agreement is unenforceable because it was never filed with the Workers' Compensation Insurance Rating Bureau (WCIRB). Under the terms of Insurance Code section 11658, carriers are supposed to file with WCIRB all agreements that affect obligations of an employer and carrier.

National Union also argued that the Federal Arbitration Act (FAA) should trump California's Insurance Code but was unable to sway the court.

Justice Eileen Bransten maintained that the McCarran-Ferguson Act, which left regulation and taxation of the insurance industry up to the states, holds sway in this dispute. "[National Union] has not shown

how mandating arbitration would not invalidate, impair or supersede the Insurance Code,” Bransten wrote. “Therefore, [National Union] has not shown that the McCarran-Ferguson Act allows the FAA to preempt the Insurance Code.”

CDI Orders Changes

That carriers were using side agreements to introduce and enforce arbitration provisions, among other terms, was not news to Insurance Commissioner Dave Jones. As a member of the Assembly, Jones carried AB 2490 to require that any agreements on dispute resolution proceedings between an employer and an insurance carrier be approved by the insurance commissioner and resolved in California.

The bill was vetoed by Gov. Schwarzenegger, but a similar measure — SB 684 by Sen. Ellen Corbett (D- San Leandro) — is in the works and would require disclosure of the policy and have it signed off by the policyholder. SB 684 has no opposition and even enjoys support from Liberty Mutual Insurance Company. But the California Department of Insurance is not waiting for the Legislature to react.

“The Insurance Commissioner has prohibited the use of collateral agreements, which is synonymous with the term ‘side-agreement,’ concerning workers’ compensation insurance unless they are attached to the policy,” CDI senior counsel Chris Citko says in a letter to WCIRB president Bob Mike. “Some insurers may not be aware of this provision, have ignored it, or may have determined that it is not applicable and have failed to submit collateral agreements to the WCIRB.”

The letter orders the bureau to remind carriers of their obligation under sections 11658 and 11750.3, and to work with them to ensure that such agreements are submitted to it in the future. It leaves in place collateral agreements already out there but places a caveat on their enforceability. That caveat is that their use is subject to review by the department, and Citko says that such a review could invalidate the collateral agreements or even lead to enforcement action against the carrier for unfair practices.

“The Department is particularly concerned with arbitration provisions contained in unattached collateral

agreements and considers such terms unenforceable unless the insurer can demonstrate that the arbitration agreement was expressly agreed to by the insured at the time the policy was issued,” he writes.

Officials at the bureau note that it complied with the letter’s directive to inform carriers of their responsibilities, but they can’t say if the industry has changed its practice.

“Some insurers have submitted new forms to us, and we review them in the same manner in which we review all forms,” says WCIRB spokesman Jack Hannan. “We don’t really know which forms are submitted to us containing language that was previously part of a side agreement. So there is no separate tracking of these forms and no statistics are available.”

[Click here](#) for a copy of the opinion in the Source One case. [Click here](#) for a copy of the department’s letter to WCIRB.

(Filed by Brad Cain in San Francisco)