

Confidentiality Agreements
What are they? When are they used?
Why are their uses growing within the reinsurance industry?
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Introduction:

With a growing trend in the insurance/reinsurance industry for the use of Confidentiality Agreements, this paper attempts to explain what a Confidentiality Agreement is; its use in the industry; the reasons behind its increased use; and issues related to these agreements. As a preface to the remainder of the paper, it is important to realize that a Confidentiality Agreement is a legal document; therefore, conferring with counsel when preparing or presented with such an Agreement is recommended.

Confidentiality Agreements Defined:

A Confidentiality Agreement ("CA"), also known as a Non-Disclosure Agreement, is a legal contract between parties who want to exchange Confidential Information ("CI"). Because the Agreement is a contract, it must fulfill the elements of a formal contract.

The exchange of CI may be either unilateral or bilateral.

In a unilateral situation, one party, the discloser, provides CI to another who is not privy to the data. For example, to facilitate the development of new business it is not uncommon for a discloser to provide CI that the recipient reviews for the potential of providing a product desired by the discloser. In consideration of the exchange, the discloser seeks to benefit economically. The party who creates the product, the recipient, may be compensated for its services; however, in some instances, the developer of the new product may be compensated only partially or not at all. This may be because the developer seeks to forge a new relationship with the discloser.

In a bilateral agreement, the parties engage in an exchange of CI whereby both parties seek economic benefit based on the CI. The intended end result is that the parties will create a product that may give one or both an advantage over the competition.

Why the Growing Trends in the Use of Confidentiality Agreements in the Reinsurance Industry?

Confidentiality Agreements have been utilized in the reinsurance industry only rarely, and historically have been found more commonly associated with employment contracts; however today, Confidentiality Agreements are becoming increasingly common within the reinsurance industry.

A wide range of reasons have been given by the industry to explain the increased use of Agreements. A few of the more prevalent are:

- **An Increase in the Use of Litigation**
- **New Product Development**
- **Claim Information and Claim Audits**
- **Mergers and Acquisitions**

Litigation:

With an increase in litigation and more complex arbitrations in the current marketplace, more parties are requesting Confidentiality Agreements. Although a reinsurer is not obligated to the policyholder for payment of a claim, an attorney, in the best interest of the client sometimes may either name a reinsurer in a suit or depose a broker or reinsurer as part of the discovery process in a pending suit against the insurer/cedent.

Presently, there is uncertainty within the industry as to whether a CA will be honored in a court of law in the event of a lawsuit.

Another reason for the growing trend in the use of Agreements is because parties are fearful that unless an Agreement is executed, confidential information provided to an attorney may not be subject to the attorney/client privilege.

New Product Development:

Another reason for the growing trend in Confidentiality Agreements is premised on new business or new product development. Given today's shrinking premium pool, competition is tough; thus, when a new product line is created, the "creator" or "developer" is especially concerned with ensuring that another party will not misappropriate its new product. As a result, intermediaries, who deal with a variety of clients, are being requested to execute CAs to ensure the confidentiality of information regarding such products in development.

There is a perception that the sharing of the CI may lead to the copying of the prospective new product by other cedents. For example, a cedent works through a broker to obtain the best possible fee structure for a new book of business. The broker submits the information to a reinsurer. The reinsurer is affiliated with a different primary insurer. The concern is that the reinsurer will provide the CI to its primary affiliate who will then take the new product line and use it as its own newly created line of business. As a result, the creating cedant may be deprived of some or all of its profits because of the efforts another cedant that did nothing to formulate or enhance the new line of business. To allay such concerns, cedants are requiring intermediaries and reinsurers to sign CAs so that the information is not shared with the primary (insurance) arm of the reinsurer.

Claim Information and Claim Audits

Insurers providing claims information to reinsurers are also seeking CAs with increased frequency. An insurer engaged in coverage litigation with a policyholder might be concerned that confidential claim information (such as coverage analysis, the analysis and opinion of its coverage counsel, claim case reserve information, etc.) provided to its reinsurers may not be protected from discovery requests arising out of the coverage litigation. The insurer may be

concerned that if a CA is not executed, the claim information provided to reinsurers may not be protected from disclosure by the attorney/client privilege, and it will be forced to provide the litigating party with such information.

Some jurisdictions recognize that insurers and their reinsurers have a common interest in the outcome of coverage litigation with policyholders. Thus, some ceding companies now require reinsurers agree to enter into CAs prior to conducting claim file reviews or audits as permitted under the Access to Records. This additional step allows the ceding company to show that in allowing a third party (i.e., the reinsurer) to review information protected from discovery by attorney/client privilege, it intended to preserve the confidential nature of that information. And, coupled with the common interest of the ceding company and the reinsurer in the outcome of the coverage litigation, such a disclosure should not destroy the privileged nature of that information. Absent such an agreement, a policyholder would have a stronger argument to compel discovery of the otherwise privileged information based on the observation that the ceding company allowed free access to such information to a third party.

Cedants and reinsurers have prevailed with this explanation when the party to the litigation seeking the information has asserted that the material is not confidential because it was shared between the cedant and the reinsurer.¹

Mergers and Acquisitions:

The volume of mergers and acquisitions occurring in the industry has increased the requests for Confidentiality Agreements. It is not uncommon for a cedent to buy reinsurance at the same time it or its parent company is involved in due diligence talks to merge with or acquire another entity. If the proposed transaction is not public knowledge, the cedent may need to request the reinsurer enter into a CA to protect itself and perhaps a primary parent company.

Issues Related to Confidentiality Agreements:

There are many factors to consider when drafting a Confidentiality Agreement, the most important of which being whether to utilize a formal written agreement. Although this is an issue to review with your legal department, in many instances, it may be more likely a “business” decision rather than a “legal” matter that determines the final decision.

¹ Citizens Cas. Co. of New York v. American Glass Co., 166 F.2d 91,94 (7th Cir. 1948) (the insured has no concern with contracts of reinsurance); Potomac Elec. Power Co. v. California Union Ins. Co., 136 F.R.D. 1,3 (D.D.C. 1990) (rejecting as irrelevant insured’s request for communications between insurance company and reinsure regarding the terms and condition of the policies that insurance company issued to the insured); Leksi, Inc. v. Federal Ins. Co., 129 F.R.D. 99, 106 (D.N.J. 1989); Olin Corp. v. Ins. Co. of North Am., No. 84 Civ. 1968 (AGS) (S.D.N.Y. 1996); Independent Petro Chemical Corp. v. Aetna Cas. & Sur. Co., 117 F.R.D. 283, 288 (D.D.C. 1986). Cited in Scott M. Seaman, Reinsurance Law & Practice, A Primer On basic Principles & Contemporary Issues in Illinois, 84 (April 1999) (unpublished manuscript, on file with author).

A. What is the Scope of the Confidentiality Agreement?

Although there are no specific criteria that will meet all instances for its use - other than those elements necessary to compose a contract - there are a number of items that should be contained within the scope of the Agreement to avoid potential disputes. These include: what is considered CI, ownership of the CI, who may have access to the CI, third party accesses to the CI, marking of the CI, responsibility for legal expenses and the length of time the recipient must treat the CI as confidential.

1. What is to be considered Confidential Information?

Agreements currently in use are inconsistent in their scope. Some clauses are overly expansive while others contain few terms. Generally, a specific question which could be considered in making a determination as to what is and is not confidential information is: "Would disclosure of this information cause the organization irreparable harm in the event of a breach? If the answer is "NO," generally it may be excluded from the Agreement. If, however, the answer is "YES," then most likely it should be included in the Agreement.

2. Who owns the information contained within the Agreement after it has been transferred?

Although most may consider the "discloser" of the information to be the owner, there may be situations during negotiations that may create an ambiguity or creates a legal right of ownership of the information. For instance, a situation in which the information is incorporated into another larger program, makes the original CI a component of the new program; thereby raising ambiguity as to its originality.

3. Who is to be given access to the CI?

An agreement should define clearly to whom access is authorized (e.g, only to the signatories to the Agreement, to others who will analyze the data). In essence, this really goes to common provisions that restrict access of CI only to necessary staff and usually it prohibits copying of the CI.

Usually, the CA will provide that if a reinsurer is subject to a subpoena which requests the reinsurer to disclose any such CI obtained hereunder or if a reinsurer becomes aware of any third party's attempt to obtain from it any such CI, the reinsurer, except where legally prohibited from doing so, will prior to releasing any information, give prompt notice to the cedent to allow the cedent to take such action as it deems necessary to prohibit or limit disclosure.

4. Is the recipient authorized to show the information to outside parties?

If the third party is known to the provider of the information this may be acknowledged within the scope of the Agreement. If, however, the third party is unknown to the discloser, it may be necessary for a separate Agreement to be entered into by these parties. In addition, many clauses provide that in certain instances, the recipient is authorized to turn over the information to an arbitrator without an allegation of a breach of the Agreement.

5. How is the CI to be marked for tracking purposes?

Marking the information as confidential allows the parties to understand whether the data is confidential or unprotected. It also assists in determining whether the data belongs to the recipient or the discloser once it is incorporated into a larger program.

6. Who is responsible for legal expenses?

In the unlikely event of a breach, many avenues to correct the issue may be negotiated in advance, including who will bear the financial responsibility in the event of a breach. Pre-determining this up front may be useful in deciding whether it will be necessary to pursue other legal post-breach remedies.

7. How long will the CI be treated as confidential?

Most CAs note that a party will be released from maintaining the confidentiality of the CI covered by the CA under four circumstances. First, the information becomes a part of the public domain or is generally known or available. Second, the information is already known to the recipient at the time of disclosure as evidenced by written pre-existing documentation at the time of the disclosure of the Information. Third, if the information is furnished to other third parties by the discloser without restriction on further disclosure. And, fourth, the information is approved for release by written authorization of the disclosing party.

If the CA is intended to last for a short duration, for example a few weeks or possibly a month, it may indicate that it was not necessary to enter into the agreement in the first place. However, it is also not prudent to maintain an agreement for an indefinite term of years. This is particularly true in rapidly advancing technological changes and impacts in the reinsurance industry. Nonetheless, with respect to certain areas such as Claims, an indefinite time period could be deemed appropriate based on the sensitivity of the data.

Ultimately, the time period decided upon will be based on a variety of factors. These factors will be unique and specific to each situation. Therefore, the duration of the Agreement is best left to the parties to negotiate based on the nature of the information being exchanged.

B. What happens with the CI once the Agreement is terminated?

Eventually, the CI becomes obsolete or it may be subject to a breach of the agreement. When this occurs, this presents the question "What is to be done with exchanged CI?"

Although this an area that rarely presents itself, to avoid potential disputes, during the negotiation stage of the CA, parties may agree upon the method of returning/destroying CI subject to the Agreement and ability to verify the return or destruction of the CI. As is the case with any business transaction, how one deals with this issue depends on the level of trust between the parties.

C. Additional Factors to Consider When Drafting a CA

Interestingly, CAs are not viewed negatively within the industry; rather, it is the craftsmanship and tone of the Agreements that causes concern.

Some construed it unreasonable to require an agreement that demands the recipient acknowledge information is unique and proprietary without first having an opportunity to view such information. To soften the request, the recipient may insert a provision within the Agreement stating that the recipient agrees that what is expected to be exchanged is considered – by the discloser – proprietary in nature, but that the recipient could not vouch for its proprietary nature.

As noted above, the manner in which an Agreement is presented may make the document acceptable. This also relates to the craftsmanship of the Agreement. In many instances, Agreements are drafted by an attorney or purchased as a standard generic form, similar to a one-size-fits-all. When necessary, modifications to the standardized form are made to meet the needs of the current situation. As a result, unnecessary clauses may inadvertently be left in the new Agreement, which causes issues of concern and confusion.

Therefore, when drafting a CA, it is helpful to review the document from the perspective of the potential recipient to determine if the CA meets the goal/purposes of the Agreement.

SUMMARY:

Now, more than ever before, Confidentiality Agreements (“CAs”) are appearing in greater numbers in the insurance industry. Several reasons for this growing trend include:

- An Increase in the Use of Litigation
- New Product Development
- Claim Information and Claim Audits
- Mergers and Acquisitions

Most CAs contain typical clauses’, however, there is always reason for review because many additional clauses are easily inserted that, if not reviewed properly, may cause issues at a later time. Several areas of particular importance include:

- What CI is to be included within scope of the CA;
 - ⇒ What is to be considered Confidential Information?
 - ⇒ Who owns the information contained within the Agreement after it has been transferred?
 - ⇒ Who is to be given access to the CI?
 - ⇒ Is the recipient authorized to show the information to outside parties?
 - ⇒ How is the CI to be marked for tracking purposes?
 - ⇒ Who will be responsible for legal expenses?
 - ⇒ How long will the CI be treated as confidential?
- What happens with the CI once the Agreement is terminated?

When drafting or reviewing a CA, one should always review the need for the CA, not only from your perspective but also from the view of the other party. Finally, “know your audience” and review the CA before you submit it for execution.