Arbitration of Insurance Disputes in Germany

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Short Bibliography: *Beckmann/Matusche*, Versicherungsrechts-Handbuch, München 2004; *Gerathewohl*, Rückversicherung, Grundlagen und Praxis, Karlsruhe 1976; *Labes*, Der Ombudsmann der Versicherungswirtschaft, Sachstand – Erwartung – Alternative, in: *Bähr/Labes/Pataki* (eds), Liber discipulorum für Gerrit Winter, Karlsruhe 2002, p. 149; *Labes*, Schiedsgerichtsvereinbarungen in Rückversicherungsverträgen, Frankfurt 1996; *Prölls*, Versicherungsaufsichtsgesetz, 12th edn, München 2005; *Prölls/Martin*, Versicherungsvertragsgesetz, 27th edn, München 2004; *Steward*, Arbitration and Insurance without the Common Law, (2004) 11(3) ARIAS Quarterly, 5; *van Bühren*, Versicherungsrecht, 3rd edn, Bonn 1997.

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I. INTRODUCTION

1 Both, (re)insurance and arbitration, are founded in a very old tradition whose purpose was furthering commerce, and which to that end employed informality, speed, low cost, and commercial realism.[1] Irrespective of this there is a clear division in the insurance market concerning the use of arbitration. While arbitration is widely used in reinsurance it plays little role in direct insurance.

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[1] *Steward*, (1994) 11(3) ARIAS Quarterly 5.

According to the standard policy wordings or standard insurance terms disputes between the insured and the direct insurer are to be decided by normal state courts.

2 The main legal instruments for monitoring insurers' activities in German law are the Insurance Supervisory Law (*Versicherungsaufsichtsgesetz* – 'VAG') and the Insurance Contract Law (*Versicherungsvertragsgesetz* – 'VVG'). Neither of these two bodies of law mentions arbitration or refers to arbitral proceedings.

3 Supervision of insurance companies in Germany is assumed by the German Federal Financial Services Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* – 'BaFin'). BaFin is an independent public-law institution and is subject to the legal and functional oversight of the Federal Ministry of Finance. Since it was established in May 2002 BaFin has brought the supervision of banks and financial service providers, insurance undertakings and securities trading together under one roof. BaFin operates only in the public interest. Its primary objective is to guarantee the proper functioning, stability and integrity of the German financial system. As part of its solvency supervision, BaFin ensures the ability of banks, financial services institutions and insurance undertakings to meet their payment obligations. Through its market supervision BaFin also enforces standards of professional conduct which preserve investors' confidence in the financial markets. BaFin's investor protection role also extends to combating the carrying-on of unauthorized financial business.

4 However, conducting arbitral proceedings does not belong to the duties of BaFin. Even if both parties so wish, BaFin could not decide an arbitral proceeding. Outside of its competence BaFin could participate as an arbitrator, however, in the past always declined to do so. In the same way the BaFin always declined to appoint an arbitrator.[2]

II. DIRECT INSURANCE

5 Direct insurance concerns the relationship between insurer and insured that often has the status of a consumer. Consequently, this relationship is affected by specific safeguards in order to protect the insured who is considered to be the weaker party compared to the generally much larger insurance companies. That may be the real reason why German insurance law does not provide for arbitration regulations. The insured is supposed to be better protected by the ordinary legal proceedings provided by the state courts. However, unlike in the area of securities trading (§ 37h Securities Trading Act (*Wertpapierhandelsgesetz* – 'WpHG')) the legislator has not imposed restrictions

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[2] *Prölls-Kollhosser* (2005), § 81 para. 62.

on the subjective or objective arbitrability of insurance claims. Furthermore the Federal Supreme Court (*Bundesgerichtshof* – 'BGH') has recently confirmed that in principle arbitration proceedings provide an equal protection to consumers as court proceedings and are therefore valid even if contained in standard terms in consumer contracts.[3] As a consequence there would be no legal obstacles to the use of arbitration also in direct insurance even with consumers.

A. Arbitration Clauses in Insurance Contracts

6 Contracts between insured and insurers in form of standard policy wordings or standard insurance terms (*Versicherungsbedingungen*), with rare exceptions, do not contain any reference to arbitration whatsoever.[4] These standard policy wordings or standard insurance terms rather provide for a jurisdiction clause and a choice of law clause which in case of a dispute brings the parties to the state courts. Therefore, disputes between insured and insurer in Germany are usually resolved by the state courts.

7 One exception is § 5 No. 1 (d) General Conditions for Legal Costs Insurance (*Allgemeine Bedingungen für die Rechtsschutzversicherung* – 'ARB') 94/2000 concerning legal costs insurance (*Rechtsschutzversicherung*). Though it does not provide directly for dispute resolution by arbitration it requires the legal costs insurer has to bear the costs for an arbitration or a mediation (*Schlichtungsverfahren*) proceeding up to those costs which would have arisen out of a first instance court procedure, in case the award is legally binding.[5] This at least indicates the possibility for the parties to solve potential disputes through arbitration although not specifically mentioned otherwise in the standard insurance terms for legal costs insurance. In contrary, § 20 ARB 94/2000, forming the jurisdiction clause within these terms, clearly refers to state court procedures only. Another exception is the noncommittal sample tariff designed by the German Insurance Association (*Gesamtverband der Deutschen Versicherungswirtschaft* – 'GDV') called 'Mustertarif 00' which in § 7.6.6 for public liability insurance (*Betriebshaftpflichtversicherung*) provides for an arbitration clause recommended for respective direct insurance contracts.[6]

8 Furthermore, the insurance industry in Germany developed under the old German arbitration law standard arbitration clauses to be included into a policy wording if

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[3] *BGH* 13.01.2005, SchiedsVZ 2005, p. 95 with note *Wagner/Quinke*, JZ 2005, 932.

[4] This is different in other jurisdictions at least with regard to legal costs insurance: e.g. in Austria (Art. 9 No. 2 ARB 88), France, Belgium (at least according to the terms of some insurers such as Art. 13 Gemeinschaftspolice ARAG/DAS Test-Achats), Italy, Greece and Spain.

[5] This was not possible according to § 2 (1)(c) ARB 75. Further comments, also with regard to § 2 (1)(c) ARB 75 in: *Beckmann/Matusche-Beckmann* (2004), § 37 para. 188; *Prölls/Martin-Prölls* (2004), § 5 ARB 94 para. 5.

[6] *Prölls/Martin-Voit/Knappmann* (2004), Betriebshaftpfl. para. 7.6.6, p. 1381.

both parties were in agreement. Such arbitration clauses are especially used in contracts providing property cover for large insured, such as large industrial companies, by replacing the jurisdiction clause.[7] A precondition for agreement on such an arbitration clause is that the parties also agree in relation to the choice of law. Furthermore, some insurers also expect an agreement in respect to certain foreign risks.[8]

9 Whilst traditional arbitration is rarely used in direct insurance there are other procedures such as the expert determination (*Schiedsgutachten*) or the insurance ombudsman which have a significant impact on direct insurance dispute resolution.

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[7] '*1. Alle Streitigkeiten, die sich im Zusammenhang mit diesem Versicherungsvertrag oder über dessen Gültigkeit ergeben und nicht gütlich beigelegt werden können, werden unter Ausschluss des ordentlichen Rechtsweges durch ein Schiedsgericht endgültig entschieden.*
2. Das Schiedsgericht besteht aus drei Schiedsrichtern. Ein Schiedsrichter wird vom Versicherungsnehmer benannt. Der zweite Schiedsrichter wird von den Versicherern, vertreten durch den führenden Versicherer benannt. Die so benannten Schiedsrichter bestimmen einen dritten Schiedsrichter als vorsitzenden Schiedsrichter (Obmann). Hat eine Partei den Schiedsrichter nicht innerhalb eines Monats nach Empfang einer entsprechenden Aufforderung durch die andere Partei bestellt oder können sich die von den Parteien genannten Schiedsrichtern nicht innerhalb eines Monats nach ihrer Bestellung auf einen dritten Schiedsrichter einigen, ist dieser auf Antrag mindestens einer Partei durch den Präsidenten des Oberlandesgerichts Frankfurts zu bestellen. Den Parteien bleibt es unbenommen, sich auf nur einen Schiedsrichter zu einigen; das Schiedsgericht besteht in diesem Fall nur aus diesem Schiedsrichter.
3. Ist ein Schiedsrichter an der Ausübung seiner Tätigkeit gehindert oder stellt dieser die Tätigkeit für das Schiedsgericht ein, ist innerhalb von 4 Wochen ein Ersatzschiedsrichter zu bestellen. Die Bestellung erfolgt nach den Regeln, die auf die Bestellung des zu ersetzenden Schiedsrichters anzuwenden waren.
4. Das Verfahren des Schiedsgerichts wird im Einzelfall durch das Schiedsgericht festgelegt. Die zwingenden gesetzlichen Regelungen des Zehnten Buches der Zivilprozessordnung finden Anwendung. Im Übrigen bestimmt das Schiedsgericht die Verfahrensregeln nach freiem Ermessen. Es kann ergänzend die Schiedsgerichtsordnung der Deutschen Institution für Schiedsgerichtsbarkeit e.V. (DIS) heranziehen und diese entsprechend anwenden.
5. Der Ort des Schiedsgerichtsverfahrens ist Frankfurt. Die Parteien können einen abweichenden Ort innerhalb Deutschlands bestimmen. Zuständig für Entscheidungen über Anträge zum Schiedsgerichtsverfahren (§ 1062 (1) ZPO) ist das Oberlandesgericht Frankfurt. Im Übrigen zuständig ist das Landgericht Frankfurt. Dort ist der Schiedsspruch auch zu hinterlegen.
6. Die Sprache des schiedsgerichtlichen Verfahrens ist deutsch. Sofern sich eine Partei auf schriftliche Beweismittel beruft, die einer anderen Sprache abgefasst sind, kann das Schiedsgericht die Übersetzung der Beweismittel auf Kosten der beweisführenden Partei anordnen. Soweit das Schiedsgericht sich ohne eine Übersetzung hinreichende Kenntnis über den Inhalt des Beweismittels verschaffen kann, soll auf die Übersetzung verzichtet werden.
7. Die Schiedsrichter erhalten für ihre Tätigkeit ein Honorar. Dessen Höhe ist für ein Verfahren auf 50 % der in der Anlage zu § 40.5 der Schiedsgerichtsordnung der Deutschen Institution für Schiedsgerichtsbarkeit e.V. (DIS) genannten Beträge, höchstens aber auf jeweils DM 40.000,00 für den ersten und zweiten Schiedsrichter und DM 52.000,00 für den vorsitzenden Schiedsrichter beschränkt.'

[8] Such as claims out of 'Catastrophes Naturelles' in France or for example terror risk (the latter discussion was recently described by *Armbrüster*, Geltung ausländischen zwingenden Rechts für deutschem Recht unterliegende Versicherungsverträge, VersR 2006, pp. 1 *et seq.*).

B. Expert Determination

10 Insurance arbitration must be distinguished from the expert determination procedures according to § 64 VVG (*Schiedsgutachterverfahren*). Such procedures only refer specific technical or factual issues (e.g. the assessment of a loss) to certain experts (assessors, appraisers, adjusters, etc.). Their purpose is to provide an expert opinion on normally limited issues; their job is not to settle a dispute.[9]

11 According to § 158n VVG, in legal costs insurance the insurance policy or a comparable contractual agreement must provide for a dispute resolution procedure using an expert evaluator (*Gutachterverfahren*).[10] If legal action cannot be avoided despite involving such an expert, the case will be dealt with by the civil courts.[11]

12 A specific expert evaluation procedure for legal costs insurance is regulated in § 17 ARB 75 and § 18 ARB 94 (standard insurance terms for legal costs insurance). In case the insurer refuses to safeguard the legal interests of the insured denying the prospects of success, the insured has the possibility to consult a legal expert (*Stichentscheid* according to ARB 75; *Schiedsgutachten* according to ARB 94) to disprove the insurer. The decision of this legal expert is binding for the insurer.[12]

13 Such expert evaluation procedure is not comparable to arbitration, nor is it a true alternative to it. Accordingly, a clause in an insurance policy which requires the parties to arrange for a mutually agreed expert opinion does not constitute an arbitration clause binding the parties.

C. Insurance Ombudsman

14 Secondly, direct insurance arbitration needs to be differentiated from the ombudsman scheme which is rather an alternative dispute resolution (ADR)[13] method.

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[9] In case there is a doubt regarding the distinction between an arbitration agreement and an agreement for expert evaluation, preference should be given to expert evaluation, since it was less invasive than an arbitration agreement: *OLG München* 07.08.2006, SchiedsVZ 2006, pp. 286 *et seq.*

[10] *Beckmann/Matusche-Beckmann* (2004), § 37 paras 440 *et seq.*; *Prölls/Martin-Prölls* (2004), § 17 ARB 75 para. 1; Austrian Law in §§ 64 and 158l ÖVVG also provides for an expert evaluation procedure (*Schiedsgutachterverfahren*).

[11] *BGH* 03.11.1995, VersR 1996, pp. 898 *et seq.*; *Beckmann/Matusche-Beckmann* (2004), § 19 para. 17; *van Bühren* (1997), pp. 305 *seq.*

[12] *Prölls/Martin-Prölls* (2004), § 17 ARB 75 paras 1 *et seq.*, § 18 ARB 94 paras 1 *et seq.*; in detail: *Schröder-Frerkes*, Konfliktbeilegungsmechanismen in der Rechtsschutzversicherung, Karlsruhe 1991, pp. 332 *et seq.*; *van Bühren* (1997), pp. 305 *seq.*

[13] ADR is in many respects a client driven process rather than a process led by lawyers and there are hardly any legal formalities to be paid attention to. ADR awards are not as such recognizable or enforceable which

15 On 1 October 2001, the German insurance ombudsman scheme[14] was established.[15] Since then, around 95 per cent of all German insurers have become members. For cases with a disputed amount of up to EUR 5,000, the ombudsman's decision is binding; for amounts of up to EUR 50,000 there is an authority to give non-binding recommendations. However, these recommendations, because of the thorough legal analysis involved, are often accepted by the parties as well.[16]

16 In the scheme's first 12 months, more than 8,500 complaints were filed, over 30 per cent of which concerned life insurance contracts. However, a large part of these complaints were inadmissible, either because the complaint exceeded the amount of EUR 50,000, the complaint related to the private health insurance, or the complainant missed the appeal period of six weeks. In 2004, 7,100 out of 10,500 complains were admissible and, of those complaints which the ombudsman was competent to decide, about 36.5 per cent were successful.[17]

17 Due to the resistance of the insurance industry to have an ombudsman also for private health insurance, the insurers providing private health insurance protection decided to have their own ombudsman scheme as from 1 October 2001.[18] The resistance of the insurance industry was mainly based on the relationship between private and public health insurance. Only about 10 per cent of the German population has got private health coverage. Therefore, about 90 per cent of all insured are not able to use the ombudsman.[19] Nevertheless, the private insurance industry considered it essential to also have an ombudsman scheme due to the importance of medical issues.

D. Arbitration Clause in a commercial Contract between an Insured and another Party

18 A situation where the insurance company which is not a party to the commercial contract can be concerned by the arbitral proceedings may initially seem

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is why a settlement out of such a procedure cannot be imposed on a party in the same way as a court judgment or an arbitral award.

[14] Officially called Versicherungsombudsmann e.V., Address: Kronenstraße 12, D-10117 Berlin or Postfach 080632, D-10006 Berlin. The election period is five years.

[15] *von Hippel*, Der Ombudsmann im Bank- und Versicherungswesen, Tübingen 2000; *Labes*, FS-Gerrit Winter (2002), pp. 149 *et seq.*

[16] *Germann*, Mehr Beschwerden beim Ombudsmann, VW 2005, 1212; *Kienzle*, Germany, Insurance and Reinsurance, IFLR 2003, pp. 49 *et seq.*

[17] *Knospe*, Starker Anstieg der zulässigen Beschwerden, ZfV 2005, pp. 770 *et seq.*

[18] The ombudman elected by the private health insurance can be found at <www.pkv.ombudsmann.de>.

[19] *Labes*, FS-Gerrit Winter (2002), pp. 166 *et seq.*, *Michaels*, Speech given at the 16th Münsterischen Versicherungstags, VW 1998, 1752; *Müller*, Der Ombudsmann in der Versicherungswirtschaft – brauchen wir noch die Beschwerdebearbeitung durch das Bundesaufsichtsamt für das Versicherungswesen, VGA-Nachrichten 4/2000, pp. 77 *et seq.*; *Surminski*, Der Ombudsmann zum Dritten, ZfV 2000, 166.

paradoxical. This revolves around the fact that the insurance company is a third party with regard to the commercial contract containing the arbitration clause. It is quite clear that the insurer did not sign the commercial contract and the arbitration clause, therefore, is not binding on the insurer. The insurer may not invoke it and it may not be raised against the insurer. An initial analysis suggests the insurer could claim not to be involved in the arbitral proceedings on the basis of, first, the principle of privacy of contract (§§ 145, 241 Civil Code (*Bürgerliches Gesetzbuch* – 'BGB'), and second, the rule that the decision of an arbitral tribunal is *res judicata* only for the parties to the arbitration.

19 However, as a consequence of the accessory nature of the insurance contract, at least for those lines of business where the insured is protected against claims from third parties such as in liability insurance, the insurer might also be affected by an arbitration clause in the commercial contract. In liability insurance, for example, the insurer acts as a 'guarantor' for the financial consequences emanating from the insured's liability.

20 According to the General Standard Insurance Terms for Liability Insurance in § 3 (2) No. 1 AHB (*Allgemeine Bedingungen für die Haftpflichtversicherung*) the insurer is obliged to settle a claim in favour of the insured:

- if the insurer acknowledged the obligation to settle a claim
- if the insurer reaches or agrees to an out-of-court settlement
- in case of a respective state court decision (*richterliche Entscheidung*)

21 The insurer, however, in principle is not obliged to settle claims based on arbitral awards since arbitration is not explicitly mentioned in the general standard insurance terms for liability insurance. Consequently, liability insurers historically declined acknowledgment of arbitral awards as long as arbitral awards were based on equitable decisions *ex aequo et bono*.[20] Liability insurers do not equate such equitable decisions with state court decisions. In the late 1960s, however, German arbitration practice confirmed the commitment of the arbitrators to substantive law. In 1970, this created an agreement between the Federation of German Industries (*Bundesverband der Deutschen Industrie* – 'BDI') and the trade association of the liability insurers (*HUK-Verband*), acknowledging arbitral awards. Preconditions for such an acknowledgment were, and are, typically:[21]

- The arbitration panel needs to consist of three arbitrators.

[20] *Lionnet/Lionnet* (2005), pp. 51, 373 *et seq.*; *Prölls*, Schiedsverfahren über Haftpflichtansprüche und Haftpflichtversicherungsschutz, VersR 1965, pp. 102 *et seq.*

[21] *Lionnet/Lionnet* (2005), p. 373.

- The umpire or chairman of the arbitration panel needs to be a fully qualified lawyer (*Befähigung zum Richteramt*) and – at least in international cases – needs to belong to a country other than that of the two parties.
- The arbitrators have to decide according to substantive law (therefore, the arbitration clause should not empower the arbitrators to decide *ex aequo et bono*). The applicable substantive law needs to be agreed together with the arbitration clause.
- The arbitration award needs to be in writing and needs to provide the reasons for the decision.

22 These criteria comply with German as well as with international arbitration standards and are therefore by no means outstanding or uncommon. The practical relevance of this acknowledgment, nevertheless, is questionable and is restricted to individual situations.

III. ARBITRATION BETWEEN INSURERS

23 It is of course, theoretically, also possible to have disputes between insurers. Just as in any other contractual relationship it would be necessary that the parties agree on an arbitration clause.

24 Additionally, there may be special cases without a contractual relationship which, nevertheless, produce the necessity to solve a dispute. Typical situations of this kind in the insurance field are co-insurance situations, competition problems, or sales and marketing disagreements.

25 However, these are typical situations where the parties need to agree on an arbitral proceeding in order to avoid state court procedures. There are no special regulations or needs just because of the fact that insurance companies are involved. As far as co-insurance is concerned, especially in an international context, reference can be made to the following comments in relation to arbitral proceedings in reinsurance matters.

26 The enforcement of awards out of an arbitral proceeding between insurers in Germany, which in the same way is also true for arbitral proceedings between insured and insurers, will have to go along the provisions of the Code of Civil Procedure (*Zivilprozessordnung* – 'ZPO') (§§ 1060 *et seq.* ZPO).

IV. REINSURANCE

27 According to § 186 VVG, insurance contract law is not applicable to reinsurance. The latter is only governed by the contractual regulations. The general principles

of insurance contract law (VVG), however, influence the interpretation of reinsurance contracts.[22]

During recent years the reinsurance industry has observed a climate where disagreements between insurers and reinsurers have become more commonplace. The era when disputes arising from reinsurance contracts were settled amicably between individuals seems to belong to the past. Reinsurance contracts have had to meet additional demands due to particular developments in the reinsurance market within the past couple of decades, such as a dramatic expansion of the market and a series of massive claims and catastrophic losses, as well as the international nature of contractual relationships. Arbitration meets in an excellent manner the specific demands of reinsurance contracts, such as the lack of specific legal provisions, the lack of relevant case law and the international nature of the contractual relationships. **28**

Almost every reinsurance contract contains an arbitration clause[23] and many reinsurance contract wordings include arbitration clauses which assign the seat of arbitration to Germany. For such cases the carefully prepared new German arbitration law provides an efficient legal basis. An important element for reinsurance, being generally international, is that the new German law in §§ 1060 ZPO *et seq.* makes a formal distinction between foreign and domestic awards. Accordingly, the recognition and execution of international awards is governed by the New York Convention 1958 which has been part of German law since 1961. Domestic awards, on the other hand, would not require recognition, but only an order of enforcement.[24] **29**

A. Drafting of Reinsurance Arbitration Clauses

As in other industries, the negotiation of an arbitration clause in reinsurance is often difficult since the contracting parties do not want to burden or even endanger the contract in total.[25] Furthermore, it should and must not be overlooked that even a clear and comprehensive arbitration clause will not deal with all possible circumstances and that there will be further questions which are likely to occur when the reinsurance arbitration proceeding is initiated and carried out. For arbitration proceedings in Germany, German arbitration law (§§ 1025 *et seq.* ZPO) will be complementary applicable. As German arbitration law is dominated by the principle of party autonomy the parties are largely free in **30**

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[22] *Prölls/Martin-Kollhosser* (2004), § 186 para. 2.

[23] *Gerathewohl* (1976), Vol. I, Chap. 7 para. 4; *Labes* (1996), pp. 6 *et seq.*; *Honsell-Schwintowski*, Berliner Kommentar zum Versicherungsvertragsgesetz, Berlin 1999, § 186 para. 18.

[24] *Cf.* Part II, *Kröll/Kraft*, § 1059 paras 20 *et seq.*

[25] *Böckstiegel-Kerr*, Arbitration Law Relevant to English German Business Relations, in: DIS Schriftenreihe No. 7, Köln 1987, p. 14.

the drafting of their arbitration clause and the way they want their proceedings to be conducted.

1. Arbitration Rules

31 The parties to a reinsurance contract have, in the same way as any other contractual parties, the possibility either to create their own code of procedure by a kind of tailor-made *ad hoc* arbitration clause, or they submit themselves to already existing institutional arbitration rules.

32 Arbitration rules which have been developed especially for reinsurance contracts[26] are provided by the International Underwriting Association (IUA),[27] the Reinsurance Association of America (RAA),[28] and the London Court of International Arbitration (LCIA).[29] Likewise, the Association Internationale de Droit des Assurances (AIDA)[30] provides arbitration rules especially for reinsurance contracts, namely the AIDA Reinsurance and Insurance Arbitration Society (ARIAS) with various national chapters such as organizations in the US,[31] in the UK[32] and in Germany[33] established just recently. Under the principle of party autonomy governing German arbitration law the parties are free to select any of these rules irrespective of whether they have been drafted for use in a different legal setting.

33 Those arbitration rules especially created for reinsurance[34] to a very large degree regulate the arbitral proceeding in the same way as the well-known sets of rules provided by other institutions such as the German Institution of Arbitration (*Deutsche Institution für Schiedsgerichtsbarkeit* – 'DIS') or ICC. All of them, for example, arrange for a panel of three arbitrators, order for certain periods to appoint arbitrators, and provide regulations on costs, written awards, place of arbitration, and proper law. Some explicit sections, however, specifically refer to the particularities of reinsurance, i.e.:

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[26] *Butler*, A new chapter on arbitration, Reinsurance April 1990, pp. 29 *et seq.*; *Gumbel*, Thoughts on arbitration under reinsurance contracts and on an attempt to draft a standard clause, FS-Schmidt, Karlsruhe 1976, p. 890; *Thompson*, Who shall arbitrate?, Reinsurance September 1991, pp. 69 *et seq.*; *Tract*, The case for litigation, ReActions July 1987, pp. 37 *et seq.*; *Shapiro*, Law may speed case settlement, Business Insurance March 1997, pp. 23 *et seq.*

[27] IUA was formed by a merger of the Reinsurance Offices' Association (ROA) and the London International Insurance and Reinsurance Market Association (LIRMA), see also <http://www.iua.co.uk>.

[28] See <http://community.reinsurance.org/ScriptContent/Index.cfm>.

[29] See <http://www.lcia-arbitration.com>.

[30] See <http://www.aida.org.uk/useful_links.asp>.

[31] See <http://www.arias-us.org>.

[32] See <http://www.arias.org.uk>.

[33] *Lansch*, Schlichten statt richten, Handelsblatt 26 September 2006, p. 24.

[34] Various examples mentioned in: *Labes* (1996), pp. 185 *et seq.*

- ROA, ILU, LUA Standard Arbitration Agreement 1990
  (4) Unless the parties otherwise agree the arbitration tribunal shall consist of persons with not less than ten years experience of insurance or reinsurance.
  (6) The appointor shall be the chairman for the time being of the Reinsurance Offices Association or if he is unable to act for any reasons such person as may be nominated by the Executive Committee of that Association.
- ARIAS (UK) Recommended Arbitration Clause
  (5) Unless the parties otherwise agree the arbitration tribunal shall consist of persons (including those who have retired) with not less than ten years experience of insurance or reinsurance as persons engaged in the industry itself or as lawyers or other professional advisers.
  (7) The appointor shall be the Chairman for the time being of ARIAS (UK) or if he is unavailable or it is inappropriate for him to act for any reason, such person as may be nominated by the Committee of ARIAS (UK). If for any reason such persons decline or are unable to act, then the appointor shall be the Judge of the appropriate Courts having jurisdiction at the place of arbitration.
- RAA Procedures for the Resolution of U.S. Insurance or Reinsurance Disputes
  (6.2) The arbitrators and umpire shall be persons who are current or former officers or executives of an insurer or reinsurer. Alternative: The arbitrators and umpire shall be persons who are current or former officers or executives of an insurer or reinsurer or other professionals with no less then ten years of experience in or serving the insurance or reinsurance industry.

34 Moreover, the RAA Procedures for the Resolution of U.S. Insurance or Reinsurance Disputes[35] in many sections refer to insurance and reinsurance specifications such as 'the panel shall apply the custom and practice of the insurance and reinsurance industry', or for example, that confidentiality has to be maintained in order 'to support reinsurance and retrocession'. None of these particular requirements as to the qualification of the arbitrators or the chosen appointing authority create any problem under German law, which in §§ 1035 (1), 1036 (2) ZPO allow the parties to regulate the appointment process and impose requirements as to the arbitrators' qualifications.

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[35] See <http://www.arbitrationtaskforce.org/images/Procedures2004_final.pdf>.

35 A very special set of rules for reinsurance disputes was formed by LCIA. The LCIA Reinsurance Arbitration Rules,[36] established in 1983, are meant to be a specific addition to the LCIA Arbitration Rules, considering the typical circumstances of reinsurance by providing a multi-party arbitration regulation.

36 Apart from these specific set of rules reinsurers can of course also choose the rules of the several institutions of international arbitration such as for example the Court of Arbitration of the International Chamber of Commerce (ICC) in Paris, the American Arbitration Association (AAA), or the DIS in Cologne,[37] all of which perform administrative work which can be compared to the functions of a legal administrative body.

37 Contrary to all the other procedural rules mentioned, DIS offers a set of rules specialized for the German market. DIS, furthermore, just recently formed a committee which consists of various specialists in insurance and reinsurance arbitration and which is supposed to develop arbitration clauses for insurance as well as reinsurance contracts. Furthermore, this committee will provide a comprehensive list of experienced arbitrators and will establish arbitration training tools for insurers and reinsurers.

38 The benefit of institutional arbitration is that the parties can rely on an organization with experience in the handling of arbitral proceedings which makes for efficiency. Such arbitration rules, however, have not been of much practical significance in reinsurance contracts to date.[38] Most reinsurance contracts contain a loosely-worded arbitration clause allowing the parties to agree their own set of rules at the time. Therefore, by far the majority of the reinsurance arbitration that takes place is *ad hoc* in this sense. This contrasts with common practice in international business contracts, where the majority of arbitral clauses contain a reference to institutional arbitration rules.[39] Reinsurers consider it to be problematic that their independence in forming the tribunal by using an institution which may also affect the reinsurers' interest in strict confidentiality.[40]

39 Moreover, the universally accepted arbitration rules of the United Nations Commission for International Trade Law (UNCITRAL) present an independent set of rules without having any institutional organization or administration.

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[36] Full text in: *Labes* (1997), pp. 200 *et seq.*

[37] For a detailed discussion of the DIS Rules see Part III.

[38] That may be different to some degree in the anglo-american world.

[39] *Böckstiegel*, Schiedsgerichtsbarkeit im wiedervereinten Deutschland, RPS 1992, p. 7; *Labes*, Rückversicherungs-Schiedsgerichtsbarkeit, VersR 1996, 1462.

[40] *Cornish*, English reinsurance developments during 1992, ZfV 1992, p. 542; *McCullough/Eilers*, ...and justice for all, ReActions September 1991, p. 53; *McCullough/Haab*, A devil of a job, ReActions October 1992, pp. 50 *et seq.*; *Tract*, The case for litigation, ReActions July 1987, p. 38; *Wollan*, The case for arbitration, ReActions September 1987, pp. 61 *et seq.*

2. *Necessary Components of an ad hoc Arbitration Clause*

In order to ensure reliable and predictable arbitral proceedings, *ad hoc* arbitration agreements obviously preferred by reinsurers should ideally provide for the essential mechanisms. This includes the regulation of details such as the appointment of arbitrators, the apportionment of costs and many other usual regulations. Although these internationally applied regulations are typically contained, many of the existing arbitration clauses in reinsurance contracts do not provide for essential regulations characteristically needed for reinsurance disputes, others comprise of regulations which in practice prove to be detaining or just redundant. Examples are given in the following paragraphs. Whenever the parties have not regulated the above issues in their arbitration agreement, the relevant provisions of German arbitration law apply and provide in nearly all situations for acceptable fall back provisions which ensure that the arbitration proceedings may be set into motion. **40**

a. Qualification of the Arbitrators: Arbitral awards have the same effect as a final and binding court judgment and challenge is limited to specific grounds.[41] It is thus particularly important that the parties end up with a tribunal in which they have confidence. Appointment of a sole arbitrator in reinsurance disputes does sometimes happen but is rare. **41**

A typical *ad hoc* arbitration clause used in German reinsurance treaties is not much different from arbitration clauses in other industries. A characteristic addition, however, is the following or a similar phrase: 'The members of the arbitration panel shall be active or retired executives of insurance or reinsurance companies.' **42**

Many arbitration clauses in reinsurance contracts provide for arbitrators in an existing executive position or similar. In general practice, however, the appointment of individuals who hold such a position in reinsurance companies and who are also willing to accept the task of being an arbitrator, can be difficult due to time constraints or conflicts of interest. **43**

More important, there should be no need for a provision on the qualification of the arbitrators, since the parties will 'in their own interest' avoid appointing candidates without the necessary qualification. Thus, a broad phrasing of the arbitration clause is recommended to simplify the appointment and to keep the range of potential candidates wide enough. **44**

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[41] § 1055 ZPO. Before an award can be challenged in court permission of the court is needed according to § 1059 ZPO. The grounds on which appeal can be made are severely limited. Very few applications for permission succeed.

45 A reliable alternative is to select from the lists of arbitrators offered by a specialized institution such as, for example, ARIAS (US).[42] Experts in the field of arbitration are often hesitant and suspect prejudice or even partiality as well as a limitation of party autonomy with the arbitrators selected from such lists. However, these lists establish a fund of arbitrators with appropriate qualification which considerably simplifies the often time-consuming process of appointment. Sometimes the appointment of the arbitrators, the election of the chairman, respectively the umpire, and their preparation for the proceedings take as much time as the remaining procedure.

46 Furthermore, concerning the course of procedure, the composing of the award and its later enforcement, it is advisable to choose at least one arbitrator, i.e. the chairman or umpire, with a legal background, especially relating to arbitration procedural law. Also German courts, acting as fall back appointing authority, will normally appoint lawyers in case of a substitute nomination of an arbitrator. It will presumably be easier to solve technical details concerning insurance by consulting an expert than having arbitrators without or with just a little legal experience decide on legal details.[43]

47 Beyond this, the parties should bear in mind that a designation of a specific arbitrator by name already in the arbitration agreement might even lead to the ineffectiveness of the whole arbitration agreement in case this specific arbitrator becomes unavailable or does not want to accept this position.[44]

48 ***b. Multi-party Arbitration:*** Difficulties concerning the designation of arbitrators also often result from multi-party arbitration proceedings. This is especially typical for reinsurance contracts, where generally insurers have several reinsurers and reinsurers distribute parts of their risk onto several retrocessionaires, who then also assign parts of their risk. The settlement of a dispute can therefore lead to a multi-party arbitral proceeding.

49 The basic problem is that the whole arbitration system is designed for two-party procedures. Therefore, intentions to combine arbitral proceedings for several contracts, or procedures with several parties require procedural rules that differ from those of a two-party procedure.

50 Two indispensable conditions for multi-party arbitration are generally accepted. Firstly, a multi-party procedure has to be established on a contractual basis. German law does not provide any means to consolidate arbitrations or the joinder of parties which have not signed the arbitration agreement without the consent of

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[42] See <http://www.arias-us.org/index.cfm?a=16&app=arbitrators>.

[43] *Hunter*, Practical Aspects of Insurance and Reinsurance Arbitration: A Common Law Approach, ICC ICArb. Bull., Arbitration, Finance and Insurance – Special Supplement 2000, p. 44.

[44] *Davis*, Pathological Clauses: Frédéric Eisemann's Still Vital Criteria, Arb.Int. 1991, 365.

all parties concerned. Secondly, it has to be guaranteed that all parties have equal influence and control of the composition of the arbitral tribunal.[45] If one of these prerequisites is missing and the parties nevertheless conduct a joint action, recognition and enforcement of the arbitral award before state courts might fail unless the courts construe the participation as consent.[46]

51 A possibility to assure equal influence of all parties is to agree on a single arbitrator. In this case all parties would in the same manner take part in the formation of the arbitral tribunal and would have equal influence. In case of a missing party directive German Law, however, provides for three arbitrators.

52 A further solution could be that each party would have the right to appoint one arbitrator and these arbitrators would then choose a chairman. This method is well established for the appointment of arbitrators in disputes with two parties. Depending on the complexity of the case however, the number of arbitrators could increase to an extent that might hinder the tribunal's ability to function properly even up to the complete inability to reach a decision.

53 Furthermore, it has been suggested for multi-party arbitrations to have the entire arbitral tribunal appointed by a third party if several parties on one side are unable to agree on a joint arbitrator.[47] This solution, however, would deprive the opposing party willing and able to appoint its own arbitrator of its power of appointment only for reasons of procedural economy without this party being at fault for the situation.

54 In the end, the best solution would seem to be to stipulate in advance a multi-party clause[48] with the intention being for all parties on one side to agree on a joint arbitrator. Then the usual principles for the formation of a three-party arbitral tribunal also apply to multi-party arbitration. Such a multi-party clause could be accepted by all parties in the same contract. It will further on be helpful to use an identical multi-party clause in all separate contracts which exist between the parties. In this case, the parties to the original contract agree on a multi-party clause and then commit themselves to include this clause in their further contracts with third parties.

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[45] The principle of equality between the parties in the appointment of the arbitral tribunal was considered to be part of the international *ordre public* in the 1992 'Dutco' case decided by the *Cour de Cassation*: *Société Siemens AG and BKMI v. Société Dutco Construction*, RdA 1992, 470; Detailed explanation in: *Labes* (1996), pp. 35 *et seq.*

[46] *OLG Frankfurt* 24.11.2005, SchiedsVZ 2006, 219 *et seq.*

[47] *Berger*, Schiedsrichterbestellung in Mehrparteienschiedsverfahren, RIW 1993, p. 707; *Luther*, Das Drei-Mann-Schiedsgericht bei der Entscheidung zwischen drei und mehr Vertragspartnern, in: *Ficker/König et al.* (eds), FS-von Caemmerer, 1978, p. 578; *Lew/Mistelis/Kröll* (2003), paras 16-11 *et seq.*

[48] *Labes* (1996), pp. 50 *et seq.*; *Laschet*, Die Mehrparteienschiedsgerichtsbarkeit, in: *Glossner* (eds), FS-Bülow, 1981, p. 119; *Nicklisch*, Mehrparteienschiedsgerichtsbarkeit und Streiterledigung bei Großprojekten, in: *Plantey/Böckstiegel/Bredow* (eds), FS-Glossner, 1994, p. 238.

55 The several parties on the one side need to elect a representative from their midst and give him the power to conduct all negotiations on procedural questions with binding force. This representative will make decisions on the arbitration proceeding and thus, for example, also on the appointment of an arbitrator. Any limits to his authority, the right to intervene, or other rights of the other parties involved should be laid down explicitly.

56 German law, however, might hinder such a solution. In a recent decision the Higher Regional Court (*Oberlandesgericht* – 'OLG') Frankfurt[49] ruled that pursuant to § 1034 (2) ZPO a party to an arbitration has an equal right to nominate a party-appointed arbitrator and can, therefore, in case of doubt ask the court to permit such a nomination. Consequently, the court ruled that a party is precluded from raising an objection against an unequal composition of the tribunal in case the party had not made use of their possibilities pursuant to § 1034 (2) ZPO.

57 ***c. Choice of the applicable Law:*** The question of the applicable law is not limited to arbitral proceedings or to reinsurance disputes. Any national judge dealing with an international case has to decide on this question. Nevertheless, the problem of the applicable law is different for arbitral proceedings because international arbitral tribunals are not bound by a *lex fori* and therefore are not vested with a specific national set of conflict of laws rules. German law in § 1051 ZPO provides for a special conflict of laws rule which allows the parties to merely decide according to their needs and ideas.[50]

58 Generally, the parties to an arbitral proceeding have very extensive autonomy in choosing both the applicable procedural law and the applicable substantive law. Reinsurance contracts in most cases already determine the place of arbitration. By choosing the place of arbitration, the parties generally have also decided on the applicable procedural law for the arbitration, since most national arbitration laws link the nationality of arbitral proceedings or arbitration awards to the place of arbitration.

59 For arbitrations taking place in Germany there are no special rules for insurance-related disputes; § 1051 ZPO does not restrict towards any contract type or modality. Therefore, § 1051 ZPO is also applicable to insurance-related disputes independent of the location of the risk.[51]

60 ***d. Common Usage in the Reinsurance Business:*** The choice of law is basically unrestricted for the parties. That is why the parties are allowed to exclude the application of substantive law and refer to the common usage and practice in the

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49 *OLG Frankfurt* 24.11.2005, SchiedsVZ 2006, pp. 219 *et seq.*
50 *Cf.* Part II, *Friedrich*, § 1051.
51 *Beckmann/Matusche-Beckmann* (2004), § 4 para. 138.

reinsurance business. This can be found in standard arbitration clauses of many reinsurance contracts.[52]

61 Being unwritten law of reinsurance contracts, common reinsurance business usage is mainly formed by business practices and the specific needs of reinsurance. It is especially influenced by the principle of equity and fair dealing. It is represented by individual reinsurance contracts and can thus neither be considered to be rules of law nor of customary law. Nevertheless, it will need to be established that a business practice has been in existence for a considerable period and that it is commonly accepted and applied in the market place.

62 For an arbitral tribunal with specific knowledge in reinsurance, a reference to common reinsurance business usage might be a reasonable basis for the final decision. But even so, reinsurance does not stand outside the legal system and reinsurance business is subject to common private and public legal obligations in the same way as any other business. Additionally, specific agreements of the parties to an individual contract always prevail. In practice, however, there remains a wide scope for the application of common usage and practices in reinsurance business.

63 If the parties wish to refer to common reinsurance business usage, they would be wise to incorporate a specific clause into the reinsurance contract, which enables the arbitrators explicitly to apply common reinsurance business usage in cases of dispute for which the contract contains either no or no clear provisions. Otherwise the arbitrators are bound to decide solely on principles of law.

3. Mediation Clause prior to an Arbitration Agreement

64 A useful supplement to an arbitration agreement in a reinsurance contract may be the obligation to conduct a mediation proceeding prior to the arbitral proceeding, so that the parties have the opportunity to reach an amicable settlement before a large-scale arbitral proceeding has to be initiated. Experience shows that the mediator can succeed in many cases, leading the parties to an amicable settlement. The threat of initiating an arbitral proceeding might itself even lead to a fast and final resolution forcing the parties to focus on the merits of their respective positions. The admissibility of such multi-tier-dispute resolution clauses is beyond doubt in Germany.

65 Due to the fact that the means do not exist to enforce mediation agreements, it is a basic precondition for a mediation agreement that the parties are willing to accept the outcome of such a proceeding as a final and conclusive resolution of the dispute and that they are willing to comply with it voluntarily. A compulsory enforcement of a mediation agreement can – with some restrictions – also be

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[52] *Labes* (1996), p. 93; *Steward*, (1994) 11(3) ARIAS Quarterly 5.

achieved by a lawyers settlement along with a submission (*Anwaltsvergleich mit Vollstreckungsunterwerfung* pursuant to §§ 796a–796f ZPO) or by an arbitral award on agreed terms (*Schiedsspruch mit vereinbartem Wortlaut* pursuant to § 1053 ZPO).[53]

66 A violation of the mediation must automatically result in a transition to the arbitral proceeding. This might be the case, for example, if the parties cannot agree on a mediator within the provided period of time. The reason for this is that the inability to agree on a mediator within a certain time-limit can be seen as an indicator of the parties' general unwillingness to complete the mediation proceedings successfully.

67 Finally, it also has to be determined which information, documents, or other parts of the mediation proceeding may be used in subsequent arbitral proceedings. Agreement should be reached between the parties, at the outset of the mediation process, that the following arbitral proceeding should be completely separate from the mediation proceeding. This means, particularly, that the mediator should not be appointed as an arbitrator and that the mediator should not be heard during the arbitral proceeding. Furthermore, all documents resulting from the mediation proceeding of either the arbitrator or the parties should be subject to absolute discretion and should only be available in the later arbitral proceedings with the permission of both parties. Settlement or other offers of the parties during the mediation proceeding should be of no significance ('privileged and confidential'/'without prejudice') for the arbitral proceeding and be excluded.

B. Conducting Reinsurance Arbitration Proceedings

68 Reinsurance arbitration proceedings are not in reality very different from other industries' arbitral proceedings involving international disputes. In particular, the differences between procedural traditions of common law and civil law become apparent. Thus, the obligation of disclosure or discovery, which is common practice in the Anglo-American legal world, does not exist under German law. However, as the arbitrators pursuant to § 1042 (4) ZPO are free to conduct the proceedings in the way they consider appropriate, the appointment of arbitrators from a common law country may lead to proceedings which incorporate certain features of common law procedure. The same is true for organisational elements such as, for example, an organisational meeting which is usually expected by American arbitrators. Another example: in the U.S. it is quite normal for the

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[53] *Kaboth*, Das Schlichtungs- und Schiedsgerichtsverfahren der Weltorganisation für geistiges Eigentum (WIPO), Frankfurt am Main 2000, p. 198; *Hasselblatt-Labes/Lörcher*, Gewerblicher Rechtsschutz, 2nd edn, p. 239; *Lörcher*, Mediation: Rechtskraft über Schiedsspruch mit vereinbartem Wortlaut?, DB 1999, pp. 789 *et seq*.

claimant to seek an order from the tribunal that the respondent to a monetary claim put up security. Purely German arbitrations do not envisage such practices.

V. RESUME AND OUTLOOK

Arbitration is of minor relevance in direct insurance where disputes are usually solved by state courts, but has long been used in reinsurance. **69**

As regards direct insurance, arbitration needs to be distinguished from an expert evaluation procedure (*Schiedsgutachterverfahren*) where an expert provides for an expert opinion but does not settle a dispute, and from the ombudsman scheme which is rather an alternative dispute resolution method. **70**

In some very rare occasions contracts between the insured and their direct insurers refer to arbitration. In order to be able to deal with a situation where an arbitration clause is advisable, the insurance industry in Germany developed standard arbitration clauses to be included into a policy wording if both parties were in agreement. **71**

Furthermore, insurers may, under certain circumstances, due to the accessory nature of insurance contracts, be affected by an arbitration clause in a commercial contract between the insured and a third party. Last but not least there may also be disputes between insurers which may lead to an arbitral proceeding. **72**

That is different in reinsurance where almost every reinsurance contract contains a loosely-worded *ad hoc* arbitration clause allowing the parties to agree their own set of rules. Arbitration rules provided by institutions have not been of much practical significance in reinsurance contracts to date. On the other side, *ad hoc* arbitration clauses in reinsurance contracts are often either missing necessary clauses although typically needed for reinsurance disputes or contain of regulations which are detaining or just redundant. **73**

Following the reform of German arbitration law in 1998, arbitration has become more and more important as a modern and flexible method of dispute settlement which is also true for the insurance and reinsurance industry. The committee set up and supported by the DIS as well as the foundation of the German chapter of ARIAS, both composed of experts dealing with insurance and reinsurance dispute resolution for many years, obviously demonstrates that insurers and reinsurers consider arbitration to be an important tool in order to solve disputes within the industry. **74**

At least the DIS committee does not at all concentrate on reinsurance only but also includes direct insurance by approaching insurers and reinsurers who deal with arbitration or are involved in arbitral proceedings and by addressing arbitrators who are particularly interested in arbitration in connection with **75**

insurance and reinsurance. The committee will establish lists with individuals from the industry who come into consideration as possible arbitrators for insurance and/or reinsurance disputes. Finally, the committee will develop appropriate standard sample clauses for insurance and reinsurance contracts and will make them available for use to interested parties.

76 This initiative goes in line with a development in Germany where an increasing number of arbitration procedures in the (re)insurance sector can be noticed. The time when disputes arising from insurance and reinsurance contracts were settled amicably between individuals seems to be over. Market developments, especially such as the expansion of the market and significant higher loss values, have created a climate in which disagreements are more commonplace. This mainly involves reinsurers which are increasingly confronted with arbitration mainly from Anglo-American business partners. But in recent years also a growing number of disputes between German parties resulted from this development.

77 This market development also involves direct insurers. They in the same way have to reflect on these developments. Within a massive consolidation process huge direct insurance groups emerged which are more and more acting opportunistic and profit oriented. This will certainly lead to a more professional claims management including dispute resolution. It needs to be seen if this is followed by an increasing use of arbitration but at least for the insurance of substantial risks such as large industrial companies or significant individual risks arbitration indeed is a considerable alternative in order to solve disputes reasonably and quick.