FROM CAPTIVE TO INDEPENDENT AGENT

by

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As with all business arrangements, there are advantages and disadvantages to representing just one insurance company or group of companies. But there may come a time when the biggest disadvantage (having all your eggs in one basket, so to speak) outweighs all the advantages. Changing volume or other business requirements imposed by the parent insurance company or reductions in commission rates or other financial benefits paid by that company may make it very difficult, or even impossible, for the captive agent to continue to run his or her agency as they would like to be able to do or to make an acceptable living from that agency. It is at such times that the captive agent may begin to wonder what the grass is like on the other side of the fence where the independent insurance agent lives.

However, before the captive agent can make the jump to the other side of that fence, careful consideration should be given to three main issues. Those issues involve the legal, financial, and practical effect of terminating the captive agent's relationship with the parent insurance company and establishing new relationships with other insurance companies. In addressing those issues below, I will discuss the questions that must be asked and answered by any captive agent who is considering becoming an independent agent.

To begin with, the captive agent must ask whether it is legally possible for him or her to become an independent insurance agent and if so, how can that be done and what restraints, if any, will be imposed on their conduct as independent agents. The answer to the first question will, except in very rare instances, be yes, as there is a constitutional prohibition against being forced to continue to work for, or with, someone else if you don't want to do so. The more important questions here are how can the relationship with the parent insurance company be terminated and once terminated, what restraints will be imposed on the captive agent's future business activities.

The answers to these two questions will be found in the written agreements between the parent insurance company and the captive agent. It is essential to thoroughly review all the written agreements that are currently in force and to seek advice from an attorney who is familiar with contract and restrictive covenant law regarding the meaning and effect of the pertinent provisions of those agreements. Since there are as many written agreements between parent insurance companies and captive agents as there are parent insurance companies, no definitive answers to the above questions can be provided in this article, but the important questions to keep in mind when reviewing those agreements can be identified and discussed. Those questions are as follows:

1. Who are the parties to the written agreements? Is it the captive agent personally, the agent's corporation or other legal entity, or both? Only the parties to such agreements will be bound by the provisions in them. Thus, for example, any restrictive covenants found in those agreements will only be binding on the parties to them. If only

the captive agent's corporation or other legal entity is a party, the captive agent individually will not be bound by those covenants, but his or her corporation or other legal entity will be. Therefore, if the captive agent wants to engage in activities that are prohibited by the restrictive covenants, he or she will have to do so without involving their corporation or other legal entity (i.e., in their own name or using another corporation or other legal entity).

2. What law is applicable to the written agreements and where are any disputes to be litigated? The first part of this question is of primary importance with respect to any restrictive covenants or forfeiture provisions that may be contained in those agreements. The Georgia law on restrictive covenants and forfeitures associated with the violation of them is very favorable to captive agents. The Georgia courts give strict scrutiny to such covenants and if a covenant fails to satisfy every requirement applicable to it, the whole covenant, and maybe others, is unenforceable, and any forfeiture of an already accrued benefit that is tied to the violation of such a covenant will likewise be unenforceable. The restrictive covenant laws of most other states are not as favorable to captive agents as Georgia's law is. The second part of this question is probably more important from a financial and practical perspective, since if any disputes are to be litigated in a state other than Georgia, the cost of being required to go to such a state to litigate a dispute with the parent insurance company may be financially prohibitive or just impractical.

3. How are the written agreements to be terminated? What, if any, amount of prior written notice of the intent to terminate is required and how is such notice to be delivered? It is very important to follow the termination provisions of the written agreements exactly as they are written. The failure to do so can give rise to a cause of action on the part of the parent insurance company that would be very distracting, not to mention costly, to have to deal with just as the captive agent's transformation to an independent agent is beginning.

4. Who owns the book of business that has been placed with the parent insurance company or through a related brokerage and the data, files, and other records associated with that book of business? Ordinarily, the answer to this question will be that the parent insurance company owns both the book of business and all the data, files, and other records associated with it, all of which will have to be returned to the parent insurance company, along with application forms, policies, brochures, etc. This fact and the associated one of restrictions on the captive agent's activities after the relationship with the parent insurance company is terminated are usually the biggest obstacles that a captive agent will have to overcome in the transition to becoming an independent agent. If the written agreements in question do not contain one or the other of these obstacles, the decision whether to become an independent insurance agent will most likely be much easier to make.

5. What restrictions, if any, are imposed on the business activities of the captive agent and/or his or her corporation or other legal entity after the relationship with the parent insurance company is terminated? More importantly, are any such restrictions enforceable? Such restrictions are known as restrictive covenants and one or more types

of restrictive covenants will almost invariably be included in the written agreements between the captive agent and the parent insurance company. The most common type of covenant is a non-solicitation covenant, which would prevent the party bound by it from soliciting the insurance business of the customers that were previously serviced by that party on behalf of the parent insurance company. Under Georgia law, but not necessarily the law of other states, such a covenant can not prohibit the "mere acceptance" of insurance business from such customers, as long as the party in question did not do anything to induce or otherwise encourage such customers to contact that party. A related restrictive covenant, known as a non-compete covenant, may also be included. This covenant prohibits the party bound by it from engaging in the insurance agency business altogether within a defined territory, which is usually a specified area around that party's current place of business. Such covenants are very difficult to enforce under Georgia law, but not so difficult under the law of other states. Other types of restrictive covenants exist (e.g., nondisclosure of confidential information) and may be found in the written agreements between the parent insurance company and the captive agent. When trying to understand what any restrictive covenant means and determining whether it is enforceable, an attorney with knowledge of this area of the law should be consulted.

The second major question to be considered by a captive agent who is thinking of becoming an independent agent is what will be the financial impact of terminating the agent's relationship with the parent insurance company. The answer to this question will also require a careful review of the written agreements between these parties, plus a realistic assessment of the expected cash flow and operating expenses of the agent's business over the 6-12 months following the termination of that relationship. Such agreements normally provide for the payment of some type of compensation to a captive agent and/or his or her corporation or other legal entity on the book of business he or she has placed with the parent insurance company after the termination of the relationship, if certain criteria have been met. Where such compensation is payable, the agreement usually provides for the forfeiture of that compensation if the party receiving it engages in specified prohibited behavior. Unlike forfeitures of accrued benefits tied to the violation of restrictive covenants, the Georgia courts will enforce any forfeiture of benefits that have not already accrued to a party if that party engages in conduct prohibited by the written agreement in question, even if that prohibition would not be enforceable as a restrictive covenant.

Thus, it is important for the captive agent to know the amount of compensation, if any, he or she will be entitled to receive after the termination of the relationship with the parent insurance company and under what conditions the payment of that compensation can be terminated. The captive agent must then determine what effect the loss of any such compensation would have on his or her ability to remain in business. It is likely that once the parent insurance company learns that the agent is continuing to engage in the insurance business and could arguably be said to be doing so in violation of the applicable provisions of their written agreement, the first action the company will probably take will be to terminate the payment of any such compensation. If the captive agent's business can not survive without such compensation, at least in the short term while the dispute over whether the parent insurance company's action was appropriate is

litigated, that would appear to be an insurmountable obstacle to becoming an independent insurance agent.

Finally, there is the practical, but still very important, question of whether the captive agent will be able to get agency agreements with enough other insurance companies to enable his or her agency business to survive. Whether such agreements can be obtained, in what time frame, and with which insurance companies are crucial questions, the answers to which will go a long way in determining whether a captive agent can successfully become an independent agent. The answers to these questions will be necessary to make a realistic projection of the captive agent's cash flow referred to above. If those answers are not positive ones, the transition to becoming an independent agent will be very difficult, if not impossible, regardless of the answers to the legal and financial questions discussed above.

As you can see from the above discussion, the path to be followed by a captive agent to become an independent agent can be a rocky one, requiring the accurate identification and successful negotiation of several significant obstacles. But with hard work and perseverance and good legal and financial advice, it is a path that can be, and has been, successfully followed by many captive agents.

This article is not intended to provide "legal advice" on the issues discussed in it. It is only for information purposes. The reader should seek advice from an attorney who is knowledgeable in this area of the law about their specific situation before acting.

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