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EXPERT ANALYSIS

A Brief Review of Reinsurance Trends in 2014

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The general trend of U.S. court decisions in reinsurance cases during 2014 was to reinforce principles and precedents familiar from recent years. On the threshold subject of the agreement to arbitrate and arbitrability, courts affirmed and elaborated on the general rule that courts should not hear claims from a party to an arbitration agreement unless the question is a "gateway" issue or the arbitral panel has issued a final award. With the notable exception of one case, courts consistently applied the "*Bellefonte* principle" to protect reinsurers from liability for defense costs beyond the specified facultative certificate limits, and continued to reject the common-interest doctrine as a basis to resist discovery of reinsurance information.

ARBITRATION AND ARBITRABILITY

Five notable 2014 cases addressed issues of arbitration or arbitrability. First, in *Milan Express Co. v. Applied Underwriters Captive Risk Assurance Co.*, 590 Fed. Appx. 482 (6th Cir. 2014), the 6th U.S. Circuit Court of Appeals vacated and remanded the lower court's three-part holding that:

- The question of arbitrability was for the court to resolve.
- The arbitration clause in a reinsurance contract was unenforceable under Nebraska law.
- Convenience of the parties and the interests of justice weighed against a transfer of venue.

The 6th Circuit based its decision on the general rule that "unless the arbitration clause itself is challenged as invalid, the question of arbitrability is for the arbitrator, not the court, to decide."

In *Milan*, it was undisputed that the parties' reinsurance agreement included an arbitration clause requiring them to arbitrate any dispute arising under the agreement. The 6th Circuit found that the District Court erred in ruling that the question of arbitrability was within the court's province because, in the lower court's view, the agreement lacked "clear and unmistakable" evidence that the parties intended questions of arbitrability to be resolved by an arbitrator. (In applying the "clear and unmistakable" criterion, the District Court cited the decision in *Solvay Pharmaceuticals Inc. v. Duramed Pharmaceuticals Inc*., 442 F.3d 471, 477 (6th Cir. 2006)).

The District Court failed to explain what was not "clear and unmistakable" in the language of the agreement. Furthermore, the 6th Circuit found, the agreement's language bore "no material difference" from that at issue in *Rent-A-Center West Inc. v. Jackson*, 561 U.S. 63, 67–70 (2010), and therefore satisfied the "clear and unmistakable" requirement.

The court also addressed the cedent's argument that the arbitration clause was unenforceable under Nebraska law. While acknowledging that might be true, the court found that the parties had expressly agreed to submit the question of enforceability to arbitration. Because the cedent had not challenged the arbitration clause on traditional contract grounds such as fraud or unconscionability the issue of enforceability remained subject to arbitration. The court did not substantively address the ruling on transfer of venue because it was mooted by the decision to vacate and remand for further proceedings.

In *Savers Property & Casualty Insurance Co. v. National Union Fire Insurance Co.*, 748 F.3d 708 (6th Cir. 2014), the 6th Circuit upheld the general rule prohibiting a party to an arbitration agreement from bringing a claim in court before the arbitration panel issues its final award. In holding that the District Court erred by "prematurely interjecting itself into this private dispute," the appeals court emphasized the policy reasons "for generally withholding judicial review until the conclusion of an arbitration proceeding."

The court noted that the advantage of arbitration as a speedy and low-cost alternative to litigation is undermined when a court considers non-"gateway" issues before a final decision is made. "Gateway" issues include whether the arbitration agreement is valid and it applies to a particular type of controversy. The court found that the interim arbitration award here was not "final" for purposes of judicial review as established by *Island Creek Coal Sales Co. v. City of Gainesville, Fla.*, 729 F.2d 1046, 1049 (6th Cir. 1984), because "[n]one of the awards in question [in this case] 'finally and definitely dispose[d] of a separate independent claim.'"

For the first time, the 1st Circuit addressed the question of whether, in a subsequent arbitration, the preclusive effect of an earlier arbitration decision is a matter for the court or the arbitrator to decide where the earlier decision had been confirmed by a federal court order. In *Employers Insurance Company of Wausau v. OneBeacon American Insurance Co.*, 744 F.3d 25 (1st Cir. 2014), a cedent entered into identical contracts containing arbitration clauses with several reinsurers. In 2007 the cedent commenced arbitration with one of the reinsurers, and the arbitration panel decided in favor of the reinsurer. When the cedent attempted to commence arbitration against the other reinsurers in 2012, its demand included billings for the same claims that the cedent had arbitrated and lost in 2007.

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Affirming the District Court, the 1st Circuit agreed that judicial confirmation of an arbitration award does not alter the general rule that an arbitrator, not the court, decides the preclusive effect of a prior arbitration award. The court noted "the arbitrator's path to reaching the decision on the merits determines the preclusive effect of the arbitration." Because the District Court would not consider in detail the steps leading to the decision in a prior arbitration, it should not have exclusive power to determine the preclusive effect of that arbitration.

In *Trenwick American Reinsurance Corp. v. CX Reinsurance Co.*, No. 3:13-cv-1264 (JBA), 2014 WL 2168504 (D. Conn. May 23, 2014), the U.S. District Court for the District of Connecticut addressed whether, in the presence of a cut-through provision in a reinsurance agreement, a subsequent commutation agreement between the cedent and reinsurer necessarily extinguished the rights of the third-party beneficiary of the cut-through provision to commence arbitration with the reinsurer.

The reinsurance agreement included a cut-through provision that, in the event of the cedent's insolvency, allowed a third-party beneficiary to "cut through" and arbitrate directly with the reinsurer. The reinsurer argued that a commutation agreement, which had not been executed before the cut-through was invoked, barred the third party's right to arbitrate. The court reasoned, however, that determining whether the arbitration provision was enforceable by the third-party beneficiary would necessitate interpreting the underlying contract; as such, that decision must be made by an arbitrator.

A New York federal court addressed disqualification of counsel in *Utica Mutual Insurance. Co. v. Employers Insurance Company of Wausau*, No. 6:12-CV-1293 (NAM/TWD), 2014 WL 4715712 (N.D.N.Y. Sept. 22, 2014). In *Utica* a cedent and its reinsurers were involved in the underlying dispute in which their common interests were represented by one law firm. In a later arbitration between the cedent and its reinsurers, the cedent engaged the same law firm, this time against the reinsurers.

The reinsurers sought to disqualify the law firm, citing the witness-advocate rule because the firm's attorneys would be necessary witnesses to the current dispute while also handling the arbitration. The cedent argued that the law firm never established a formal attorney-client relationship with the reinsurers, so that the witness-advocate rule did not apply.

The court ruled for the reinsurers, finding that, although the reinsurers had not been the law firm's clients "in the traditional sense," an inquiry into the potential conflict may still be warranted if "there exist sufficient aspects of an attorney-client relationship." The court granted limited discovery under Federal Rule of Civil Procedure 56(d) to permit the reinsurers to investigate the basis for the law firm's possible disqualification. After a motion for reconsideration, the parties settled.

COMPEL ARBITRATION

In 2014 courts continued the trend to deny motions to compel arbitration in unusual circumstances. In *Transatlantic Reinsurance Co. v. National Indemnity Co.*, No. 14 C 1535, 2014 WL 2862280 (N.D. Ill. June 26, 2014), the U.S. District Court for the Northern District of Illinois denied a reinsurer's amended petition to compel a non-signatory third party to join an arbitration. The reinsurance agreement provided for arbitration of any dispute arising between the cedent and reinsurer with regard to interpretation of the agreement or their rights as regards any transaction involved.

The cedent later entered into a reinsurance agreement and a services agreement with a separate reinsurer that was not a party to the original reinsurance agreement. The second reinsurer was responsible for collecting proceeds and pursuing recoveries on the cedent's behalf. Years later, the original reinsurer stopped making payments to the cedent, and the cedent commenced arbitration. The original reinsurer sued, seeking to compel the second reinsurer to arbitrate as a party in the original reinsurer-cedent arbitration.

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Generally, a party may not be compelled to arbitrate a dispute absent its having agreed to do so. The 7th Circuit, however, recognizes several exceptions. In addition to arguing that the second reinsurer was bound by the broad language in the original reinsurance agreement, the original reinsurer argued that the recognized exceptions of assumption, agency, and estoppel applied.

In denying the original reinsurer's petition, the court briefly reviewed applicable law. The District Court found that:

- The earlier reinsurance agreement explicitly used narrow language limiting the parties that are required to arbitrate to the cedent and the original reinsurer.
- The second reinsurer entered into entirely separate agreements with the cedent, did not evidence any intent to assume the original parties' obligation to arbitrate and sought to distance itself from the arbitration clause.
- The only relevant language containing any reference to the original reinsurance agreement was that the second reinsurer agreed to provide services to the cedent "in accordance with the contractual terms of the applicable third-party reinsurance agreements," which was not sufficiently explicit or specific to constitute an assignment of rights.
- The second reinsurer was not estopped from disclaiming an obligation to arbitrate because the benefit the second reinsurer received was only indirectly related to the original reinsurance agreement.

ARBITRATOR/SELECTION

In 2014 the U.S. District Court for the Southern District of New York provided another example of a court preferring not to get involved in arbitrator selection. In *Odyssey Reinsurance Co. v. Certain Underwriters at Lloyd's London Syndicate 53*, No. 13 Civ. 9014 (PAC), 2014 WL 3058377 (S.D.N.Y. June 30, 2014), a retrocedent sought to appoint an umpire to serve in its arbitration with its retrocessionaire. The retrocedent argued that the retrocessionaire's candidates were not qualified. The court rejected the retrocedent's petition to have the court appoint an umpire.

The court held that, absent a breakdown in the selection process that justifies court intervention, the parties must proceed to the next stage of the arbitrator selection process as detailed in the retrocessional agreements. The court also reiterated 2nd Circuit precedent that a district court cannot entertain an attack on the qualifications or partiality of arbitrators until after the conclusion of arbitration and the issuance of the award.

CONTRACT INTERPRETATION

Eight noteworthy decisions in 2014 dealt with reinsurance contract interpretation. The first applied long-standing precedent that the primary objective in contract interpretation is giving effect to the parties' intent as revealed by the language they used. In *Aioi Nissay Dowa Insurance Co. v. Prosight Specialty Management Co.*, 563 Fed. App'x 68 (2d Cir. 2014), the 2nd Circuit affirmed a judgment finding that a reinsurer was charged too much for reinstatement premiums on aviation reinsurance contracts that cedents purchased from a reinsurance pool and that were triggered by the Sept. 11 terrorist attacks.

The parties entered into two types of contracts: an excess-of-loss contract and a reinstatement-of-premium-protection contract. Cedents contended that the contracts were best understood, under the "interrelated contracts doctrine," as equivalent to each cedent in the pool effectively having its own, single contract with the reinsurers. The court disagreed, noting that the "interrelated contracts doctrine" should be used only to effectuate the parties' intent and finding that, because the contracts were negotiated as independent, separately priced transactions, the parties did not intend the contracts to be interrelated.

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The court also addressed commutation agreements between the parties. The court rejected cedents' contention that the commutations included payment of reinstatement premiums, finding that the commutations were cancellations of contracts, not settlement of claims. The court also rejected cedents' contention that the commutations comprised reinstatement premium payments in the form of accelerated potential future obligations, finding that the commutations consisted of a lump sum, based on various considerations other than cedents' internal estimates of their net recoveries and for which cedents never presented a claim for indemnity of the premiums allegedly paid in the context of these commutations.

Cedents also argued that the phrase "covered loss" in the stipulated formula for calculating reinstatement premiums should have been limited to the amount actually recouped from the reinsurance pool. The court found that the more natural reading of "covered loss" was the amount paid to an airline to settle an underlying claim, as evidenced by language in the contract indicating that "covered loss" encompassed the total amount that could have been claimed under the contracts, rather than the sum actually paid.

The literal wording of a contract is not always determinative, however, as was the case in *Greenlight Reinsurance Ltd. v. Appalachian Underwriters Inc.*, 34 F. Supp. 3d 321 (S.D.N.Y. 2014). There the U.S. District Court for the Southern District of New York concluded that for two contracts between the parties, each containing a "guarantee of payment" provision, the guarantors were bound only by one because the other was not in substance a guarantee at all. The court found no genuine issue to dispute reinsurer's claim that it was owed debts under certain reinsurance and retrocession agreements; in dispute was whether the guarantor was obligated to pay those debts.

As to the first purported "guarantee," the court determined that it was not a guarantee of payment despite being so labeled. Rather, it was a promise to fund certain companies with which the reinsurer conducted business so that those companies remained solvent. By contrast, as to the second "guarantee," the court found that it was a guarantee because it promised full and prompt payment as and when due under "relevant contracts."

Two noteworthy cases dealt with the appropriate boundaries of contractual provisions and obligations. In the first, *Public Risk Management of Florida v. One Beacon Insurance Co.*, 569 Fed. App'x 865 (11th Cir. 2014), the 11th Circuit held that because claims raised in a suit against the cedent's insured could have been covered by the cedent's policy — thus triggering the cedent's duty to defend — the legal fees incurred in defending against those claims would also be covered by the reinsurance agreement.

The cedent, an intergovernmental risk management association, incurred legal fees defending one of its member cities against claims from a construction company that the city had made mistakes, misstatements or omissions in breach of the city's contract with the company.

The 11th Circuit determined that the alleged mistakes, misstatements and omissions could be construed as "wrongful acts" with resulting damages and, therefore, could have been covered under the cedent's policy with the city. The court observed that, if the underlying defense fees were covered by the insurance policy, then those fees would also be covered under the reinsurance agreement.

In *Global Reinsurance Corporation of America v. Century Indemnity Co*., No. 13 Civ. 06577 (LGS), 2014 WL 4054260 (S.D.N.Y. Aug. 15, 2014), which is also discussed below for another purpose, the cedents argued that a loss portfolio transfer constituted treaty insurance and, therefore, did not violate the retention and anti-assignment provisions in the facultative certificates because it did not transfer all liabilities. The U.S. District Court for the Southern District of New York disagreed, finding that the loss portfolio transfer may have violated the retention and anti-assignment provisions.

As to the retention requirement, the court found that the loss portfolio transfer could not be treaty reinsurance because it applied retroactively. The court cited language in New York Court of Appeals cases purporting to hold that treaty reinsurance must be obtained in advance of actual coverage.

As to the assignment provision, the court found that, although the loss portfolio transfer contained an upper limit for coverage — and therefore did not constitute an assignment — the upper limit was so high as to be illusory.

This case warrants attention because the court specifically held that treaty reinsurance is prospective only. That may vary from the assumption of some in the reinsurance industry that a treaty is simply the reinsurance of a broad portfolio of business, regardless of retroactive or prospective risk assumption.

COSTS-IN-ADDITION/*BELLEFONTE*

With one important exception, three cases continued the trend of upholding the "*Bellefonte* principle" — derived from *Bellefonte Reinsurance Co. v. Aetna Casualty & Surety Co.*, 903 F.2d 910 (2d Cir. 1990), which established that liability for defense costs will not extend above the total liability limit clearly specified in a facultative certificate of reinsurance.

In *Utica Mutual Insurance Co. v. Clearwater Insurance Co.*, No. 6:13-cv-1178 (GLS/TWD), 2014 WL 6610915 (N.D.N.Y. Nov. 20, 2014), the U.S. District Court for the Northern District of New York found for the reinsurer in a dispute involving limits of liability under a facultative reinsurance certificate. Consistent with the many *Bellefonte* progeny, here the facultative certificates reinsuring umbrella policies had a liability and basis-of-acceptance clause, which identified the exposure reinsured.

As the court noted, the sole issue was whether the cedent could recover defense costs or other expenses in excess of the sums stated in the liability clauses in the certificates. In ruling for the reinsurer, the court rejected the cedent's argument that the lack of the word "limit" in the certificates was a distinguishing factor and denied its request for further discovery and consideration of extrinsic evidence. The court found that the certificates were unambiguous and *Bellefonte* was directly applicable to the liability limits at issue.

Similarly, in *Global Reinsurance v. Century Indemnity*, discussed above, the court adhered to 2nd Circuit precedents regarding overall cap on liability limits in a dispute involving nine facultative certificates that contained a "reinsurance accepted" value ranging from $250,000 to $2 million. The reinsurer claimed that the reinsurance limit constituted a cap on its liability, while the cedent asserted it constituted a cap on losses only, leaving recovery for expenses uncapped.

The court found that, because each certificate contained a "subject to" clause (which stated that the reinsurance was in consideration of payment of premiums and subject to terms, conditions and amount of liability) and stated a dollar amount of liability in the "reinsurance accepted" section, the total liability for both loss and expenses was capped at the dollar amount stated in the "reinsurance accepted" section of each certificate. In so holding, the court found that the language in the certificates was nearly identical to that relied on in *Bellefonte*.

Third of this group, in *Continental Casualty Co. v. MidStates Reinsurance Corp.*, 24 N.E.3d 122 (Ill. App. Ct., 1st Dist. 2014), an Illinois appeals court found for the reinsurer where its facultative certificates clearly and unambiguously provided an aggregate limit on reinsurance assumed. The reinsurer paid claims for environmental liabilities up to the total of the reinsurance limits under the certificates; the cedent contested the limits.

Applying the "four corners" approach to contract construction, the court held that the certificates clearly and unambiguously provided for an aggregate policy limit that included both losses and expenses because the "reinsurance provision" portion of the contract only discussed liability in general terms, which indicated that the contracting parties did not intend to separate losses from expenses when calculating the reinsurer's liability. The court adopted the *Bellefonte* principle as widely accepted and held that the facultative certificates provided a clear policy limit, inclusive of expenses.

By contrast, a decision from the 2nd Circuit — the court that gave birth to *Bellefonte* — distinguished the facultative certificate in that case from those in *Bellefonte* and its progeny, *Unigard Security Insurance Co. v. North River Insurance Co.*, 4 F.3d 1049 (2d Cir. 1993), and *Excess Insurance Co. v. Factory Mutual Insurance Co.*, 3 N.Y.3d 557 (2004).

In *Utica Mutual Insurance Co. v. Munich Reinsurance America Inc.*, 594 Fed. Appx. 700 (2d Cir. 2014), a summary order with no precedential effect, the court reversed summary judgment for the reinsurer, holding that extrinsic evidence was needed to determine the intent of the facultative certificate's wording.

Here, the certificate provided that the reinsurer would indemnify the cedent against "losses or damages" as "subject to the reinsurance limits shown in the declarations." In subsequent paragraphs, settlements and expenses were not expressly subject to the reinsurance limits, and the court found the certificate ambiguous as to whether expenses were expressly excluded from the reinsurance limits.

The court determined that the language at issue was distinct from that in *Bellefonte* and that *Excess* did not extend the rule to mean that every limit of liability is presumptively expense inclusive, absent express language to the contrary or a separate limit for expenses. Rather, the court determined that although that presumption may reflect the parties' intentions in most cases, a party is bound by the terms to which it has agreed.

What is notable and controversial given the summary order nature of the decision is the 2nd Circuit's willingness to re-examine its precedent and that of the New York Court of Appeals and distinguish the language of the facultative certificates in each case. Essentially, the court, while acknowledging the judicial development of a presumption that the limits of liability in a facultative certificate are unambiguously expense-inclusive, held that the presumption can be rebutted by more than showing express language excluding expenses or a separate limit for expenses.

DISCOVERY

Continuing a trend of recent years, courts in 2014 again rejected the common-interest doctrine and required both cedents and reinsurers to produce reinsurance communications.

In *Progressive Casualty Insurance Co. v. Federal Deposit Insurance Corp.*, 302 F.R.D. 497 (N.D. Iowa 2014), the U.S. District Court for the Northern District of Iowa granted an insolvent bank receiver's motion to compel production of reinsurance communications regarding the bank's insurance policies. The court broadly rejected arguments that reinsurance communications were protected by the attorney-client and attorney work product privileges and the common-interest doctrine.

The court concluded that the information was created in the ordinary course of the cedent's business and was provided to the reinsurer and the broker for business purposes. Because the cedent provided those documents to the reinsurer and broker, the court concluded it had waived any attorney-client privilege. Because the information was not provided to build a legal defense or for litigation strategy, the court rejected the common-interest doctrine, with this telling statement: "The unique circumstances of the reinsurance business do not automatically give rise to a common legal interest."

Similarly, in a case from Minnesota, *National Union Fire Insurance Co. v. Donaldson Co.*, No. 10-4948 (JRT/JJG), 2014 WL 2865900 (D. Minn. June 24, 2014), the U.S. District Court for the District of Minnesota ordered a cedent to produce communications with its reinsurer. The cedent sought reimbursement from its insured for amounts paid into a settlement that fell within the insured's deductible.

The insured counterclaimed for bad faith, claiming the cedent failed to notify the insured of its method of policy interpretation in a timely manner. The insured sought discovery in support of its bad faith claim of three types of documents: internal underwriting files, loss reserve information and communications with reinsurers.

The court approved these disputed requests. The court reasoned that these documents could reveal the cedent's intended contract interpretation for purposes of determining coverage, which would be relevant to the insured's bad-faith claim. The court also concluded the categories of documents sought could reveal what the cedent knew, and when it knew its plans for applying coverage to the insured's claims.

These cases continue a growing trend of federal courts around the country — including in California, Iowa, Minnesota, New York and Washington — that in recent years have ruled that the scope of discovery of reinsurance information is broad, and that the common-interest doctrine does not apply to the regular business dealings of cedents and their reinsurers. These cases have all been decided at the district court level. Whether appellate courts will ultimately approve this approach, if and when these issues reach them, remains to be seen.

STATUTES OF LIMITATIONS

As in previous years, 2014 provided several cases concerning statutes of limitation in the reinsurance context. In one, *Hill v. Flagstar Bank*, No. 12-2770, 2014 WL 2892397 (E.D. Pa. June 26, 2014), the U.S. District Court for the Eastern District of Pennsylvania granted summary judgment to a reinsurer on limitations grounds. The case involved several plaintiffs who sued a cedent that allegedly violated the Real Estate Settlement Procedures Act. The plaintiffs agreed that they filed suit after RESPA's one-year limitations period expired. They argued that the doctrine of equitable tolling applied and permitted their claims.

In granting the cedent's motion for summary judgment, the court noted the general rule that, when a plaintiff seeks to invoke equitable tolling and a defendant seeks summary judgment on the issue, courts must determine whether there is sufficient evidence supporting a finding that:

- Defendant engaged in concealment to mislead plaintiff regarding facts supporting their claim.
- Plaintiff exercised reasonable diligence.
- Plaintiff was not aware, nor should have been, of the facts supporting their claim until a time within the limitations period measured backward from when the complaint was filed.

The court found that each plaintiff failed to diligently pursue its claims during the limitations period. Specifically, neither party investigated or pursued their claims until their attorneys prompted them to do so, well after the limitations period expired. The court also found that the record was devoid of evidence that the cedent actively misled the plaintiffs. The cedent never communicated with plaintiffs and had no duty to do so. In the absence of a duty to speak, silence is insufficient to toll the limitations period in RESPA cases.

In a second case, *In re ROM Reinsurance Management Co. v. Continental Insurance Co.*, 982 N.Y.S.2d 73 (N.Y. App. Div., 1st Dep't 2014), a New York intermediate appellate court ruled that, in certain circumstances, state law may override the presumption that procedural issues are for arbitrators and not courts to decide. Here, the parties had an agreement that contained an arbitration clause; neither party disputed that the Federal Arbitration Act controlled.

Under the FAA, "resolution of a statute of limitations defense is presumptively reserved to the arbitrator, not the court," but parties may expressly agree to leave timeliness issues to the court. A New York arbitration statute provides that determining whether a claim is barred as untimely is for a court to decide. The arbitration clause in the parties' agreement expressly provided that the "arbitration laws of New York state" governed. The issue was thus whether timeliness of an arbitration demand was to be determined by the court or the arbitrator.

The court held that the agreement's wording evidenced intent to have New York law govern questions regarding arbitration and enforcement. It was the "critical language concerning enforcement" required by common law that allows for the exception that statute-of-limitations issues may be addressed by the court. The court noted that, when parties clearly agree to abide by state rules of arbitration, enforcing those rules is consistent with the goals of the FAA.

FOLLOW-THE-SETTLEMENTS/DEFENSE COSTS

In *Employers Insurance Company of Wausau v. R&Q Reinsurance Co.*, No. 13-cv-709-bbc, 2014 WL 2006719 (W.D. Wis. May 16, 2014), the U.S. District Court for the Western District of Wisconsin granted partial summary judgment on billings of indemnity and expense in favor of the cedent. The cedent issued two umbrella policies to its insured that defined the limit of liability per occurrence as the total limit of liability for damages, direct and consequential, and defense expense because of personal injury. The reinsurer issued facultative certificates covering the umbrella policies. The facultative certificates included standard following language and provided that, if the cedent's policy limit included expenses, the reinsurer's maximum limit of liability was that stated in the declarations.

Losses were paid by the cedent in a settlement that included costs for indemnity and expense. The cedent billed under the facultative certificates, and the reinsurer refused to pay. The issue was whether defense expenses could qualify as a portion of the settlement. Both parties relied on the "follow the settlements" clause.

The court granted partial summary judgment to the cedent on its claim that it could bill indemnity and expenses together. The court found for the cedent in part because the reinsurer never explained why it believed defense expenses did not qualify. Specifically, the reinsurer never demonstrated that it was being asked to pay outside the contract's scope or argued that the settlement amount exceeded the policy limit. This case illustrates the simple but important point that, to argue that the usual application of the follow-the-settlements doctrine is inappropriate, a party must show a reasoned basis why it is inappropriate.

TAX ISSUES

Tax issues are seldom addressed in reinsurance disputes. A particularly interesting case regarding excise taxes, however, was decided in 2014. In *Validus Reinsurance Ltd. v. United States*, 19 F. Supp. 3d 225 (D.D.C. 2014), the U.S. District Court for the District of Columbia addressed whether excise taxes could be collected on retrocession transactions. Under 26 U.S.C. § 4371(3), insurance transactions involving policies issued by foreign insurers or reinsurers are taxed. Under that section, a retrocedent — a Bermuda corporation — paid excise taxes on premiums paid on reinsurance contracts. The retrocedent purchased the reinsurance from foreign retrocessionaires to cover the risks associated with its own reinsurance contracts. The retrocedent sought to collect the full amount of the excise tax.

The court held that the plain language of the statute did not impose an excise tax on retrocessional transactions. Specifically, the retrocedent's transactions fell outside the plain language of paragraphs (1) and (2), which limit the section's application to reinsurance contracts. The court further held that neither the statute's introductory language nor the definition of "policy of reinsurance" warranted a different conclusion.

The court granted summary judgment in favor of the retrocedent and held that 26 U.S.C. § 4371 does not impose an excise tax on retrocessional transactions. The case is currently on appeal before the District of Columbia U.S. Circuit Court of Appeals.






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