SQUIRE PATTON BOGGS

Reinsurance Newsletter

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Recent Case Summaries

Wisconsin Federal Court Compels Arbitration Over Question of Effect of Prior Arbitration Award

Emplrs Ins. of Wausau v. Cont'l Cas. Co., No. 15-cv-22-wme, 2016 U.S. Dist. LEXIS 18850 (W.D. Wisc. Feb. 17, 2016).

A Wisconsin federal court granted a cedent's application to compel arbitration and dismissed, without prejudice, a complaint by the reinsurer seeking a declaration and injunction seeking to preclude the cedent from allegedly re-arbitrating the final decision of a prior arbitration between the parties on the same treaty concerning the same underlying insured.

In a 2004 arbitration, a final award issued concerning whether the reinsurance treaties covered an underlying asbestos settlement. In 2015, the cedent demanded arbitration on unpaid billings concerning asbestos claims made by the same insured under the same policies and treaties. The reinsurer claimed that the billings were covered under the 2004 arbitration award. The reinsurer followed this with an action for a declaration that the cedent was precluded by the prior award from re-arbitrating the prior decision.

In granting the cedent's motion to compel arbitration, the court determined that the dispute between the parties – whether the dispute was a new dispute or precluded by the prior arbitration award – was an arbitrable dispute under the reinsurance treaties and had to be decided by a new arbitration panel. It is the arbitration panel, said the court, that must in the first instance determine how a previous arbitration award affects a current dispute.

Notably, the court made it clear that it was simply concluding that the dispute, like any other dispute between the parties, had to be decided by the arbitrators. It was up to the arbitrators to determine if this was a new dispute or if the previous award was being violated by an improper billing. The court was not declaring that the dispute was entitled to a new arbitration or even a re-arbitration of the prior award.

Maine Federal Court Finds That Parties Had Contractually Agreed to Submit to Arbitration the Question of the Enforceability of an Arbitration Agreement

Mt. Valley Prop., Inc. v. Applied Risk Servs., Inc., No. 1:15-cv-00187-DBH, 2015 U.S. Dist. LEXIS 171799 (D. Me. Dec. 22, 2015).

A Maine federal court sent to arbitration a dispute between a property management company and a group of affiliated insurers and administration companies, finding that the parties had contractually agreed to submit the question of arbitrability to arbitrators, and not to a court of law.

The management company participated in an insurance program that was marketed and sold by the defendant companies as an insurance alternative that integrated multiple lines of insurance and also provided certain payroll and tax services. The program was governed by a series of related agreements, one of which – a Reinsurance Participation Agreement – contained an arbitration clause. None of the other transaction agreements did. The arbitration clause stated that disputes regarding the execution and delivery, construction or enforceability of the agreement would be submitted to a panel of arbitrators, as would issues related to the breach of the overall transaction.

After a dispute arose, the insurer sent an arbitration demand to the management company, while the management company instituted an action in federal court. When the insurers moved to compel arbitration, the management company resisted, arguing that the arbitration clause was unlawful under the governing law and that certain defendants were not parties to the arbitration agreement and thus could not invoke it.

The court rejected the management company's arguments. In the first instance, it noted that, while courts are often tasked with determining the enforceability of an arbitration agreement, here the parties had specifically agreed in the Reinsurance Participation Agreement to arbitrate the question of "enforceability." Thus, the question of whether the arbitration clause was unlawful under state law had to be decided by the arbitrators. The court also rejected the management company's argument that the affiliated non-signatory defendants could invoke the arbitration clause, noting that the management company itself had described all defendants as alter egos of each other. Moreover, a stay of proceedings against some of the non-signatories was appropriate against at least some of the affiliated administration companies because the conduct arose out of their duties as the insurer's agent.

New York Federal Court Directs Arbitration to Take Place in New York and Rejects Endorsement Requiring London Arbitration as Inapplicable

Infrassure, Ltd. v. First Mut. Transp. Assur. Co., No. 15-cv-08230 (GBD) (S.D.N.Y. Jan. 22, 2016).

In a dispute between a reinsurer and the New York Metropolitan Transportation Authority's captive insurer over Hurricane Sandy claims, a New York federal court has declared that the parties must arbitrate in New York under Section U.4 of the certificate of facultative reinsurance and that Endorsement No. 2 to the certificate is inapplicable. After the parties disagreed whether and where the dispute should be arbitrated, the reinsurer brought a declaratory judgment action in New York federal court to declare that Section U of the certificate was the applicable provision relevant to resolving disputes. The cedent disagreed and sought a declaration that Endorsement No. 2 was applicable and that arbitration had to take place in London.

In granting the reinsurer's declaration, the court concluded that Section U was the relevant arbitration provision, not Endorsement No. 2. Endorsement No. 2 expressly provided that it governed disputes between the cedent and "UK and Bermuda Insurers." Because the reinsurer here was a Swiss company, the court held that Endorsement No. 2 was inapplicable. The cedent has filed an appeal to the Second Circuit.

Interestingly, the proceeding was not brought under the FAA or the New York Convention as a petition to compel arbitration, but was brought as a declaratory judgment to determine the controlling dispute resolution provision in the certificate.

Arizona Federal Court Declines to Modify an Award and Confirms the Award Instead

Scottsdale Ins. Co. v. John Deere Ins. Co., No. CV-15-00671-PHX_PGR, 2016 U.S. Dist. LEXIS 18986 (D. Az. Feb. 17, 2016).

An Arizona federal court could not find a basis to modify an arbitration award and, accordingly, was compelled to confirm the award under Section 5 of the FAA. After an award was issued concerning a dispute over the cession of a significant underlying loss, the cedent sought to modify the award claiming that there was a miscalculation by the panel. The reinsurer sought to confirm the award as rendered.

The arbitration award, which was set forth in full in the opinion, provided no reasoning and merely directed the reinsurer to pay its share of a set amount. After skirmishing about whether Arizona arbitration law or the FAA applied, the court held that the FAA governed the review of the arbitration award.

In denying the application to modify, the court determined that to find a computational error in the award would require improper speculation because the alleged mathematical error was not patently obvious from the face of the award. Because the court could not determine the correctness of the claim of error from the face of the award, it had no choice other than to confirm the award for lack of an evident material calculation.

Michigan Federal Court Orders Parties to Second Arbitration Over Disputed Prejudgment Interest Amount

Star Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., No. 14-12915, 2016 U.S. Dist. LEXIS 9136 (E.D. Mich. Jan. 27, 2016).

Following an arbitration award in favor of one reinsurer, the cedent moved the Michigan federal court to modify the award of prejudgment interest, which it argued had been miscalculated and awarded in absence of reviewing the cedent's supporting documentation. The court agreed and confirmed the arbitration award in part, subject to a possible modification of the prejudgment interest amount, and then ordered the parties to submit to a second arbitration as to that issue. Both parties appealed.

While the appeals were pending, the reinsurer filed a motion to amend the judgment and stay arbitration. The reinsurer argued that the calculation of prejudgment interest could be ascertained by the federal court using a formula, without the need to have the matter re-submitted to arbitration. A second arbitration, they argued, would be both time consuming and costly, in addition to being beyond the scope of the court's authority under Michigan Arbitration Law. Consequently, the reinsurer sought to have the federal court amend the arbitration award on its own or, in the alternative, to have the matter stayed pending their appeal.

The court denied the reinsurer's two motions, noting that the dispute concerning the prejudgment interest award was substantive in nature, as the parties disagreed over the method as well as the rate at which the prejudgment interest was calculated. After balancing the interests of the parties, the court also denied the reinsurer's motion to stay arbitration pending the appeal, weighing expediency above the cost of a second arbitration.

New York Federal Court Holds That Reinsurer Failed to Show Cedent's Settlement Decision Was Dictated by Availability of Reinsurance

Utica Mut. Ins. Co. v. Clearwater Ins. Co., No. 6:13-cv-1178, 2016 U.S. Dist. LEXIS 6219 (N.D.N.Y. Jan. 20, 2016).

A New York federal court granted summary judgment to a ceding insurer, rejecting a reinsurer's contention that the cedent's allocation of asbestos claims was done to maximize reinsurance recoveries. The cedent had issued multiple primary and umbrella policies to the insured covering a three year period. The reinsurer reinsured the umbrella policies, either directly or as a member of a pool. It did not reinsure any of the primary policies.

The cedent and its insured were involved in a lengthy coverage dispute that, in part, revolved around the question of whether the primary policies contained an aggregate limit. Concerned that the coverage court would determine that no aggregate limit existed, the cedent settled the coverage dispute. Several years after that settlement, it began billing the reinsurer for indemnity and defense costs under the umbrella policies. The reinsurer disputed the billings, claiming that the cedent had allocated losses to the umbrella policies, and not to the primary policies, only because of the availability of reinsurance for the umbrella policies. The cedent argued in turn that the reinsurer was bound by the settlement under the follow-the-settlements doctrine. It moved for summary judgment.

The court granted summary judgment to the cedent, finding that there was no evidence that the settlement was unduly influenced by reinsurance considerations. It noted that the cedent's in- house staff testified that they had not calculated the impact of its reinsurance recovery during its settlement negotiations with the insured, and that the reinsurer had presented no evidence to the contrary. The court noted that a cedent was not required, in any event, to pick an allocation that minimized reinsurance recovery. Instead, a cedent's reasonable settlement decision would be given deference under the follow-the-settlements doctrine. Given the uncertainty at the time of settlement as to how the issue of the aggregate limit in the primary policies would be resolved, the cedent was reasonable to negotiate a settlement that reduced its overall liability.

Illinois Federal Court Remands Case Back to State Court Based on Service-of-Suit Clause in a Reinsurance Agreement

Pine Top Receivables of Ill., LLC v. Transfercom, Ltd., No. 15-CV-8908, 2015 U.S. Dist. LEXIS 167202 (N.D. Ill. Dec. 14, 2015).

An Illinois federal court remanded a reinsurance dispute back to state court after holding that a service-of-suit clause constituted a voluntary removal waiver. The reinsurance contract had a service-of-suit clause that applied to reinsurers not domiciled in the US. The clause provided as follows:

> It is agreed that in the event of the failure of the Reinsurer hereon to pay any amount claimed to be due hereunder, the Reinsurer hereon, at the request of the Company, will submit to the jurisdiction of any Court of competent jurisdiction within the United States and will comply with all the requirements necessary to give such Court jurisdiction and all matters arising hereunder shall be determined in accordance with the law and practice of such Court.

The now-insolvent ceding insurer commenced a breach of contract action against its reinsurer in state court. The reinsurer, a UK company, removed the case to federal court. The cedent asked that the case be remanded to state court arguing that removal contravened the service-of-suit clause. The federal court agreed and remanded the dispute back to state court.

In analyzing the issue, the court found that the plain and ordinary meaning of the service-of-suit clause was a voluntary removal waiver. The reinsurer not only agreed to submit to the court selected by the cedent, but agreed to comply with all the requirements necessary to give the court jurisdiction. As characterized by the court, the reinsurer agreed to submit itself to the cedent's court-choice, and stay there. The terms of the service-of-suit clause, including the term that required all matters to be determined under the law and practice of the court, according to the court, specified that the cedent reserved the exclusive authority to select both jurisdiction and venue and that the reinsurer agreed to oblige. Thus, said the court, the service-of suit-clause was a clear and unequivocal waiver of the reinsurer's removal right.

The contract drafting point here is that if the parties want to forego the ability to remove a case to federal court they may do so by expressly waiving the parties' right to removal by specifically and clearly waiving that removal right. In this case, according to the court, the plain and ordinary meaning of the service of suit clause was a clear and unequivocal waiver of removal rights.

New York Federal Court Grants Motion to Dismiss Counterclaims and Third-Party Complaint

AmTrust N. Am. Inc. v. Safebuilt Ins. Servs., Inc., No. 14 Civ 09494 (CM), 2015 U.S. Dist. LEXIS 162515 (S.D.N.Y. Dec. 1, 2015).

This dispute stems from allegations by a reinsurer that it was fraudulently induced to become a party to a reinsurance program. The complex reinsurance arrangement sought to insulate the reinsurer from risk through multiple levels of underwriting, but ultimately – in the court's words – left them holding the "proverbial bag." In response to these claims, the alleged creators of this scheme filed counterclaims against the reinsurer, and a third-party complaint against the reinsurer's subsidiary. The court dismissed each of the counterclaims, as well as the third-party complaint. Notably, the court previously dismissed similar claims against the third party claims administrator in an October 2015 decision.

The counterclaims and third-party complaint were principally based upon a breach of fiduciary duty and tortious interference with prospective business relations, though several other causes of action based in tort were also plead. The gravamen of the counterclaims and third-party complaint was that the reinsurer wrongfully and inappropriately used policyholder data, collected through internal audits of the cooperating insurance providers, to steal customers. While the court noted that there is a fiduciary obligation owed by an agent toward its principal, the converse is not necessarily true. In this case, the court concluded that the reinsurer, as principal, did not owe any fiduciary obligation to its agent.

The court also found that the allegation of stealing clients was neither wrongful nor tortious. None of the operative agreements between the parties prohibited the alleged conduct and, without a fiduciary obligation on behalf of reinsurer, they were free to engage in conduct that advanced their business interests – absent allegations of physical violence, fraud, misrepresentation or other unlawful restraint of trade, none of which were alleged.

New Jersey Federal Court Sustains Personal Jurisdiction Against a Non-US Retrocedent

Nat'l Indem. Co. v. Companhia Siderurgica Nacional S.A., No. 15-752 (JLL), 2016 U.S. Dist. LEXIS 14873 (D. N.J. Feb. 8, 2016).

A New Jersey federal court denied a non-US retrocedent's motion to dismiss a complaint for lack of personal jurisdiction, but only sustained jurisdiction for declaratory judgment claims and not for tort claims. This case mainly focuses on specific personal jurisdiction and the fact-specific tests for sustaining jurisdiction.

The case arises from a complicated Brazilian insurance and reinsurance program that was retroceded in part to a US-based retrocessionaire through a New Jersey reinsurance broker. The claims arose from a settlement agreement purporting to deny the existence of one of the retrocessional contracts placed in the US. The retrocessionaire sued for a declaratory judgment and also for various tort claims. In sustaining personal jurisdiction over the declaratory judgment portion of the complaint, the court found that the retrocedents purposely availed itself of doing business in New Jersey and, accordingly, minimum contacts existed for a finding of specific jurisdiction over those claims. The court, however, dismissed the tort claims finding that the events took place in Brazil and, therefore, no contacts with New Jersey supported personal jurisdiction for the tort claims.

Nevada Federal Court Applies Work Product Doctrine to Insurer's Communications to Reinsurer

Ooida Risk Retention Group, Inc. v. Bordeaux, No. 3:15-cv-00081-MMD-VPC, 2016 U.S. Dist. LEXIS 12851 (D. Nev. Feb. 3, 2016).

A Nevada federal court denied a claimant's request for compelled discovery relating to email communications between an insurer and its reinsurer. The claimant was injured in a vehicle accident by a driver who was insured by the insurer. The claimant and insured driver entered into a settlement agreement, pursuant to which the claimant was assigned the insured's rights and claims against the insurer.

During discovery, the insurer withheld email communications between it and its reinsurer that discussed the liability lawsuit, coverage issues, reserves and the budget from outside coverage counsel. The insurer claimed that these communications were subject to the work product doctrine and/or attorney-client privilege, which extended to these communications through the common interest doctrine, under which parties with common legal interests may share privileged information without waiving protection. The claimant challenged the insurer's position on the ground that the insurer failed to show that the communications with the reinsurer were for the purpose of obtaining or providing legal services.

The court held that, given the subject of the emails and the posture of the parties at the time the emails were sent, the insurer carried its burden of demonstrating that the emails were prepared in anticipation of litigation. Notably, however, one category of emails was not given a date by the insurer and, therefore, the court ordered discovery of those emails due to an absence of proof that they were prepared in anticipation of litigation.

South Carolina Federal Court Sustains Most Claims by a Fronting Cedent Against the Trustee of Reinsurance Collateral Trusts

Companion Prop. & Cas. Ins. Co. v. U.S. Bank Nat'l Ass'n, No. 3:15-cv-01300-JMC, 2015 U.S. Dist. LEXIS 158489 (D. S.C. Nov. 24, 2015).

A South Carolina federal court was asked to construe a trust agreement established as part of a fronted insurance program with two reinsurance companies. The program was secured by reinsurance collateral trusts established for the nominal cedent's sole benefit as required by the reinsurance agreements. In other words, the primary purpose of the trusts was to provide liquid assets to the cedent to satisfy the reinsurers' reinsurance obligations if they became insolvent.

The assets in the trusts had to be liquid and marketable. The reinsurers were authorized under the trust agreements to substitute assets of comparable value from time to time. When doing so, the reinsurers' direction to substitute assets was considered a representation and warranty that the substitute assets were eligible securities and that the trustee has determined that the fair market value of the substituted assets are not less than the fair market value of the assets being replaced.

While the trustee had various obligations and requirements, which the court set out, the trust agreements also provided that the duties and obligations of the trustee are only those set out in the trust agreements and no implied duties or obligations should be read into the agreement. Additionally, the trustee could not be held liable except for its own negligence, willful misconduct or lack of good faith. Finally, the trust agreements stated that the trustee "shall not be responsible for the genuineness or value of the Assets or for the validity, perfection, priority or enforceability of liens in any of the Assets."

Of course, the reinsurers substituted assets in the trusts that were allegedly approved by the trustee and allegedly had little value. The cedent sued the trustee and the trustee moved to dismiss the complaint.

In deciding the motion to dismiss, the court denied the motion for the claims of breach of contract, breach of fiduciary duty, negligence and gross negligence and negligent misrepresentation. The court found that the pleadings were sufficient to sustain these claims at the motion to dismiss stage. The court did, however, dismiss claims for equitable estoppel and statutory violations. In so finding, the court held that the cedent sufficiently alleged a special relationship, which gave rise to a separate duty of care and loyalty to sustain an independent breach of fiduciary duty claim against the trustee.

Missouri Federal Court Dismisses RICO Claim Based on McCarran-Ferguson Act Preemption

Ludwick v. Harbinger Group, Inc., No. 15-00011-CV-W-DGK, 2016 U.S. Dist. LEXIS 17317 (W.D. Mo. Feb. 12, 2016).

A Missouri federal court dismissed a putative class action claim brought under the Racketeer Influenced and Corrupt Organizations Act (RICO) by purchasers of annuities against a variety of insurance entities. The claim was that the various contracts, including the transfer of liabilities to offshore captives and reinsurers, falsely shored up the insurer's financial condition in violation of various accounting standards and rules.

In dismissing the complaint, the court found that the allegations impinged directly in state insurance regulators' responsibilities and powers, including the National Association of Insurance Commissioners' adoption and promulgation of insurance statutory accounting principles. Under the McCarran-Ferguson Act, held the court, RICO, a federal statute having nothing to do with insurance regulation, was preempted by state insurance regulatory law and the powers of state insurance regulators to address the issues raised in the complaint.

Pennsylvania Federal Court Denies Mortgage Reinsurer's Motion to Dismiss in RICO Class Action Case

Weiss v. Bank of Am. Corp., No. 15-62, 2015 U.S. Dist. LEXIS 170728 (W.D. Pa. Dec. 22, 2015).

A Pennsylvania federal court denied a mortgage lender's motion to dismiss class action claims brought under RICO. Plaintiff-borrowers alleged that their mortgage lender referred them to private mortgage insurers who provided illegal kickbacks to the lender through lender's affiliated reinsurer, while the reinsurer did not assume any real risk. Thus, the borrowers claim that they paid more for mortgage insurance because the price included the kickbacks to the lenders.

The lender sought to dismiss the complaint on the ground that the claims were time barred by the statute of limitations, because the borrowers knew or should have known of their claim when they entered into the loan transactions, which occurred outside of the limitations period. The court ruled that the statute of limitations was equitably tolled because, although there was sufficient information in the public realm to put the borrowers on inquiry notice of their claim, the borrowers pled facts from which a jury could find that the mortgage documents misled them and improperly characterized the reinsurance relationship with an appearance of propriety.

The mortgage lender also sought to dismiss the complaint for lack of standing and failure to plead a RICO violation. The court rejected these arguments as well, holding that the borrowers' well-pleaded complaint was sufficient to survive a motion to dismiss under the applicable broad legal standard.

Communications With Reinsurers May Be Discoverable When Discovery Relates to Claims Other Than Policy Interpretation

PCS Phosphate Co. v. Am. Home Assur. Co., No. 5:14-CV-99-D, 2015 U.S. Dist. LEXIS 165548 (E.D. N.C. Dec. 10, 2015).

A North Carolina federal court ordered a cedent to produce communications with its reinsurers in a coverage dispute involving environmental liability. During the course of discovery, the insured requested that its insurer produce "all communications with any reinsurer or regulatory agency regarding the Underlying Claim." The court denied the cedent's motion for a protective order, explaining that "communications between cedents and their insurers [may be] discoverable… depend[ing] on the nature of the issues to which they are alleged to be relevant." Citing earlier decisions from the District of Kansas and the Eastern District of Pennsylvania, the court explained "courts "appear reluctant to allow the discovery of communications between cedents and their reinsurers for the purpose of establishing proper interpretation of an unambiguous insurance policy." Courts, however, are more willing to allow the discovery of reinsurer communications where the claims at issue go beyond policy interpretation, such as an insurer's bad faith, or the insurer's effort to deny claims for late notice.

Concluding that the insured's request for reinsurance communications was tied to its claims beyond mere policy interpretation, it ordered the cedent to produce non-privileged information responsive to the request.

DC Federal Court Refuses to Modify Protective Order, Finding No Good Faith Basis to Do So

Munchener Ruckversicherungs-Gesellschaft Aktiengesellschaft in Munchen v. Northrop Grumman Risk Mgmt., No. 10-551(JEB), 2015 U.S. Dist. LEXIS 164809 (D.D.C. Dec. 9, 2015).

A Washington DC federal court denied a motion to modify a protective order the court had previously issued on the ground that the moving party failed to establish the requisite "good cause" to modify a protective order issued under Rule 26(c). This decision is the latest development in litigation involving the intersection of a reinsurance dispute in London, a lawsuit commenced under the False Claims Act in Mississippi, and one attorney's relentless pursuit to hold a company responsible for allegedly defrauding the US Navy.

This story begins with a reinsurance arbitration in 2008, when the reinsurer initiated proceedings in London against a captive insurer. The reinsurer disputed a claim for losses caused by Hurricane Katrina and sought reimbursement under the reinsurance contract. Through the arbitration, the reinsurer sought the production of certain documents in the possession of the US Navy. But the insured and the Navy adamantly refused to produce the requested documents until a protective order was first secured protecting the confidentiality of the documents and limiting their release outside of the arbitration.

As a result, the reinsurer initiated a separate action for the singular purpose of securing a protective order. After the parties reached an agreement regarding the limited use of the documents, the DC District Court approved the protective order resulting in the release of the Navy documents for use by the reinsurer in the reinsurance arbitration pending in London.

During the time the protective order was being secured, the reinsurer's counsel separately initiated a qui tam action under the False Claims Act against the insured, alleging that the company defrauded the Navy of approximately US$835 million of taxpayer money earmarked for the Hurricane Katrina relief fund. Counsel allegedly ignored the terms of the protective order and submitted the documents to the US Department of Justice's Civil Fraud Division and the Mississippi District Court presiding over the *qui tam* action. The Mississippi federal court dismissed the *qui tam* action, admonishing counsel for ethical violations, and finding that he was "well aware of the terms" of the [DC District] Court's protective order and "knowingly violated the obligations imposed" by them."

Counsel appealed the dismissal of the *qui tam* action while simultaneously moving in the Washington DC federal court for an order modifying the protective order to permit disclosure of the Navy documents outside the reinsurance arbitration.

In denying the modification request, the court found that counsel failed to meet the threshold of good cause required by Rule 26(c) to modify a protective order. The court held that because neither the insured nor the Navy would have agreed to the release of the documents without the issuance of the protective order, to now change the terms of the order and permit the use of the documents for reasons not contemplated by the order would negate the very purpose of the order. The court also noted the procedural and potential conflict of interest issues arising from counsel's filing the motion to modify on behalf of the reinsurer, when the motion "moves the Court to allow him to correct his inadvertent disclosure of materials to the U.S. Justice Department…"

A Brief Review of Reinsurance Trends in 2015

The general trend of US court decisions on reinsurance issues during 2015 continued to reinforce principles and precedents familiar from recent years. On the threshold subject of the agreement to arbitrate and arbitrability, multiple decisions reinforced the federal policy in favor of arbitration and the extremely narrow scope of review of arbitration awards, particularly where a reinsurance agreement contains an "honorable engagement" provision. Three courts grappled with issues surrounding the application of the "*Bellefonte* Principle" and exercised discretion when analyzing facultative certificate language as a whole not necessarily bound by a presumption that all limits of liability are expense-inclusive. Continuing a trend of recent years, many courts in 2015 again rejected the common-interest doctrine and required both cedents and reinsurers to provide reinsurance communications in response to discovery requests. One court grappled with the different language in a "follow-the-settlements" provision as compared to a "following form" provision. Several cases continued to reflect the emphasis that courts place on the duty of utmost good faith due in a reinsurance relationship.

Arbitration

Multiple decisions in 2015 reinforced the federal policy in favor of arbitration and the extremely narrow scope of review of arbitration awards, particularly where a reinsurance agreement contains an "honorable engagement" provision.

Arbitrability

The District of Maine followed the trend of courts letting arbitration panels decide arbitrability based on contract language. In *Mt. Valley Prop. v. Applied Risk*, No. 1:15-cv-00187-DBH, 2015 U.S. Dist. LEXIS 171799 (D. Me. Dec. 22, 2015), the court first addressed the threshold issue of whether it or the arbitral panel had authority to decide arbitrability. The language of the reinsurance participation agreement indicated that all disputes related to the "enforceability" of the agreement were to be decided by the arbitrators. The court determined this to be a clear and unmistakable agreement to arbitrate the issue of arbitrability.

Another interesting facet of the decision included the court's rejection of the plaintiff-participant's "reverse preemption" argument. Essentially, it argued that under the McCarron-Ferguson Act's provision prohibiting federal law from overriding state insurance law, the Federal Arbitration Act (FAA) was "reverse preempted" by Nebraska law. In plaintiff's view, Nebraska law prohibited arbitration of the claims. In response, the court found that even if the plaintiff's interpretation of Nebraska law were correct, because the parties' unmistakably agreed to arbitrate the arbitrability issue, the issues of whether Nebraska law applies and whether it prohibits enforcement of the arbitration provision are, in the first instance, for the arbitrator to decide.

Proper Party to Arbitration Proceeding

The District Court of Montana addressed a relatively rare situation in 2015 – whether a protected cell created by a captive reinsurer is a proper party to an arbitration demand under a captive reinsurance agreement. *Pac Re 5-AT v. AmTrust N.A., Inc.*, No. CV-14-131-BLG-CSO, 2015 U.S. Dist. LEXIS 65541 (D. MT, May 13, 2015). Protected cell company legislation in general is a relatively recent creation, and this case was one of first impression in terms of analyzing the Montana legislation. Under that law, protected cells may or may not be incorporated, and each cell must have separate and identifiable assets and liabilities, among other requirements. The court rejected the reinsurer's argument that the protected cell company could alone be subject to the arbitration demand. While under the statute a protected cell must be segregated and isolated from the core entity that does not necessarily render the cell a separate legal person that can sue or be sued. Thus, the captive reinsurer was in fact a proper party to the arbitration demand.

Given the rarity of judicial opinions addressing the impact of protected cell legislation on the identity of parties to arbitration, this decision should prove instructive to future courts addressing similar legislation.

Stay of Proceedings

The Second Circuit Court of Appeals addressed an open issue that has yet to be addressed by the US Supreme Court – namely, whether a district court may dismiss a complaint when faced with an application to compel arbitration and stay litigation. In *Katz v. Cellco Partnership*, 794 F.3d 341 (2d Cir. 2015), a class action suit was brought by local wireless subscribers against a network. The class moved for summary judgment while the network sought to compel arbitration and stay proceedings based upon the arbitration clause in the customer service agreement. The circuit court acknowledged that whether a district court was able to dismiss rather than merely stay the proceedings had not previously been settled. Upon review of Section 3 of the FAA, the court determined that the language was plain and unambiguous in its direction to allow the parties to proceed directly to arbitration without dealing with tedious appeals. Although outright dismissal would likely have been more efficient and a stay would likely have led to a dismissal once arbitration was completed, the court held that efficiency does not supersede a statutory mandate allowing only a stay.

Although this was not a reinsurance case, it does help clarify an issue that will likely have an impact on the other circuits when and if this issue arises in other jurisdictions. The question that remains is whether the law will be changed to better address the effectiveness and expediency of these procedural steps.

Challenges to arbitrations are frequent, and a challenge on statute of limitations grounds is not surprising. In *ROM Rein. Mgt. Co. v. Continental Ins. Co.*, No. 654480, Sup. Ct. N.Y. Co. (Jan 5, 2015), the reinsurer, in its second attempt to stay arbitration, claimed that the statute of limitations had expired. The cedent argued that the reinsurer waived the statute of limitations defense by participating in the arbitration process and picking its own arbitrator. The court determined that the statute of limitations objection had been waived because the reinsurer participated in the selection process and there was no difference between selecting a party-appointed arbitrator or a neutral arbitrator to determine when arbitration commenced. Overall, the court subscribed to the belief that, if you attempt to take control of your own destiny, you will be responsible for it.

Arbitration Panel Selection

Arbitration panel selection is one of the key aspects of reinsurance arbitration. In *Odyssey Reins. Co. v. Certain Underwriters at Lloyd's London*, 615 Fed. App'x 22 (2d Cir. 2015), the Second Circuit remanded a case addressing panel selection. The district court previously denied a petition to appoint an arbitration umpire on the ground that it did not have the statutory authority to do so. The Second Circuit found that the district court not only had the authority, but also the obligation, to appoint the umpire when the parties could not agree upon an umpire without court input. The Second Circuit remanded the case to the district court, ordering the court to appoint an umpire under Section 5 of the FAA when the parties had previously been unable to agree upon an umpire.

Although unusual and intriguing, this case has no precedential value and the court did not directly address what factors and circumstances permit a court to review an umpire's credentials prior to an arbitration proceeding. Nevertheless, the court did indicate that in appointing the umpire, the district court would have to address qualifications as an incident to its appointment.

Challenges to Arbitration Awards

The First Circuit – in a case of first impression for that court – interpreted an "honorable engagement" provision in *First State Ins. Co. v. Nat'l Cas. Co.*, 781 F.3d 7 (1st Cir. 2015). The eight reinsurance agreements in the underlying arbitration directed the arbitrators to consider each agreement as an "honorable engagement" rather than merely a legal obligation. These clauses afford arbitrators the power to grant forms of relief such as equitable remedies that are not explicitly mentioned in the underlying agreements. The honorable engagement clauses provide flexibility to tailor remedies fitting the particular circumstances, which, in the case at hand, involved the equitable reservation of rights procedure fashioned by the panel. Thus, in view of the already circumscribed nature of federal court review of arbitration decisions, the existence of the honorable engagement provision even further limited the district court's ability to vacate an award. Accordingly, the First Circuit had ample grounds to affirm the district court's refusal to vacate in the face of the reinsurer's substantive objections to the arbitration award.

At the end of the day, as long as an award takes its essence from the reinsurance contract, an equitable remedy consistent with the contract will, in the First Circuit, not be viewed as exceeding the arbitrator's powers. Courts rarely have occasion to tackle honorable engagement provisions. The First Circuit's expansive and colorfully written opinion should prove instructive to future courts faced with similar issues.

Also in 2015, a New York federal court perpetuated the strong deference accorded to the arbitration process and at the same time reinforced the importance of federally-mandated deadlines for challenging arbitral awards. In *Arrowood Indmn. Co. v. Equitas Ins. Ltd.*, No. 13cv7680 (DLC), 2015 U.S. Dist. LEXIS 63643 (S.D.N.Y. May 14, 2015), the court denied a reinsurer's motion under Federal Rule of Civil Procedure 60(b)(3), which challenged a judgment confirming an arbitration award. Its challenge centered on the cedent's alleged fraud on the arbitral panel. Although the reinsurer acknowledged that Section 10 of the FAA is the appropriate avenue for challenging an arbitration award, it argued that the alleged misconduct extended to the judicial proceeding to confirm the award. The court rejected the reinsurer's argument, seeing it simply as a way to escape the three-month limitation period imposed by the FAA on motions to vacate an arbitration award. This decision reaffirms the point that confirmation proceedings are of a strictly summary nature and that challenges of the type asserted by the reinsurer must be advanced in the context of the arbitration proceedings.

Not only are standards of review for arbitration awards incredibly high, so are standards for reviewing challenges to arbitral awards. In *Arrowood Indemn. Co. v. Equitas Ins. Ltd.*, No. 3:14-cv-00458-VAB, 2015 U.S. Dist. LEXIS 139595 (D. Conn. Oct. 14, 2015), related to the case discussed above, a different district court denied the reinsurer's motion to permit a second arbitration demand to be used to nullify a prior arbitration award. Shortly after the arbitration award was made in favor of the cedent, the reinsurer demanded a second arbitration on two grounds: (1) it demanded access to certain of the cedent's documents, and (2) it asserted that there was intentional misconduct under the Rule 60(b)(3) motion discussed above.

Due to the narrow judicial review permitted in arbitration cases, the court determined that the motion for a second arbitration was a collateral attack on the original award and, therefore, not permitted. Furthermore, the court stated that because the FAA does not permit the merits of a prior arbitration award to be revisited, it was prohibited in deference to the "twin goals of arbitration, namely settling disputes efficiently and avoiding long and expensive litigation."

The significant deference courts give to the arbitration process was emphasized in *Liberty Mut. Ins. Co. v. Nationwide Mut. Ins. Co.*, 87 Mass. App. Ct. 1127 (2015). The original case involved a reinsurer that demanded arbitration in an attempt to access all documents relevant to underlying claims from a cedent, including privileged documents. The privileged documents included those protected by attorney-client and attorney work-product privileges that are typically not provided so that cedents may avoid claims of waiver by coverage counsel and plaintiff's counsel in the underlying claims. Upon reaching arbitration, the panel determined that the clause permitting a reinsurer access to records did not reach so far as to include privileged documents.

Both the motion court and the Massachusetts State Appeals Court affirmed the arbitration award and denied the reinsurer's motion to vacate. The Appeals Court cited the severely limited review that courts are permitted to give arbitration awards in its affirmation of the prior rulings. There was, however, an insinuation that the Appeals Court might have disagreed with the interpretation of the access to records analysis employed by the arbitration panel. Nevertheless, whether the court disagrees on the substance of an award is not the test when courts review arbitration awards.

Review of arbitration awards is not limited to challenging the specific award. In *Am. United Life Ins. Co. v. Travelers Indemn. Co.*, No. 3:14cv1339 (WWE), 2015 U.S. Dist. LEXIS 108585 (D. Conn. Aug. 18, 2015), the court was asked to determine whether a prior arbitration award had an effect on a future arbitration award regarding the valuation of pending claims. In a prior arbitration, the panel issued an award dictating the valuation method to be used for certain claims between the cedent and reinsurer. The reinsurer disputed whether all relevant information to value the claims was provided and demanded arbitration under the arbitration clause of the reinsurance contract. The cedent, pursuant to the commutation clause of the contract, requested that a panel of actuaries determine whether sufficient information was provided in lieu of arbitration.

The court reviewed the broad language of the arbitration clause and construed it to include the dispute at hand related to provision of information. The court took the ruling a step further by holding that the cedent did not forfeit its right to name umpire candidates because the cedent had failed to do so while attempting to settle the dispute without input of either the actuarial or arbitration panel. The prior arbitration award was found not to forestall the future arbitration and related award.

The Fifth Circuit, in *PoolRe Ins. Corp. v. Organizational Strategies, Inc.*, 783 F.3d 256 (5th Cir. 2015), addressed the consequences of an arbitrator not being properly selected. Indeed, the court vacated an arbitration award because the arbitrator exceeded his authority in granting the award.

In this dispute involving a captive insurance program, the reinsurance agreements required that the arbitration take place in Anguilla and that the arbitrator be selected by the Anguilla, B.W.I. Director of Insurance. After a series of events leading to the cancellation of the agreements and the filing of the arbitration, the arbitration demand was forwarded to a dispute resolution professional who appointed himself as arbitrator. In fact, it turned out that there was no Anguilla Director of Insurance and hence no one in the position to nominate an arbitrator per the terms of the agreements.

Over objections, the dispute resolution professional made himself the arbitrator and ultimately issued an award in favor of the reinsurer and its manager. The district court vacated the award holding that the arbitrator exceeded his authority in rendering an award by not being appointed by the required method under the agreements. Although Section 5 of the FAA provides a mechanism for a party to move the district court to appoint an arbitrator if for any reason there is a lapse in the naming of an arbitrator, that procedure was not followed in this case.

This case presents another in a series of cautionary tales about arbitration clauses being drafted that name certain appointing authorities, arbitral organizations and rules that end up being wrong or so specific that there is a real possibility that should a dispute arise, compliance would be impossible. Often these situations arise out of an impasse in the selection process. Nonetheless, care needs to be taken in appointing individuals, organizations and invoking rules that allow for sufficient contingencies.

Bellefonte

Three courts in 2015 grappled with issues surrounding the application of the "*Bellefonte* Principle" in light of the Second Circuit's late-2014 decision styled *Utica Mut. Ins. Co. v. Munich Reins. Am., Inc.*, 594 F. App'x 700 (2d Cir. 2014). The *Bellefonte* Principle is derived from Bellefonte Reins. Co. v. Aetna Cas. & Sur. 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*, the court held that *Bellefonte* did *not* establish a blanket rule whereby all limits of liability are presumptively expense exclusive.

In the first post-Utica case, the Southern District of New York, in *Global Reins. Corp. of Am. v. Century Indemn. Co.*, No. 13 Civ. 06577 (LGS), 2015 U.S. Dist. LEXIS 50236 (S.D.N.Y. Apr. 15, 2015), rejected the cedent's view that *Utica* represented a change in controlling law. The court rejected the cedent's motion for reconsideration of the court's prior grant of summary judgment to the reinsurer. Although not denying that *Utica* constituted a clarification of the *Bellefonte* Principle, the district court found *Utica* distinguishable because the language of the reinsurance certificates there differed from those under its consideration.

The second post-*Utica* case arrived at a similar result. Indeed, the Northern District of New York rejected a cedent's motion to reconsider after likewise concluding that Utica did not represent a change in controlling law. *Utica Mut. Ins. Co. v. Clearwater Ins. Co.*, No. 6:13-cv-1178 (GLS), 2015 U.S. Dist. LEXIS 95826 (N.D.N.Y. Jul. 23, 2015). And, like in *Global*, the facultative certificates were distinguishable from the one in the Second Circuit's *Utica* decision. Indeed, the certificates did not specify that only "losses or damages" were subject to the liability cap and, thus, were more akin to the provision in *Bellefonte* insofar as they unambiguously specified that reinsurance was subject to the certificates' terms and conditions.

In Century *Indemn. Co. v. OneBeacon Ins. Co.*, No. 02928, 2015 Phila. Ct. Com. Pl. LEXIS 25 (Pa. Ct. Comm. Pl. Mar. 27, 2015), a Pennsylvania state court denied a reinsurer's motion for summary judgment in a case once again involving certificates of facultative reinsurance and whether the "Reinsurance Accepted" limit placed a total cap on the reinsurer's liability. The court referred to *Utica* as having "recently clarified that *Bellefonte* did not establish a blanket rule that all limits of liability are presumptively expense-inclusive." This contributed to the court's ultimate decision to deny the reinsurer's motion for summary judgment. Indeed, the reinsurer argued that the limit stated in the Reinsurance Accepted provision was a total cap on the reinsurer's liability, inclusive of expenses, while the cedent took the opposite view.

In reviewing the certificates, the court determined that the reinsurer's liability was subject to all terms and conditions of the cedent's policy, which made the case distinguishable from *Bellefonte* where the reinsurance premium was subject to the terms of the certificate and the amount of liability set forth. The *Utica* decision gave the court further cover in allowing a party to overcome the presumption that limits of liability are expense inclusive and permitting the court to analyze the certificate as a whole.

In sum, it appears that courts post-*Utica* will continue to exercise the discretion to analyze certificate language as a whole and not be bound by a presumption that all limits of liability are expense-inclusive.

Civil Procedure

An often important early procedural question in reinsurance litigation is whether multiple reinsurers are properly joined as defendants under Rule 20, or under the applicable state procedural rules, or whether the matters should be severed. In *Utica Mut. Ins. Co. v. Am. Re-Ins. No.*, 1078 CA 15-00408, 2015 N.Y. App. Div. LEXIS 7474 (N.Y. App. Div. 4th Dep't Oct. 9, 2015), the New York court granted the reinsurers' motion to sever under New York law finding that a lack of commonality among the claims brought against the different reinsurers dictated severing the claims. Although decided under New York law, the standard applied is very similar to Federal Civil Rule 20 and case law applying Rule 20.

Contract Interpretation

In *Granite State Ins. Co. v. Transatlantic Reins. Co.*, No. 652506/23, 2015 N.Y. App. Div. LEXIS 7591 (App. Div. 1st Dep't Oct. 15, 2015), a New York appellate court held that whether a reinsurance agreement was retroactive or prospective could not be decided as a matter of law. The underlying dispute involved facultative certificates of reinsurance for a series of excess liability policies written by the cedent for a number of corporate insureds. The facultative certificates provided for a retention warranty that the cedent would retain for its own account, "subject to treaty insurance only," the amount specified on the face of the certificate. The facultative certificate also had a clause that precluded assignment of the certificates without written consent of the reinsurer.

Many years later, the cedent entered into a loss portfolio transfer agreement (LPT) with a third-party reinsurer transferring all its asbestos liabilities, including those arising under the excess liability policies reinsured by the reinsurer's facultative certificates. After the LPT was entered into, the reinsurer stopped making claim payments. When the cedent brought this action for breach of contract, the reinsurer counterclaimed and asserted affirmative defenses, including that the cedent had breached the retention warranty and assignment clauses by entering into the LPT. The cedent moved to dismiss the affirmative defenses and for partial summary judgment.

In declining to dismiss the retention warranty defenses, the trial court concluded that, because the LPT was retroactive, it was not treaty insurance. On appeal, the appellate court affirmed the motion court's denial of the motions, but addressed the treaty reinsurance finding of the trial court. The appeals court held that the question of whether the LPT was treaty reinsurance could not be resolved as a matter of law at the current stage of the proceedings. The court noted that the motion court relied on dicta to reach its finding and pointed out that the cases relied upon by the motion court did not explicitly hold that treaty reinsurance could never be retroactive.

The appellate court pointed out that the term "treaty reinsurance" was not defined and that it was not clear from the four corners of the certificates whether treaty reinsurance was exclusively prospective. The court also indicated that there was nothing in the record that established a universally accepted definition of "treaty reinsurance" "in the specialized reinsurance industry." While not resolving the issue, the appellate court provided some guidance on the issue and some brief case law analysis. Arbitrators likely would have little difficulty with this issue.

A service of suit provision whereby a party agreed to "submit to the jurisdiction of any Court of competent jurisdiction with the United States and will comply with all requirement necessary to give such Court jurisdiction" precluded a defendant from removing an Illinois state court action to federal court. *Pine Top Receivables v. Transfercom*, No. 15-CV-8908, 2015 U.S. Dist. LEXIS 167202 (N.D. Ill. Dec. 14, 2015). Under the language of this service of suit provision, the court found an explicit waiver of the right to remove, even though a specific forum was not provided in the provision but rather the parties agreed to the jurisdiction of "any Court" in the US.

Follow-the-Settlements/Follow-the-Fortunes

There is a significant amount of case law that applies the principle of follow-the-settlements to allocation issues. Where it applies, the principle of follow-the-settlements means that the reinsurer will not be permitted to second-guess the cedent's good faith settlement decisions. One notable 2015 case, *New Hampshire Ins. Co. v. Clearwater Ins. Co.*, No. 653547/11, 2015 N.Y. App. Div. LEXIS 2452 (1st Dep't Mar. 24, 2015), determined that specific language was not a "follow-the-settlements" provision, but rather was a "following form" requirement (for the purpose of achieving concurrency between the reinsured contract and the reinsurance policy).

The provision at issue – "liability . . . shall follow [New Hampshire's] liability in accordance with the terms and conditions of the policy reinsured hereunder" – contained no reference to the cedent's claims handling and did not include any other expected language such as "settlement," "compromise," "payment," "allowance" or "adjustment." Because there was no express follow-the-settlements clause in the certificate, the court held that it need not decide whether there was an implied duty of the reinsurer to follow the cedent's settlement based on the undeveloped record. Because on the limited record, the court had no way of telling whether the cedent's allocation of the settlement was reasonable, it affirmed the denial of the motion for summary judgment on allocation.

In *AmTrust NA v. Safebuilt*, No. 14 Civ 09494 (CM), 2015 US Dist. LEXIS 147628 (S.D.N.Y. Oct. 28, 2015), the court also declined a third-party claims administrator's request to dismiss a case under the "follow-the-fortunes" doctrine. On other grounds, the court ultimately dismissed the case alleging that a pair of reinsurers was fraudulently induced to become parties to a reinsurance program. The case consisted of a complex reinsurance arrangement that sought to insulate the reinsurers from risk, but ultimately – in the court's words – left them "holding the proverbial bag."

Under the arrangement, a managing underwriter controlled by the creators of the scheme was to underwrite primary policies that would be issued by a third-party and reinsured by the reinsurers. In turn, the reinsurers would have their risk retroceded 100% to a "protected cell," which consisted of an entity that was wholly owned by the scheme creators. As the court explained, the "idea behind [this] scheme" was to allow the reinsurers to provide reinsurance without actually having anything at risk.

When the scheme creators undercapitalized the entities that were ultimately tasked with absorbing the reinsurers' risk, the latter sued, claiming that the undercapitalization violated the trust, agency and reinsurance agreements that formed the basis of the arrangement. In turn, the scheme creators brought a claim against the third-party claims administrator, who moved to dismiss the third-party complaint. Among other things, the claims administrator argued that the scheme creators' claim was barred by the follow-the-fortunes doctrine, insisting it – at bottom – constituted "second-guessing good faith determinations" made by the reinsurers (in their capacity as retrocedents).

Essentially, the claims administrator argued that because the scheme creators "owned and/or controlled" the "reinsurers who matter to [the] case" (i.e., the non-party entities that were tasked with reinsuring the reinsurer's risk), the follow-the-fortunes doctrine barred the scheme creators from recovery. While the court conceded that the "wall separating [the scheme creators from [their wholly-owned entities] may ultimately fall," the wall – at least in this stage in the litigation – remained intact, thus, preventing resort to the follow-the-fortunes doctrine.

Utmost Good Faith

Several cases in 2015 continued to reflect the emphasis that courts place on the duty of utmost good faith due in a reinsurance relationship.

In an issue of first impression, a New York federal court upheld a magistrate's decision permitting a "reverse bad faith" claim to be made. In *Utica Mut. Ins. Co. v. Century Indemn. Co.*, No. 6:13-CV-995, 2015 U.S. Dist. LEXIS 71348 (N.D.N.Y. May 11, 2015), a reinsurer amended its answer to add a counterclaim that alleged the cedent had manipulated records to extract excessive sums of money from the reinsurers, which the parties have termed a "reverse bad faith" claim. The claims arose concerning asbestos losses and determination of whether there was proper allocation between the primary or umbrella policies covering the losses.

The reverse bad faith claim was challenged on the ground that no New York court had previously recognized such a claim when made in a reinsurance context. While the court acknowledged this, the court found that there was a lack of controlling authority explicitly rejecting such a claim and that lack was fatal to the contrary to law objection raised by the cedent. Further, the court stated that the counterclaim was plausible due to the utmost good faith duty that is inherent to the reinsurance relationship and is owed by both cedent and reinsurer. This case should provide interesting grounds for future counterclaims.

In another case of first impression, a Florida federal court addressed a negligence claim made by a reinsurer against its cedent. In *Old Republic Natl' Title Ins. Co. v. First Am. Title Ins. Co.*, No. 8:15-cv126-T-30EAJ, 2015 U.S. Dist. LEXIS 37747 (M.D. Fl. Jun. 8, 2015), the cedent had issued title insurance policies to a borrower and lender to finance the acquisition of property and construction of a related power plant. The reinsurer assumed a specified share of the contractual liability under the title insurance policies. Both the borrower and lender made claims under the title policies and the cedent settled the claims and later asserted that the reinsurer was obligated to pay a proportionate share of the settlement.

After payment of a proportionate share under a full reservation of rights, the reinsurer proceeded to bring this suit for negligence, to which the cedent filed a motion to dismiss. The court denied the motion for dismissal on the ground that the reinsurer pleaded accounts in the alternative, one of which is that negligence could be found if the cedent did not meet its duty to underwrite the title policies in a reasonably prudent manner. The court also rationalized dismissal of the counterclaims made by the cedent by stating that they were duplicative of those dismissed against another reinsurer. The court cited the prior reasoning that the counterclaims were not related to a breach of a contractual provision and because a breach of good faith does not exist apart from a breach of contract, the claims should be dismissed.

In a non-precedential opinion, the US Court of Appeals for the Third Circuit held that although an insurer withheld some information from the reinsurer, the information was not material and thus, there was no breach of the duty of utmost good faith by the insurer. *Munich Reinsurance Am, Inc. v. Am. Nat'l Ins. Co.*, No. 14-2045, 601 Fed. App'x 122 (3d Cir. Feb. 3, 2015). The Third Circuit held that a breach of the duty of utmost good faith justifies rescinding the reinsurance relationship and that duty requires that all material facts be disclosed to the reinsurer.

There was no breach of the reinsurance relationship here, found the court, because the information that was not provided included information about the insured's own losses, the break-even price calculated by the insured, a claims audit and several other items determined not to be material to any decision made by the reinsurer.

These cases addressing utmost good faith accentuate the value that courts continue to place on the full disclosure of material facts between cedent and reinsurer. While the good faith doctrine continues to evolve in the courts, the duty of utmost good faith continues to be a pillar in reinsurance relationships as well as expanding with this year's notable case including reverse bad faith claims.

Agents

A notable case discussing the interpretation of a reinsurance agreement and the calculation of provisional commissions is *Odyssey Reins. Co. v. Cal-Regent Ins. Servs. Corp.*, No. 3:14-cv-00458-VAB, 2015 U.S. Dist. LEXIS 139595 (D. Conn. Oct. 14, 2015). There, the court determined how provisional commissions should be calculated under a reinsurance agreement.

The reinsurer brought suit against the managing agent arguing that its commissions should be adjusted for each underwriting year based on a sliding scale schedule that depended upon the loss experience of the business written. According to the reinsurance agreement, if the loss ratio for an Underwriting Year exceeded 66.5%, then the difference in percentage points between the loss ratio and 66.5% must be multiplied by premiums earned for the period, and the product must be carried forward to the "next adjustment period as a debit (additional) to losses incurred."

The court disposed of the straightforward commission adjustments for four specific years. For year 2006, the issue was more complicated as the parties disputed whether or not a debit carryforward from Underwriting Year 2005 could be applied to losses incurred in Underwriting Year 2006. The court agreed with the reinsurer and ruled that under the explicit terms of the reinsurance agreement, the debit carry forward from Underwriting Year 2005 must be applied to Underwriting Year 2006 as a debit to "losses incurred." In so ruling, the court determined the meaning of the phrase "next adjustment period as a debit (additional) to losses incurred." The term "adjustment period" was undefined, and the court determined that it meant an underwriting year. The court also considered the definition of "Losses Incurred," and ultimately concluded that its application applied to any renewal periods under the reinsurance agreement. Thus, the court found that the 2006 Policy Year was an "Underwriting Year" under the reinsurance agreement and, after applying the debit carry-forward, awarded the reinsurer the entire amount of its claimed commission adjustment for 2006, as well as prejudgment interest on the entire judgment.

Fronting/Trust Agreement

Cases ruling on fronted insurance programs are relatively rare and, in late 2015, the District of South Carolina ruled on a motion to dismiss involving such a program. In *Companion Prop & Cas. Ins. Co. v. United States Bank*, No. 3:15-cv-01300-JMC, 2015 U.S. Dist. LEXIS 158489 (D. S.C. Nov. 24, 2015), the court denied the defendant reinsurers' motion to dismiss breach of contract, breach of fiduciary duty, negligence and negligent misrepresentation claims brought by plaintiff insurance company which was a participant in a fronted insurance program. The claims stemmed from alleged mismanagement of funds by the reinsurers that resulted in the significant diminishing of the cash and investment value of reinsurance collateral trusts securing the reinsurance obligations of the defendants under the fronting arrangement.

Accepting as true the allegations of the insurance company, the court found that it adequately pleaded that the reinsurers violated their contractual obligations in the process of substituting investments in the trusts and also breached a duty to ensure the value of substituted assets was comparable to that of the original trust assets. However this case may ultimately be decided, reinsurers participating in fronting arrangements must be cognizant of their contractual obligations when making investment choices and the possibility that a court may find the existence of a duty such that they could be subject to tort claims.

Discovery of Reinsurance Information and Communications

Continuing a trend of recent years, courts in 2015 again rejected the common-interest doctrine and required both cedents and reinsurers to provide reinsurance communications.

In *Great Am. Ins. Co. v. Castleton Commodities Int'l LLC*, No. 15 Civ. 3976 (JSR), 2015 U.S. Dist. LEXIS 144338 (S.D. N.Y. Oct. 15, 2015), the Southern District of New York made multiple rulings regarding information that is discoverable from insurance companies. The court held that discussions between the insurance company and its attorneys prior to the denial of coverage are not protected by the attorney-client privilege unless the discussions are "primarily or predominately a communication of a legal character." The court next announced a general rule regarding an insurance company's assertion of the work product privilege. The court held that "if a declination decision has been made, documents subsequently drafted are presumed to have been created in anticipation of litigation; if the claim has not yet been rejected the documents are part of the claim investigation process and are not work product."

The court also considered instances in which primary and excess insurers may validly assert the joint defense or "common interest" privilege. After noting that primary and excess insurers' legal interests actually conflict, the court assumed that insurers' discussions among themselves are entitled to the benefits of the common interest privilege for the sole purpose of not waving other forms of privilege. The court, however, held that the common interest privilege is not an "independent source of privilege or confidentiality." The court ruled that "[i]f a communication is not protected by the attorney-client privilege or the attorney workproduct doctrine, the common interest doctrine does not apply." As a result of the court's rulings, the reinsurer was ordered to produce many documents that it previously withheld from discovery.

Many courts hold that reinsurance agreements and any related communications are relevant and discoverable in cases in which a plaintiff seeks bad faith penalties against an insurance company. See *Leevac Shipbuilders LLC v. Westchester Surplus Lines Ins. Co.*, No. 2:14-cv-00399, 2015 U.S. Dist. LEXIS 5070 (W.D. La. Jan. 15, 2015); *Pcs Phosphate Co. v. Am. Home*, No. 14-CV-99, 2015 U.S. Dist. LEXIS 1655408 (E.D.N.C., Dec. 10, 2015). In *Pcs Phosphate Co.*, the court noted that this type of information is generally not discoverable where the claims are limited to interpretation of an insurance policy. 2015 U.S. Dist. LEXIS 1655408, at *10. Of course, there are limits to discovery in bad faith cases. In Leevac Shipbuilders LLC, the court rejected discovery of every prior bad faith lawsuit against the defendant as it would be unduly burdensome and any potential relevance was outweighed by the extraordinary costs of production. 2015 U.S. Dist. LEXIS 5070, at *14-15.

Communications between cedents and reinsurers was also held admissible in a New York federal court as evidence in a dispute between a policyholder of a series of universal life policies. *U.S. Bank Nat'l Ass'n v. PHL Variable Life Ins. Co.*, 112 F. Supp. 3d 122 (S.D.N.Y. 2015). Here, the dispute centered on whether the insurer could raise the cost of insurance rates on these universal life policies. As part of the evidence at trial, the policyholder sought to introduce certain reinsurance communications. These included communications between the cedent and its reinsurer discussing a rate increase and internal communications at a reinsurer discussing the nature of a rate increase by the insurer. The court denied the motions in limine by the insurer to preclude these reinsurance communications holding that they were both relevant and probative on whether the insurer breached its duties.

Two cases in 2015 somewhat bucked the discovery trend and did not permit the discovery of certain reinsurance information under the specific facts of those cases. In *Broadrock Gas Servs., LLC v. AIG Specialty Ins. Co.*, No. 14 Civ. 3927 (AJN) (MHD), 2015 U.S. Dist. LEXIS 26462 (S.D.N.Y. Mar. 2, 2015), a New York federal court denied discovery of claims memoranda containing reinsurance information in a coverage dispute over the failure to cover two separate claims under a pollution liability policy. The policyholder sought discovery of a variety of documents, among which included redacted executive claim summaries. The redactions, the court stated, included a number of issues including reinsurance issues. The court held that there was no reason to question the accuracy of counsel's description of the redactions of reinsurance calculations and treaty participation percentages. Rejecting the policyholder's arguments about the redactions, the court reasoned that reinsurance calculations were distinguishable from reserve information. Because the redactions related only to reinsurance calculations, and the policyholder sought only reserve information, discovery was not required. Other discovery requests not related to reinsurance information were allowed by the court and the decision includes a good discussion of the applicability and waiver of privilege.

In a pair of opinions issued in a coverage dispute between a cedent and its insured, an Indiana federal court limited the scope of discovery of reinsurance documents permitted. *Indianapolis Airport Auth. v. Travelers Prop. Cas. Co. of Am.*, No. 1:13-cv-01316-JMS-TAB, 2015 U.S. Dist. LEXIS and 2015 U.S. Dist. LEXIS 45148 (S.D. Ind. Apr. 7, 2015). The limitations applied to documents both in the possession of a nonparty reinsurer and the cedent.

While acknowledging the reinsurance contract as separate and distinct from the underlying policy, both opinions reconfirmed the very limited relevance of reinsurance documents on the issue of coverage under the original insurance policy. Further, the court held that this limited utility is far outweighed by the burden imposed when production of the commercially-sensitive reinsurance relationship is required. In the first opinion, the court denied the insured's motion to compel after concluding that the contractual relationship between a cedent and a reinsurer was not relevant to the coverage claims. The insured was, therefore, not entitled to discovery related to the cedent's reinsurance guidelines.

In the second opinion, after the court accepted the cedent's standing to challenge a subpoena issued to the reinsurer, the court acknowledged that reinsurance documents may be relevant in only the limited circumstance where (1) the original insurance policy contains ambiguous terms and (2) the reinsurance documents provide an indication as to the cedent's intent when issuing the original policy. The court conducted an in camera review of the subpoenaed documents and found that they did not address the cedent's intent in the original policy and did not clarify any ambiguous term. Further, because the subpoena requested documents for an extensive time period that exceeded the time when the reinsurance contract was in effect, it was deemed to be overbroad. Accordingly, the motion to quash was granted.

Recent Speeches and Publications

John Nonna is speaking on "New Products: Panelists discuss new products in the marketplace," at the ARIAS·U.S. Spring Educational Seminar on March 10, 2016, in Chicago.

Larry Schiffer is speaking on "Priority of Coverage in Competing Policies," at the Construction OCIP/CCIP Insurance Programs: Potential Coverage Gaps and Other Coverage Pitfalls live webinar hosted by Strafford on April 5, 2016.

Larry Schiffer's article, "Service of Suit and Removal," was published on Mondaq.com on January 19, 2016.

Larry Schiffer's Reinsurance Commentary, "Clash Cover and Bad Faith," was published on IRMI.com in December 2015.

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