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Reinsurance Newsletter

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Recent Case Summaries

Second Circuit Sends Certified Question to New York Court of Appeals on *Bellefonte*

Global Reins. Corp. of Am. V. Century Indemn. Co., No. 15-2164-cv, 2016 U.S. App. LEXIS 21822 (2d Cir. Dec. 8, 2017).

In a highly anticipated decision, the US Court of Appeals for the Second Circuit has certified an important question of reinsurance law to the New York Court of Appeals. The appeal had *amicus* briefs from reinsurance intermediaries supporting the cedent's argument that the so-called "*Bellefonte* Principle" should not apply.

The Second Circuit was faced with a cedent's appeal of a district court's determination that the dollar amount stated in the "Reinsurance Accepted" section of certificates of facultative reinsurance unambiguously capped the amount the reinsurer was obligated to pay the cedent for both loss and expense combined. The district court's determination was based upon the Second Circuit's well-known precedents, *Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co.*, 903 F.2d 910 (2d Cir. 1990), and *Unigard Sec. Ins. Co. v. N. River Ins. Co.*, 4 F.3d 1049 (2d Cir. 1993).

What makes this opinion important and interesting is the court's analysis of its precedent and its willingness to accept that there was validity to the cedent's and *amici's* arguments that *Bellefonte* and *Unigard* were wrongly decided. The court, after indicating that the brokers' argument was "not without force," stated that it "found it difficult to understand the *Bellefonte* court's conclusion that the reinsurance certificate in that case unambiguously capped the reinsurer's liability for both loss and expenses. Looking only to the language of the certificate, we think it is not entirely clear what exactly the 'Reinsurance Accepted' provision in *Bellefonte* meant." While the court did not suggest an outcome or state whether it would overrule its precedents, the opinion, while certifying a question to New York's highest court for resolution, for the first time outlined the competing arguments and the issues underlying them.

Because the question of how these facultative certificates ("fac certs") should be interpreted is one of state law – here New York law – the court certified the question below to the New York Court of Appeals for an answer before resolving this appeal:

> Does the decision of the New York Court of Appeals in *Excess Insurance Co. v. Factory Mutual Insurance Co.*, 3 N.Y.3d 557 (2004), impose either a rule of construction, or a strong presumption, that a per occurrence liability cap in a reinsurance contract limits the total reinsurance available under the contract to the amount of the cap regardless of whether the underlying policy is understood to cover expenses such as, for instance, defense costs?

Most interesting is that the court did not limit the question to fac certs, but used the words "reinsurance contract" in describing the question. Second, the circuit court stated that by certifying this question "we do not bind the Court of Appeals to the particular question stated. The Court of Appeals may modify the question as it sees fit and, should it choose, may direct the parties to address other questions it deems relevant." The latter suggestion may give rise to the New York Court of Appeals giving consideration to evidence of custom and practice or pattern and practice between the cedent and the reinsurer.

Even more interesting is the circuit court's analysis of its own decisions (both relied upon by the New York Court of Appeals in *Excess*). The opinion goes on to state that in neither *Bellefonte* nor *Unigard* did the court explain why the "Reinsurance Accepted" provision was an explicit limitation on liability. The court merely described the amount stated in that provision as a cap, but was never asked to adjudicate why it was a cap. The court noted that in *Excess*, the parties agreed that there was a liability cap in the fac cert and that the court never addressed the question of whether the stated limit represented an absolute coverage limit for losses and expenses combined. Because the Second Circuit was uncertain whether *Excess* imposed a rule or presumption on the cap issue, it was appropriate to ask the New York Court of Appeals to weigh in.

On January 10, 2017, the New York Court of Appeals accepted the certified question. 2017 N.Y. LEXIS 28 (N.Y. Ct. of App.). The appellant's brief is due March 13; the respondent's brief is due April 27; and a reply brief, if any, is due May 12. Notably, the court welcomes motions for *amicus curiae* participation from those qualified and interested in the subject matter of these certified questions. You can bet that a few *amici* will be filed now that the New York Court of Appeals has accepted the certified question.

Second Circuit Affirms Order Confirming Arbitration Awards

National Indemn. Co. v. IRB Brasil Reseguros S.A., No. 16-1267-cv, 2017 U.S. App. 1686 (2d Cir. Jan. 31, 2017) (Summary Order).

In March 2016, a New York federal court affirmed an order confirming three arbitration awards issued in favor of a retrocessionaire in a reinsurance dispute. See our June 2016 Reinsurance Newsletter for a summary of the case. The Second Circuit recently affirmed.

The appeal was based on the alleged evident partiality and misbehavior of the umpire, which are grounds for vacatur under Section 10 of the Federal Arbitration Act (FAA). The salient fact is that the umpire was appointed as party-arbitrator by an entity allegedly identical to retrocessionaire in a separate case while this arbitration was pending.

The Second Circuit reasoned that a reasonable person would find no evident partiality in view of the following circumstances: the umpire had a purely professional relationship with the retrocessionaire and its affiliated entity, without any familial, business or employment connection; he voted against the retrocessionaire's affiliated entity in his party-arbitrator role; he acted as party-arbitrator on behalf of parties opposed to the retrocessionaire in other cases.

The Second Circuit did not address the argument of misbehavior because it was improperly raised for the first time on appeal.

New York Federal Court Grants Motion to Stay Lawsuit and Compel Arbitration

HDI Global SE v. Lexington Ins. Co., No. 16 Civ. 7241 (CM), 2017 U.S. Dist. LEXIS 18677 (S.D.N.Y. Feb. 7, 2017).

A New York federal court granted a cedent's motion to stay litigation and compel arbitration over whether a facultative certificate covered a loss arising out of a public authority light rail development project. The substantive question, which the court held was for the arbitrators to decide, was whether the loss in question was covered by the policy actually issued by the cedent to the policyholder and whether that policy was facultatively reinsured by the certificate. The facts indicate that the certificate was to cover a specific policy form with a negligence trigger issued by the cedent to the policyholder and that the cedent may have issued a different policy form.

The reinsurer's successor-in-interest brought the lawsuit seeking a declaration that the reinsurance certificate was void for lack of mutual assent. The cedent moved to stay the litigation and compel arbitration under the FAA.

In granting the cedent's motion, the court relied on section 4 of the FAA and the factors discussed in the federal substantive law on arbitration derived from section 4. The court found that there was no question that the reinsurer signed the facultative certificate and that the certificate had an arbitration clause. The court found the reinsurer's argument, that because of the dispute over the underlying form of contract the court should determine whether the reinsurance contract existed, was without merit.

The substantive issue, held the court, was for the arbitrators to determine, not the court. Because the reinsurer did not plead facts challenging the validity and enforceability of the arbitration clause itself, the court found that the parties must arbitrate their dispute. Where there is no issue over the formation of the reinsurance contract, the dispute over the underlying policy must be answered by the arbitrators.

This case is consistent with the federal policy in favor of arbitration.

New York Appellate Court Affirms Order Denying Last Minute Change of Venue

U.S. Fid. & Guar. Co. v. Am. Re-Insurance Co., No. 604517/02, 2016 N.Y. App. Div. LEXIS 8457 (N.Y. App. Div., 1st Dep't Dec. 22, 2016).

On the eve of trial in a reinsurance dispute, the reinsurers moved for a change of venue. The motion court denied the motion as untimely and the appellate court affirmed.

The basis for the change of venue motion, according to the court, was that an impartial trial could not be had because the cedent's former lead counsel, who was scheduled to be a fact witness, became a judge in the same trial court (the New York Supreme Court, Commercial Division). In affirming the denial of the motion, the appellate court noted that the motion court correctly determined that the motion was untimely. According to the court, the motion was made nine months after the witness was designated as an acting Justice of the Supreme Court and until just before the trial, all the arguments made existed at that time, not when he was later appointed to the Commercial Division.

The appellate court also found that the motion was based on conclusory allegations. The court said that the record demonstrated that there was no personal relationship between the trial judge and the witness. The court also found that the jury's discovery that the witness was a judge is not enough to prejudice the reinsurers where the cedent was not seeking to exploit the witness's status to enhance his credibility.

Illinois Appeals Court Affirms Dismissal of Fraud Suit Based on the Statute of Limitations

Guarantee Trust Life Ins. Co. v. Kribbs, No. 1-16-0672, 2016 Ill. App. LEXIS 895 (Ill. App. Dec. 29, 2016).

An Illinois appeals court recently affirmed an order dismissing several claims as untimely. The dispute involved the alleged fraudulent transfer of funds from a reinsurer's custodial account containing premiums paid by the cedent to the reinsurer's principal's personal account.

The cedent originally sued the principal for unjust enrichment, conversion, constructive fraud, concert of action and civil conspiracy in 2006. Although the complaint alleged that the scheme required the assistance of the principal's employees, the cedent did not depose them until 2012. The whole scheme then came to light: how the principal's reinsurance company was formed by two former employees of the cedent, how they collected dividends from the cedent's custodian account and how they paid commissions to the cedent's employee who authorized the transfers. The cedent re-filed the action in 2013, joining two of its employees as co-defendants. The court, however, held that the five-year limitation period had elapsed. The cedent appealed, arguing that the limitation period did not start until 2012, when the depositions were taken.

The Illinois appeals court rejected each of the cedent's arguments. First, the court held that discovery rule did not apply because the cedent could have discovered the wrongful conduct of its employees through reasonable diligence. Second, the fraudulent concealment doctrine was also inapplicable because the cedent failed to assert any affirmative act of fraud by its employees. The late discovery was not excused by the alleged fiduciary breach of its employees. As a matter of law, the duty of employees is one of fidelity and loyalty, not one of candor and disclosure. In any case, the employees' silence, held the court, did not justify the cedent's failure to investigate the details of a scheme that it knew existed. Third, the equitable arguments could not be raised for the first time on appeal. They lacked merit anyway: the doctrine of laches was inapplicable because the action was for a money judgment; the doctrine of equitable estoppel could not be invoked because the employees did nothing to prevent the cedent from investigating; and the doctrine of equitable tolling required proof of extraordinary barriers, rather than negligence.

While this decision deals primarily with issues of discovery and computation of the limitations period, it is also interesting for its analysis of the responsibilities of cedants, reinsurers and their respective employees in a complex fraud case.

Pennsylvania Appeals Court Reverses Transfer of Reinsurance Benefits to a Third Party

In re Dwyer, No. 149-WDA-2016, 2017 WL 384113 (Pa. Super. Ct. Jan. 27, 2017) (Non-Precedential Decision).

At issue in this case was a reinsurance agreement obligating the reinsurer to make weekly payments to a beneficiary. The cedent was an insurance carrier that provided the beneficiary's former employer with a workers' compensation insurance policy. When the beneficiary was injured in the course of his employment, he filed a workers' compensation claim under the federal Longshore and Harbor Workers' Compensation Act (LHWCA). The claim was settled pursuant to an agreement by which the cedent would pay the beneficiary a lump sum and would enter into the relevant reinsurance agreement for weekly payments to the beneficiary. After the agreement was finalized, the beneficiary agreed to transfer its weekly payments from the reinsurer to a third party factoring company in exchange for a lump sum. The factoring company filed a petition to transfer the weekly payments, but the reinsurer opposed the transfer on the basis that it was prohibited by the anti-assignment provision in the LHWCA.

The trial court granted the petition to transfer the weekly payments to the factoring company. It relied primarily on a federal appeals court decision, *In re Sloma*, 43 F.3d 637 (11th Cir. 1995), which had held that monthly annuity payments to settle a LHWCA workers' compensation claim were not subject to the LHWCA's anti-assignment provision. However, the Pennsylvania Superior Court reversed the trial court.

In its reversal, the appeals court first acknowledged that the dispute differed from *Sloma* because the reinsurer's weekly payments to the beneficiary were pursuant to a reinsurance agreement; these were not payments from an annuity. The court, however, did not rely on this difference in its reversal. Instead, the court rejected the holding of *Sloma* and held that the LHWCA's anti-assignment provision prevents the assignment or transfer of structured settlement payments (whether pursuant to a reinsurance policy or otherwise) from an LHWCA workers' compensation claimant to a third party. This holding denied the attempted transfer of the reinsurance policy payments and, thus, shielded the reinsurer from potential exposure to duplicative and simultaneous payment obligations to both the beneficiary/cedent and the third party factoring company.

Connecticut Federal Court Orders In Camera Review of General Counsel's Reinsurance Analysis

ITT Corp. v. Travelers Cas. & Sur. Co., No. 3:12-CV-38, 2017 U.S. Dist. LEXIS 11196 (D. Conn. Jan. 27, 2017).

This litigation commenced in 2012 when an indemnity policyholder and an insurance policyholder alleged that their insurer had changed its interpretation of the policies to effectively eliminate their coverage. Discovery remains ongoing because the district court stayed the case for more than three years beginning in February 2013. Discovery motions, including the present dispute, have permeated the litigation since the first such motion appeared on the docket less than two months after the policyholders filed their complaint.

Prior to the litigation, the insurer had requested that the Associate General Counsel of its reinsurance department produce a memo analyzing the reinsurance implications of different coverage scenarios for claims made under policies similar to those at issue in the case. The policyholders requested production of this reinsurance analysis memo on the theory that it might shed light onto the insurer's prior interpretation of its policies. The insurer claimed that the attorney-client privilege and attorney work product doctrine protected the reinsurance analysis memo and refused to produce the document.

Interpreting Connecticut law, the court pointed out that the insurer, as the party claiming the privilege, had the burden of establishing that the reinsurance analysis memo had been prepared either in anticipation of litigation or for the predominant purpose of communicating legal advice. The court determined that the insurer had not established facts sufficient to warrant protection. Privilege could not rest upon the mere fact that the creator of the reinsurance analysis memo held the title of Associate General Counsel with the insurer. Accordingly, the court ordered the insurer to provide the document to the court for *in camera* review, with the expectation that it will ultimately be produced to the policyholders.

This is another in a long line of cases from many jurisdictions allowing documents created by outside and in-house counsel to be produced to policyholders where the party seeking to maintain the privilege cannot tie the document to anticipated litigation or a request for legal advice.

New York Federal Court Affirms Magistrate Judge's Ruling Denying Reinsurer's Motion to Compel Production of Cedent's Attorney Notes

Utica Mut. Ins. Co. v. Munich Reinsurance Am., Inc., No. 6:13-CV-00743 (BKS/ATB) (N.D.N.Y. Jan. 13, 2017).

A New York federal court affirmed a magistrate judge ruling denying a reinsurer's motion to compel a cedent's document containing attorney notes. The case concerned a dispute between the reinsurer and cedent regarding the limits of liability under two reinsurance contracts and whether the contracts had independent or aggregate limits. The cedent settled claims with its policyholder and brought

suit when the reinsurer failed to pay all outstanding amounts. The reinsurer argued that the cedent falsely represented that the reinsured policies were subject to aggregate limits and that the cedent's settlement was fraudulently orchestrated to create or maximize reinsurance coverage to which the cedent was not entitled.

The reinsurer alleged that the attorney notes at issue – which had been mistakenly produced in an unredacted format and then clawed back – were evidence of the cedent's fraudulent attempts to engineer a settlement under which it received maximum reinsurance coverage. The attorney notes then, argued the reinsurer, fell under the crime-fraud exception to privilege and should be produced.

In denying the motion to compel, the magistrate judge reasoned it was not inherently improper for a cedent to consider its reinsurance contracts during settlement negotiations. Additionally, because a prior court had determined the cedent's contracts were subject to aggregate limits, it was not fraudulent for the cedent to take that position here. Finally, the magistrate judge held that the settlement was not fraudulently obtained, as it was endorsed by judges in a prior litigation and found to be "fair, just and reasonable" and made at "arm's length and in good faith." Thus, the crime-fraud exception did not apply and the court would not compel disclosure of the privileged document.

The district court judge affirmed the magistrate judge's decision, holding there is no basis to find that the ruling is clearly erroneous or contrary to law.

Connecticut Federal Court Denies Reinsurer's Motion for Reconsideration on Privileged Documents

Travelers Cas. & Sur. CO. v. Century Indemn. Co., No. 3:16-cv-170(JCH), 2017 U.S. Dist. LEXIS 3445 (D. Ct. Jan. 10, 2017).

A Connecticut federal court denied a reinsurer's motion for reconsideration concerning a discovery dispute. The cedent sought reimbursement for asbestos-related settlement funds that the cedent paid on behalf of a policyholder. In October 2016, the reinsurer filed a motion for leave to file a motion to compel production. The reinsurer sought to compel the cedent to respond to a set of requests for production seeking, *inter alia*, documents concerning the cedent's settlement of the underlying claims. The reinsurer stated that the cedent failed to produce non-privileged portions of its outside coverage counsel files, and failed to live up to its contractual obligation to provide adequate information concerning the underlying settlement. The reinsurer argued that the parties' reinsurance contracts obliged the cedent to provide certain information. The court denied the motion and the reinsurer sought reconsideration.

In denying the motion, the court held that the motion for reconsideration presented no reasoning that could persuade the court to alter its decision. The reinsurer has not shown good cause for the belated nature of its motion to compel production, which it should have filed within 14 days of the ruling from which the relief was sought. The reinsurer argued that it had to review more than 30,000 documents, but, according to the court, did not give an adequate reason for why it had to review all the documents to determine that the cedent had not produced the outside coverage counsel files, when the cedent already had objected to the production of those files.

Furthermore, the court stated that the documents sought effectively went to the merits of what the underlying dispute was about. In its amended complaint, the cedent asked the court to declare, *inter alia*, that the reinsurer's obligation to pay was not preconditioned on access to records.

In the end, the court found that the reinsurer presented no intervening change of controlling law, no new evidence, manifest injustice or anything that would suggest that the court might reasonably be expected to alter its opinion.

Utah Federal Court Grants Motion for Discovery of Reinsurance Information in Directors and Officers Suit

Western Ins. Co. v. Rottman, No. 2:13-CV-436-DAK, 2016 U.S. Dist. LEXIS 180161 (D. Utah. Dec. 29, 2016).

A Utah federal court held that reinsurance information regarding an insolvent insurer was relevant to the defense of directors and officers being sued for negligence by the liquidator. The liquidator sued a group of insurer's former directors and officers for negligence, breach of fiduciary duty, liability and other claims. The directors and officers moved to compel discovery from the insolvent carrier in the form of a Federal Rules of Civil Procedure 30(b)(6) deposition on a variety of topics, including reinsurance and whether the insolvent insurer had received reinsurance payments.

In granting discovery of reinsurance information, the court found that the liquidator's objection seemed to admit the relevance of reinsurance information given that the liquidator contended that the directors and officers should have caused reinsurance claims to be made prior to liquidation and failing to do so lost millions of dollars for the insolvent carrier. Given this assertion, the court held that the directors and officers would be entitled to discovery regarding reinsurance policies, payments and settlements to prepare their defense to the assertion.

Maryland Federal Court Allows Claims Based on Allegations That the Reasons for Increased Cost of Life Insurance Fees Are Specious

Dickman v. Banner Life Ins. Co., No. WMN-16-192, 2016 U.S. Dist. LEXIS 176364 (D. Md. Dec. 21, 2016).

A Maryland federal court denied a life insurer's motion to strike allegations related to its reinsurance and dividends transactions. The court found that the transactions were potentially relevant to the breach of contract and fraud claims in that they provide an alternative reason for the increased cost of insurance fees.

In this case, the insured purchased life insurance policies from the insurer. The insured paid the minimum premiums to keep the policy in force for a guaranteed 20 years. The insured had the option to pay above and beyond the minimum premium and the excess was invested for the benefit of the policy holder. The extra funds could be used to extend the coverage past 20 years, reimbursed or, in the event the insured died, the money would go to the policy's beneficiary. The insurer extracted an expense fee and a cost of insurance (COI) fee with each premium. The remainder after the fees were extracted was added to the policy's cash value.

In October 2015, the insurer dramatically increased the COI. As a result of the increase, monthly premium payments would no longer cover the COI and the difference was taken from the accumulated cash values. Because the cash values would be completely drained, the option to extend the policies beyond the 20-year guarantee was no longer available. Thus, the insured would no longer receive an additional benefit from the years of additional payments.

The insurer sent a letter notifying its policy holders that the COI would increase. The notification did not indicate by how much the COI would increase. The insured said the increase was due to "reevaluated assumptions regarding the number and timing of death claims, how long people would keep their policies, how well investment would perform, and the cost to administer policies." The insured claim that the insurer's reasons are specious – that the real reason is a scheme to funnel cash into its corporate parent. The insured allege that the parent company was in a distressed financial condition and the insurer set up wholly-owned captive reinsurers offshore or out-of-state for the purpose of offloading its policies in exchange for phantom or inflated assets so it would appear to have sufficient reserves to permit distribution of dividends.

The insured brought breach of contract, unjust enrichment, conversion and fraud claims. The court dismissed the unjust enrichment and conversion claims. The unjust enrichment claim was dismissed because the subject matter of the unjust enrichment claim was covered by an express contract. The conversion claim was dismissed because the cash values of the insured policies were not specific or identifiable as required by the claim of conversion.

The insured's fraud claim survived the insurer's argument that it is barred by the economic loss and source of duty rule, which provides that a tort claim cannot be maintained with a breach of contract claim. As the court explained, the exception to this rule is when a party alleges fraud in the inducement, which "establishes an independent, willful tort that is factually bound to the contractual breach but whose legal elements are distinct from it." The court found that this case involved fraud in the inducement based on the inference that the insurer sent the insured financial statements that did not indicate its financial instability, thus the statements were made to induce continued excess payments. The court limited the insured's fraud and breach of contract claim in that they could not be brought against the insurer's parent company citing a longstanding practice of courts rejecting foisting liability on parent companies for the acts of their subsidiaries.

Pennsylvania Federal Court Holds That the Continuing Violation Doctrine Applies to Captive Reinsurance Schemes Claims Brought Under RESPA

White v. PNC Fin. Servs. Grp., No. 11-7928, 2017 U.S. Dist. LEXIS 3240 (E.D. Pa. Jan. 9, 2017).

After five years of joint motions to stay litigation pending the outcome of various cases, a Pennsylvania federal court granted homeowners leave to amend their complaint to include the legal theory of continued violations doctrine as it relates to a captive reinsurance scheme claim under the Real Estate Settlement Procedures Act (RESPA), 12 U.S.C. § 2607. The homeowners claimed that the involved insurers, lenders and reinsurers colluded to create a scheme that violates RESPA. Specifically, the homeowners claim that the lenders formed subsidiary companies that became the reinsurers and ultimately accepted fees, kickbacks and referrals that violated RESPA. But the court denied the motion to amend to add RICO claims on the grounds of undue delay and prejudice to the lenders, insurers and reinsurers.

In granting the motion on the continuing violation claim, the court explained its rationale. RESPA has a one year statute of limitations period that commenced on the date of the violation. The Third Circuit has held that the date of closing constitutes the date of the violation. The Third Circuit has also stated that the doctrine of continued violations is not dependent on which statute gives rise to the claims. The continued violation doctrine provides that the statute of limitations runs from the date of the last alleged violation rather than the first. The court reasoned that just because RESPA's statute of limitations begins to run at the date of closing does not eliminate the possibility that subsequent violations of RESPA will trigger the continued violations doctrine, thereby resetting the statute of limitations with each new violation.

The court agreed with the Consumer Financial Protection Bureau (CFPB) in *In the Matter of PHH Corp.*, No. 2014-CFPB-0002 (CFPB, June 4, 2015), in which the CFPB held that a reinsurer violated RESPA every time it accepted a reinsurance payment and was liable for each violation even though the payments were associated with a loan that was closed prior to that date. In that decision, the CFPB distinguished between a situation where the homeowner pays for the insurance in full at one time and captive reinsurance schemes where insurance payments are made in conjunction with the mortgage payments.

The court held that RESPA §8 makes it clear that each illegal fee, kickback or referral is its own RESPA violation, thus each violation starts a new one-year state of limitations. According to the court, to hold otherwise would mean that reinsurers could avoid liability for continuing violations occurring one year or later after the closing date.

Recent Regulatory Developments

United States

Federal Insurance Office Submits "Covered Agreement" to Congress; House Financial Committee Subcommittee Holds Hearing

Background and Key Dates

The Dodd Frank Act created the Federal Office of Insurance (FIO) in the US Treasury Department, and authorized FIO to negotiate with foreign governments and regulatory authorities in regard to "prudential measures with respect to the business of insurance or reinsurance" and to enter into an agreement called a "Covered Agreement." Notably for the US state-based regulatory system, in some circumstances, Dodd Frank also gives FIO the authority to preempt state laws that are inconsistent with the terms of a Covered Agreement. Dodd Frank requires that after a Covered Agreement is negotiated, it must be submitted to Congress for 90 days before it becomes effective. Dodd Frank, however, does not require Congressional approval of a Covered Agreement.

On January 13, 2017, FIO submitted to Congress a Covered Agreement negotiated with the EU addressing: (1) group supervision; (2) reinsurance; and (3) exchange of information between regulators. On February 16, 2017, the Housing and Insurance Subcommittee of the House of Representatives Financial Services Committee held a hearing on the Covered Agreement.

February 16, 2017 Congressional Hearing

Witnesses at the hearing were: Michael T. McRaith, former Director of the FIO; Ted Nickel, Wisconsin Insurance Commissioner and President of the National Association of Insurance Regulators; Leigh Ann Pusey, President and CEO of the American Insurance Association; and Charles Chamness, President and CEO of the National Association of Mutual Insurance Companies.

Mr. McRaith and Ms. Pusey supported the Covered Agreement as negotiated, emphasizing that it preserves the regulatory authority of both US and EU regulators and will save US companies operating in the EU millions of dollars in compliance costs. They emphasized that, once implemented, the Covered Agreement: (1) eliminates EU collateral and local presence requirements for US insurers operating in the EU and (2) eliminates US state collateral and local presence requirements for EU insurers operating in the US.

Messrs. Nickel and Chamness did not support the agreement as negotiated and urged the Trump Administration to renegotiate the agreement. Their primary objections were to the failure of the EU regulators to recognize the US state regulatory system as "equivalent" to the EU system under the EU's Solvency II standards, and to the ultimate elimination of reinsurance capital requirements for EU companies doing business in the US.

Several witnesses also commented on a new NAIC accreditation standard state regulators must comply with by January 1, 2019, which will reduce some reinsurer collateral requirements.

Some members of the subcommittee expressed support for the Covered Agreement, while others expressed concern about the absence of congressional approval requirements and the lack of consensus across the insurance industry. Several subcommittee members endorsed the suggestion that the Trump Administration renegotiate the agreement.

What Is Next?

Under Dodd Frank, no Congressional approval is required. The Covered Agreement can take effect after all of the following occur: (1) expiration of the 90-day Congressional waiting period (April 13, 2017); (2) the US and the EU exchange written notice that their respective internal requirements have been met; and (3) seven days pass after that written notice. It is not clear at this time what, if any, next steps Congress or the Trump Treasury Department will take in regard to the Covered Agreement.

Copies of the witnesses' written testimony, the House Committee Memorandum for the hearing, and a video of the actual hearing are available on the website of the House Financial Services Committee. The text of the Covered Agreement and a Fact Sheet about it are available on the Treasury Department website.

United Kingdom

Important New Law in the UK Relating to Payment of Insurance and Reinsurance Claims

At the moment, English law says that insurers and reinsurers are not under a positive duty to pay valid claims within a reasonable time. If an insurer/reinsurer delays in paying a claim, or fails to pay at all, an insured/reinsured can only claim the sums due under the policy and interest. An insured/reinsured cannot claim damages for late payment if it suffers additional losses by reason of a delay.

That position will change after May 4, 2017 when certain parts of the Enterprise Act 2016 introduce a new section 13A into the Insurance Act 2015. The result of the new legislation is that any insurance/reinsurance (including retrocession) policy issued or renewed after May 4, 2017, and which is subject to English law, will contain an implied term that requires an insurer/reinsurer to pay claims within a reasonable period. If they act in breach of such a term, then they are potentially liable to pay contractual damages to the insured/reinsured, as well as sums due under the policy and interest.

Going forward there is likely to be debate about what constitutes "reasonable time," but it will include giving time to an insurer/reinsurer to investigate and assess the claim. And what is "reasonable" will turn on issues such as the type of insurance in question, the size and complexity of the claim, compliance with relevant statutory and regulatory rules/guidance and factors outside an insurer's/reinsurer's control.

The new legislation also provides a defense to an insurer/reinsurer and they will not be in breach of the implied term if they can prove that they have reasonable grounds for not paying the claim. The manner in which the claim is handled will, therefore, be a factor in determining whether there has been a breach of the implied term.

An insured/reinsured must issue the court claim for damages within one year of the date that the insurer/reinsurer pays all sums due under the insurance contract. This introduces a new limitation period for legal claims under English law.

Insurers and reinsurers should note that it will be possible to contract out of the new provisions provided they do so in a transparent manner and draws this to the insured's attention before the policy is entered into.

Comment

While on the face of it this is all good news for insureds, insurers can take comfort from the fact that claims for breach of the implied term will not be straightforward and may not, therefore, be widespread. In particular, insureds/reinsureds will still have to satisfy the court on issues such as causation, remoteness and mitigation before a claim can succeed. And insurers/reinsurers will only be liable for foreseeable losses suffered by their insureds/reinsureds.

Going forward, practical steps to be taken by insurers include responding promptly to an insured's request for claims' information, continuing to carefully document the claims process and to consider making interim payments to an insured if appropriate. These will significantly improve the chances of an insurer/reinsurer successfully defending any legal actions taken by insureds/reinsured alleging a failure to pay a claim within a reasonable time and claiming damages.

A Brief Review of Reinsurance Trends in 2016

In 2016, courts 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. The *Bellefonte* Principle gained more prominence with the Second Circuit Court of Appeals seemingly questioning its earlier precedent and certifying a question of law to the New York Court of Appeals. Late notice cases continue to appear and follow-the-settlements is still evolving. Courts also cut back on allowing reinsurance information discovery, but overall continued the trend of ordering production if there was any reasonable relevance to the underlying dispute.

Arbitration

Courts in 2016 addressed a variety of arbitration issues, including arbitrability, enforceability, arbitrator and panel selection, and the review of arbitration awards. The majority of the decisions continued the trend toward allowing arbitrators to determine most issues and enforcing arbitration awards except for unusual circumstances.

Arbitrability

Whether enforcing or declining to enforce arbitration clauses in reinsurance agreements, courts in 2016 upheld the longstanding principle that arbitration is a matter of consent and not of coercion. In addition to deciding on whether a party is subject to arbitration, courts reinforced the established rule that matters within the scope of an arbitration clause can only be decided by arbitrators.

For example, the court in *Applied Underwriters, Inc. v. Top's Pers., Inc.*, No. 8:15-cv-90, 2016 U.S. Dist. LEXIS 78568 (D. Neb. May 26, 2016), reinforced the rule that an arbitration clause cannot apply to a party who did not agree to be bound by it. There, the cedent fell behind on premiums and executed a promissory note in favor of the reinsurer's affiliate. The cedent breached the promissory note and sought to stay an action for breach of the note and compel arbitration under the reinsurance agreement. The court held that the affiliate – a non-signatory to the reinsurance agreement – was not bound by the arbitration clause. As a non-signatory, the affiliate could only have been subject to the agreement to arbitrate if the promissory note had incorporated by reference either the entire reinsurance agreement or expressly incorporated the arbitration provision.

In *S. Jersey Sanitation Co. v. Applied Underwriters Captive Risk Assur. Co.*, 840 F.3d 138 (3d Cir. 2016), the Third Circuit vacated the district court's judgment and remanded the case, finding that courts can only consider whether an arbitration agreement is enforceable if an *arbitration provision-specific* challenge is made. If the challenge encompasses the contract as a whole, i.e., the validity of that contract, the court held that the matter was for an arbitrator to decide.

Multiple decisions in 2016 upheld the longstanding principle that courts should decline to rule on issues within the scope of an arbitration clause. For example, in *Emplrs Ins. of Wausau v. Cont'l Cas. Co.*, No. 15-cv-22-wme, 2016 U.S. Dist. LEXIS 18850 (W.D. Wis. Feb. 17, 2016), the reinsurer sought to preclude re-arbitration of a final decision reached by an arbitral panel in 2004 between the same parties to the same treaty. The court held that the unpaid billing issues arising after the 2004 decision were within the scope of the treaty's arbitration provision. Therefore, it was within the arbitral panel's sole discretion to determine whether that issue needed to be re-arbitrated.

In *Star Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, No. 1412915, 2016 U.S. Dist. LEXIS 9136 (E.D. Mich. Jan. 27, 2016), after an arbitration award was issued in favor of a reinsurer, the cedent moved to modify the award of prejudgment interest, which it argued had been miscalculated. The parties, however, disputed the relevant calculations and backup material, and the amount at issue could not be readily ascertained by a formula. Thus, given the substantive nature of this dispute, the court held that it could only be decided by the arbitral panel.

In *Jade Apparel, Inc. v. United Assur., Inc.*, 2016 N.J. Super. Unpub. LEXIS 2250 (N.J. App. Div. Oct. 13, 2016), the court found that the language contained in the parties' agreement clearly and unmistakably set forth the parties' decision to submit all disputes regarding execution, construction, enforceability and breach of the agreement to arbitration under the rules of the American Arbitration Association and, therefore, the arbitrator was to decide arbitrability. Furthermore, the *Jade Apparel* court recognized two exceptions allowing non-signatories to compel arbitration. First, a non-signatory may compel arbitration against a signatory to an arbitration agreement when an agency agreement exists between a signatory and the non-signatory against whom arbitration is sought. Second, a non-signatory may compel arbitration against a signatory to an arbitration agreement via equitable estoppel, which does not apply absent proof of detrimental reliance. Where the agreement incorporates non-signatories, an agency relationship exists and arbitration of claims involving those non-signatories is required.

While an arbitration provision-specific challenge brings the enforceability of the provision into the purview of the courts, if a delegation provision is contained in the arbitration provision, then the courts' ability to determine arbitrability is further narrowed. Indeed, in *Mike Rose's Auto Body, Inc. v. Applied Underwriters Captive Risk Assur. Co.*, No. 16-cv-1864-EMC, 2016 U.S. Dist. LEXIS 133747 (N.D. Cal. Sept. 28, 2016), the court considered whether the parties clearly and unmistakably delegated the issue of arbitrability to the arbitrator. The court ultimately found that, by incorporating the American Arbitration Association rules by reference (which have been found equivalent to a delegation provision), the parties intended to delegate adjudication of disputes concerning the validity and enforceability of the arbitration clause to the arbitrator. Therefore, because the party opposing the motion to compel arbitration challenged the entire arbitration clause rather than just the delegation provision specifically, the validity and enforceability of the arbitration clause was for the arbitrator to determine.

Finally, the Sixth Circuit Court of Appeals, in granting a stay of arbitration proceedings, reaffirmed the necessity of the arbitral panel actually deciding on issues subject to an arbitration clause. In *Ameritrust Ins. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, No. 15-1403, 2016 U.S. App. LEXIS 9731 (6th Cir. Apr. 7, 2016), the parties had appealed a district court's decision confirming part of an arbitration award while denying confirmation for the award of prejudgment interest. On the latter issue, the district court had ordered the parties to arbitration. The Sixth Circuit granted the cedent's request to stay the arbitration of the prejudgment interest

award pending the appeal, relying on the following four factors: (1) the movant's likelihood of success on appeal; (2) whether the movant will be irreparably harmed absent a stay; (3) the harm other interested parties will suffer if a stay is granted; and (4) where the public interest lies. While granting the stay, the court made clear that the stay would have no effect on the district court order referring the prejudgment interest issue to further arbitration.

Arbitration Panel Selection

The FAA does not authorize a court to remove or inquire into the capacity of any arbitrator to serve *prior* to issuance of an arbitral award, even if the challenge arises from an express term in the arbitration agreement or is based on an arbitrator's alleged bias. In *John Hancock Life Ins. Co. U.S.A. v. Employers Reassurance Corp.*, No. 15-cv-13626, 2016 U.S. Dist. LEXIS 80592 (D. Mass. Jun. 21, 2016), the court made very clear that there is no exception to this well-settled rule, following in line with decisions from the Fifth Circuit, Second Circuit and multiple district courts. The *John Hancock* court stated the following on this point: "[t]hus, based upon the express terms of the FAA, challenges to a party-appointed arbitrator, such as allegations of bias, are properly considered by courts only at the conclusion of the arbitration."

As decided in *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Odyssey Reins. Co.*, No. 162684/2014, 2016 N.Y. Misc. LEXIS 1200 (N.Y. Sup. Ct. Apr. 5, 2016), however, where the parties' arbitration clause specifically provides for judicial appointment of an umpire, "if the arbitrators fail to appoint an umpire within one month of a request in writing by either of them," the court may appoint an umpire. In this case, the reinsurer claimed possible bias or the appearance of bias in favor of the cedent. Therefore, the court had authority to – and, in fact, did – appoint an umpire who had no prior or current relationship with either party in any capacity. Of note, this decision was later reversed, but on other grounds. *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Odyssey Reins. Co.*, 143 A.D.3d 626, 626, (1st Dep't 2016).

Court Review of Arbitration Awards

Under the FAA, a court's authority to vacate or modify an arbitration award is exceedingly limited. On a factual level, there must be an evident material miscalculation or material mistake in the description of any person, thing or property referred to in the award. On a legal level, there must be something beyond and different from a mere error in law or failure on the part of arbitrators to understand and apply the law. And when it comes to the conduct of the arbitration, there must be a showing of evident partiality of an arbitrator, improper *ex parte* communications or other serious misconduct prejudicing a party's rights. Additionally, courts have narrow discretion to award fees and costs associated with review of an arbitral award. Courts in 2016 continued the pattern of limited judicial review of arbitration awards.

In *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), the 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. In denying the application to modify, the court determined that finding 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.

In *AmTrust North America, Inc. v. Pacific Re, Inc.*, No. 15 Civ. 7505 (CM), 2016 U.S. Dist. LEXIS 44889 (S.D.N.Y. Mar. 25, 2016), the court rejected an argument that arbitrators made their award in manifest disregard of the law where they applied a Montana federal district court ruling as they understood it to be. Here, the court determined that the arbitrators had "plainly applied" a Montana federal court ruling as they understood it to be and nothing about their decision constituted a manifest disregard of the law. As a policy matter, the court noted that where parties "choose to by-pass the courts," they cannot then be heard to complain if arbitrators do not reach the result they think a court would have reached. Moreover, even to the extent that the award was of an interim nature, the arbitration agreement permitted interim awards and the courts could freely confirm interim awards.

In *Nat'l Indemn. Co. v. IRB Brasil Resseguros S.A.*, No. 15 Civ. 3975 (NRB), 2016 U.S. Dist. LEXIS 30871 (S.D.N.Y. Mar. 10, 2016), a decision that has since been affirmed on appeal, No. 16-1267-cv, 2017 U.S. App. LEXIS 1686 (2d Cir. Jan. 31, 2017) (Summary Order), the district court declined to vacate an arbitration award on the ground that the umpire failed to timely disclose that he was appointed as a party-appointed arbitrator for an affiliate of the retrocedent during the period of time between his nomination as umpire (after having filled out an umpire questionnaire) and his eventual appointment (some two years later). Here, even to the extent that the umpire had served as a party-arbitrator for an affiliate of the retrocedent, he had no familial, business or employment relationships with the companies, and no financial interest in the outcome. Between the times he filled out the umpire questionnaire and was appointed, two years had elapsed, during which he had taken on 15 new assignments, and already had a roster of active and dormant cases, and was under consideration for more.

The court declined to fashion a rule whereby an umpire candidate, while waiting to find out whether the umpire appointment would come to pass, must disclose every possible conflict that might arise in all cases to all parties. Indeed, the court noted that a continuous pre-selection disclosure obligation would result in an unreasonable burden as it could "easily add up to hundreds of supplemental disclosures, and failure to make any of them would be grounds to vacate any award ultimately issued." Thus, while "evident partiality" is a basis for vacatur under Section 10 of the FAA, the party seeking vacatur bears a heavy burden. It must be shown that "a reasonable person, considering all the circumstances, would have to conclude that an arbitrator was partial to one side." *Applied Indus. Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi*, A.S., 492 F.3d 132, 137 (2d Cir. 2007) (emphasis in original). That standard was not met here.

One Circuit Court in 2016 did vacate an arbitration award in the context of misconduct prejudicing a party's rights. In *Star Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, Nos. 151403, 15-1490, 656 Fed. Appx. 240 (6th Cir. Aug. 18, 2016) (Unpublished), the Sixth Circuit, applying Michigan law, addressed whether to vacate an award based on *ex parte* communications between counsel for the reinsurer and the reinsurer's party-appointed arbitrator in violation of the arbitration panel's scheduling orders on *ex parte* communications. After analyzing earlier Michigan decisions, the panel concluded that under Michigan law, communications between a party and an arbitrator may not categorically be grounds for vacating an arbitration

award, but such communications do void an award if they violate the parties' arbitration agreement. In this case, the scheduling orders forbade the parties from communicating *ex parte* with the arbitration panel after filing their initial pre-hearing briefs. Despite that prohibition, the reinsurer's counsel and its party-appointed arbitrator had, according to the court, three *ex parte* communications. As a result of these communications, the Sixth Circuit held that the district court should have vacated the two arbitration awards of the panel.

Courts may award fees and costs incurred as a result of an arbitral award review when the contract between the parties dictates that fees and costs may be awarded or when there is a showing of bad faith. In *Yosemite Ins. Co. v. Nationwide Mut. Ins. Co.*, 16 Civ. 5290, 2016 U.S. Dist. LEXIS 157061 (S.D.N.Y. Nov. 10, 2016), the cedent sought to vacate an arbitration award based on its claim that the arbitration panel incorrectly interpreted the reinsurance contract. In response, the reinsurer sought to confirm the award, while also seeking fees and costs incurred in opposing the cedent's challenge. The court denied the cedent's request for vacatur, finding that granting vacatur would require the court to exceed the limited scope of judicial review of an arbitral decision. The court opined that it may rule on whether an arbitrator did or did not interpret the parties' contract, but not on whether the panel got its meaning right or wrong. The court then granted the reinsurer's petition to confirm, but denied the reinsurer's motion for fees and costs. Sanctions, whether sought under 28 U.S.C. §1927 or under the court's inherent power to award costs and fees, require a showing of bad faith. The court found that even when a claim is not meritorious, unless it is objectively unreasonable, it does not merit sanctions.

In *Scottsdale Ins. Co. v. John Deere Ins. Co.*, No. CV-15-00671-PHX-PGR, 2016 U.S. Dist. LEXIS 96595 (D. Ariz. Jul. 22, 2016), however, the court did award costs and fees, though it did so based strictly on the reinsurance agreement language. The cedent filed an action seeking to have the court modify or correct an arbitration award. In response, the reinsurer filed a motion to confirm the arbitration panel's award and to have a judgment entered on that award. The parties' reinsurance agreements specifically provided that, if the court entered an order confirming an arbitration award, "the attorneys' fees of the party so applying and court costs will be paid by the party against whom confirmation is sought." Therefore, the court awarded the reinsurer "its reasonable attorneys' fees and costs [that] it incurred in seeking the confirmation of the final arbitration award."

Finally, the court in *Nat'l Cas. Co. v. Resolute Reins. Co.*, No. 15 Civ. 9440 (DLC), 2016 U.S. Dist. LEXIS 38797 (S.D.N.Y. Mar. 24, 2016), addressed another aspect of the FAA, namely Section 9. Under that provision, if the parties have agreed to arbitration, any party may petition for the award to be confirmed. As long as there is no basis to vacate, modify or correct an award, the court must confirm it. Even though the reinsurer complied with a final arbitration award by promptly paying the amounts due, the cedent sought confirmation of the award.

The court granted the petition to confirm because the parties agreed to the application of the FAA and, once the statutory prerequisites of that statute were met, the court must grant the petition. It also rejected the reinsurer's claim that the amount in controversy requirement was not met for purposes of establishing federal jurisdiction because Second Circuit precedent held that prior compliance with an award is not a ground to refuse confirmation of it.

Arbitration – Contract Interpretation

In *Leonberger v. Missouri United School Ins. Council*, No. ED 103669, 2016 Mo. App. LEXIS 521 (E.D. Div. Four, May 24, 2016), the court construed the Missouri Arbitration Act, which dictates that an arbitration provision contained in an insurance contract is invalid. In determining that the contract in this case was not simply a reinsurance contract and was more like an insurance contract, the court explained that the difference between contracts of indemnity against loss and contracts of indemnity against liability is that, in the former, the insurance company does not become liable until loss has actually been suffered and the amount of the insurance does not become available until the assured has paid the loss. Reinsurance contracts, nonetheless, can be drafted so that they resemble insurance contracts, i.e., the reinsurer and cedent were co-insurers. In these situations, under Missouri law, an arbitration provision would be invalid. Additionally, while not implied in all reinsurance contracts, a reinsurance contract may be drafted in such a way as to make the cedent's insured a third-party beneficiary of the reinsurance agreement (insured could bring bad faith claim against reinsurer).

It should be noted that this case is very fact specific and very specific to Missouri law.

In *Infrassure, Ltd. v. First Mut. Transp. Assur. Co.*, No. 15-cv-08230 (GBD) (S.D.N.Y. Jan. 22, 2016), the court was asked to determine where a matter between a cedent and its reinsurer was to be arbitrated under arbitration procedures (Section U) in the facultative certificate. The reinsurer filed suit seeking a declaration that the arbitration provision contained in the body of the form of the certificate was controlling. The cedent then filed a motion to compel arbitration, asking the court to order the reinsurer to arbitrate in London, England under arbitration procedures set forth in Endorsement No. 2 to the certificate.

The court concluded that Section U set forth the arbitration procedures to disputes between the parties. Endorsement No. 2, the court found, was inapplicable because it expressly stated that it governed only disputes between cedent and "UK and Bermuda Insurers," and cedent was a Swiss insurer. The cedent appealed and the Second Circuit affirmed the district court's decision, holding that the reinsurance certificate was not ambiguous. *Infrassure, Ltd. v. First Mut. Transp. Assur. Co.*, 842 F.3d 174 (2d Cir. 2016). The court found that the arbitration clause in the body of the certificate controlled; it was not displaced by the endorsement because the endorsement was expressly limited to UK and Bermuda insurers. The court also rejected cedent's argument that the title of the clause required the court to ignore the context provided by the title of the endorsement.

"Follow-the-Settlements" Doctrine

Under the follow-the-settlements doctrine, a reinsurer must accept the cedent's good faith decisions on all things concerning the underlying insurance terms and claims against the underlying insured, including settlements and settlement allocation. *Utica Mut. Ins. Co. v. Clearwater Ins. Co.*, No. 6:13-cv-1178 (GLS/TWD), 2016 U.S. Dist. LEXIS 6219 at *10 (N.D.N.Y. Jan. 20, 2016) (citations omitted). As long as the cedent settles in good faith, reasonably and within the applicable policies, the reinsurer is bound by the settlement and cannot relitigate the underlying coverage disputes. *Id.* at *11 (citations and quotation marks omitted).

In *Utica*, the cedent issued multiple primary and umbrella insurance policies to the insured. The cedent reinsured the umbrella policies and the reinsurer had those retroceded. Beginning in 1997, more than 140,000 claims were filed against the insured alleging asbestos-related bodily injuries attributed to the insured's pump products. The insured brought two suits against the cedent regarding its coverage obligations. One issue in dispute concerned whether the primary policies contained an aggregate limit. The cedent settled these cases, concerned that the court would determine that no aggregate limit existed.

Several years later, cedent began to bill its reinsurer for indemnity and defense costs from its umbrella policies issued to the insured. After the reinsurer failed to pay all of the costs, the cedent brought suit. Seeking summary judgment, the cedent argued that the reinsurer was bound by cedent's settlement with the insured under the follow-the settlements doctrine. The reinsurer argued that the cedent acted in bad faith, therefore in violation of the follow-the settlements doctrine. The court rejected the reinsurer's bad faith argument, finding that a cedent has no obligation to strictly align its interests with the reinsurer. Also, held the court, a cedent is not required to choose the settlement allocation that minimizes its reinsurance recovery to avoid a finding of bad faith. And the cedent's decision to enter into a settlement was reasonable in light of the uncertain liability of the lawsuit brought by the insured. The court granted cedent's motion for summary judgment, thus continuing the trend in enforcing the follow-the-settlements doctrine.

In contrast, in *Granite State Ins. Co. v. Clearwater Ins. Co.*, No. 653546/11, 2016 N.Y. Misc. LEXIS 2314 (Sup. Ct., N.Y. Co. Jun. 17, 2016), a New York motion court ruled that the specific language in a facultative certificate was not a follow-the-settlements clause. Instead, the court held that it was a "following form" condition, i.e., for the purpose of achieving concurrency between the reinsured contract and the reinsured policy. *Id.* at *26. The clause stated that reinsurer's liability "shall follow [the cedent's] liability in accordance with the terms and conditions of the policy reinsured hereunder." *Id.* at *25. According to the court, it did not contain language one would expect in follow-the-settlement clauses, referring in some way to cedent's claims handling decisions, such as the use of terms "settlement," "compromise" or "allowance." As a result, the court found that the reinsurer could challenge cedent's allocation of insurance proceeds to the underlying claims, on a theory that cedent cannot prove that the losses it allocated to the certificate were actually covered by the certificate.

Bellefonte

In 2016, two courts dealt with application of the *Bellefonte* Principle. In *Utica Mut. Ins. Co. v. Abeille Gen. Ins. Co.*, No. CA2013-002320 (N.Y. Sup. Ct., Oneida Cty., Aug. 15, 2016), a group of reinsurers brought a partial motion of summary judgment on one of their affirmative defenses seeking to "dismiss[] the complaint filed by [cedent]… insofar as it seeks amounts in addition to the stated limits of the applicable reinsurance certificates." Cedent's claim included loss adjustment expenses in excess of the coverage amount stated in the reinsurance certificates issued by the reinsurers. The cedent presented no evidence other than the reinsurance certificates.

The court agreed with the reinsurers that there was nothing ambiguous regarding the certificates, thus no extraneous evidence could be relied upon. Accordingly, reinsurers' total liability was limited to the amount of coverage stated in the certificates and did not include loss adjustment and legal expenses in excess of the stated coverage amount. The reinsurers were entitled to partial summary judgment on their third affirmative defense pertaining to a cap on liability "for both loss and expenses" in the face amount of the reinsurance certificates.

Contrasting Utica's traditional Bellefonte ruling is the Second Circuit Court of Appeals decision in *Global Reins. Corp. of Am. v. Century Indemn. Co.*, 843 F.3d 120 (2d Cir. 2016). In this case, the dispute was about the extent to which the reinsurer was obliged to reinsure cedent under certain reinsurance certificates. The reinsurer made the traditional *Bellefonte* argument that the dollar amounts under the "Reinsurance Accepted" portion of the certificates unambiguously capped the amount the reinsurer was obligated for both losses and expenses. The cedent argued that those limits only applied to losses and that the reinsurer was required to pay all expenses in addition to the limits.

The reinsurer moved for partial summary judgment seeking a declaration that its interpretation of the certificates was correct. On summary judgment, the district court sided with the reinsurer, relying upon *Bellefonte Reinsurance Co. v. Aetna Casualty & Surety Co.*, 903 F.2d 910 (2d Cir. 1990) and *Unigard Security Ins. Co. v. North River Ins. Co.*, 4 F.3d 1049 (2d Cir. 1993). In both cases, the Second Circuit ruled that the reinsurers were not obligated to pay expenses over and above the limits of liability stated in the certificates.

The cedent appealed, arguing that *Bellefonte* and *Unigard* were wrongly decided. The cedent claimed that the certificates should be interpreted to cover both loss and expenses because the certificates follow form to underlying policies, and the underlying policies expressly provide for payment of expenses in addition to loss. The cedent was supported by *amici* briefs filed by several reinsurance intermediaries. Noting that the cedent's argument "is not without force," the Second Circuit rejected the reinsurer's contention that *Excess Insurance Co. v. Factory Mutual Co.*, 3 N.Y.3d 577 (2004), was controlling because it did not explicitly address whether a stated limit represented a coverage limit for losses and expenses combined. The court further distinguished *Excess* because the expenses related to the cedent's cost of litigating with the underlying insured, not the insured's defense costs.

After questioning its own precedents and analyzing both sides of the debate, the Second Circuit certified the following question to the New York Court of Appeals: "Does the decision in of the New York Court of Appeals in *Excess Ins. Co. v. Factory Mut. Ins. Co.*, 822 N.E.2d 768 (2004) impose either a rule of construction, or a strong presumption, that a per occurrence liability cap in a reinsurance contract limits the total reinsurance available under the contract to the amount of the cap regardless of whether the underlying policy is understood to cover expenses such as, for instance, defenses costs?"

The answer to the certified question, while solely relevant to New York law, may cause the Second Circuit to rethink its precedents even more. Given the widespread adoption of the *Bellefonte* Principle by many courts, the ultimate decision here may have wide-ranging ramifications.

Late Notice

Another reinsurance trend in 2016 was case law addressing "late notice." In *R&G Reins. Co. v. St. Paul Fire & Marine Ins. Co.*, Case No. 15-cv-7784, 2016 U.S. Dist. LEXIS 42489 (N.D. Ill. Mar. 30, 2016), the reinsurer filed a complaint for declaratory judgment against cedent asking the court to find it had no obligation to pay cedent because cedent's notice of loss was not timely. A month later, the cedent filed a parallel suit for damages against the reinsurer in the Eastern District of Pennsylvania. Cedent asked the Northern District of Illinois to transfer the case to the Eastern District of Pennsylvania. One aspect the court looked at in determining whether transfer was proper was the situs of material events. The court held that, in a breach of contract case, the location where the business allegedly causing a breach occurred is more relevant than the location of contract formation. The court further held that, in a case involving late notice, the primary factual inquiry is when the cedent became obligated to notify the reinsurer. Material events would include communications between the cedent and its underlying insured because this information would put cedent on notice of the need to file a claim with the reinsurer. As the bulk of these material events occurred in areas much closer to or in Pennsylvania, this favored transfer.[1]

In *Granite State Ins. Co. v. Clearwater Ins. Co.*, No. 653546/11, 2016 N.Y. Misc. LEXIS 2314 (Sup. Ct., N.Y. Co. Jun. 17, 2016), discussed above in the context of follow-the-settlements, after the cedent issued dozens of policies to the insured, the cedent entered into an agreement with the reinsurer who subsequently entered into retrocessional contracts with its reinsurer. Subsequently, hundreds of thousands of bodily injury claims were brought against insured. Insured brought suit against its insurers, including the cedent, in 2000. The cedent did not bill its reinsurer until 2010 when payments first began to be allocated under the original policy. No specific or formal notice of any kind was made to the reinsurer prior to 2010. When the reinsurer declined payment, the cedent brought this lawsuit.

The reinsurer claimed that the cedent unreasonably delayed informing reinsurer of the likelihood that the original policy limits would be reached, causing reinsurer to be substantially prejudiced. The court first dealt with cedent's claim that the reinsurer had waived its right to assert the cedent's alleged delay in notifying the reinsurer of the exhaustion of the original policy in light of reinsurer's two-year delay in denying coverage on the basis of late notice. Following California law, the court applied the standard that an insurer waives defenses to coverage not asserted in its denial only if the insured can show misconduct by the insurer or detrimental reliance by the insured. Finding neither of these, it held that the reinsurer did not waive its defense that cedent failed to give prompt notice of the approaching exhaustion of the original policy.

The court next examined whether the reinsurer had received constructive notice that the original policy would likely be exhausted. The court found the reinsurer had not. Cedent provided various documents, claiming these advised the reinsurer sufficiently of the state of the original litigation to put the reinsurer on adequate inquiry notice that the original policy would likely be exhausted. The court rejected the argument, finding that the documents were insufficient to put the reinsurer on notice of the likely exhaustion of the original policy as they merely recounted the nature of the insured's original claims and that many insurance policies were affected by the original litigation.

Finally, the court looked at whether the reinsurer was prejudiced by the cedent's late notice. The reinsurer claimed it was prejudiced because it made a disadvantageous commutation with its retrocessionaire. The reinsurer claimed it would not have commuted had it known of its exposure under the certificate. The court pointed to a case that expressly found that a failure to collect from a retrocessionaire is a "collateral matter" and found no case law to support the proposition that collateral matters may constitute prejudice so as to relieve an insurer from its liability. So, while the court found that the reinsurer had demonstrated cedent's failure to provide timely notice, the reinsurer failed to show the "actual and substantial" prejudice that would allow it to avoid its obligations under the certificate.

Contract Interpretation

There were several examples of contract interpretation matters in reinsurance cases in 2016. For example, in *Hartford Steam Boiler Insp. & Ins. Co. v. Int'l Glass Prods., LLC.*, No. 2:08 cv 1564, 2016 U.S. Dist. LEXIS 135045 (W.D. Pa. Sept. 29, 2016), the reinsurer brought suit against the policyholder of the reinsured policy. Having paid substantial claims through the cedent, the reinsurer brought multiple claims against the policyholder. The court granted the policyholder's motion for summary judgment on the basis that the reinsurer, as a party to the reinsurance treaty with the cedent, lacked contractual privity with the policyholder and had no contractual rights relative to the underlying policy. This case represents the reverse of the typical situation where the policyholder seeks to bring a direct claim against a reinsurer and is denied because of lack of contractual privity.

In *NEM Re Receivables, LLC v. Fortress Re, Inc.*, 173 F. Supp. 3d 1 (S.D.N.Y. 2016), the assignee of a reinsurer's receivables brought suit against an agent and manager for insurance companies who participated in a reinsurance pool, seeking an accounting and for breach of contract for amounts owed to it under an assignment received in 2004. The court rejected the assignee's argument, finding that it had provided no evidence that the parties were in a relationship of sufficient trust and confidence to create a fiduciary duty or a confidential relationship. The court also found that a claim for accounting in this instance was not proper because the assignee

[1] In the action filed by St. Paul, the district court dismissed without prejudice St. Paul's complaint based on the first-filed rule. *St. Paul Fire & Marine Ins. Co. v. R & Q Reinsurance Co.*, No. 15-cv-5528, 2016 U.S. Dist. LEXIS 72136 (E.D. Pa. Jun. 2, 2016). See the discussion below.

also sought a breach of contract claim. As to the breach of contract claim, it was subject to a six-year statute of limitations that began running in 2004 when it received the legal right to demand payment. This expired in 2010.

In *Pine Top Receivables of Ill., LLC v. Transfercom, Ltd.*, 836 F.3d 784 (7th Cir. 2016), two reinsurance treaties were in dispute. Each treaty contained a service-of-suit clause. The cedent sued in state court, alleging that the reinsurer breached its duty to pay on the two treaties. The reinsurer removed the matter to federal court. The cedent moved to remand, arguing that the reinsurer waived the right to remove based on the language of the service-of-suit clause. The clause stated that if the reinsurer failed to pay any money claimed to be due under the reinsurance agreements, the reinsurer, at the request of the cedent, "will submit to the jurisdiction and will comply with all 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 court found that this constituted a waiver of the right to remove the case to federal court.

Pre-Pleading Security

A cedent filed suit against its reinsurer for breach of the reinsurance contract in *Select Ins. Co. v. Excalibur Reinsurance Corp.*, No. 15 CV 715 (JAM), 2016 U.S. Dist. LEXIS 31264 (D. Conn. Mar. 10, 2016). Two weeks later, cedent filed a Motion for Pre-Pleading Security when the reinsurer had not posted its pre-pleading security, despite having filed its answer. Pre-pleading security is a mandatory statutory requirement, intended to ensure that any insurer, domestic or foreign, selling insurance or reinsurance to a person in Connecticut will have sufficient assets to satisfy any judgment. Thus, under Connecticut law, before an unauthorized insurer can file a pleading in a case brought against it, it must either post a pre-pleading security, procure the proper authorization to do business in Connecticut, or seek an order from the court dispensing with the pre-pleading security requirement. Here, the reinsurer repeatedly tried to argue that the pre-pleading security statute was substantive, not procedural and, thus, the choice-of-law provision in the reinsurance contract should govern. The court rejected this, ultimately concluding that the statute is a procedural rule that is not controlled by the reinsurance agreement's choice of law provision. The reinsurer had to pay the security, which would be determined in a future hearing.

Calculation of Interest on Breach of Reinsurance Contract Claim

A New York federal court in 2016 addressed the method of calculating prejudgment interest after awarding monetary damages to the cedent. In *Utica Mut. Ins. Co. v. Clearwater Ins. Co.*, No. 6:13-cv-1178 (GLS/ TWD), 2016 U.S. Dist. LEXIS 91413 (N.D.N.Y. Jul. 14, 2016), the court noted that, under New York law, there were two bases to calculate interest: (a) computing interest for each item from the date it was incurred or (b) computing interest upon all of the damages from a single reasonable intermediate date. The court opted to use the intermediate date methodology and calculated a midpoint between the disputed positions. This case evidences the difficulty courts often face in calculating prejudgment interest, particularly when damages are incurred at various times and there are multiple different breaches.

Statute of Limitations

Claims for breach of reinsurance treaties accrue under their contractual terms, and these claims are subject to the statute of limitations.

The Illinois statute of limitations for claims arising from written contracts is 10 years. The court in *Pine Top Receivables of Ill., LLC v. Banco Seguros del Estado*, 2016 U.S. Dist. LEXIS 70462 * (N.D. Ill. May 31, 2016), examined the application of this rule where the parties entered into numerous agreements that contained account billing provisions. The reinsurer entered into liquidation and the cedent sat on its "otherwise ripe contract claims." The cedent attempted to argue that parties to reinsurance contracts typically do not comply with their accounting provisions once a party enters liquidation, and so the 10-year limitation did not accrue. The court found that this argument lacked merit, holding that a liquidation set-off provision does not operate to delay accrual of otherwise ripe contract claims nor does it blunt the impact of a general statute of limitations in any way.

In Alabama, however, the statute of limitations has a caveat. A party can allege compulsory counterclaims that would otherwise be barred by the statute of limitations, if the underlying causes of action are timely, i.e., all compulsory counterclaims, whether offensive or defensive, are not subject to the statute-of-limitations defense, if the initial claims triggering the compulsion to file the counterclaims are timely. *Regions Bank v. Old Republic Union Ins. Co.*, 2016 U.S. Dist. LEXIS 108041, *8, 2016 WL 4366871 (N.D. Ala. Aug. 16, 2016).

Discovery of Reinsurance Information

Courts in 2016 consistently ruled that reinsurance agreements should be treated as insurance agreements that are subject to disclosure under Federal Rule of Civil Procedure 26(a)(1)(A)(iv). *See First Horizon Nat'l Corp. v. Houston Cas. Co.*, No. 2:15-cv-2235-SHL-dkv, 2016 U.S. Dist. LEXIS 142330, at *45 (W.D. Tenn. Oct. 5, 2016) (compelling the production of the cedents' reinsurance agreements under Rule 26(a)(1)(A)(iv)); *Certain Underwriters at Lloyd's v. AMTRAK*, No. 14-CV-4717 (FB), 2016 U.S. Dist. LEXIS 64088, at *67 (E.D.N.Y. May 16, 2016).

There was also a trend to liberally apply federal work product protections to reinsurers. In *Amtrust N. Am., Inc. v. Safebuilt Ins. Servs., Inc.*, No. 14-CV-9494 (CM) (JLC), 2016 U.S. Dist. LEXIS 75906, at *16 (S.D.N.Y. June 10, 2016), the court applied the work product doctrine to protect from disclosure a reinsurer's communications with an outside auditor. The court found that the auditor was hired in anticipation of litigation, noting that whether an attorney advised the reinsurer to hire an auditor is not determinative. Id. at *12. The trend continued in *Ooida Risk Retention Grp., Inc. v. Bordeaux*, No. 3:15-cv-00081-MMD-VPC, 2016 U.S. Dist. LEXIS 12851, at *25–28 (D. Nev. Feb. 3, 2016), where the court determined that federal work product protections extend to communications between a defendant cedent and its reinsurer under the common interest doctrine.

Another trend that can be seen in three cases decided last year is that courts will protect information held by a reinsurer unless the discovering party makes an adequate showing that the material sought is relevant. In *First Horizon Nat'l Corp.*, the court denied the insured's request for communications between the cedents and their reinsurers because the communications were not relevant to the plaintiff's claims and merely reflected business information relating to the cedents' decision to spread their risks. 2016 U.S. Dist. LEXIS

142330, at *42–45. Similarly, in *Certain Underwriters at Lloyd's*, the court denied the insured's request for communications between cedent and its reinsurer. There, the cedents sued the insured for declaratory relief. The court ruled that the insured failed to explain how the communications with the reinsurer were needed to identify policies or terms in the insurance contracts. 2016 U.S. Dist. LEXIS 64088, at *20–23.

But in *Western Ins. Co. v. Rottman*, No. 2:13-CV-436-DAK, 2016 U.S. Dist. LEXIS 180161, at *9–10 (D. Utah Dec. 29, 2016), the court ruled that the insurer had to produce its reinsurance policy, payment and settlement information. There, the insurer admitted that the information was relevant by arguing that the defendants should have caused reinsurance claims to be made before the litigation and that their failure to do so resulted in losses.

In *Amtrust N. Am., Inc. v. Safebuilt Servs., Inc.*, 186 F. Supp. 3d 278, 279 (S.D.N.Y. 2016), the court noted that it was continuing the trend of declining to recognize a general insurance-examination privilege. There, the defendant captive reinsurance companies asserted under Montana law a statutory state-law privilege over an examination report and related material. The court rejected the defendants' privilege claims, stating that the statutory provision did not expressly create a privilege nor did case law reviewing similar statutes prohibit disclosure of the material.

Jurisdiction and Venue

During 2016, courts demonstrated that they will carefully scrutinize a party's contacts with a forum state in deciding whether specific personal jurisdiction exists. In *Am. Ins. Co. v. R&Q Reinsurance Co.*, No. 16-cv-03044-JST, 2016 U.S. Dist. LEXIS 141467, at *8 (N.D. Cal. Oct. 12, 2016), the court dismissed the cedent's claims against its reinsurer. The court determined that neither the reinsurer's contracting with a California company nor its contacts with the cedent's California office made while adjudicating the cedent's claims created personal jurisdiction. Id.

In *Nat'l Indemn. Co. v. Companhia Siderurgica Nacional S.A.*, No. 15-752 (JLL), 2016 U.S. Dist. LEXIS 14873, at *46 (D.N.J. Feb. 8, 2016), the court denied a motion to dismiss a declaratory judgment action brought against a Brazilian company, CSN. There, the retrocedent entered into an arrangement with a New Jersey reinsurance broker to obtain retrocessional coverage. When the retrocedent was unable to pay its premium, CSN paid it. Several years later, the retrocedent disclaimed that it had entered into retrocessional agreement and CSN sought the return of the premium. The retrocessionaire sought a declaration that the retrocessional contract was enforceable and also filed tort claims alleging, among other things, that CSN had tortiously interfered with its retrocessional contract. The court found that a meaningful link existed between CSN's contacts with New Jersey and the retrocessionaire's request for declaratory relief, but that its tort claims were not sufficiently related to CSN's New Jersey contacts.

A Pennsylvania court showed that it was not apt to allow parties to play games by using the first-filed rule to dismiss a complaint. In *St. Paul Fire & Marine Ins. Co. v. R&Q Reinsurance Co.*, No. 15-5528, 2016 U.S. Dist. LEXIS 72136, at *14 (E.D. Pa. June 2, 2016), the court dismissed a cedent's action against its reinsurer. The reinsurer had filed a declaratory judgment action against the cedent in Illinois federal court. The cedent moved to transfer venue to Pennsylvania. While that motion was pending, the cedent filed a declaratory judgment action in Pennsylvania. The Illinois federal court transferred to Pennsylvania, the venue of the reinsurer's action, concluding that the location where "the business decisions allegedly causing a breach occurred [were] more relevant than the location of contract formation." *Id.* at *4. The Pennsylvania federal court dismissed cedent's complaint, concluding that the suits substantially overlapped and that cedent identified no exception to the first-filed rule. *Id.* at *8–14.

Preemption

In *Ludwick v. Harbinger Group, Inc.*, 161 F. Supp. 3d 769 (W.D. Mo. 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 overlapped with state insurance regulators' responsibilities and powers and were, therefore, preempted. Under the McCarran-Ferguson Act, "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance…unless such Act specifically relates to the business of insurance." 15 U.S.C. §1012(b). Moreover, on the issue of reverse preemption, the court followed Eighth Circuit precedent, which holds that RICO claims are reverse preempted where a private right of action under the state insurance code is unavailable. Under the respective insurance codes of Iowa and Missouri, there were no private rights of action; thus, the availability of common law remedies under those states' laws did not save the RICO claim from reverse preemption.

Intermediaries

In *Boomerang Recoveries, LLC v. Guy Carpenter & Co., LLC*, 182 F. Supp. 3d 212, 215 (E.D. Pa. 2016), an auditor concluded that the cedent had been overcharged by its reinsurer. An intermediary performed an independent review, concluding that the auditor failed to offset the premiums that the cedent owed to its reinsurers. The auditor, who was supposed to collect a percentage of the overcharges recovered, sued the intermediary in state court for, among other things, tortious interference with a contractual relationship, commercial disparagement and unfair competition. *Id.* at 216. The intermediary removed the action to federal court. The district court did not reach the merits of the intermediary's claim, but instead remanded the action back to state court on the basis of the forum-defendant rule. *Id.* at 220. This case remains pending in state court.

Recent Speeches and Publications

Larry Schiffer spoke on "Mediating/Arbitrating Disputes Among Insurers and Reinsurers," at the American Bar Association's Tort, Trial & Insurance Practice Section's Day at Lloyd's III program on February 7, 2017 in New York.

Larry Schiffer will be speaking at the Stafford Publications live webinar, "Construction OCIP/CCIP Insurance Programs: Potential Coverage Gaps and Other Coverage Pitfalls," on April 4, 2017.

John Nonna and Larry Schiffer are two of the co-chairs for the ARIAS•U.S. Spring Conference taking place from May 3 to 5, 2017, in Naples, Florida. Eridania Perez will be participating in a Rapid Fire case presentation at the same conference.

Larry Schiffer's Reinsurance Commentary, "Exclusive Arbitral Authority Dangers in Reinsurance Contracts," was published on IRMI.com in December 2016.

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