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Reinsurance Newsletter

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Recent Case Summaries

New York Court of Appeals Answers Certified Question in the Negative

Global Reinsurance Corp. of Am. v. Century Indemn. Co., No. 124, 2017 N.Y. LEXIS 3723 (N.Y. Ct. of App. Dec. 14, 2017).

On November 15, 2017, the New York Court of Appeals heard argument in a so-called *Bellefonte* case, which came to the court about a year ago as a certified question from the Second Circuit Court of Appeals. The question the Second Circuit asked the New York Court of Appeals to answer was: "Does the decision of the New York Court of Appeals in [*Excess*] 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?" *Excess* refers to *Excess Ins. Co., Ltd. v. Factory Mutual Ins. Co.*; a case that many observers believed put New York law squarely in the *Bellefonte* column.

In its December 14, 2017 decision, the New York Court of Appeals answered the Second Circuit's certified question in the negative. No, said the court. "Under New York law generally, and in *Excess* in particular, there is neither a rule of construction nor a presumption that a per occurrence liability limitation in a reinsurance contract caps all obligations of the reinsurer, such as payments made to reimburse the reinsured's defense costs." The opinion, written by Judge Feinman who asked several questions at oral argument, was unanimous. The opinion is a mini-treatise on reinsurance law, and on insurance and reinsurance contract interpretation.

A couple of interesting points come out of the decision. First, although the certified question did not explicitly limit itself to facultative reinsurance – a concern that many had when reading the Second Circuit's decision – the New York Court of Appeals took the question to be solely about facultative reinsurance and not about reinsurance treaties, "which do not have a single 'underlying policy.'"

Second, the court never mentioned *Bellefonte*. The opinion hewed closely to *Excess* and what *Excess* held under New York law. The court recognized that, while in *Excess* it did not say that defense costs under a facultative certificate are unambiguously or presumptively capped by the liability limits of the certificate, some courts read Excess that way. As stated by the court, "[w]e now dispel any intimation that Excess established such a rule."

The court explained that, in *Excess*, it focused on the limited context of that case and the specific contract wording and was not faced with the question of whether there was some blanket rule or presumption. "Critically, we did not read the limit clause in isolation, but in light of the entire agreement as an integrated whole, 'giv[ing] meaning to every sentence, clause and word' thereof" (citations omitted). The court also noted that the expenses in *Excess* were incurred in coverage litigation and not as third-party defense costs, so the issue of whether the following form clause subjected the reinsurer to the same terms as the original policy so as to require the reinsurers to cover defense costs in excess of the limit was not at issue.

To be clear, the court stated, "[w]e hold definitively that *Excess* did not supersede the 'standard rules of contract interpretation' . . . otherwise applicable to facultative reinsurance contracts." (Citation omitted). The court read *Excess* in harmony "with the traditional rules of contract interpretation reiterated numerous times by this Court." The latter comment is followed by a string of New York Court of Appeals citations, but also alludes to its recent decision in *Viking Pump*, where the court rejected another attempt at a blanket rule.

The court concluded with a few more statements that are important. First, it reiterated, "New York law does not impose either a rule, or a presumption, that a limitation on liability clause necessarily caps all obligations owed by a reinsurer, such as defense costs, without regard for the specific language employed therein." That, of course, does not mean that reinsurers now lose and ceding companies now win. It means that New York courts have to look at the words and context of the specific contract, read it in harmony as a whole and determine on a specific basis whether defense costs are payable outside the facultative certificate's liability limit. Second, the court emphasized that it was asked only to decide a narrow issue – the certified question about *Excess* – and nothing else.

The next step is for the Second Circuit, now that it has its certified question answered, to determine how the facultative certificate will be interpreted, not based on a presumption, but based on the specific words of the specific contract. Briefs were submitted to the circuit court on February 9 at the request of the court so that the parties could tell the court how the New York Court of Appeals' answer to the certified question applies in the case.

Texas District Court Refuses to Abstain and Orders Transfer of Venue Based on Reinsurance Agreement's Forum Selection Clause on Motion to Compel Arbitration

Gramercy Ins. Co. v. Contr.'s Bonding, Ltd., No. AU-17-CA-00723-SS, 2018 U.S. Dist. LEXIS 8674 (W.D. Tex. Jan. 19, 2018).

This matter started in 2012 when the reinsurer began to experience financial difficulties. After the reinsurer was placed in receivership, the receiver issued a written demand to the cedent alleging the cedent owed the reinsurer upwards of US$1 million under the parties' reinsurance agreement and brought an action in state court to recover the amount due. The cedent removed the action to federal court, moved to compel arbitration and sought to transfer the case to a district court in Georgia pursuant to the forum selection clause in the reinsurance agreement.

In an effort to remand the case back to state court, the reinsurer argued that that court should abstain from exercising jurisdiction over the matter. The court found that abstention was inappropriate because the Federal Arbitration Act (FAA) does not provide the court discretion on the cedent's motion to compel arbitration. The reinsurer argued that, under the McCarran-Ferguson Act, state law reverse preempted the FAA and that the FAA was inapplicable because the cedent waived its right to arbitration.

The court found that Texas' insurance regulatory scheme did not reverse preempt the FAA under the McCarran-Ferguson Act. Although Texas Insurance Code § 443.005(e) explicitly condoned the parties' contractual right to arbitration, the FAA did not invalidate, impair or supersede the state law and, therefore, the court held that it lacked discretion to abstain.

As for the forum selection clause in the reinsurance agreement, the reinsurer did not contest the validity of the clause. Instead, the reinsurer argued that the clause did not apply because the current proceedings were not "proceedings to compel, stay or enjoin arbitration" as required by the reinsurance agreement. The court found that, because the reinsurer's motion to remand had been disposed of and the only pending motion was the cedent's motion to compel arbitration, the current proceedings complied with the language contained in the reinsurance agreement and ordered the case transferred to Georgia.

California Appellate Court and New York Trial Court Each Find That, Under the McCarran-Ferguson Act, the FAA Was Reverse Preempted by State Law

Citizen of Humanity, LLC v. Applied Underwriters, Inc., 226 Cal Rptr. 3d 1 (Cal App. 2017);

Mimar Food Grp. II, LLC v. Applied Underwriters, Inc., 2017 N.Y. Misc. LEXIS 4634 (N.Y. Sup. Dec. 5, 2017).

Two state courts reached substantially similar conclusions when addressing the convergence of the FAA, the Nebraska Uniform Arbitration Act (NUAA) § 25-2602.01(f)(4) and the McCarran-Ferguson Act, when deciding whether an arbitration and delegation provision in a Reinsurance Participation Agreement was enforceable.

In both cases, each plaintiff was the purchaser of workers' compensation insurance. Under the workers' compensation program, affiliated companies issued workers' compensation policies while other affiliates entered into reinsurance agreements with a related reinsurance company. The reinsurer then entered into a reinsurance participation agreement with the policyholders, which it was argued made the policyholders a party to the reinsurance agreements.

The reinsurance participation agreements each contained an arbitration clause and a statement that the reinsurance participation agreement was to be governed and construed in accordance with Nebraska law. Each arbitration clause also included a delegation provision, stating that the arbitrator should decide the issue of arbitrability. The plaintiffs sued in state court alleging various fraud claims relating to the program and the defendants moved to compel arbitration.

The courts each noted that the FAA favors the general enforceability of arbitration provisions. The McCarran-Ferguson Act, however, endowed states with plenary authority over the regulation of insurance and, in certain circumstances, exempts state laws from FAA preemption. The NUAA exempts from enforceability arbitration provisions in "any agreement concerning or relating to an insurance policy." Both courts recognized the conflicts between the FAA, McCarran-Ferguson and NUAA. Thus, as a threshold issue, each court needed to determine the gateway question of whether a court or an arbitrator should decide the issue of arbitrability before it could decide whether the FAA compelled arbitration.

The courts applied McCarran-Ferguson and recognized that Nebraska law could invalidate the entire arbitration clause, including the delegation provision. The courts, therefore, held that courts should resolve the issue of arbitrability. Each court determined that, under Nebraska law, the reinsurance participation agreement was an agreement concerning or relating to insurance and, thus, the enforceability of the arbitration provision under the FAA was reverse preempted by state law. Each court, therefore, determined that it was appropriate to deny the defendants' motion to compel arbitration.

New York Federal Court Upholds Judgment Against Retrocedent

Nat'l Indemn. Co. v. IRB Brasil Resseguros S.A., No. 15 Civ. 3975 (NRB), 2018 U.S. Dist. LEXIS 17819 (S.D.N.Y. Jan. 23, 2018).

A New York federal court upheld a motion to enforce a judgment in favor of the retrocessionaire and against the retrocedent. Prior arbitration proceedings considered and found that retrocessionaire had reinsured the retrocedent for the appropriate time, despite retrocedent's representations to the policyholder during settlement negotiations. As a result, the arbitration panel required the retrocedent to hold harmless and indemnify the retrocessionaire against any claim brought by the underlying policyholder for recovery of a premium paid directly to retrocedent. This award, along with two others, was confirmed by the New York federal court.

The policyholder subsequently brought litigation against retrocessionaire for recovery of premium. This litigation ultimately settled. The retrocessionaire then sought indemnification from retrocedent for the settlement with the policyholder under the arbitration award. The retrocedent refused to indemnify, causing the retrocessionaire to file the motion to enforce the judgment entered after confirming the award.

In granting the enforcement motion, the court noted that the obligation to indemnify was not a contractual agreement between the retrocessionaire and the retrocedent, but rather, a court order. Therefore, the obligation was not properly characterized as "an insurer's obligation to indemnify."

Ultimately, the court granted the retrocessionaire's motion to enforce judgment against the retrocedent for indemnification of the settlement reached between the retrocessionaire and the policyholder.

Pennsylvania Federal Court Dismisses Policyholder Claims Against Reinsurer

Three Rivers Hydroponics, LLC. V. Florists' Mut. Ins. Co., No. 2:15-cv-00809, 2018 U.S. Dist. LEXIS 20699 (W.D. Pa. Feb. 8, 2018).

A Pennsylvania federal court dismissed three counts of an amended complaint against a reinsurer in an insurance coverage action. The policyholder sued its insurance company for coverage after damage to its hydroponic farm. Because its carrier's reinsurer had claim investigation responsibility, it brought claims against the reinsurer for breach of contract, bad faith and civil conspiracy. The reinsurer move to dismiss the claims.

In granting the motion, the court concluded that the amended complaint failed to allege a contract between the policyholder and the reinsurer. On its face, the policyholder was not a party to the reinsurance agreement. The court found that nothing in the reinsurance agreement relieved the cedent of its obligations to the policyholder. Also, the court found that the reinsurer did not directly assume any of the cedent's obligations to the policyholder under the policy. Because there was no privity, the claim was dismissed.

The court also held that there was no third-party beneficiary status. The court noted that the reinsurance agreement did not express and intention to benefit the policyholder. Moreover, said the court, the reinsurance contract was entered into more than 12 years before the cedent issued the policy to the policyholder. Because there was no express intention in the reinsurance agreement to benefit the policyholder, the court concluded that there was no third-party beneficiary status in this case.

The court rejected the idea that the claims investigation role would require a different result. The court stated that the policyholder had failed to explain convincingly why the reinsurer filing both the reinsurer and claims investigator roles is different from an insurer obtaining a reinsurer and a separate claims adjuster.

The court also dismissed the bad faith claim, concluding that the cedent, not the reinsurer, was the policyholder's insurer for the purposes of bad faith under Pennsylvania law. Finally, the court dismissed the conspiracy claim because breach of contract is not a tort and does not qualify as an act underlying a conspiracy claim. The court held that the amended complaint did not show the required malice, especially given the allegations that the cedent and reinsurer conspired for the sole purpose of minimizing their losses and maximizing their profits.

New York Federal Court Rejects Reinsurance Claims Brought Under State Sponsor of Terrorism Exception of the Foreign Sovereign Immunities Act

Cont'l Cas. Co. v. Al Quaeda Islamic Army (In re Terrorist Attacks Sept. 11, 2001), No. 03-MDL-1570, 2017 U.S. Dist. LEXIS 196192 (S.D.N.Y. Nov. 27, 2017).

A New York federal court refused to award a default judgment against the Islamic Republic of Iran for damage claims for reinsurance claims paid after the September 11, 2001 terrorist attacks on the United States. The "state sponsor of terrorism exception" of the Foreign Sovereign Immunities Act authorizes "actions [to] be brought for reasonably foreseeable property loss, whether insured or uninsured, third party liability, and loss claims under life and property insurance policies." The court, however, held that plaintiffs, as reinsurers, could not recover under this exception the US$305 million in claims paid out under their reinsurance contracts.

The court reasoned that a reinsurance contract operates solely between the reinsurer and the reinsured, and confers no rights on the policyholder. Under the equitable doctrine of subjugation, an insurer is entitled to "stand in the shoes" of its insured and seek indemnification from third parties whose wrongdoing has caused a loss for which the insurer is contractually bound to reimburse.

Reinsurers, however, have no contractual obligation to the policyholder who suffered the initial loss or damage and, therefore, have no subrogation rights. Because the "reasonably foreseeable property loss" was sustained not by their reinsureds, but by the policyholders, the reinsurers cannot equitably subrogate to and "stand in the shoes" of the policyholders' claims. Thus, the reinsurers were not entitled to recover the money paid under their reinsurance contracts.

Economic Loss Doctrine Bars Breach of Fiduciary Duty and Negligence Claims

Holborn Corp. v. Sawgrass Mut. Ins. Co., No. 16-cv-09147 (AJN), 2018 U.S. Dist. LEXIS 7848 (S.D.N.Y. Jan. 17, 2018).

A cedent brought claims against its reinsurance broker for breach of fiduciary duty and negligence. The cedent alleged that the broker's failure to recommend a certain type of reinsurance product was a breach of the broker's fiduciary duty and was negligent.

The court found that New York's economic loss doctrine precluded recovery under either theory of liability because the cedent alleged purely economic losses resulting from a breach of contract. The court also declined to recognize that a "special relationship" existed between the broker and the cedent because, under New York law, brokers have "no continuing duty to advice, guide or direct a client to obtain additional coverage." Had the two parties discussed the specific reinsurance product at issue, this may have been enough to create a "special relationship." But, as no such conversation took place, ultimately the court found that the general discussions about the "most advantageous" coverage were insufficient to create a special relationship.

Pennsylvania Federal Court Grants Motion to Compel Insurer to Produce Reinsurance-Related Documents to Policyholder

Golon, Inc. v. Selective Ins. Co., No. 17cv0819, 2017 U.S. Dist. LEXIS 201792 (W.D. Pa. Dec. 7, 2017).

In this coverage case, a Pennsylvania federal court granted in part and denied in part a policyholder's motion to compel its insurer to produce documents referencing or discussing reinsurance. The underlying action involved a tragic motor vehicle accident, in which the policyholder's vehicle driven by the policyholder's employee crashed into a disabled car, injuring a family.

In a bad faith action, the specific issues before the court included the policyholder's attempt to compel production of 77 documents the insurer alleged either were protected by mediation privilege or were not relevant because they referenced or related to reinsurance. The court ultimately held that none, except a portion of one document, evoked the protection of the mediation privilege.

On the reinsurance documents, the court found that there was no absolute exclusion of reinsurance information and courts have permitted discovery of reinsurance information. Specifically, the court found that Pennsylvania courts allow discovery into reserves for claims of bad faith involving the insurer's failure to settle or where there is a dispute regarding the value of a claim.

Here, the court held that, based on the nature of the policyholder's claims, the documents referencing or discussing reinsurance should be produced in their entirety so that the policyholder may evaluate what the insurer did or did not do with its own reinsurer, in relation to the underlying claim.

A Brief Review of Reinsurance Trends in 2017

Toward the end of 2017, the New York Court of Appeals began what might be a new trend by answering a certified question from the Second Circuit Court of Appeals on the Bellefonte principle in the negative. Courts also continued to issue rulings consistent with the longstanding principle that only arbitrators should decide matters within the scope of an arbitration clause. While the courts' review of arbitration awards remains extremely limited, it was clear that courts would not hesitate to vacate an award where the arbitrator's conduct rises to the level of evident partiality. Finally, courts continued to interpret broadly the scope of discovery regarding reinsurance communications.

Arbitrability

In line with the longstanding principle that courts should decline to adjudicate issues within the scope of an arbitration clause, in *HDI Global SE v. Lexington Ins. Co.*, 232 F. Supp. 3d 595 (S.D.N.Y. 2017), a New York federal court made clear that an arbitrator must decide challenges to a contract. In the underlying case, the policyholder sought indemnification for a US$66 million judgment under a professional liability policy issued in 2002 (2002 policy). At first, the cedent argued that the 2002 policy contained a negligence trigger and the policyholder had not demonstrated that the loss arose out of professional negligence. The cedent eventually conceded that the 2002 policy did not contain a negligence trigger and paid the claim. When the cedent sought to recover from the reinsurer, the reinsurer argued that it had not agreed to the 2002 policy, but that it had agreed to a policy that contained a negligence trigger, which the 2002 policy did not have.

The reinsurer sued in federal court and the cedent filed a motion to stay the lawsuit and compel arbitration. The reinsurer asked the court to stay arbitration and decide whether a contract even existed (i.e., that the contract was void for lack of mutual assent) because the reinsurer had not agreed to reinsure the 2002 policy. The court reiterated the strong federal support for arbitration as a method of dispute resolution and relied on the Second Circuit's longstanding rule that, if the challenge is to the arbitration clause itself, an issue that goes to the making of the agreement to arbitrate, the court may proceed to adjudicate it. If, however, the challenge goes to the interpretation of the contract, as was the case here (reinsurer claimed the loss was not covered by the terms of the policy), that issue goes to the arbitrator. The court held that the reinsurer had executed a contract that contained a mutually agreed upon arbitration clause and had put forth no challenge to its formation. Thus, an arbitrator had to answer the issue of whether the policy covered the loss.

Similarly, in *Nat'l. Union Fire Ins. Co. of Pittsburgh, PA v. Fed. Ins. Co.*, No. 16-CV-8821 (VEC), 2017 U.S. Dist. LEXIS 88470 (S.D.N.Y. Jun. 8, 2017), a New York federal court granted a petition to compel arbitration, stating that it would not rule on a speculative question relating to the real party-in-interest. The parties had entered into a series of reinsurance agreements reinsuring certain excess workers' compensation policies. Although both parties agreed that they were required to arbitrate the dispute, a question arose over whether to include additional parties to the arbitration. The reinsurer claimed it was acting as a "front" for a pool of reinsurers known as the Pinehurst Accident Reinsurance Group (PARG). The parties disagreed over whether to include members of PARG as interested parties on the umpire questionnaire. The parties filed cross petitions to compel arbitration. The cedent moved to compel arbitration between the parties without inclusion of PARG. The reinsurer claimed the intent and meaning of words in the original treaty directed the parties to arbitrate with entities that are the real parties-in-interest in the arbitration, including PARG. The court noted that the real party-in-interest issue could present a question of arbitrability. Accordingly, citing the federal policy favoring arbitration, the court granted the cedent's petition to compel arbitration and granted, in part, the reinsurer's petition, leaving the arbiters to decide the issue.

In *Ala. Mun. Ins. Corp. v. Munich Reinsurance Am., Inc.*, No. 2:16-cv—948 (WHA)(SRW), 2017 WL 3927607 (M.D. Ala. Sep. 7, 2017), not only did the court hold that arbitration was proper, the court clarified what constitutes a waiver of the right to arbitrate. The cedent sued for breach of contract. The cedent subsequently filed an amended complaint adding another reinsurance agreement between the parties and moved to stay pending arbitration under that agreement. The reinsurer argued that the issue was not arbitrable because the claimed loss did not occur under that agreement and, therefore, there was no breach under the agreement. The court found this to be a merit-based defense under the agreement referenced in the amended complaint, which contained an arbitration clause. Thus, any questions as to whether the alleged breach took place under the agreement referenced were for the arbitrator.

The reinsurer also argued that the cedent had waived arbitration. In rejecting this claim, the court stated that a party waives its right to arbitrate if, under the totality of the circumstances, the party has acted inconsistently with the arbitration right and, in doing so, has prejudiced in some way the other party. The court rejected the reinsurer's argument that the cedent waived the right to arbitrate because it invoked the litigation process (i.e., filed suit, noticed depositions, participated in initial disclosures). The court stated that any actions taken after the cedent filed its complaint should not constitute waiver because the cedent was simply following the court's scheduling order. The court also found that the reinsurer failed to show how it was prejudiced in any way by the cedent's conduct.

Court Review of Arbitration Awards

During 2017, courts did not stray from the pattern of limited review of arbitration awards, even when the arbitrator held that the issues involved had to be adjudicated in court. This was the case in *Mountain Valley Prop., Inc. v. Applied Risk Servs., Inc.*, No. 16-2189, 2017 WL 2981798 (1st Cir. Jul. 13, 2017). In *Mountain Valley*, an arbitrator issued an award finding that the parties' claims under a reinsurance participation agreement were not arbitrable and had to be adjudicated in court because of reverse preemption under the Nebraska Uniform Arbitration Act. That statute bans arbitration of insurance policies regardless of the parties' intent to arbitrate. Despite this finding, the First Circuit Court of Appeals affirmed the denial of a motion to vacate the arbitration award. The circuit court refused the arguments that the arbitrator's award showed a manifest disregard of the law and that the arbitrator exceeded his powers. The court found that the arbitrator's reasoning and conclusions were at the very least "colorable."

Under the Federal Arbitration Act (FAA), a court's authority to vacate or modify an arbitration award is exceedingly limited. When courts are moved to review an arbitrator's conduct, there must be a substantial showing of evident partiality, improper ex parte communications or some other serious misconduct prejudicing a party's rights.

In an exception to the general trend, in *Certain Underwriting Members at Lloyd's of London v. Ins. Co. of the Ams.*, No. 16-cv-323 (VSB), 2017 WL 5508781 (S.D.N.Y. Mar. 31, 2017), a New York federal court vacated an arbitration award against reinsurers. The court did so on the basis that the arbitrator's conduct had risen to the level of evident partiality for failing to disclose his significant business connections to one of the parties despite multiple opportunities to do so. During the arbitration proceeding, the cedent's arbitrator stated only that he knew the cedent's attorney with whom he had some potential business relations a decade earlier. He affirmatively stated that he had no connection to the cedent or a related company. As the evidence in court revealed, however, the arbitrator was president and CEO of companies that shared an office suite with the cedent, had hired an officer of the cedent as his company's CFO, shared the same claims manager with the cedent and his company's counsel was previously a director of the cedent. The court noted that, despite there not being a per se rule establishing that non-disclosure of material relationships constitutes evident partiality, the evidence in this case was significant enough to demonstrate evident partiality.

Contract Interpretation

In the case of insolvency or runoff, it is critical to determine what contractual rights and liabilities have been purchased. If only the debts have been purchased and not the reinsurance contracts, then the right to enforce the arbitration clause in the underlying reinsurance contract will not exist.

Consistent with the trend of narrowly construing transferred rights under assigned reinsurance contracts, in *Pine Top Receivables of Ill., LLC v. Transfercom, Ltd.*, 2017 IL App (1st) 161781 (Ill. App., 2017), an Illinois appellate court affirmed a decision denying a motion to compel arbitration in a reinsurance dispute arising over the reinsurance collection efforts of an insolvent insurance company. The liquidator sold the insolvent's account receivables to an entity formed solely for the purpose of accepting and collecting receivables. In a prior case, the Seventh Circuit Court of Appeals concluded that the assignment by the liquidator conveyed only the right to collect the debt and not the right to enforce the arbitration provision of the reinsurance contract. In the 2017 case, the assignee sought to compel a different reinsurer to arbitrate under a different reinsurance contract. In declining to consider whether the assignee could compel arbitration, based on the collateral estoppel or issue preclusion effect, the court found that the Seventh Circuit had resolved the merits of whether the assignment of accounts receivable included the right to demand arbitration.

Bellefonte

For years, reinsurers have made the traditional *Bellefonte* argument that the limits provision in a facultative certificate caps the amount the reinsurer is obligated for both losses and expenses. But, in an important ruling from the New York Court of Appeals, the court rejected the *Bellefonte* principle as a bright line rule and reiterated that, when interpreting an insurance or reinsurance contract under New York law, the regular rules of contract construction apply and each contract stands on its own terms, conditions and facts.

In *Global Reins. Corp. of Am. v. Century Indemn. Co.*, No. 124, 2017 WL 6374281 (N.Y. Ct. of App., Dec. 14, 2017), the New York Court of Appeals answered in the negative the following certified question from the Second Circuit Court of Appeals: "Does the decision 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?" *Excess* refers to the case that some argue put the *Bellefonte* principle under New York law.

In responding "No" to the certified question, the Court of Appeals explained that "under New York law generally, and in *Excess* in particular, there is neither a rule of construction nor a presumption that a per occurrence liability limitation in a reinsurance contract caps all obligations of the reinsurers, such as payments made to reimburse the reinsured's defense costs." The court explained that, in *Excess*, it focused on the limited context of that case and the specific contract wording. The court in *Excess* did not face the question whether there was some blanket rule or presumption. Although the certified question was not explicitly limited to facultative reinsurance, the Court of Appeals took the question to be solely about facultative reinsurance.

While the New York Court of Appeals' answer to the Second Circuit's certified question was pending, a New York state intermediate appellate court affirmed the grant of partial summary judgment to reinsurers, but modified the judgment and declared that the cedent was not entitled to recover from the reinsurers any amounts exceeding the "reinsurance accepted" amount set forth in the facultative certificate. *Utica Mut. Ins. Co. v. Alfa Mut. Ins. Co.*, 154 A.D.3d 1287 (N.Y. App. Div. 4th Dep't Oct. 6, 2017). The court provided no analysis and no acknowledgement of the pending matter before the Court of Appeals.

In contrast, a Pennsylvania appellate court distinguished *Bellefonte* and affirmed a lower court's decision denying summary judgment to the reinsurer seeking to cap its liabilities based on the limits of a facultative certificate and granted judgment to the cedent on the claims for recovery of expenses. *Century Indemn. Co. v. OneBeacon Ins. Co.*, 2017 Pa. Super. 328 (Super. Ct. Pa. 2017). In doing so, the court affirmed the lower court's determination that the facultative certificate was ambiguous, allowed and credited the cedent's extrinsic evidence, including expert testimony on custom and practice, and provided a detailed analysis of *Bellefonte* and its progeny. The court noted that this was a case of first impression for the Pennsylvania courts.

The number of cases that have distinguished *Bellefonte* has grown and now it appears that, with the New York Court of Appeals decision, this trend will continue.

Discovery

Courts in 2017 continued the trend of broadly interpreting the scope of discovery and carefully scrutinizing claims of work product and attorney-client privilege.

There were two notable cases on the scope of discovery and the cedent's loss reserve information. In *R&Q Reinsurance Co. v. St. Paul Fire & Marine Ins. Co.*, No. 16-1473, 2017 WL 3272016 (E.D. Pa. Aug. 1, 2017), the cedent began defending the underlying claims in the 1980s, but did not provide notice to its reinsurer until 2013. Thus, one of the issues in dispute was whether the cedent provided prompt notice of the claims to the reinsurer. The court determined that the cedent's historical loss reserves for the underlying policies were relevant to this issue and not protected by the work product doctrine. The court also determined that information regarding other reinsurers of the underlying policies was relevant to the notice issue. The court further found that, because a protective order was in place to safeguard proprietary information exchanged between the parties, the cedent could not withhold or redact proprietary information requested by the reinsurer.

The trend continued in *ContraVest Inc. v. Mt. Hawley Ins. Co.*, No. 9:15-cv-00304, 2017 WL 1190880 (D.S.C. Mar. 31, 2017), a bad faith action in which a South Carolina federal court also compelled a cedent to produce information on loss reserves and all communications with its reinsurer concerning the underlying claims. The court determined that information on the cedent's loss reserves was relevant to assessing the validity of the insured's claims under an excess policy and the cedent had failed to carry its burden of showing that this information was protected by the work product doctrine. Regarding the cedent's communications with its reinsurer, the court reasoned that these communications might reveal why the cedent changed its coverage positions. In particular, the court determined that the discoverable communications were not limited to the underlying claims, but included communications about other claims by the insured under the same excess policy, because those communications would show whether the cedent changed its interpretation once it knew that it would have to provide coverage.

In *Baxter Int'l, Inc. v. AXA Versicherung*, 320 F.R.D. 158 (N.D. Ill. 2017), an Illinois federal court also granted an insured's motion to compel the cedent to produce litigation notices and post-litigation communications exchanged with its reinsurers and co-insurers on the basis that the information could contain admissions by the cedent on the scope of coverage. The court rejected the cedent's argument that the communications were per se protected work product. Notably, the cedent had not made a relevancy challenge. The court permitted the cedent to redact the amount of its reserves, stating that it was not convinced that the information was discoverable, but noted that it was willing to revisit its ruling.

In a case addressing privilege protections, *Utica Mut. Ins. Co. v. Munich Reinsurance Co.*, Nos. 6:12-CV-00196, 6:13-CV-00743 (N.D.N.Y. Jan. 13, 2017), a New York federal court took a narrow view of the crime-fraud exemption to a claim of privilege. The court affirmed a magistrate judge ruling denying a reinsurer's motion to compel production a cedent's document containing attorney notes. The reinsurer argued that the document would help establish the cedent's attempt to defraud the reinsurer by engineering a settlement under which it received maximum reinsurance coverage. The attorney notes, the reinsurer argued, then fell under the crime-fraud exception. The court affirmed that the crime-fraud exception did not apply because the party seeking the communication must demonstrate a factual basis for showing probable cause that a fraud or crime has been attempted or committed and that the communication was made in furtherance of the crime or fraud. Because the reinsurer could not show that the notes were made in furtherance of the fraud, the motion to compel was denied. In denying the motion, the court reasoned it was not inherently improper for a cedent to consider its reinsurance contracts during settlement negotiations.

Venue

Courts continued to demonstrate that they would carefully scrutinize a party's request to change venue and consider the party's own actions in the course of litigation as defeating the request. In *R&Q Reins. Co. v. Allianz Ins. Co.*, No. 653744/2014, 2017 WL 3024262 (N.Y. Sup. Ct., Jul. 17, 2017), a New York state court denied a cedent's motion to dismiss the case for *forum non conveniens*, in part, due to the cedent's own actions in the course of litigation. The reinsurer sued the cedent in New York state court for breach of contract and other related claims. The cedent removed the action to the federal court where the parties agreed there were no venue issues. The federal court, however, proceeded to remand the case back to state court. The cedent then filed a claim against the reinsurer in California, but the California court dismissed it based on inconvenient forum, stating that, *inter alia*, the fact that the cedent filed counterclaims in New York suggested that the cedent was able to accommodate the New York forum. Nevertheless, the cedent moved to dismiss the New York action.

The court found that the cedent had not met its burden of proof of demonstrating the inconvenience of New York as a forum. The court reasoned that the parties' out-of-state domiciles and the need for the New York court to apply California law were unpersuasive because neither party was domiciled in California and courts commonly apply the law of other jurisdictions. The court also rejected the cedent's claim of undue burden in holding discovery in New York, as more than 100,000 pages of relevant documents had already been produced in New York and a California venue would be just as inconvenient for some of the witnesses as a New York venue would be for others. Further, the court pointed out that the cedent previously filed counterclaims in New York state court and attempted to remove the case to New York federal court.

Statute of Limitations

In *Pine Top Receivables of Ill., LLC v. Banco de Seguros del Estado*, No. 16-3499, 2017 WL 3379385 (7th Cir. Aug. 7, 2017), the Seventh Circuit Court of Appeals affirmed dismissal of a case seeking to collect reinsurance proceeds assigned out of liquidation as untimely. The court rejected the assignee's argument that Illinois law allowed the liquidator to ignore the statute of limitations and the terms of the treaties because Illinois insolvency law allows the offsetting of mutual debits and credits and provides no time limitation for doing so in a liquidation. The court made clear that there is "no statutory basis for thinking that a liquidator has *carte blanche* to do the netting any time he pleases and thus to deprive reinsurers of the benefit of negotiated deadlines and extend the statute of limitations for well, potentially forever."

Recent Speeches and Publications

- Larry Schiffer moderated the ARIAS•U.S. webinar "Catastrophe Bonds: What are Cat Bonds and How Do They Differ From Insurance and Reinsurance?" on January 25, 2018.
- Congratulations to Carole Sportes, Larry Schiffer, former partner John Nonna, and new partners Deirdre Johnson and Paul Kalish, who are listed in *Who's Who Legal: Insurance & Reinsurance* 2018.
- Larry Schiffer has been appointed Editor-in-Chief for the ARIAS•U.S. Quarterly.

Squire Patton Boggs and its insurance and reinsurance disputes practice welcomes Deirdre Johnson and Paul Kalish. Deirdre and Paul join from a well-known Washington DC law firm with decades of experience in handling complex insurance and reinsurance disputes, including Bermuda Form arbitrations and advice to captives and captive managers and warranty providers. You can view their welcome announcement here.

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Authors

Larry P. Schiffer
Editor, Partner, New York
T +1 646 557 5194
E larry.schiffer@squirepb.com

Eridania Perez
Partner, New York
T +1 646 557 5137
E eridania.perez@squirepb.com

Kelly Mihocik
Associate, Columbus
T +1 614 365 2836
E kelly.mihocik@squirepb.com

Emily K. Mikes
Associate, Cleveland
T +1 216 479 8716
E emily.mikes@squirepb.com

Seth D. Osnowitz
Associate, Cleveland
T +1 216 479 8658
E seth.osnowitz@squirepb.com

Weslynn P. Reed
Associate, Denver
T +1 303 894 6344
E weslynn.reed@squirepb.com

India Scarver
Associate, Columbus
T +1 614 365 2719
E india.scarver@squirepb.com

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