A brief review of reinsurance trends in 2018

(March 22, 2019) - Squire Patton Boggs (US) LLP attorneys Larry P. Schiffer, Nicholas P. Zalany, Ellen M. Farrell, Dilpreet K. Dhanoa, Samantha R. Walker and Holly Wallinger provide a review of reinsurance trends in 2018.

Last year brought about important decisions concerning the limited bases to vacate an arbitration award and the ability of an arbitration panel to revisit an award to fix a problem. It also gave us some insight into how the courts will react to the 2017 case that essentially overturned the infamous Bellefonte decision.

There were also a number of consistent decisions on reverse preemption of arbitration provisions in certain insurance contracts. And the trend of expansive discovery into reinsurance information continued.

This year, we also introduce a brief review of reinsurance trends under the laws of England and Wales as part of our 2018 retrospective.

Arbitration

Arbitrability

Cases in 2018 further clarified the situations in which courts can rule upon the enforceability of arbitration clauses, particularly in the context of reinsurance participation agreements (RPAs). Generally, courts will entertain timely challenges to delegation clauses.

For example, in *Nielsen Contracting, Inc. v. Applied Underwriters, Inc.*, No. D072393, 2018 WL 2054580 (Cal. App. 4th Dist. May 3, 2018), the insurer and related defendants sought to compel arbitration, while the policyholder countered that the delegation and arbitration provisions in the RPA were unenforceable because they were collateral agreements modifying the obligations of the underlying policy and should have been filed with the Insurance Commissioner for approval.

The court affirmed the trial court's finding that the policyholder asserted a specific, substantive challenge to the delegation clause separate from the challenge to the arbitration clause and the underlying contracts. *Nielsen* falls within a line of California state court precedent following *Rent-A-Center, West, Inc. v. Jackson* (2010), 561 U.S. 63 (2010), which recognize that a court is the appropriate entity to resolve challenges to a delegation clause.

In a late 2018 decision relying on *Nielsen*, the court in *Luxor Cabs, Inc. v. Applied Underwriters Captive Risk Assur. Co.*, No. A147962, 2018 WL 6333743 (Cal. App. Dec. 4, 2018), affirmed the trial court's ruling that it was the proper forum for determining arbitrability under an RPA, and agreed with its conclusion that both the delegation clause and the arbitration provision were void and unenforceable because they each separately constituted an "endorsement" to the policy that was not properly vetted and approved by the Insurance Commissioner, as required under California law.

In an Illinois case involving an RPA, *Onken's Am. Recyclers, Inc. v. Cal. Ins. Co.*, No. 4-18-0240, 2018 IL App (4th) 180240-U (Ill. App. Sept. 10, 2018), the reinsurers filed a demand for arbitration against the insureds to recover unpaid insurance premiums.

The insureds moved in Illinois state court to stay the arbitration arguing that no valid agreement to arbitrate existed between the parties because the arbitration provision found in the 2012 RPA was procedurally and substantively unconscionable.

Pursuant to *Rent-A-Center*, the appellate court deemed the insureds' challenge as going to the delegation clause of the arbitration agreement, and, thus, held that the trial court had authority to consider the challenge to arbitrability.

Unlike the respondent in *Rent-A-Center* who did not raise the enforceability of the delegation clause at the trial court level and thus waived it on appeal, the appellee here did raise it at the trial court level and both parties had the opportunity to litigate the matter.

Reverse preemption

Whether the McCarran-Ferguson Act, 15 U.S.C. § 1011, et seq., requires the reverse preemption of the Federal Arbitration Act (FAA) is a question that arose in both state and federal courts when faced with state arbitration statutes that preclude arbitration of insurance disputes between policyholders and their insurers. In most cases, courts found that McCarran-Ferguson reverse preempted the FAA.

Four state courts reviewed substantially similar fact patterns and reached nearly identical conclusions when addressing the convergence of the FAA, the Nebraska Uniform Arbitration Act (NUAA) § 25-2602.01(f)(4), and McCarran-Ferguson, when deciding whether an arbitration and delegation provision in a RPA was enforceable. *See Citizens of Humanity, LLC v. Applied Underwriters, Inc.*, 226 Cal. Rptr. 3d 1 (Cal. App. 2017); *Milmar Food Grp. II, LLC v. Applied Underwriters, Inc.*, 58 Misc. 3d 497 (N.Y. Sup. Dec. 5, 2017); *Onken's Am. Recyclers, Inc. v. Cal. Ins. Co.*, 2018 IL App (4th) 180240-U (Sept. 10, 2018); and *Luxor Cabs v. Applied Underwriters Captive Risk Assur. Co.*, 30 Cal. App. 5th 970 (Dec. 4, 2018).

All cases involved the purchase of workers' compensation insurance from one affiliated company while other affiliate companies entered into a reinsurance agreement with a related reinsurance company. The reinsurer then entered into a RPA with the policyholders and argued that the policyholders were then a party to the reinsurance agreements and subject to its terms.

The RPAs contained an arbitration clause and provision stating that the agreement was to be construed under Nebraska law. In addition, the arbitration clause included a delegation provision stating that the arbitrator would decide arbitrability (discussed above).

In *Citizens* and *Milmar*, plaintiffs sued in state court alleging fraud related to the program, and defendants moved to compel arbitration. In *Onken's* and *Luxor*, the appellate court reviewed the trial court's denial of defendants' motion to compel arbitration.

While noting the general enforceability of arbitration provisions under the FAA, each court recognized McCarran-Ferguson's endowment of plenary authority to the states over the regulation of insurance. The NUAA exempts from enforceability such arbitration provisions in "any agreement concerning or relating to an insurance policy."

To untangle these conflicts among the FAA, McCarran-Ferguson, and the NUAA, each court teased out the threshold issue: whether the court or an arbitrator should decide the issue of arbitrability before it could determine whether the FAA compelled arbitration.

Enter McCarran-Ferguson reverse pre-emption. In applying McCarran-Ferguson, each court recognized that Nebraska law could invalidate the entire arbitration clause — including the delegation provision — and held that the court should resolve the issue of arbitrability.

Thereafter, the court determined that, under Nebraska law, the reinsurance 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.

The *Citizens* and *Milmar* courts denied the defendants' motion to compel arbitration; the *Onken's* court upheld the trial court's denial of defendants' motion to compel arbitration.

In *Luxor*, the trial court had declined to reach this issue, but the appellate court found the *Citizens* court's decision to be persuasive and held that reverse preemption provided another, separate basis for upholding the trial court's arbitrability determinations.

In a non-reinsurance case, a Missouri federal court remanded a coverage dispute back to state court, finding that Missouri's arbitration statute, Mo. Rev. Stat. § 435.350 (2010), reverse preempted Section 205 of the FAA by operation of McCarran-Ferguson. *Foresight Energy, LLC v. Certain London Market Ins. Cos.*, No. 17-CF-2266 CAS, 311 F. Supp. 3d 1085 (E.D. Mo. 2018).

The defendants had removed the state insurance dispute to federal court, claiming federal jurisdiction under chapter 2 of the FAA, which implements the Convention of the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention), 21 U.S.T. 2517.

The *Foresight* court determined that it lacked subject-matter jurisdiction on the basis that the plain language of McCarran-Ferguson states that no act of Congress can supersede state law regulating the business of insurance — and, thus, chapter 2 of the FAA, as an act of Congress, was reverse preempted by Missouri's anti-arbitration provision.

Arbitrator selection

One notable decision from 2018 addressed the scope of a court's ability to decide upon the umpire selection process in a matter that both parties agreed was arbitrable. *Employers Ins. Co. of Wausau v. The Hartford*, No. 2:18-cv-07240-CAS-AGR, 2018 WL 6330425 (C.D. Calif. Dec. 3, 2018).

In this case, each of the 19 reinsurance treaties required a three-arbitrator panel. The umpire selection process and certain procedures, however, varied under the treaties' arbitration clauses.

The cedent sought an order from the court directing the reinsurer to proceed with the umpire selection process pursuant to the language in one treaty, while in its cross-motion to compel arbitration, the reinsurer requested that the court direct the insurer to select one arbitrator and participate in a single panel for a consolidated arbitration.

The court reasoned that while the issue of a consolidated arbitration is one that the arbitrators rather than the court decides, it is within the court's purview to compel the parties to proceed to arbitration in accordance with the terms of their agreements.

The court determined that one specific treaty provided an unambiguous procedure for the creation of an arbitration panel to resolve this and any other disputes that might later arise.

Arbitration awards

In 2018, there were two important decisions out of the Second Circuit that further limit the circumstances under which a court may vacate an arbitration award.

In *Certain Underwriting Members of Lloyd's of London v. State of Florida*, 892 F.3d 501 (2d Cir. 2018), the Second Circuit reversed an order vacating an arbitration award on the ground that the cedent's party-appointed arbitrator failed to disclose close relationships with former and current directors and employees of the cedent.

The court determined that the district court wrongly weighed the arbitrator's conduct under the standard governing neutral arbitrators, holding that "a party seeking to vacate an award under Section 10(a)(2) [of the Federal Arbitration Act] must sustain a higher burden to prove evident partiality on the part of an arbitrator who is appointed by a party and who is expected to espouse the view or perspective of the appointed party."

The court justified its ruling by recognizing that party-appointed arbitrators are generally expected to serve as de facto advocates, and that in the reinsurance context in particular, an arbitrator's specialized knowledge is valued more than stringent impartiality.

On remand, the district court was charged with determining whether the reinsurers had shown, by clear and convincing evidence, that the failure to disclose by the cedent's party-appointed arbitrator either violated the "disinterested" qualification in the arbitration contract or if the undisclosed fact resulted in a prejudicial effect on the award.

Given the heightened scrutiny now required when challenging an award for evident partiality of a party-appointed arbitrator, parties to reinsurance disputes should continue to be aware of the availability of neutral arbitrators through the ARIAS U.S. Neutral Panel Rules.

In *General Re Life Corp. v. Lincoln Nat'l Life Ins. Co.*, 909 F.3d 544 (2d Cir. 2018), the Second Circuit joined the Third, Fifth, Sixth, Seventh and Ninth Circuits in allowing an exception to the doctrine of *functus officio* when a final award is ambiguous. Under that doctrine, once an arbitrator renders a decision regarding the issues submitted, he or she lacks any power to reexamine that decision.

In the case at hand, the parties returned to the panel over a dispute concerning the calculation of payments required under the award, and the panel provided the appropriate clarification. The Second Circuit held that the clarification constituted a proper exception to the doctrine of *functus officio* because the final award was intended to be read in the context of the parties' reinsurance agreement and the clarification did not actually rewrite the award. Thus, it was in keeping with the objectives of arbitration in settling disputes efficiently and avoiding long and expensive litigation.

In addition to these Second Circuit decisions, the Southern District of New York upheld a motion to enforce an arbitration award in the face of a retrocedent's challenge. *Nat'l Indemn. Co. v. IRB Brasil Resseguros S.A.*, No. 15 Civ. 3975 (NRB), 2018 WL 739450 (S.D.N.Y. Jan. 23, 2018).

The court recognized the general rule that the power to enforce an arbitration award does not extend beyond the scope of the confirmed award embodied in a judgment. There was no need for the court to deviate from this rule in the case at hand — the retrocedent's obligation to pay any amount the retrocessionaire owed the policyholder preceded the settlement agreement between the retrocessionaire and the policyholder, and thus constituted an obligation embodied in a judgment of the court.

The court similarly rejected the retrocedent's argument that the US$5 million settlement itself was unreasonable or reached in bad faith, particularly because the policyholder claimed more than US$15 million in damages in its state court action.

Follow-the-fortunes/follow-the-settlements

Last year brought new decisions in the follow-the-fortunes/follow-the-settlements arena, all stemming from the 2007 settlement of asbestos bodily injury claims against Gould's Pumps.

In *Utica Mut. Ins. Co. v. Fireman's Fund Ins. Co.*, 287 F. Supp. 3d 163 (N.D.N.Y. 2018), a New York federal court agreed that the cedent was not required to prove by a preponderance of the evidence that its excess policies provided coverage in order for follow-the-settlements to apply to the reinsurer.

Instead, the court agreed that the cedent needed only to establish that there was sufficient evidence for a reasonable jury to find that the cedent's settlement decisions were objectively reasonable.

The dispute between the cedent and Gould's Pumps centered on whether the cedent's primary policies contained aggregate limits, such that those policies could exhaust and trigger its excess policies. The reinsurer reinsured certain of those excess policies.

After reciting evidence, both for and against the existence of primary policy aggregate limits, the court found that there was sufficient evidence for a jury to conclude that the primary policies did contain aggregate limits and, thus, that the cedent's decision to settle with its policyholder on that basis was objectively reasonable.

Notably, the court rejected the argument that the cedent's settlement allocation was improper simply because it would have reinsurance implications — and instead affirmed the principle that "the cedent is permitted to choose the allocation most favorable to it when faced with multiple reasonable allocations."

In *Utica Mut. Ins. Co. v. Munich Reins. Am., Inc.*, No. 6:12-cv-00196, 2018 WL 313847 (N.D.N.Y. June 27, 2018)*Utica Mut. Ins. Co. v. Munich Reins. Am., Inc.*, No. 6:12-cv-00196, 2018 WL 313847 (N.D.N.Y. June 27, 2018), the same court considered a different issue — namely, whether the doctrines of follow-the-fortunes or follow-the-settlements are implied in facultative reinsurance certificates when there is no express wording to that effect.

In unsuccessful cross-motions for summary judgment, the cedent and its reinsurer presented conflicting expert opinions on whether custom and practice imply follow-the-fortunes or follow-the-settlements in all reinsurance contracts.

Before the court was the reinsurer's motion in limine to preclude the cedent's evidence at trial that follow-the-fortunes or follow-the-settlements should be implied as a matter of custom and practice.

After weighing this conflicting evidence, the court found that "[w]hile Utica Mutual may ultimately be unable" to demonstrate that those clauses were "fixed and invariable in the reinsurance industry" when the reinsurance contracts at issue were issued (in 1973 and 1977), the court denied the reinsurer's motion to preclude the evidence.

The court held that the cedent had the burden of proof to demonstrate a fixed and variable custom and practice in the reinsurance industry to import the follow-the-fortunes or follow-the-settlement clause into the facultative certificates.

Bellefonte

In 2018, New York federal courts issued multiple rulings on the *Bellefonte* issue — i.e., whether the limit stated on a facultative reinsurance contract is the most that the reinsurer must pay for both loss and expense. These rulings took into account the 2017 New York Court of Appeals decision in *Global Reins. Corp. of Am. v. Century Indem. Co.*, 30 N.Y.3d 508, 69 N.Y.S.3d 207, 91 N.E.3d 1186 (2017).

By way of background, in *Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co.*, 903, F.2d 910 (2d Cir. 1990), the Second Circuit held that the limit on the reinsurance contract in that case was the maximum amount the reinsurer was obligated to pay for both loss and expense.

The 2017 Court of Appeals decision rejected the notion that courts should "simply assume … that any clause bearing the generic marker of a 'limitation of liability' or 'reinsurance accepted' clause was intended to be cost-inclusive;" and instead directed courts to apply principles of contract interpretation to each reinsurance contract before them to determine how the limit of liability applies.

The 2017 Court of Appeals decision had a direct impact on *Global Reins. Corp. of Am. v. Century Indem. Co.*, 893 F.3d 74 (2d Cir. 2018), because in an earlier decision the Second Circuit had certified the issue that was decided in that 2017 Court of Appeals decision.

The district court in that case held that the stated limit in the facultative reinsurance certificate was the most that the reinsurer would have to pay for loss and expense combined.

After the Court of Appeals' decision, the Second Circuit vacated the district court's decision and remanded the case for consideration of the terms of the contract at issue, using "standard principles of contract interpretation."

The Court of Appeals decision also impacted the Second Circuit's decision in *Utica Mut. Ins. Co. v. Clearwater Ins. Co.*, 906 F.3d 12 (2d Cir. 2018). There, the reinsurer argued (among other things) that any liability to the cedent would be capped at the stated liability limits in the facultative reinsurance contracts. The lower court agreed with the reinsurer and the cedent appealed.

The Second Circuit reversed. In applying principles of contract interpretation to those reinsurance contracts, the Second Circuit held that the contracts required payment of expense in addition to the contracts' stated limits in light of follow the form language in the contracts and the absence of language stating that the reinsurer's liability would be "subject to" the stated limits of liability.

In *Utica Mut. Ins. Co. v. Munich Reins. Am., Inc.*, No. 6:12-cv-00196, 2018 WL 1737623 (N.D.N.Y. Mar. 20, 2018), a New York federal district court considered cross-motions for summary judgment regarding whether the limits of two

facultative reinsurance contracts were the most that the reinsurer had to pay under those contracts, or whether the reinsurer also had to pay expense in addition to those limits.

The court applied principles of contract interpretation and found that questions of material fact precluded either party's motion for summary judgment, because the reinsurance contracts were ambiguous and neither party had submitted extrinsic evidence on the issue.

The court then denied the cedent's motion for reconsideration because testimony of the reinsurer's Senior Claims Officer, which the cedent claimed was overlooked, did not "shed any light on the ambiguity identified by the Court…"

Reinsurance pooling agreements and direct actions

Policyholders and others often try to thread the needle through existing case law to reach reinsurance proceeds. Generally, those attempts are unsuccessful. That trend continued in 2018.

In *Hollander v. XL Capital Ltd.*, No. B276621, 2018 WL 2017183 (Cal. Ct. App. May 1, 2018), a California appellate court rejected an attempt by policyholders to use the existence of inter-company reinsurance agreements as a basis for suing the parent and affiliates of their insurer.

In that case, the policyholders disagreed with their insurer's valuation of damage to insured paintings and sued not only the insurer for breach of contract and other claims, but also the insurer's parent and affiliates. The policyholders based these claims on alter ego/single enterprise and agency theories of liability.

To support these allegations, the policyholders asserted that (1) the insurer would be insolvent without a quota share reinsurance agreement with an affiliate, and (2) certain affiliated companies shared in profits and losses through a reinsurance pooling agreement.

The appellate court rejected the evidence regarding the insurer's solvency as "unsupported and unexplained conjecture," and evidence about the reinsurance pooling agreement as "misplaced," because none of the defendants in the case were members of the reinsurance pools that were the subject of those agreements.

Direct right of action against reinsurer

In 2018, courts continued to bar actions by insureds against reinsurers based on contract principals, but opened the door for tort, breach of implied contract and other equitable claims.

In *Three Rivers Hydroponics, LLC v. Florists' Mut. Ins. Co.*, 2:15-cv-00809, 2018 WL 791405 (W.D. Penn. Feb. 8, 2018), a commercial producer of hydroponic herbs brought suit against a reinsurer for breach of contract under a theory of assumed contractual duty. Although the insured and the reinsurer were not in privity of contract, the insured alleged that it was a third-party beneficiary of the reinsurance agreement.

A Pennsylvania district court dismissed the claim against the reinsurer, noting that under Pennsylvania law, a party becomes a third-party beneficiary only where the beneficiary's status is expressly set out in the contract or where "the

circumstances are so compelling that recognition of the beneficiary's right is appropriate to effectuate the intention of the parties [to the contract]."

The court determined that the circumstances of this case were not "compelling" such that the insured qualified for third-party beneficiary status.

In so doing, the court noted that "in those cases where a plaintiff has been permitted to bring a claim for breach of contract against a reinsurer or third party administrator, it has been under circumstances where recovery was not possible from the original insurer" suggesting that recovery directly against a reinsurer is an equitable remedy.

The court in *Vantage Commodities Fin. Servs. I, LLC v. Assured Risk Transfer PCC, LLC*, No. 1:17-cv-01451, 2018 WL 3732133 (D. D.C. Aug. 6, 2018) ("*Vantage Commodities I*"), reiterated the rule that a reinsurer does not have a direct contractual relationship with an insured unless the terms of the reinsurance contract creates a relationship.

When an insured attempted to collect on a multi-million dollar arbitration award against the cedent, and discovered that a reinsurer denied the cedent's reinsurance claim for failure to provide prompt notice of the loss, the insured sought to collect against both the reinsurer and the reinsurance broker directly based on a breach of contract theory.

The court dismissed the claims because the insured could not show a direct contractual relationship with either the reinsurer or the reinsurance broker.

Subsequently, in *Vantage Commodities Fin. Servs. I, LLC v. Assured Risk Transfer PCC, LLC*, No. 1:17-cv-01451, 2018 WL 6025774 (D.C.D.C. Nov. 16, 2018) ("*Vantage Commodities II*"), the insured sought leave to amend its breach of contract claim and to add extra-contractual claims against the reinsurer.

The court denied the insured's leave to amend the breach of contract claim, concluding that the allegations did not overcome the long-standing rule that a reinsurer does not have a direct contractual relationship with an insured unless explicitly provided for in the reinsurance contract.

The court, however, found that the insured had alleged sufficient facts in support of its claim for breach of implied contract, promissory estoppel and unjust enrichment. In so holding, the court indicated that although contractual privity remains a hurdle in the reinsurance context, tort actions may provide an equitable remedy to claimants who would otherwise have no recourse except against their direct insurers.

In *Jonacha's Case*, 93 Mass. App. Ct. 179, 2018 WL 2027081 (App. Mass. May 2, 2018), the Appeals Court of Massachusetts held that a reinsurer was required to pay benefits even though the reinsurance policy's retention provision had not been reached.

The claimant sustained a permanent and totally incapacitating injury at his workplace. The employer was self-insured and held a surety bond for US$2.4 million. The employer also maintained a reinsurance policy with a retention provision for US$400,000.

When the employer went bankrupt, and the surety bond became exhausted, the insured filed a claim with the reinsurer for resumption of benefits.

The reviewing board of the Department of Industrial Accidents held that the reinsurer was responsible for continued payment to the insured and this suit followed.

In affirming the reviewing board of the Department of Industrial Accidents findings, the court found that the legislative history of the Workers' Compensation Act evidenced a clear intent to "guarantee [payment of] benefits … to injured employees."

As a result, the court found the retention provision of the reinsurance policy null and void. This decision appears to be grounded in both principles of legislative intent and equity.

Notwithstanding the cases discussed above, courts continue to deny claims based on lack of contractual privity, especially where there are no equitable considerations.

The Second Circuit Court of Appeals held in *Keller Founds., LLC v. Zurich Am. Ins. Co.*, No. 18-1280-cv, 2018 WL 64315537 (2d Ct. App., Dec. 6, 2018), that a cedent was not obligated to reimburse an insured for losses suffered as a result of an intercompany agreement between the insured and insured's parent company.

The case involved a claim by Hayward Baker, Inc. (HBI) against the cedent for losses HBI suffered as a result of reimbursing its parent company, Keller Group PLC (Keller). The case began when a general contractor filed a breach of contract action against HBI.

HBI tendered a claim to the cedent under its commercial general liability policy for defense of the breach of contract claim, which the cedent undertook to defend. Separately, the general contractor filed a claim with the cedent, claiming it was an additional insured under the commercial general liability policy.

After settling with the general contractor, the cedent obtained reimbursement from Keller, its reinsurer. HBI was then required to reimburse Keller pursuant to an intercompany agreement between HBI and Keller.

HBI and Keller thereafter sued the cedent alleging breach of contract and damages in the form of the reimbursement.

The court rejected this argument, with respect to HBI, noting that payment of the reimbursement sums was not due to any breach of contract by the cedent. The court also rejected Keller's breach of contract claim, holding that Keller was neither an insured nor a third-party beneficiary under the commercial general liability policy.

Claims against reinsurance brokers

The decision in *Vantage Commodities I* also entertained the reinsurance broker's motion to dismiss the insured's negligence claims against it. In so denying, the court emphasized that the reinsurance broker transmitted all communications and payments related to the reinsurance contracts, knew that the insured considered the reinsurance essential, and intended for the insured to rely on the credit insurance binders.

Pointing to a District of Columbia law that creates a duty of reasonable care on a person who undertakes to render services "which he should recognize as necessary for the protection of a third person or his things," the court concluded that the reinsurance broker's undertakings created a duty to the insured that is actionable in tort.

In contrast, in *Holborn Corp. v. Sawgrass Mut. Ins. Co.*, 304 F. Supp. 3d 392 (S.D.N.Y. 2018), a New York federal court dismissed tort claims by a cedent against its reinsurance broker. After the reinsurance broker sued the cedent for failing to pay premiums due under a broker contract, the cedent asserted counterclaims for negligence, breach of fiduciary duty and breach of contract.

Relying on the economic loss doctrine, the broker moved to dismiss the negligence and breach of fiduciary claims that were based on the broker's alleged failure to recommend certain reinsurance coverage to the cedent.

The broker argued that the economic loss doctrine, which precludes recovery on tort claims where a claimant has a remedy in contract, applied because the broker contract (and other contracts) governed the parties' relationship.

The court agreed that the economic loss doctrine as interpreted under New York law applied (as opposed to the doctrine as interpreted by Florida law, which would have been more narrow), and rejected the cedent's argument that the parties had a special relationship that would preclude the application of that doctrine.

Discovery

Continuing trends seen in 2016 and 2017, courts in 2018 broadly interpreted the scope of discovery of reinsurance contracts. In *Contravest Inc. v. Mt. Hawley Ins. Co.*, No. 9:15-cv-00304-DCN, 2018 WL 5281951 (D.S.C. Oct. 24, 2018), a South Carolina federal court ordered a cedent to produce reinsurance and reserve documents for review by its insured.

As part of an ongoing lawsuit between a cedent and its insured, the cedent argued that its reinsurance and reserve documents should be subject to in camera review. The court did not specifically address the cedent's request for in camera review in its order.

Nevertheless, on reconsideration, the court denied the cedent's motion to stay, finding that while it did not explicitly state that it denied the cedent's request for in camera review, the order denied the cedent's motion in full, which included the request for in camera review. Accordingly, the cedent was ordered to produce the requested reinsurance documents.

Fraud

A Maryland federal court denied a cedent's motion to dismiss a claim for fraud, finding that a class of insureds made a plausible showing that a cedent's captive reinsurance transactions were used to deceive insureds and make the cedent appear profitable.

Rich v. William Penn Life Ins. Co., No. GLR-17-2026, 2018 WL 4599675 (D.C.M.D. Sept. 25, 2018), involved a class action alleging that during the 2008 recession, the cedent experienced significantly eroded profitability and became aware that it would need to increase the insurance premium for its "no-lapse-guarantee" policies in order to remain viable.

The complaint further claimed that in an effort to appear financially stable, the cedent reduced its liabilities by ceding a block of life insurance policies to an undercapitalized, affiliated company. In 2015, the cedent raised its insurance premiums, in an alleged attempt to recoup losses suffered in the previous years.

The class brought an action in fraud arguing that but for the cedent's reinsurance transfer scheme, the class would not have continued to pay premiums and excess premiums for its policies.

The cedent sought to dismiss the claim by raising defenses, which included that the claim was barred by the source of duty rule and the economic loss rule.

The court denied the cedent's motion to dismiss noting that the misrepresentations and omissions alleged in the cedent's annual reports was analogous to a fraud-in-the-inducement claim, thereby excluding it from the source of duty and economic loss rules.

Similarly, the court found that although the Policy Statements were governed by the terms of the policy itself, the policy did not specifically require the Policy Statements to be "accurate."

The cedent therefore had a duty outside of the terms of the contract to avoid misrepresenting information in its Policy Statements and accordingly, the Class's claims were not barred by the source of duty rule.

Moreover, because the Class alleged that it could have stopped paying premiums under its respective policies had the cedent been forthright in its Policy Statements, the court also found that the economic loss rule did not bar the Class's claims against the cedent.

Insurance/reinsurance trends: UK in 2018

With the UK moving out of the European Union following the infamous Brexit vote, 2019 is yet to bring changes to the reinsurance market (given the UK's close following of EU legislation in this arena in some respects).

There is often a tension in the UK reinsurance market that can be caught between two concerns: first, a desire to avoid costly and expensive investigation looking into why the reinsured has decided to settle with the insured; and, second, the reinsurer's concern that the reinsured may not have yet decided to settle with the insured. The UK has a long-established doctrine of "follow the settlements" clauses.

One issue that has long required clarification seems to have slowly been dealt with by the courts in 2018: the sensitive issue of mesothelioma reinsurance claims. In the long awaited decision of *Equitas Insurance Ltd v Municipal Mutual Insurance Ltd* [2018] EWCA Civ 991 that came before the Court of Appeal, the dispute had arisen between the parties concerning the treatment of mesothelioma claims for the purposes of certain contracts of employers' liability reinsurance.

The question before the court was: whether the reinsured was entitled to present each outwards reinsurance claim to any single triggered reinsurance contract of its choice and, if so, in what manner the recoupment and contribution were to calculated.

Reinsurance claims like these have had a long and tumultuous history in the English courts. The background is critical to understanding the importance of *Equitas Insurance*.

In the case of *Fairchild v Glenhaven Funeral Services Ltd* [2002] UKHL 22, the House of Lords held that any employer who had exposed a victim to asbestos was liable for mesothelioma (thus dispensing with the 'but for' test).

In *Barker v Corus* (UK) plc [2006] UKHL 20, the courts started to define the nuances and parameters, holding that liability could be apportioned between employers according to the extent to which they had contributed to that risk.

Just over a decade ago, The Compensation Act 2006 reversed the *Barker* position. Essentially, it provided that an employees who had contracted mesothelioma could claim compensation in full from any one employer, in the event that they had potentially contracted it from any one of a number of employments.

The Act provided that the employer could then claim a contribution from other liable employers (where they could be readily identified and/or located).

The courts appeared to support this when, in 2015, in *Zurich Insurance v International Group* the Supreme Court held that insurers would be liable for the whole claim even when they were only carried part of the risk for the relevant exposure period; further adding that the relevant insurer could then claim contributions from other insurers on risk, or even the employer.

The case before the Judge-Arbitrator, Flaux LJ, was in the context of a confidential arbitration, whereby it had been alleged that the reinsured had made attempts to "spike" the reinsurer with mesothelioma claims — in other words, to choose which reinsurance year to allocate losses.

Flaux LJ's award, which permitted the "spike," became the subject of a challenge under section 69 of the Arbitration Act 1996 on a point of law. The Court of Appeal granted permission to appeal on three grounds: (1) implied allocation; (2) good faith; and, (3) recoupment and contribution.

The substance of the three grounds was made out in the following way: first, as already noted, Flaux LJ, in applying *Zurich*, had held that a reinsurer could be held liable for the whole loss even though it was in fact only partly liable. The Court of Appeal was persuaded on the ground that there was a "seriously arguable case" for treating insurance and reinsurance positions differently.

Secondly, Flaux LJ had held that the reinsured's duty of good faith was limited only to a duty not to act dishonestly (thus not affecting the reinsured's ability to "spike"). The Court of Appeal was persuaded that if a reinsured had the choice as to how it could allocate losses, then this placed a restraint on the reinsured's duty of good faith.

Finally, with respect to the reinsurer's right to claim a contribution from other reinsurers and against the reinsured for any "self-insurance," the Court of Appeal was persuaded that the issue of contribution and recoupment was different from that in *Fairchild*, which did not require the case to be proved as to who caused the injury.

The Court of Appeal concluded that it was just and proper for the court to determine this appeal, particularly as the court was alive to the fact that the issue would likely come up in subsequent cases and arbitrations.

The court granted the reinsurers permission to appeal the arbitration award in which the Tribunal had permitted the reinsured to "spike" each mesothelioma reinsurance claim to any applicable year of reinsurance cover of its own choosing.

The debate, however, has still been left somewhat open, and it will be interesting to see (as per Gloster LJ's judgment in the Court of Appeal) whether overarching principles of fairness will trump entrenched doctrines of insurance law.

Another area of reinsurance that have taken an interesting development are in respect of the Joint Excess Loss Committee's "Excess Loss Clauses."

In *Allianz Insurance Plc v Tonicstar Ltd* [2018] EWCA Civ 343, two reinsurers had appealed against the removal of an arbitrator that had appointed to determine a reinsurance dispute with the reinsured. The appointed arbitrator was a QC who had over 10 years' experience of acting in insurance and reinsurance cases.

The appeal was permitted, and interesting questions were raised on whether there was a distinction between "insurance law" and insurance itself. It was held that a lawyer who had specialized in the area for more than 10 years would likely have considerable practical knowledge of the business.

An interesting move which may bring the UK and US markets more in alignment is the Agreement between the two countries on Prudential Measures regarding Insurance and Reinsurance, which was agreed and issued on December 18, 2018, but is not yet in force.

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