SQUIRE PATTON BOGGS

Reinsurance Newsletter

September 2019

In This Issue

- Recent Case Summaries
- Recent Regulatory/Policy Developments
- Recent Speeches and Publications

Recent Case Summaries

New York Federal Court Lets Arbitration Panel Decide on Preclusive Effect of Confirmation of Interim Security Award

In re Platinum-Beechwood Litigation, 18-cv-6658 and 18-cv-1208 (JSR), 2019 U.S. Dist. LEXIS 114645 (S.D.N.Y. Jul. 10, 2019).

In a procedurally complicated case, an arbitration panel issued an interim security award and then stayed the arbitration pending litigation. The interim security award was confirmed and reduced to a judgment. In this litigation, the federal court faced a new motion for security.

The cedents brought cross-claims against their insolvent reinsurer for breach of contract within a case brought by investors claiming wrongdoing against the reinsurer, the cedents and others. The cedents sought an order compelling the reinsurer to post security for the cross-claims or striking the reinsurer's pleadings and entering a default judgment for failure to post security as required by state law.

Previously, in an arbitration between the cedents and the reinsurer, the arbitration panel issued an interim security award in favor of the cedents, but at a much smaller amount. The federal court confirmed the interim security award and entered it as a judgment. The arbitration between the cedents and the reinsurer was stayed pending this litigation, with the arbitration panel retaining jurisdiction over the security award.

The reinsurer argued that the confirmed interim arbitration award, which was reduced to a judgment by the court, precluded the cedents from bringing their motion. The reinsurer also argued that the pre-answer security statutes did not apply to it as an insolvent reinsurer. In denying the cedents' motion, the court held that the security statutes applied to the reinsurer even thought it was in liquidation. The court stated that the statutes clearly applied to the reinsurer and that the motions the reinsurer was making were considered pleadings under the security statutes. While sympathetic to the equitable concerns raise by the reinsurer, the court said that it was unable to square these equitable concerns with the plain text of the security statutes. The court held that the security statutes applied, notwithstanding the liquidation proceedings.

The court then determined that the arbitration panel must decide in the first instance whether its interim security order as confirmed by the court precluded the cedents from moving to seek security in the litigation (in this case a substantially greater amount than had been granted by the arbitration panel). The court noted that the reinsurance agreements had very broad arbitration clauses and that, under Second Circuit precedents, the claims-preclusive effect of a prior federal judgment confirming an arbitration award must be left to the arbitrators to determine. Thus, the court denied the cedents' motion for security, although noting that if the arbitration panel concludes that the cedents are not precluded from bringing the security motion, then the parties can return to the court for further proceedings on the matter.

Notably, pending before the court were motions by the reinsurer to dismiss part of the cedents' cross-claims and to compel arbitration, which the court refused to stay.

On Remand, New York Federal Court Denies Reinsurer's Motion for Summary Judgment on Obligation to Pay Defense Costs

Utica Mut. Ins. Co. v. Clearwater Ins. Co., No. 6:13-cv-1178 (GLS/TWD), 2019 U.S. Dist. LEXIS 124077 (N.D.N.Y. Jul. 25, 2019).

After the Second Circuit remanded this case back to the district court because of the New York Court of Appeal's decision in *Global Reinsurance Corp. of Am. v. Century Indemn. Co.*, 30, N.Y.3d 508 (2017), the district court had to determine, in light of the Second Circuit's decision, *Utica Mut. Ins. Co. v. Clearwater Ins. Co.*, 906 F.3d 12 (2d Cir. 2018), whether the cedent was entitled to recover defense costs from the reinsurer. That determination all depended on whether the cedent was obligated to pay defense costs to the policyholder under its umbrella policies.

In denying the reinsurer's motion for partial summary judgment, the court found the operative language of the umbrella policies to be ambiguous, finding that the "not covered by" language was susceptible to more than one reasonable meaning. The court noted that the reinsurer did not provide any extrinsic evidence to allow the court to resolve the ambiguity as a matter of law.

The relevant provision required the cedent to defend the insured for any occurrence "not covered by the policies listed in the schedule of underlying insurance . . . but covered by the terms and conditions of this policy . . . ." Each side, the court found, had a reasonable interpretation of the meaning of "not covered by."

The real issue was whether the exhaustion of the primary policies meant that the occurrence was no longer covered by the primary policies, so as to trigger the defense obligations under the umbrella policies. As the court stated, "the language here suggests that [the cedent] would provide defense costs to [the policyholder] for accidents that the underlying policies did not compensate them for, but it does not unambiguously state whether it is referring to compensation that does not occur because it is outside of the scope of the underlying primary policies' coverage grant or because the underlying policy has been exhausted."

Finding that the provision could apply to either or both situations, the court denied the motion and set the case down for trial.

New York Federal Court Dismisses Captive Reinsurer's Counterclaims

AmTrust North America, Inc. v. Signify Insurance Ltd., No. 18-cv-3779(ER), 2019 U.S. Dist. LEXIS 115576 (S.D.N.Y. Jul. 11, 2019).

A New York federal court denied a captive reinsurer's motion to dismiss a cedent's complaint and, instead, dismissed several of the captive reinsurer's counterclaims against the cedent. The cedent and the captive reinsurer entered into a captive reinsurance agreement whereby the cedent and its affiliates would issue workers' compensation policies for the captive's parent, which the cedent would reinsurer with the captive reinsurer. The agreement had several requirements for security given the off shore domicile of the captive reinsurer.

At some point, the cedent issued no new policies and demanded that the captive reinsurer fulfill its obligations to provide the required security. The cedent wrote to the reinsurer stating that, "unless" the reinsurer posted the security within 30-days, the cedent terminated the captive agreement from inception. The reinsurer posted a significant portion of the required security two days later and 30 days later wrote to the cedent accepting the termination to inception. On its part, the cedent withdrew its notice of intent to terminate, but demanded the rest of the security.

Subsequently, the cedent and its affiliates commenced a breach of contract action and sought a declaration that the reinsurer was required to, and shall remain required to, maintain the security obligations. The reinsurer counterclaimed that the reinsurance agreement had been terminated from inception by the cedent and, in the alternative, that the court should rescind the reinsurance agreement. There were other counterclaims as well.

Both parties moved for judgment on the pleadings – the cedent to dismiss the first two counterclaims and the reinsurer to dismiss the cedent's complaint in its entirety.

The court granted the cedent's motion and denied the reinsurer's motion. The court found that a reasonable person would understand the cedent's letter to be a request for a cure and was insufficient to effect a rescission of the reinsurance agreement. The court also rejected the reinsurer's argument that it had accepted the cedent's offer of rescission. The court held that there was no offer. The court found that the cedent had sufficiently pled that the reinsurer had not adequately performed under the reinsurance agreement and denied the reinsurer's motion to dismiss the complaint. Notably, the court found that, under the reinsurance agreement, the cedent's obligation to cede gross and net premium arose only after a series of events, one of which was receipt of confirmation from the bank that the letter of credit (the collateral) had been increased to the levels required by the loss fund. Thus, said the court, the cedent's duty to cede the premiums never arose.

California Federal Court Grants Summary Judgment to Reinsurer Against Individual Principals of Defunct Insurance Agency

Odyssey Reinsurance Co. v. Nagby, No. 16-cv-03038-BTM-WVG, 2019 U.S. Dist. LEXIS 111794 (S.D.N.Y. Jul. 2, 2019).

In our June Reinsurance Newsletter we reported on an earlier decision in this case that gave the reinsurer access to funds held on deposit with the court belonging to the insurance agency's successor. In this decision, the other shoe dropped, and the reinsurer obtained summary judgment on various counts against the two former principals of the insurance agency.

In granting summary judgment to the reinsurer, the court held that assets, including the renewals and relationships with insurance brokers, were transferred from the insurance agency to its successor, leading to at least 75% of the value of the insurance agency transferred to the successor. The court found that there were no issues of fact, so the only issue was whether the transfer of these assets was sufficient to hold the principals liable for the amounts transferred.

The court also held that the reinsurer became a creditor of the successor to the insurance agency before the distribution of the successor's assets to the principals occurred, which left the successor insolvent. Thus, held the court, liability was found under a constructive fraud theory, that a fraudulent transfer occurred, which entitled the reinsurer to recover a judgment against the successor equal to the amounts claimed.

The court also held that the reinsurer established its creditor status under the California Uniform Fraudulent Transfer Act and on the basis of successor liability. Under all these findings, and the lack of a triable issue of fact, the court granted summary judgment in favor of the reinsurer and against the principals of the insurance agency.

Massachusetts Court Denies Reinsurers' Discovery Request for Declaratory Judgment Expense Documents

Lamorak Ins. Co. v. Certain Underwriters at Lloyd's, London, No. 188CV00200-BLS2, 2019 Mass. Super. LEXIS 385 (Mass. Super. Jun. 19, 2019).

In a dispute over reinsurance coverage for an environmental settlement with the underlying policyholder, the reinsurers brought a motion to compel the cedent to produce its documents regarding its declaratory judgment expenses in the cedent's coverage litigation with the policyholder. The court denied the motion because of a lack of relevance to the issues before the court.

The main dispute is over whether the reinsurers are obligated to reimburse the cedent for the underlying settlement and related costs. The cedent had not asked the reinsurers to pay any part of the declaratory judgment expenses. Nevertheless, the reinsurers counterclaimed for a declaration that the reinsurers were not obligated to pay the declaratory judgment expenses.

In denying the motion to compel, the court stated that the reinsurers have not shown that the disputed document request is reasonably calculated to lead to the discovery of any relevant evidence. The court also found that the reinsurers have not shown that the requested documents have any relevance to the meaning of the reinsurance contracts. Even though the documents are relevant to the counterclaim, the court stated that "the possibility that the documents may be relevant and therefore discoverable in a hypothetical future action regarding the DJ Expenses does not make them discoverable here." Thus, because there was no actual controversy over the declaratory judgment expenses, the court declined to decide an abstract legal question or offer an opinion about hypothetical future conduct.

Alabama Federal Court Lifts Confidentiality Designation on Reinsurance Agreement

Theriot v. The Northwestern Mut. Life Ins. Co., No. 2:18-CV-688-ALB-SMD (M.D. Ala. May 17, 2019).

In a dispute over claims under a disability policy, the insurance company's designation of a reinsurance agreement as confidential has been lifted by a magistrate judge in Alabama federal court. The reinsurance agreement and other documents were subject to a stipulated sealing order and a confidentiality designation. The court decided that the documents did not need to be sealed or designated confidential because the defendant insurance company did not make a particularized showing of the specific harm that would result from the loss of confidentiality and how that harm outweighs the public interest. While stating that the reinsurance agreement contained "all manner of confidential and proprietary business information," the court found that the insurance company did not explain how those things are proprietary or what specific harm would result from disclosure. Nor did the defendant explain why redaction of particular information would not suffice.

New York Federal Court Holds Reinsurance Information Relevant and Subject to Production

99 Wall Development, Inc. v. Allied World Specialty Ins. Co., No. 18-CV-126 (RA)(KHP), 2019 U.S. Dist. LEXIS 100454 (S.D.N.Y. Jun. 14, 2019).

A New York magistrate judge ruled similarly to the decision above, that reinsurance information was relevant to the case, and found in favor of the policyholder in this insurance breach of contract and bad faith action. The underlying loss was two water leaks and the policyholder brought a breach of contract action and alleged bad faith claims handling. The court found that, because the complaint contained allegations of bad faith, the reinsurance information was relevant to the case because it shed light on the insurer's internal evaluations of the losses.

Recent Regulatory/Policy Developments

EU Third Country Equivalence and Reinsurance

On July 29, 2019, the European Commission published its "Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions." The Communication states the Commission's view and overall approach to third country equivalence and describes how the Commission will grant future equivalence to non-EU countries (including the UK after Brexit).

"Equivalence" refers to a process whereby the Commission assesses and determines that a third country's regulatory, supervisory and enforcement regime is equivalent to the corresponding EU framework. Recognition makes it possible for the competent authorities in the EU to rely on compliance with the third country framework, which has been deemed "equivalent" by the Commission. Equivalence is primarily used to reduce overlaps in regulatory and supervisory compliance. EU financial law includes approximately 40 provisions that allow the Commission to adopt an equivalence decision. On this basis, the Commission has taken more than 280 equivalence decisions for more than 30 countries, across various parts of the financial industry.

For reinsurers, positive Commission equivalence decisions can promote an open international insurance market, while simultaneously ensuring that policyholders are adequately protected globally. There are three distinct areas for equivalence assessment and decisions under the Solvency II regime (DIRECTIVE 2009/138/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)):

- Reinsurance (Article 172 of the Solvency II Directive) – Relevant for reinsurers from third countries. If the third country's rules are deemed equivalent, EU supervisors must treat that country's reinsurers in the same way as the EU reinsurers. This is likely to increase the attractiveness for EU insurers of entering into reinsurance arrangements with reinsurers from third countries. Further, where the solvency regime of a third country has been deemed to be equivalent to that laid down in the Directive, reinsurance contracts concluded with undertakings having their head office in a third country shall be treated in the same manner as reinsurance contracts concluded with undertakings authorized in accordance with the Solvency II Directive.
- Group Solvency calculation (Article 227 of the Solvency II Directive) – Relevant for EU insurers and reinsurers operating in a third country. A positive equivalence decision with regard to the capital requirements will allow internationally active insurance and reinsurance groups to use the national rules relating to capital (own funds) and capital requirements rather than the Solvency II rules. This would relieve the related companies in the third country from having to recalculate their data in conformity with the Solvency II requirements.
- Group supervision (Article 260 of the Solvency II Directive) – Relevant for insurers and reinsurers from third countries with activities in the EU. If the third country's supervisory rules are deemed equivalent in this area, EU supervisors will, under certain conditions, rely on the group supervision exercised by a third country. This would free the third country international groups from being subject to the unnecessary burdens arising from dual group supervision.

There are three types of equivalence under Solvency II for the three areas mentioned above, with the following characteristics:

- Full equivalence – Can be determined for all three areas mentioned above for an unlimited period of time.
- Temporary equivalence – Can be determined (if progress is being made towards full equivalence) for reinsurance (Art. 172. No 2, 3 of the Solvency II Directive) and third country groups operating in the EU (Art. 260 No.3 of the Solvency II Directive) for a limited period (until December 31, 2020 with the possibility to extend by one year).
- Provisional equivalence – Can be determined (if progress is being made towards full equivalence) for EU groups operating in the third jurisdiction (Art. 227. No 5 of the Solvency II Directive) for limited period (10 years, renewable for further 10-year periods).

For more, see Commission Delegated Decision (EU) 2015/2290 (June 12, 2015) on the provisional equivalence of the solvency regimes in force in Australia, Bermuda, Brazil, Canada, Mexico and the US, and applicable to insurance and reinsurance undertakings with head offices in those countries. The initial period of the provisional equivalence determined by this Decision is 10 years. The Commission may, nevertheless, undertake a specific review of an individual third country or territory at any time outside the general review, where relevant developments make it necessary for the Commission to re-assess the equivalence determined by this Decision. The Commission will continue to monitor, with the technical assistance of the European Insurance and Occupational Pensions Authority, the evolution of the regimes in force in the third countries covered by this Decision and the fulfilment of the conditions based on which this Decision has been adopted.

Recent Speeches and Publications

- Mary Jo Hudson will be speaking on the use of predictive analytics in life insurance underwriting at the Lexis/Nexis annual user symposium on September 18, 2019 in Colorado Springs, Colorado.
- Suman Chakraborty will be speaking on "Pick a Place: Is Arbitration Still the Preferred Forum for Reinsurance Disputes?" at the Association of Life Insurance Counsel (ACLI) Regional Roundtable on September 24, 2019 in Atlanta, Georgia.
- Eridania Perez is one of the co-chairs of the upcoming ARIAS• U.S. Fall Conference. At the Conference, Suman Chakraborty will be speaking on "The Life Reinsurance Partnership – Is the Relationship Heading for a Breakup?"; Deirdre Johnson will be speaking on "Rules for the Resolution of Insurance and Contract Disputes – Making an Expanded ARIAS a Reality"; Ellen Farrell will be speaking on "Effective Mediation Strategies for Insurance and Reinsurance Disputes"; and Larry Schiffer will be speaking on "Round Pegs in Round Holes: Effectively (and ethically) Marketing, Evaluating, and Selecting Arbitrators in a Changing World." The conference will be on October 3-4, 2019 in Brooklyn, New York.
- Eridania Perez spoke on "Tips on Oral Advocacy, Combining Substance with Technique" and participated as Claimant's Counsel as part of a Mock Hearing and Witness Examination, at the International Contracts and Arbitration Conference on June 28, 2019 in Siena, Italy.
- Mary Jo Hudson moderated a panel on "Predictive Modeling and the Future of Insurance Regulation" at the ALIC Annual Meeting on May 20, 2019 in Palm Beach, Florida.
- Larry Schiffer participated as the featured guest on the *Spot on Insurance Podcast* on June 11, 2019. His topic: Reinsurance 101.
- Larry Schiffer's commentary, "Consolidation of Reinsurance Disputes under Reinsurance Contracts" was published on IRMI.com in June 2019.
- Eridania Perez and Larry Schiffer both have chapters in the newly published *Insurance Law Practice, Third Edition* (John M. Nonna et al. eds., New York State Bar Association, 2019). Larry authored Chapter 15, "Reinsurance," and Eridania authored Chapter 17, "Arbitration as a Forum for Resolving Coverage Disputes."
- Congratulations to our firm for its great showing in *The Legal 500* 2019. Our Insurance & Reinsurance Group was recognized in The Legal 500 Industry Focus – Insurance: Advice to Insurers. Mentioned in the commentary about the firm were Deirdre Johnson, Paul Kalish, David Godwin and Suman Chakraborty. Larry Schiffer was recognized as a Leading Lawyer – Industry Focus: Insurance: Advice to Insurers: Reinsurance and continues to be recognized as a member of The Legal 500 Hall of Fame.
- Congratulations to Peter Kramer, Mark Sheridan, Larry Schiffer, Deirdre Johnson and Paul Kalish for being listed in the 2020 edition of *U.S. News & World Report*'s annual list of *The Best Lawyers in America*®.

Subscribe to our *Insurance & Reinsurance Disputes* blog. Please visit InReDisputesBlog and subscribe on the right side of the page via RSS feed or enter your email address in the box indicated.

Authors

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

Andreas Fillmann
Partner, Frankfurt
T +49 69 1739 2423
E andreas.fillmann@squirepb.com