SQUIRE PATTON BOGGS

REINSURANCE NEWSLETTER

March 2015

In this Issue

- Recent Case Summaries
- Recent Regulatory Developments
- A Brief Review of Reinsurance Trends in 2014
- Recent Speeches and Publications

Recent Case Summaries

Second Circuit Reverses Summary Judgment and Finds Ambiguity in Facultative Certificate's Limit of Liability Provision

Utica Mut. Ins. Co. v. Munich Reins. Am., Inc., No. 13-4170-cv, 2014 U.S. App. LEXIS 22765 (2d Cir. Dec. 4, 2014) (Summary Order).

Since the Second Circuit's decision in *Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co.*, 903 F.2d 910 (2d Cir. 1990), ceding insurers have been fighting an uphill battle to collect reinsurance proceeds for expenses where those loss adjustment expenses exceeded the overall limit of the facultative certificate. In a Summary Order, the Second Circuit weighed in on this issue again and distinguished the specific facultative certificate in this case from those in *Bellefonte*, *Unigard Sec. Ins. Co. v. N. River Ins. Co.*, 4 F.3d 1049 (2d Cir. 1993) and *Excess Ins. Co. v. Factory Mut. Ins. Co.*, 3 N.Y.3d 557 (2004), to find an ambiguity. The circuit court, in its summary order, which has no precedential effect, reversed summary judgment granted to the reinsurer, holding that extrinsic evidence was needed to determine the intent of the facultative certificate's language.

Here, the facultative certificate provided that the reinsurer agreed to indemnify the cedent "against losses or damages" "subject to the reinsurance limits shown in the Declarations." In subsequent paragraphs, settlements and expenses are not expressly made subject to the reinsurance limits. The court found this language ambiguous as to whether expenses were expressly excluded from the reinsurance limits. The court distinguished this language from the certificate language in *Bellefonte, Unigard* and *Excess*. The court noted that in *Bellefonte* and *Unigard*, the operative language expressly made all reinsurance obligations subject to the certificate's limit of liability, which was not the case here.

As to the New York Court of Appeals opinion in *Excess*, the Second Circuit conceded that the case establishes a presumption that a facultative certificate is presumptively expense-inclusive because it serves to cap a reinsurer's total exposure, but did not read Excess as holding that any presumption of expense-inclusiveness can be rebutted only though express language or a separate limit for expenses. While the court found that the certificate language here reasonably implies that expenses are not subject to the limit of liability, it is not strong enough to demonstrate that the expenses are unambiguously excluded from the limit of liability.

Nevertheless, the court's finding of ambiguity here did not suggest that the cedent was likely to or should prevail following the consideration of extrinsic evidence. The circuit court sent the case back to the district court to examine the parties' extrinsic evidence and then rule on the issue.

While the "costs in addition to the limits" issue was the main issue in the case, two other issues were determined. First, the court found that that the district court did not abuse its discretion in denying the cedent's motion to continue the case on the ground that the certificate language had not been proven. The court found that the parties did not really differ on the legitimacy of the specimen policy used to prove the contents of the second page of the certificate and that the cedent only raised this issue after the reinsurer moved for summary judgment.

Finally, the court also determined that there was no genuine dispute over whether the certificate contained a choice-of-law clause. It did not and based on a conflicts analysis, New York law was correctly applied.

Although this is a summary order without precedential value, this case is important because of the Second Circuit's willingness to consider extrinsic evidence on the issue of the scope and meaning of the limit of liability provision of a facultative certificate. As most cases, this case is very fact specific. Similar challenges to a *Bellefonte*-type defense will continue to be unsuccessful unless the precise certificate language provides for some ambiguity.

Illinois Intermediate Appeals Court Affirms Judgment for Reinsurer on Fac Cert

Cont'l Cas. Co. v. MidStates Reins. Corp., No. 1-13-3090, 2014 Ill. App. LEXIS 872 (IL. App. 1st Dist. Dec. 16, 2014).

In contrast to the Second Circuit case discussed above, an Illinois intermediate appellate court has affirmed judgment for a reinsurer in yet another *Bellefonte*-type case. Here there were five facultative certificates and the losses arose from environmental liabilities. In affirming the circuit court's grant of summary judgment to the reinsurer that the facultative certificates' limits-of-liability were expense-inclusive, the appellate court agreed with the circuit court that the certificates were not ambiguous.

The court noted the traditional "four corners" approach and that an ambiguity will not be found simply because the parties disagree on the meaning of a contractual provision. The appellate court agreed that the facultative certificates in this case were substantially similar to those in *Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co.*, 903 F.2d 910 (2d Cir. 1990). The appellate court noted that the analysis in *Bellefonte* has been widely accepted and agreed with the circuit court's finding that nothing in the provisions of the certificates can be said to remove expenses from the overall liability cap provided. Accordingly, the judgment for the reinsurer was affirmed.

Third Circuit Affirms Judgment in Favor of Retrocedent Dismissing Duty of Utmost Good Faith Rescission Claim

Munich Reins. Am. Inc. v. Am. Nat'l Ins. Co., No. 14-2045, 2015 U.S. App. LEXIS 1652 (3d Cir. Feb. 3, 2015).

In a non-precedential opinion, the Third Circuit Court of Appeals affirmed a district court's judgment dismissing a retrocessionaire's breach of contract and rescission counterclaims based on an alleged breach of the duty of utmost good faith to disclose material information. The underlying business was workers' compensation.

The retrocedent reinsured an excess-of-loss segment of the original cedent's business. It then retroceded an excess layer of the same business through a managing agent to a retrocessionaire. This structure existed or a few years until the managing agent replaced the original retrocessionaire with a new retrocessionaire. The retrocedent gave the managing agent for the new retrocessionaire the same underwriting files that the retrocedent had obtained from the original cedent. The retrocedent, however, did not provide the retrocessionaire with information about the retrocedent's losses and other information concerning the underlying program.

After the retrocessional relationship broke down, the retrocedent sued the retrocessionaire for breach of contract. The retrocessionaire counterclaimed to rescind the reinsurance contracts claiming that the retrocedent breached its duty of utmost good faith by withholding information. After a bench trial, the district court held that the retrocessionaire had breached the contract and that the retrocessionaire was not entitled to rescission. The retrocessionaire appealed.

In affirming the district court, the circuit court found that all parties agreed that New York law on breach of the duty of good faith applied. The circuit court rejected the retrocessionaire's contention that he district court applied too harsh of a standard. The court agreed with the district court's formulation of materiality; information was material only if an objectively reasonable reinsurer would consider the information material and that material information needed to be disclosed only if a reasonable cedent would know it was material.

On the merits, the circuit court analyzed the findings of how the managing agent underwrote the retrocessional contract for the second retrocessionaire and found that the managing agent did not take into consideration much of the information that the retrocessionaire complained about. Also, although some requested information was not disclosed, the nondisclosure did not substantially thwart the retrocessionaire's purpose in asking for that information. Based on this analysis, the circuit court found that the district court did not clearly err in finding that the withheld information was not material to the retrocessionaire and did not need to be disclosed.

New York Federal Court Rules Arbitration Clause Governs Later Contract Dispute

Barton Malow Enters. v. Steadfast Ins. Co., No. 14cv7347, 2014 U.S. Dist. LEXIS 180106 (S.D.N.Y. Dec. 31, 2014).

A New York federal court granted a cedent's request to stay litigation pending arbitration, where a reinsurer argued that a subsequent settlement agreement barred both cedent's claims and its demand for arbitration.

The cedent provided insurance to an entity and, in 2013, ultimately paid US$15 million in settlement of a claim to the insured. Part of the settlement was a release of the insured and all of its unnamed "subsidiaries and affiliates." After executing the settlement agreement, the cedent discovered it has previously purchased reinsurance from the reinsurer, and that the reinsurer was a wholly-owned subsidiary of the released insured entity.

The cedent made a claim under the reinsurance contract, and reinsurer opposed payment because the cedent had released all claims under the 2013 settlement agreement. The reinsurer brought a breach of contract claim in federal court and cedent sought to stay the federal court action and compel arbitration under the terms of the arbitration clause in the reinsurance agreement.

The court held that because the 2013 settlement agreement was silent on the issue of forum selection, the arbitration provision controlled and required that the parties submit their dispute to arbitration. The court reasoned that the reinsurer's claims fell within the broad scope of the reinsurance agreement's arbitration provision as the reinsurer's claims implicated both the rights and obligations of cedent and reinsurer. The court also rejected the reinsurer's arguments concerning the invalidity of the arbitration clause. The court found that the 2013 settlement agreement did not include express language stating that the later-executed settlement agreement overrode the reinsurance contract. Neither did the settlement agreement specify that any disputes would be heard in federal court rather than in arbitration.

Reinsurer Loses Motion to Stay Arbitration

ROM Reins. Mgt. Co. v. Continental Ins. Co., No. 654480/2012 (N.Y. Sup. Ct., N.Y. Co. Jan. 5, 2015).

On a second try at seeking to stay arbitration over two reinsurance contract, the reinsurer's application was denied. In the first attempt, the reinsurer claimed that the statute of limitations had expired. That issue ended up being sent back to the motion court to determine after an intermediate appellate court held that New York law applied and required the court to make that determination rather than the arbitrators.

In the second attempt at a stay, the cedent argued that the statute of limitations was waived by the reinsurer participating in the arbitration process. The reinsurer claimed that while it picked its own arbitrator, it did not participate in picking the neutral arbitrator and therefore the arbitration had not begun. The court rejected this argument finding that the reinsurer had engaged in the arbitration and waived its right to stay arbitration. The court found no distinction between selecting a party-appointed arbitrator or a neutral arbitrator to determine when the arbitration commenced. Accordingly, the reinsurer waived the statute of limitations by participating in the arbitration and the stay was denied.

Arbitration Award Confirmed, But Sealing of Record Not Decided

Clearwater Ins. Co. v. Granite State Ins. Co., No. 15-cv-165 (RJS), 2015 U.S. Dist. LEXIS 13792 (S.D.N.Y. Feb. 5, 2015).

A New York federal court granted a reinsurer's unopposed petition to confirm an arbitration award, but required more briefing on whether it was appropriate to seal the record. Both parties jointly requested the court to seal. The court noted that in the Southern District the papers on a petition to confirm an arbitration award are judicial documents and that the parties must overcome a strong presumption of public access. Because in this case the parties offered no facts or arguments that justify sealing, the court gave the parties the opportunity to submit briefs to support the sealing.

The trend in the courts is to refuse to seal the record even if the underlying matter arose in a confidential reinsurance arbitration. While there is some precedent in the Seventh Circuit that supports sealing, that is not the situation in New York. This is an important issue for reinsurance arbitration given the confidential nature of most proceedings.

Broad Discovery Requests for Non-Party Information Denied

Utica Mut. Ins. Co. v. Clearwater Ins. Co., No. 6:13-CV-01178 (N.D.N.Y. Jan. 20, 2015).

In a highly contentious dispute over facultative reinsurance coverage for asbestos losses arising out of policies issued to Goulds Pumps, Inc., both the cedent and the reinsurer sought discovery of documents from non-parties to help them prove their case. The cedent sought documents concerning the reinsurer's other cedents that issued policies to Goulds Pumps and the reinsurer sought documents concerning policies the cedent wrote for other similar insureds and for a loss portfolio transfer agreement. The Magistrate Judge denied both motions (the court did require the reinsurer to respond to an interrogatory) finding that the documents requested were not relevant to the claims in dispute.

In denying both motions to compel discovery, the Magistrate Judge found that only the documents relied upon by the reinsurer in initially approving and paying the cedent's claim and then denying it under the specific facultative reinsurance certificates are relevant and discoverable. The specific documents sought by the cedent on unrelated contracts with non-parties were irrelevant. The court found these documents were not relied upon by the cedent to make its claims decisions.

Similarly, the information the reinsurer sought about an issue that had already been settled was unrelated to the issues in dispute. Moreover, the court found that the loss portfolio transfer agreement was unrelated to the obligations between the cedent and the reinsurer for the facultative certificates at issue.

New York Federal Court Allows Late Notice and Bad Faith Defenses to Go to Trial

Utica Mut. Ins. Co. v. Fireman's Fund Ins. Co., No. 6:09-VC-853, 2015 U.S. Dist. LEXIS 15068 (N.D.N.Y. Feb. 9, 2015).

In yet another Goulds Pumps asbestos case, a New York federal court denied the cedent's motions for partial summary judgment dismissing a reinsurer's defenses of late notice and bad faith. Late notice defenses are relatively rare and difficult to sustain, but here the reinsurer provided proof that it commuted with all its retrocessionaires prior to receiving notice of loss from the cedent and that those commutations would have been either different or not consummated if the reinsurer had known about the Goulds Pumps asbestos losses.

In denying the motions, the court concluded that commutations are not collateral matters and maybe used to establish prejudice under a late notice defense if a reinsurer can demonstrate it suffered tangible economic injury resulting from the cedent's late notice. The cedent argued that commutations were merely collateral and did not bear on the reinsurance recoveries under the facultative certificates. The court rejected the cedent's position and articulated how commutations could be used to establish prejudice under a late notice defense. The court also held that a reinsurer that establishes prejudice would be entitled to complete relief from its duty to indemnify, not merely the measure of damages for which it was harmed.

The court also held that the cedent's claim for indemnification will be barred if the reinsurer can show that the cedent acted in bad faith in failing to provide timely notice. Because there remained genuine issues of material fact on whether the cedent was grossly negligent or reckless in failing to provide prompt notice under the facultative certificates, summary judgment was inappropriate.

Louisiana Federal Court Orders Production of Reinsurance Information in Bad Faith Case

Leevac Shipbuilders LLC v. Westchester Surplus Lines Ins. Co., No. 2:14-cv-00399, 2015 U.S. Dist. LEXIS 5070 (W.D. La. Jan. 15, 2015).

The insured sought to compel discovery of reinsurance documents and communications in the possession of the cedent or "practically obtainable by them" in furtherance of its bad faith claim. The cedent had previously produced more than 2,200 pages of documents and had indicated that those were "all of the documents and information available to [cedent] with respect to the [insured]'s policy, claim, and current lawsuit."

Nevertheless, the court compelled production of reinsurance documents and communications to the insured to the extent the information had not already been provided. The court noted that "every case brought to this Court's attention that specifically considered the relevance of reinsurance-related communications to the issue of bad faith . . . found that such communications are discoverable," and thus saw "no reason to break from such precedent." Those cases included decisions from district courts in Louisiana, Kansas, and Illinois.

In reaching its decision, the court here joins a growing cadre of district courts in California, Iowa, Minnesota, New York, and Washington, which have reached similar conclusions, as this Newsletter has previously discussed. The appellate courts have yet to weigh in decisively on this issue.

Recent Regulatory Developments

US Treasury Department Issues FIO Report on Reinsurance

In a very interesting document issued in December 2014, the Federal Insurance Office provides its comprehensive report on reinsurance. The report provides a nice history of reinsurance and a good overview of how reinsurance works, including the current state of the market, but breaks no new ground concerning reinsurance. The descriptions of the various forms of reinsurance and the historical background may be useful in describing reinsurance to courts and juries. In any event, it is worth reading if you are involved in reinsurance. The report may be accessed on Treasury's website (PDF).

A Brief Review of Reinsurance Trends in 2014

The general trend of US court decisions in reinsurance cases during 2014 was to reinforce principles and precedents familiar from recent years. On the threshold subject of the agreement to arbitrate and arbitrability, courts affirmed and elaborated on the general rule that courts should not hear claims from a party to an arbitration agreement unless the question is a "gateway" issue or the arbitral panel has issued a final award. With the notable exception of one case, courts consistently applied the "*Bellefonte* Principle" to protect reinsurers from liability for defense costs beyond the specified facultative certificate limits, and continued to reject the common interest doctrine as a basis to resist discovery of reinsurance information.

Arbitration and Arbitrability

Five notable 2014 cases addressed issues of arbitration or arbitrability. First, in *Milan Express Co. v. Applied Underwriters Captive Risk Assurance Co.*, No. 14-5193, 2014 U.S. App. LEXIS 20637 (6th Cir. Oct. 23, 2014), the Sixth Circuit Court of Appeals vacated and remanded the district court's three-part holding that (1) the question of arbitrability was for the court to resolve, (2) the arbitration clause in a reinsurance contract was unenforceable under Nebraska law, and (3) convenience of the parties and the interests of justice weighed against a transfer of venue. The Sixth Circuit based its decision on the general rule that "unless the arbitration clause itself is challenged as invalid, the question of arbitrability is for the arbitrator, not the court, to decide."

In *Milan*, it was undisputed that the parties' reinsurance agreement included an arbitration clause requiring them to arbitrate any dispute arising under the agreement. The circuit court found that the district court erred in ruling that the question of arbitrability was within the court's province because, in the lower court's view, the agreement lacked "clear and unmistakable"[1] evidence that the parties intended questions of arbitrability to be resolved by an arbitrator. The district court failed to explain what was not "clear and unmistakable" in the language of the agreement; furthermore, the Sixth Circuit found, the agreement's language bore "no material difference" from that at issue in *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63, 67–70 (2010), and therefore satisfied the "clear and unmistakable" requirement.

The court also addressed the cedent's argument that the arbitration clause was unenforceable under Nebraska law. While acknowledging that might be true, the court found that the parties had expressly agreed to submit the question of enforceability to arbitration. Because the cedent had not challenged the arbitration clause on traditional contract grounds such as fraud or unconscionability the issue of enforceability remained subject to arbitration. The court did not substantively address the ruling on transfer of venue because it was mooted by the decision to vacate and remand for further proceedings.

In *Savers Prop. & Cas. Ins. Co. v. Nat'l Union Fire Ins. Co.*, 748 F.3d 708 (6th Cir. 2014), the Sixth Circuit upheld the general rule prohibiting a party to an arbitration agreement from bringing a claim in court before the arbitration panel issues its final award. In holding that the district court erred by "prematurely interjecting itself into this private dispute," the circuit court emphasized the policy reasons "for generally withholding judicial review until the conclusion of an arbitration proceeding." The court noted that the advantage of arbitration as a speedy and low-cost alternative to litigation is undermined when a court considers non-"gateway" issues before a final decision is made. "Gateway" issues include whether the arbitration agreement is valid and it applies to a particular type of controversy. The court found that the interim arbitration award here was not "final" for purposes of judicial review as established by *Island Creek Coal Sales Co. v. City of Gainesville, Fla.*, 729 F.2d 1046, 1049 (6th Cir. 1984), because "[n]one of the awards in question [in this case] 'finally and definitely dispose[d] of a separate independent claim.'"

For the first time, the First Circuit Court of Appeals addressed the question whether, in a subsequent arbitration, the preclusive effect of an earlier arbitration decision is a matter for the court or the arbitrator to decide where the earlier decision had been confirmed by a federal court order. In *Emp'rs. Ins. Co. of Wausau v. OneBeacon Am. Ins. Co.*, 744 F.3d 25 (1st Cir. 2014), a cedent entered into identical contracts containing arbitration clauses with several reinsurers. In 2007, the cedent commenced arbitration with one of the reinsurers, and the arbitration panel decided in favor of the reinsurer. When the cedent attempted to commence arbitration against the other reinsurers in 2012, its demand included billings for the same claims that the cedent had arbitrated and lost in 2007.

1 In applying the "clear and unmistakable" criterion, the district court cited the decision in *Solvay Pharms., Inc. v. Duramed Pharms., Inc.*, 442 F.3d 471, 477 (6th Cir. 2006).

Affirming the district court, the circuit court agreed that judicial confirmation of an arbitration award does not alter the general rule that an arbitrator, not the court, decides the preclusive effect of a prior arbitration award. The court noted, "the arbitrator's path to reaching the decision on the merits determines the preclusive effect of the arbitration." Because the district court would not consider in detail the steps leading to the decision in a prior arbitration, it should not have exclusive power to determine the preclusive effect of that arbitration.

In *Trenwick Am. Reins. Corp. v. CX Reins.Co.*, No. 3:13cv1264 (JBA), 2014 U.S. Dist. LEXIS 70823 (D. Conn. May 23, 2014), the court addressed whether, in the presence of a cut-through provision in a reinsurance agreement, a subsequent commutation agreement between the cedent and reinsurer necessarily extinguished the rights of the third-party beneficiary of the cut-through provision to commence arbitration with the reinsurer. The reinsurance agreement included a cut-through provision that, in the event of the cedent's insolvency, allowed a third-party beneficiary to "cut through" and arbitrate directly with the reinsurer. The reinsurer argued that a commutation agreement, which had not been executed before the cut-through was invoked, barred the third party's right to arbitrate. The court reasoned, however, that determining whether the arbitration provision was enforceable by the third-party beneficiary would necessitate interpreting the underlying contract; as such, that decision must be made by an arbitrator.

A New York federal court addressed disqualification of counsel in *Utica Mut. Ins. Co. v. Emp'rs. Ins. Co. of Wausau*, No. 6:12-CV-1293 (NAM/TWD), 2014 U.S. Dist. LEXIS 132271 (N.D.N.Y. Sept. 22, 2014). In *Utica*, a cedent and its reinsurers were involved in the underlying dispute in which their common interests were represented by one law firm. In a later arbitration between the cedent and its reinsurers, the cedent engaged the same law firm, this time against the reinsurers. The reinsurers sought to disqualify the law firm, citing the witness-advocate rule because the firm's attorneys would be necessary witnesses to the current dispute while also handling the arbitration. The cedent argued that the law firm never established a formal attorney-client relationship with the reinsurers, so that the witness-advocate rule did not apply. The court ruled for the reinsurers, finding that, although the reinsurers had not been the law firm's clients "in the traditional sense," an inquiry into the potential conflict may still be warranted if "there exist sufficient aspects of an attorney-client relationship." The court granted limited discovery under Fed. R. Civ. P. 56(d) to permit the reinsurers to investigate the basis for the law firm's possible disqualification. After a motion for reconsideration, the parties settled.

Compel Arbitration

Last year also continued the trend of courts denying motions to compel arbitration in unusual circumstances.

In *Transatlantic Reins. Co. v. Nat'l Indem. Co.*, No. 14 C 1535, 2014 U.S. Dist. LEXIS 85533 (N.D. Ill. Jun. 24, 2014), an Illinois federal court denied a reinsurer's amended petition to compel a non-signatory third party to join an arbitration. The reinsurance agreement provided for arbitration of any dispute arising between the cedent and reinsurer with regard to interpretation of the agreement or their rights as regards any transaction involved. The cedent later entered into a reinsurance agreement and a services agreement with a separate reinsurer that was not a party to the original reinsurance agreement. The second reinsurer was responsible for collecting proceeds and pursuing recoveries on the cedent's behalf. Years later, the original reinsurer stopped making payments to the cedent, and the cedent commenced arbitration. The original reinsurer sued, seeking to compel the second reinsurer to arbitrate as a party in the original reinsurer-cedent arbitration.

Generally, a party may not be compelled to arbitrate a dispute absent its having agreed to do so. The Seventh Circuit, however, recognizes several exceptions. In addition to arguing that the second reinsurer was bound by the broad language in the original reinsurance agreement, the original reinsurer argued that the recognized exceptions of assumption, agency, and estoppel applied.

In denying the original reinsurer's petition, the court briefly reviewed applicable law. The court found that: (1) the earlier reinsurance agreement explicitly used narrow language limiting the parties that are required to arbitrate to the cedent and the original reinsurer; (2) the second reinsurer entered into entirely separate agreements with the cedent, did not evidence any intent to assume the original parties' obligation to arbitrate, and sought to distance itself from the arbitration clause; (3) the only relevant language containing any reference to the original reinsurance agreement was that the second reinsurer agreed to provide services to the cedent "in accordance with the contractual terms of the applicable Third Party Reinsurance Agreements," which was not sufficiently explicit or specific to constitute an assignment of rights; and (4) the second reinsurer was not estopped from disclaiming an obligation to arbitrate because the benefit the second reinsurer received was only indirectly related to the original reinsurance agreement.

Arbitrator/Selection

In 2014, a New York federal court provided another example of a court preferring not to get involved in arbitrator selection. In *Odyssey Reins. Co. v. Certain Underwriters at Lloyd's London Syndicate 53*, No. 13 Civ. 9014 (PAC), 2014 U.S. Dist. LEXIS 96356 (S.D.N.Y. Jun. 30, 2014), a retrocedent sought to appoint an umpire to serve in its arbitration with its retrocessionaire. The retrocedent argued that the retrocessionaire's candidates were not qualified. The court rejected the retrocedent's petition to have the court appoint an umpire.

The court held that, absent a breakdown in the selection process that justifies court intervention, the parties must proceed to the next stage of the arbitrator selection process as detailed in the retrocessional agreements. The court also reiterated Second Circuit precedent that a district court cannot entertain an attack on the qualifications or partiality of arbitrators until after the conclusion of arbitration and the issuance of the award.

Contract Interpretation

Eight noteworthy decisions in 2014 dealt with reinsurance contract interpretation. The first applied longstanding precedent that the primary objective in contract interpretation is giving effect to the parties' intent as revealed by the language they used. In *Aioi Nissay Dowa Ins. Co. v. Prosight Specialty Mgmt. Co.*, 563 Fed. App'x 68 (2d Cir. 2014), the Second Circuit affirmed a judgment finding that a reinsurer was charged too much for reinstatement premiums on aviation reinsurance contracts that cedents purchased from a reinsurance pool and that were triggered by the September 11, 2001 terrorist attacks. The parties entered into two types of contracts: an excess-of-loss contract and a reinstatement of premium protection contract. Cedents contended that the contracts were best understood, under the "interrelated contracts doctrine," as equivalent to each cedent in the pool effectively having its own, single contract with the reinsurers. The court disagreed, noting that the "interrelated contracts doctrine" should be used only to effectuate the parties' intent and finding that, because the contracts were negotiated as independent, separately-priced transactions, the parties did not intend the contracts to be interrelated.

The court also addressed commutation agreements between the parties. The court rejected cedents' contention that the commutations included payment of reinstatement premiums, finding that the commutations were cancellations of contracts, not settlement of claims. The court also rejected cedents' contention that the commutations comprised reinstatement premium payments in the form of accelerated potential future obligations, finding that the commutations consisted of a lump sum, based on various considerations other than cedents' internal estimates of their net recoveries and for which cedents never presented a claim for indemnity of the premiums allegedly paid in the context of these commutations.

Cedents also argued that the phrase "covered loss" in the stipulated formula for calculating reinstatement premiums should have been limited to the amount actually recouped from the reinsurance pool. The court found that the more natural reading of "covered loss" was the amount paid to an airline to settle an underlying claim, as evidenced by language in the contract indicating that "covered loss" encompassed the total amount that could have been claimed under the contracts, rather than the sum actually paid.

The literal wording of a contract is not always determinative, however, as was the case in *Greenlight Reins., Ltd. v. Appalachian Underwriters, Inc.*, No. 12-CV-8544 (JPO), 2014 U.S. Dist. LEXIS 102779 (S.D.N.Y. Jul. 28, 2014). There a New York federal court concluded that for two contracts between the parties each containing a "guarantee of payment" provision the guarantors were bound only by one because the other was not in substance a guarantee at all. The court found no genuine issue to dispute reinsurer's claim that it was owed debts under certain reinsurance and retrocession agreements; in dispute was whether the guarantor was obligated to pay those debts. As to the first purported "guarantee," the court determined that it was not a guarantee of payment despite being so labeled. Rather, it was a promise to fund certain companies with which the reinsurer conducted business so that those companies remained solvent. By contrast, as to the second "guarantee," the court found that it was a guarantee because it promised full and prompt payment as and when due under "relevant contracts."

Two noteworthy cases dealt with the appropriate boundaries of contractual provisions and obligations. In the first, *Pub. Risk Mgmt. of Fla. v. One Beacon Ins. Co.*, 569 Fed. App'x 865 (11th Cir. 2014), the court held that because claims raised in a suit against the cedent's insured could have been covered by the cedent's policy—thus triggering the cedent's duty to defend—the legal fees incurred in defending those claims would also be covered by the reinsurance agreement. Cedent, an intergovernmental risk management association, incurred legal fees defending one of its member cities against claims from a construction company that the city had made mistakes, misstatements, or omissions in breach of the city's contract with the company. The Eleventh Circuit determined that the alleged mistakes, misstatements, and omissions could be construed as "wrongful acts" with resulting damages and, therefore, could have been covered under the cedent's policy with the city. The court observed that, if the underlying defense fees were covered by the insurance policy, then those fees would also be covered under the reinsurance agreement.

In *Global Reins. Corp. of Am. v. Century Indem. Co.*, No. 13 Civ. 06577 (LGS), 2014 U.S. Dist. LEXIS 113793 (S.D.N.Y. Aug. 15, 2014), which is also discussed below for another purpose, the cedents argued that a loss portfolio transfer constituted treaty insurance and, therefore, did not violate the retention and anti-assignment provisions in the facultative certificates because it did not transfer all liabilities. The court disagreed, finding that the loss portfolio transfer may have violated the retention and anti-assignment provisions. As to the retention requirement, the court found that the loss portfolio transfer could not be treaty reinsurance because it applied retroactively.

The court cited language in New York Court of Appeals cases purporting to hold that treaty reinsurance must be obtained in advance of actual coverage. As to the assignment provision, the court found that, although the loss portfolio transfer contained an upper limit for coverage—and therefore did not constitute an assignment—the upper limit was so high as to be illusory.

This case warrants attention because the court specifically held that treaty reinsurance is prospective only. That may vary from the assumption of some in the reinsurance industry that a treaty is simply the reinsurance of a broad portfolio of business, regardless of retroactive or prospective risk assumption.

Costs-in-Addition/Bellefonte

With one important exception, three cases continued the trend of upholding the "*Bellefonte* Principle"—derived from *Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co.*, 903 F.2d 910 (2d Cir. 1990), which established that liability for defense costs will not extend above the total liability limit clearly specified in a facultative certificate of reinsurance. In *Utica Mut. Ins. Co. v. Clearwater Ins. Co.*, No. 6:13-cv-1178 (GLS/TWD), 2014 U.S. Dist. LEXIS 162645 (N.D.N.Y. Nov. 20, 2014), a New York federal court found for the reinsurer in a dispute involving limits of liability under a facultative reinsurance certificate. Consistent with the many *Bellefonte* progeny, here the facultative certificates reinsuring umbrella policies had a liability and basis of acceptance clause, which identified the exposure reinsured. As the court noted, the sole issue was whether the cedent could recover defense costs or other expenses in excess of the sums stated in the liability clauses in the certificates. In ruling for the reinsurer, the court rejected cedent's argument that the lack of the word "limit" in the certificates was a distinguishing factor and denied its request for further discovery and consideration of extrinsic evidence. The court found that the certificates were unambiguous and *Bellefonte* was directly applicable to the liability limits at issue.

Similarly, in *Global Reins. Corp. of Am. v. Century Indem. Co.*, No. 13 Civ. 06577 (LGS), 2014 U.S. Dist. LEXIS 113793 (S.D.N.Y. Aug. 15, 2014), discussed above, the court adhered to Second Circuit precedents regarding overall cap on liability limits in a dispute involving nine facultative certificates that contained a "Reinsurance Accepted" value ranging from US$250,000 to US$2 million. The reinsurer claimed that the reinsurance limit constituted a cap on its liability, while the cedent asserted it constituted a cap on losses only, leaving recovery for expenses uncapped.

The court found that, because each certificate contained a "Subject To" clause (which stated that the reinsurance was in consideration of payment of premiums and subject to terms, conditions, and amount of liability), and stated a dollar amount of liability in the "Reinsurance Accepted" section, the total liability for both loss and expenses was capped at the dollar amount stated in the "Reinsurance Accepted" section of each certificate. In so holding, the court found that the language in the certificates was nearly identical to that relied on in *Bellefonte.*

Third of this group, in *Continental Cas. Co. v. MidStates Reins.Corp.*, No. 1-13-3090, 2014 Ill. App. Unpub. LEXIS 2456 (Ill. App. Ct. Nov. 4, 2014), an Illinois appeals court found for the reinsurer where its facultative certificates clearly and unambiguously provided an aggregate limit on reinsurance assumed. Reinsurer paid claims for environmental liabilities up to the total of the reinsurance limits under the certificates; cedent contested the limits. Applying the "four corners" approach to contract construction, the court held that the certificates clearly and unambiguously provided for an aggregate policy limit that included both losses and expenses because the "reinsurance provision" portion of the contract only discussed liability in general terms, which indicated that the contracting parties did not intend to separate losses from expenses when calculating the reinsurer's liability. The court adopted the *Bellefonte* principle as widely accepted and held that the facultative certificates provided a clear policy limit, inclusive of expenses.

By contrast, a decision from the Second Circuit—the court that gave birth to *Bellefonte*— distinguished the facultative certificate in that case from those in *Bellefonte* and its progeny, *Unigard Sec. Ins. Co. v. N. River Ins. Co.*, 4 F.3d 1049 (2d Cir. 1993) and *Excess Ins. Co. v. Factory Mut. Ins. Co.*, 3 N.Y.3d 557 (2004). In *Utica Mut. Ins. Co. v. Munich Reins. Am., Inc.*, No. 13-4170-cv, 2014 U.S. App. LEXIS 22765 (2d Cir. Dec. 4, 2014), a summary order with no precedential effect, the court reversed summary judgment for the reinsurer, holding that extrinsic evidence was needed to determine the intent of the facultative certificate's wording. Here, the certificate provided that the reinsurer would indemnify the cedent against "losses or damages" as "subject to the reinsurance limits shown in the Declarations." In subsequent paragraphs, settlements and expenses were not expressly subject to the reinsurance limits, and the court found the certificate ambiguous as to whether expenses were expressly excluded from the reinsurance limits. The court determined that the language at issue was distinct from that in *Bellefonte,* and that *Excess* did not extend the rule to mean that every limit of liability is presumptively expense inclusive, absent express language to the contrary or a separate limit for expenses. Rather, the court determined that although that presumption may reflect the parties' intentions in most cases, a party is bound by the terms to which it has agreed.

What is notable and controversial given the summary order nature of the decision is the Second Circuit's willingness to re-examine its precedent and that of the New York Court of Appeals and distinguish the language of the facultative certificates in each case. Essentially, the court, while acknowledging the judicial development of a presumption that the limits of liability in a facultative certificate are unambiguously expense-inclusive, held that the presumption can be rebutted by more than showing express language excluding expenses or a separate limit for expenses.

Discovery

Continuing a trend of recent years, courts in 2014 again rejected the common interest doctrine and required both cedents and reinsurers to produce reinsurance communications.

In *Progressive Cas. Ins. Co. v. FDIC*, 302 F.R.D. 497 (N.D. Iowa 2014), the court granted an insolvent bank receiver's motion to compel production of reinsurance communications regarding the bank's insurance policies. The court broadly rejected arguments that reinsurance communications were protected by the attorney–client and attorney work product privileges and the common interest doctrine. The court concluded that the information was created in the ordinary course of the cedent's business and was provided to the reinsurer and the broker for business purposes. Because the cedent provided those documents to the reinsurer and broker, the court concluded it had waived any attorney–client privilege. Because the information was not provided to build a legal defense or for litigation strategy, the court rejected the common interest doctrine, with this telling statement: "The unique circumstances of the reinsurance business do not automatically give rise to a common legal interest."

Similarly, in a case from Minnesota, *Nat'l Union Fire Ins. Co. v. Donaldson Co.*, No. 10-4948 (JRT/JJG), 2014 U.S. Dist. LEXIS 85621 (D. Minn. Jun. 24, 2014), the court ordered a cedent to produce communications with its reinsurer. Here the cedent sought reimbursement from its insured for amounts paid into a settlement that fell within the insured's deductible. The insured counterclaimed for bad faith, claiming the cedent failed to notify the insured of its method of policy interpretation in a timely manner. The insured sought discovery in support of its bad faith claim of three types of documents: (1) internal underwriting files; (2) loss reserve information; and (3) communications with reinsurers.

The court approved these disputed requests. The court reasoned that these documents could reveal the cedent's intended contract interpretation for purposes of determining coverage, which would be relevant to the insured's bad faith claim. The court also concluded the categories of documents sought could reveal what the cedent knew, and when it knew its plans for applying coverage to the insured's claims.

These cases continue a growing trend of federal courts around the country—including in California, Iowa, Minnesota, New York, and Washington—that in recent years have ruled that the scope of discovery of reinsurance information is broad, and that the common interest doctrine does not apply to the regular business dealings of cedents and their reinsurers. These cases have all been decided at the district court level. Whether appellate courts will ultimately approve this approach, if and when these issues reach them, remains to be seen.

Statutes of Limitations

As in previous years, 2014 provided several cases concerning statutes of limitation in the reinsurance context. In one, *Hill v. Flagstar Bank*, No. 12-2770, 2014 U.S. Dist. LEXIS 86889 (E.D. Pa. Jun. 26, 2014), a Pennsylvania federal court granted summary judgment to a reinsurer on limitations grounds. The case involved several plaintiffs who sued a cedent that allegedly violated the Real Estate Settlement Procedures Act ("RESPA"). Plaintiffs agreed that they filed suit after RESPA's one-year statute of limitations expired. They argued that the doctrine of equitable tolling applied and permitted their claims.

In granting cedent's motion for summary judgment, the court noted the general rule that, when a plaintiff seeks to invoke equitable tolling and a defendant seeks summary judgment on the issue, courts must determine whether there is sufficient evidence supporting a finding that: (1) defendant engaged in concealment to mislead plaintiff regarding facts supporting their claim; (2) plaintiff exercised reasonable diligence; and (3) plaintiff was not aware, nor should have been, of the facts supporting their claim until a time within the limitations period measured backward from when the complaint was filed.

The court found that each plaintiff failed to diligently pursue its claims during the statute of limitations period. Specifically, neither party investigated or pursued their claims until their attorneys prompted them to do so, well after the statute of limitations expired. The court also found that the record was devoid of evidence that the cedent actively mislead the plaintiffs. The cedent never communicated with plaintiffs and had no duty to do so. In the absence of a duty to speak, silence is insufficient to toll the statute of limitations in RESPA cases.

In a second case, *In re ROM Reins. Mgmt. Co., Inc. v. Continental Ins. Co., Inc.*, 982 N.Y.S.2d 73 (N.Y. App. Div. 2014), a New York intermediate appellate court ruled that, in certain circumstances, state law may override the presumption that procedural issues are for arbitrators and not courts to decide. Here the parties had an agreement that contained an arbitration clause; neither party disputed that the Federal Arbitration Act ("FAA") controlled. Under the FAA, "resolution of a statute of limitations defense is presumptively reserved to the arbitrator, not the court," but parties may expressly agree to leave timeliness issues to the court. A New York arbitration statute provides that determining whether a claim is barred as untimely is for a court to decide. The arbitration clause in the parties' agreement expressly provided that the "arbitration laws of New York State" governed. The issue was thus whether timeliness of an arbitration demand was to be determined by the court or the arbitrator.

The court held that the agreement's wording evidenced intent to have New York law govern questions regarding arbitration and enforcement. It was the "critical language concerning enforcement" required by common law that allows for the exception that statute of limitations issues may be addressed by the court. The court noted that, when parties clearly agree to abide by state rules of arbitration, enforcing those rules is consistent with the goals of the FAA.

Follow-the-Settlements/Defense Costs

In *Emp'rs. Ins. Co. of Wausau v. R&Q Reins. Co.*, No. 13-cv-709-bbc, 2014 U.S. Dist. LEXIS 67473 (D. Wis. May 16, 2014), a Wisconsin federal court granted partial summary judgment on billings of indemnity and expense in favor of the cedent. The cedent issued two umbrella policies to its insured that defined the limit of liability per occurrence as the total limit of liability for damages, direct and consequential, and defense expense because of personal injury. The reinsurer issued facultative certificates covering the umbrella policies. The facultative certificates included standard following language and provided that, if the cedent's policy limit included expenses, the reinsurer's maximum limit of liability was that stated in the declarations.

Losses were paid by the cedent in a settlement that included costs for indemnity and expense. The cedent billed under the facultative certificates, and the reinsurer refused to pay. The issue was whether defense expenses could qualify as a portion of the settlement. Both parties relied on the "follow-the-settlements" clause.

The court granted partial summary judgment to the cedent on its claim that it could bill indemnity and expenses together. The court found for the cedent in part because the reinsurer never explained why it believed defense expenses did not qualify. Specifically, the reinsurer never demonstrated that it was being asked to pay outside the contract's scope or argued that the settlement amount exceeded the policy limit. This case illustrates the simple but important point that, to argue that the usual application of the follow-the-settlements doctrine is inappropriate, a party must show a reasoned basis why it is inappropriate.

Tax Issue

Tax issues are seldom addressed in reinsurance disputes. A particularly interesting case regarding excise taxes, however, was decided in 2014. In *Validus Reins., Ltd. v. United States*, 19 F. Supp. 3d 225 (D.D.C. 2014), the court addressed whether excise taxes could be collected on retrocession transactions. Under 26 U.S.C. § 4371(3), insurance transactions involving policies issued by foreign insurers or reinsurers are taxed. Under that section, a retrocedent – a Bermuda corporation—paid excise taxes on premiums paid on reinsurance contracts. The retrocedent purchased the reinsurance from foreign retrocessionaires to cover the risks associated with its own reinsurance contracts. The retrocedent sought to collect the full amount of the excise tax.

The court held that the plain language of the statute did not impose an excise tax on retrocessional transactions. Specifically, the retrocedent's transactions fell outside the plain language of paragraphs (1) and (2), which limit the section's application to reinsurance contracts. The court further held that neither the statute's introductory language nor the definition of "policy of reinsurance" warranted a different conclusion. The court granted summary judgment in favor of the retrocedent and held that 26 U.S.C. § 4371 does not impose an excise tax on retrocessional transactions. The case is currently on appeal before the Court of Appeals for the District of Columbia Circuit.

Congratulations to John Nonna, who was elected to his second three-year term on the ARIAS• U.S. Board of Directors.

We are proud to announce the launch of our new blog, the Insurance & Reinsurance Disputes Blog. Edited by Larry Schiffer and Suman Chakraborty, the blog will provide timely commentary on a wide variety of insurance and reinsurance disputes issues. Please visit InReDisputesBlog at http://www.inredisputesblog.com/.

Recent Speeches and Publications

- **Norma Krayem** is speaking on international cybersecurity issues at the American Conference Institute's Forum on Cyber & Data Risk Insurance on March 23, 2015 in Chicago.
- **Suman Chakraborty** spoke on "Attorney Disqualification in Reinsurance Disputes: Where Do We Draw The Line?" at the IRU/ Reinsurance Networking Group meeting on December 9, 2015, in New York City.
- **Larry Schiffer** authored, "Which Came First, the Insurance Policy or the Reinsurance Contract?" an Expert Commentary on Reinsurance for IRMI.com, the website of International Risk Management Inc., in December 2014.

Authors of Squire Patton Boggs' Reinsurance Newsletter

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

Gary Timin
Miami, FL
T +1 305 577 2860
E gary.timin@squirepb.com

Maxine Martin
Denver, CO
T +1 303 894 6177
E maxine.martin@squirepb.com

Gregory S. Schneider
Phoenix, AZ
T +1 602 528 4803
E gregory.schneider@squirepb.com

Andrew H. King
Columbus, OH
T +1 614 365 2843
E andrew.king@squirepb.com

Ben Tarbell
Washington DC
T +1 202 457 6159
E ben.tarbell@squirepb.com

Martha Wrangham
Denver, CO
T +1 303 894 6115
E martha.wrangham@squirepb.com

16581/02/15