SQUIRE PATTON BOGGS

# REINSURANCE NEWSLETTER

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## Squire Patton Boggs Make Strong Showing in *Chambers USA 2015*

We are proud to announce that among the many rankings in *Chambers USA 2015*, the firm was ranked Band 3 for New York for Insurance: Dispute Resolution: Insurer. Congratulations to John Nonna, who was ranked in Band 1 for Nationwide: Insurance: Dispute Resolution: Insurer; Nationwide: Insurance: Dispute Resolution: Reinsurance; and New York: Insurance: Dispute Resolution: Insurer; Larry Schiffer, who was ranked in Band 2 for New York: Insurance: Dispute Resolution: Insurer; and Mark Sheridan and Lew Murphy, who were ranked in Band 3 for New Jersey: Litigation: Insurance and Florida: Litigation: General Commercial, respectively.

## Recent Case Summaries

### First Circuit Rules on Honorable Engagement Provision in an Arbitration Clause

*First State Ins. Co. v. Nat'l Cas. Co.*, No. 14-1664, 2015 U.S. App. LEXIS 4614 (1st Cir. Mar. 20, 2015).

In a rare court opinion notable for the court's use of words not normally seen in everyday writing, the United States Court of Appeals for the First Circuit addressed the operation and effect of an honorable engagement provision in an arbitration clause in a reinsurance treaty. The focus of the appeal was on whether an arbitration award should be vacated or confirmed based on the remedy contained in an arbitration award.

A billing dispute arose between a retrocedent and its retrocessionaire over a series of reinsurance contracts. The parties agreed to a single arbitration before a panel of arbitrators. The panel first addressed certain contract interpretation issues and issued an award that produced a payment protocol for how billings would be handled in the future. The award stated that payments on the billings may be subject to a reservation of rights where the retrocessionaire identifies specific facts that create a reasonable question of coverage under the reinsurance contracts. The award further stated that the payment obligations were not conditioned on the retrocessionaire's audit rights or production of additional information.

The retrocedent sought to confirm the award and the retrocessionaire sought to dismiss the petition to confirm and to transfer venue. The case was transferred from the Southern District of New York to the District of Massachusetts. In the interim, the arbitration reached its conclusion, a final award was issued and confirmation of the final award was sought. The district court heard both petitions, confirmed the award and denied the retrocessionaire's motion to vacate.

In affirming, the circuit court noted the familiar refrain that a party seeking to vacate an arbitration award "normally faces a steep uphill climb." Of more relevance, the court stated that where an arbitration clause contains an honorable engagement provision "judicial review is encumbered by yet a further level of circumscription." An issue arose concerning whether the motion to vacate was made within the requisite 90-day period, but the court sidestepped that issue to reach the merits.

At its essence, the retrocessionaire claimed that the arbitration panel exceeded the scope of its authority by ordering the payment protocol and decoupling payments from the retrocessionaire's audit rights. The court noted that the award explained that the payment protocol was based on the terms of the reinsurance contracts and confined the retrocessionaire's payment obligation to the obligations existing under those contracts. Moreover, found the court, the award tracked language directly from the payment provisions in the reinsurance contracts. Based on these and other factors, the court found that the award was indeed based on the arbitrators' construing the reinsurance agreements. In reaching this conclusion, the court made it "perfectly clear" that whether the arbitrators were correct was not within the court's purview.

But the retrocessionaire also challenged the reservation of rights procedure crafted by the arbitration panel and claimed that this procedure operated to circumscribe the retrocessionaire's broad audit rights. The court disagreed and relied on the honorable engagement provision of the arbitration clause to reach that conclusion. The court held that "an honorable engagement provision empowers arbitrators to grant forms of relief, such as equitable remedies, not explicitly mentioned in the underlying agreement." The court thought

this to be a "huge advantage" because it enhanced the prospects for a successful arbitration based on the arbitrators' flexibility to custom-tailor remedies to fit particular circumstances. The honorable engagement provision, said the court, "ensures that flexibility." Accordingly, the court held that the honorable engagement provisions in the arbitration clauses of the reinsurance agreements authorized the arbitrators to grant equitable remedies and that the reservation of rights procedure was such a remedy.

Very few cases interpret the honorable engagement provision. Here, the First Circuit found that this provision fits nicely with the federal policy favoring arbitration because it enhances the flexibility of arbitration and allows for the crafting of awards to fit the circumstances of reinsurance disputes. As long as the award takes its essence from the reinsurance contract, an equitable remedy consistent with the contract will, in the First Circuit, not be viewed as exceeding the arbitrator's powers.

**Fifth Circuit Vacates Arbitration Award Because Arbitrator Exceeded Authority**

*PoolRe Ins. Corp. v. Organizational Strategies, Inc.*, No. 14-20433, 2015 U.S. App. LEXIS 5601 (5th Cir. Apr. 7, 2015).

The United States Court of Appeals for the Fifth Circuit vacated an arbitration award because the arbitrator exceeded his authority in granting the arbitration award. The dispute involved a captive insurance program. The contracts between the manager and the principal company required American Arbitration Association (AAA) arbitration, while the contracts between the reinsurer and the captive insurance companies required International Chamber of Commerce (ICC) arbitration. Moreover, the reinsurance agreements required that the arbitration take place in Anguilla and that the arbitrator be selected by the Anguilla, B.W.I. Director of Insurance.

A dispute arose over the premiums being paid and the principal company sought an audit. After the company's request for accounting changes was rebuffed, the agreements were cancelled and arbitration was filed. A further dispute arose over whether deposits were properly refunded under the reinsurance agreements. The arbitration demand was forwarded to a dispute resolution professional who appointed himself as arbitrator. He also became the arbitrator under the reinsurance agreements when the director of the Anguilla Financial Services Commission advised the reinsurer that there was no Anguilla Director of Insurance.

Despite objections and the joinder of the reinsurer in the arbitration, the arbitrator, under AAA rules, retained jurisdiction. After other procedural scrambling and court proceedings, the arbitrator ultimately issued an award in favor of the reinsurer and its manager. The award was challenged and the district court vacated the award holding that the arbitrator exceeded his authority.

In affirming, the circuit court noted the difference in appointment authority and in the governing rules under the different categories of contracts. The court also noted that the arbitrator could not have been appointed by the authority required under the reinsurance agreements because that person did not exist. Nevertheless, the court found that an arbitration award made by an arbitrator not appointed under the required method must be vacated. The court outlined the procedure for resolving the problem of a non-existent appointing authority; Section 5 of the Federal Arbitration Act (FAA). Under Section 5, the district court can appoint an arbitrator if there is a lapse in the naming of the arbitrator. Here, the mechanical breakdown in the arbitrator selection process that occurs when the appointing authority does not exist is the kind of lapse that can be addressed by an application for appointment under Section 5.

The court also held that the forum selection clause in the reinsurance agreements was also violated. The arbitrator had not applied ICC rules and therefore acted contrary to an express contractual provision. Accordingly, the arbitrator had exceeded his authority and the award was vacated.

With alarming frequency, arbitration clauses are drafted that name appointing authorities (often on impasse in the selection process), arbitral organizations and rules. Often these annotations are wrong or so specific that there is a real possibility that should a dispute arise compliance would be impossible. Care needs to be taken in naming appointing individuals, organizations and in invoking a particular set of rules to allow for contingencies should those individuals, organizations and rules no longer exist as described.

**Second Circuit Rules in Favor of Reinsurer on Late Notice Defense**

*Granite State Ins. Co. v. Clearwater Ins. Co.*, No. 14-1494-cv, 2015 U.S. App. LEXIS 5278 (2d Cir. Apr. 2, 2015) (Summary Order).

In a non-precedential Summary Order, the Court of Appeals for the Second Circuit held that Illinois law applied and that the reinsurer did not need to show prejudice where the notice of the reinsurance loss was untimely. The underlying dispute concerned the cession of asbestos-related personal injury claims under certificates of facultative reinsurance. The reinsurer claimed that notice of settlement of a large portfolio of these losses violated the prompt notice provisions of the certificates. The district court agreed and the circuit court affirmed.

The certificates required prompt notice of any event or development that the cedent reasonably believed might result in a claim against the reinsurer. The disputed question was whether, in the absence of a choice-of-law provision in the certificates, a New York court would apply the substantive law of New York or of Illinois to determine the effect of the cedent's failure to give timely notice.

Under New York law, late notice without a showing of prejudice is insufficient to defeat a cedent's billing. Under Illinois law, according to the court, late notice, regardless of whether the reinsurer suffered prejudice, is sufficient to defeat a cedent's claim for coverage. Citing a recent case by the same court (also a Summary Order), the circuit court in this case followed the finding that a New York state court would interpret Illinois law as containing a no prejudice rule. Thus, the reinsurer was not required to show prejudice because of the late notice when refusing to pay the cedent's billing.

With certain jurisdictions (a small minority) seemingly adhering to the no prejudice rule, where a case is filed and what law applies makes all the difference in the world.

**New York Federal Court Rejects Effort to Challenge a Judgment Confirming an Arbitration Award**

*Arrowood Indmn. Co. v. Equitas Ins. Ltd.*, No. 13cv7680 (DLC), 2015 U.S. Dist. LEXIS 63643 (S.D.N.Y. May 14, 2015).

A New York federal court denied a motion seeking to challenge a judgment confirming an arbitration award. The cedent and the reinsurer arbitrated over the billing of asbestos claims. The reinsurer demanded and the cedent opposed requests for documents involving other reinsurers. Ultimately, the cedent prevailed in the arbitration and petitioned the court to confirm the arbitration award, which was granted after the parties notified the court of a stipulation by which the reinsurer agreed not to oppose confirmation.

Some months later, the reinsurer communicated with other reinsurers on the same reinsurance contract and obtained a document that the reinsurer believed demonstrated that the cedent committed fraud on the arbitration panel. Essentially, the document allegedly set forth the reinsurance broker's views on how a specific clause was interpreted, which allegedly was consistent with the interpretation the reinsurer made at the arbitration. The reinsurer confronted the cedent and demanded access to all documents. The cedent had considered the very document and had objected to its production and opposed the reinsurer's request for documents as an overbroad audit request.

The reinsurer moved under Federal Rules of Civil Procedure 60(b)(3) to relieve itself of the judgment confirming the arbitration award based on fraud, misrepresentation or misconduct by an opposing party and for post-judgment discovery. The court denied the motions. In denying the motions, the court explained that Rule 60(b)(3) cannot be used as an end-around the provisions of the FAA on vacating or modifying an arbitration award. The court noted that, here, the judgment was entered to confirm an arbitration award and that the FAA controlled over any conflicting civil procedures. The grounds for challenging an arbitration award are set forth in Section 10 of the FAA. The reinsurer acknowledged that Rule 60(b)(3) cannot be used to challenge arbitration proceedings or the award, but argued that the alleged misconduct extended to the judicial proceeding to confirm the award.

The court saw the reinsurer's argument as a way to escape the three-month limitation period imposed by the FAA on motions to vacate an arbitration award. The court rejected this argument. Essentially, because the proceeding to confirm an arbitration award is a summary affair and because the real challenge by the reinsurer was to the arbitration proceeding not the judicial proceeding, the reinsurer was out of luck. The court outlined other cases with similar results. These courts all found that a party cannot attack an arbitration award through the Rule 60(b)(3) procedural mechanism. The strong presumption in favor of arbitration and deference to the arbitral process cannot be upended by claims of alleged misconduct in an arbitration proceeding by using Rule 60(b)(3).

**New York State Appeals Court Affirms Denial of Stay of Arbitration on Statute of Limitations Grounds**

*ROM Reins. Mgt. Co. v. Continental Ins. Co.*, No. 15198N, 654480/12, 2015 N.Y. App. Div. LEXIS 4292 (N.Y. App. Div. 1st Dep't May 21, 2015).

This case was summarized in our March 2015 Reinsurance Newsletter. The appellate court held that because the reinsurer participated in the arbitrator selection process it was precluded from seeking a stay on statute of limitations grounds from the court. The court reminded the parties that the statute of limitations issue was still subject to determination by the arbitrators.

**Montana Federal Court Holds Captive Reinsurance Company a Proper Party to an Arbitration Under a Captive Reinsurance Agreement Involving a Protected Cell**

*Pac Re 5-AT v. AmTrust N.A., Inc.*, No. CV-14-131-BLG-CSO, 2015 U.S. Dist. LEXIS 65541 (D. MT, May 13, 2015).

A Montana federal court has determined that a captive reinsurer that created a protected cell was a proper party to an arbitration demand under a captive reinsurance agreement. The dispute here was whether only the protected cell was the proper party to the arbitration demand. The arguments are complicated and get into the intricacies of protected cells and their legal status in the context of captive insurance under Montana law.

In finding against the reinsurer, the court performed a detailed analysis of Montana's protected cell company legislation. The court held that the protected cell was not a separate legal person from the protected cell company and did not have the capacity to sue or be sued independent from the larger protected cell company. The protected cell remains part of the protected cell company. The court found that here the reinsurer acted on behalf of the cell on the captive reinsurance agreement in dispute. Accordingly, the court granted the cedent's motion for summary judgment and held that the captive reinsurer was the proper party named and was bound by the results of the arbitration.

**New York Federal Court Denies Reconsideration on "Bellefonte" Issue**

*Global Reins. Corp. of Am. v. Century Indemn. Co.*, No. 13 Civ. 06577 (LGS), 2015 U.S. Dist. LEXIS 50236 (S.D.N.Y. Apr. 15, 2015).

A New York federal court has denied a cedent's motion for reconsideration on a "Bellefonte" issue in spite of the Second Circuit's subsequent decision finding ambiguity in a certificate of facultative reinsurance sufficient to deny summary judgment to the reinsurer. *Utica Mut. Ins. Co. v. Munich Reins. Am. Inc.*, 594 F. App'x 700 (2d Cir. 2014) (summarized in our March 2015 Reinsurance Newsletter).

The court denied the motion for reconsideration because it did not believe the cedent had pointed to a change in controlling law. It rejected any argument that the *Utica* decision represented a change in the law on whether the liability cap in a facultative certificate is a hard cap for all loss and expense.

The court also addressed *Utica* on the merits and distinguished the language in the facultative certificates in *Utica* from the language in this case. The court held that "*Utica* confirms that where, as here, 'a provision in the policies at issue … expressly ma[kes] all of the reinsurers' obligations 'subject to' the limit of liability' those polices 'are unambiguously expense-inclusive.'"

The "Bellefonte" wars continue.

**Illinois Supreme Court Denies Leave to Appeal on a "Bellefonte" Case**

*Cont'l Cas. Co. v. Midstates Reins. Corp.*, No. 1-13-2090, 2015 Ill. LEXIS 241 (Ill. Sup. Ct. Mar. 25, 2015).

In our December 2014 Reinsurance Newsletter, we reported on this case where an Illinois intermediate appellate court affirmed the motion court's grant of summary judgment in favor of a reinsurer on the total limits in a facultative certificate. The cedent's petition for leave to appeal to the Illinois Supreme Court was denied.

**Pennsylvania State Court Denies Summary Judgment to Reinsurer on "Bellefonte" Issue**

*Century Indemn. Co. v. OneBeacon Ins. Co.*, No. 02928 (Pa. Ct. Comm. Pl. Mar. 27, 2015).

A Pennsylvania state motion court denied a reinsurer's motion for summary judgment on yet another "Bellefonte" dispute. Once again the issue involves certificates of facultative reinsurance and whether the "Reinsurance Accepted" limit places a total cap on the reinsurer's liability.

In this case, the court carefully describes the relevant provisions of the facultative certificates, including the "Reinsurance Accepted" provision, which contains a clause subjecting the reinsurance to the general conditions set forth on the reverse side of the certificates. The general conditions included a provision stating that the liability of the reinsurer followed that of the cedent and another provision stating that the reinsurer will be bound by the settlements of the cedent to pay its proportionate share of the settlements and "in addition thereto," in the ratio that the reinsurer's loss payment bears to the cedents' gross loss payment, its proportionate share of expenses.

The reinsurer moved for summary judgment on the ground that the limit stated in the Reinsurance Accepted provision was a total cap on the reinsurer's liability, inclusive of expenses. The cedent obviously took a contrary view.

In denying summary judgment to the reinsurer, the court noted that this was a case of first impression in Pennsylvania. The court was faced with the parties' analysis of all the relevant cases in the *Bellefonte* line of cases and those that deviated from *Bellefonte*. *Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co.*, 903 F.2d 910 (2d Cir. 1990). The court found that the certificates in this case, while similar to *Bellefonte*, contained slight variations that lead to a different conclusion. Specifically, the court noted that on the front of the certificates the reinsurance premium was subject to the general conditions of the certificate and that General Condition I also stated that the reinsurer's liability will be subject to all the terms and conditions of the cedent's policy. In other words, held the court, the reinsurer's liability was subject to the terms and conditions here, while in *Bellefonte* the terms of the certificate were subject to the liability of the reinsurer. In *Bellefonte*, the reinsurance premium was subject to the terms of the certificate and the amount of liability set forth. The court found that the certificates in this case placed greater emphasis on the conditions themselves. Thus, said the court, a condition that excludes expenses in calculating the total loss limit holds more weight than the amount of "Reinsurance Accepted" when interpreting the certificates.

In reaching its conclusion, the court seized on the Second Circuit's "clarification" of *Bellefonte* where it held that *Bellefonte* did not establish a blanket rule that all limits of liability are presumptively expense-inclusive. *Utica Mut. Ins. Co. v. Munich Reins. Am., Inc.,* 594 F. App'x 700 (2d Cir. 2014) (summarized in our March 2015 Reinsurance Newsletter).

The court found that the terms of the certificates may have created a presumption of expense-exclusiveness as opposed to inclusiveness. Accordingly, the court denied the reinsurer summary judgment. And just to put a point on it, the court also stated it would have denied the motion on the ground that a latent ambiguity existed. Had it not denied summary judgment, it would have allowed evidence of industry custom and usage on the meaning of the certificates.

**New York State Appellate Court Denies Cedent's Motion for Summary Judgment Based on an Undeveloped Factual Record**

*New Hampshire Ins. Co. v. Clearwater Ins. Co.*, No. 653547/11, 2015 N.Y. App. Div. LEXIS 2452 (1st Dep't Mar. 24, 2015).

A New York state intermediate appellate court affirmed the denial of a cedent's motion for summary judgment on its allocation of asbestos losses under a facultative certificate and reversed the grant of the cedent's motion for summary judgment dismissing the reinsurer's affirmative defenses on notice and reporting obligations under the facultative certificate. The court held that because of the undeveloped factual record, summary judgment was inappropriate.

The dispute stems from the settlement of a policyholder's asbestos claims, the allocation of that settlement to the cedent's policies and the cession of those claims under a facultative certificate. The facultative certificate provided that the reinsurer's liability will follow the cedent's liability in accordance with the terms and conditions of the policy reinsured except for terms inconsistent with the certificate. The certificate also had a prompt notice provision.

The cedent's agreement settling the asbestos claims allowed the cedent to allocate the settlement as it saw fit. According to the court, the cedent allocated 100% of the settlement to asbestos products claims and 0% to any other claim (premises, bad faith and defense costs). Based on this allocation, the cedent ultimately billed the reinsurer under the facultative certificate for the reinsurer's share of the settlement and the reinsurer refused to pay.

The motion court had denied the cedent's motion for summary judgment based on its interpretation of the following provision of the certificate as a follow-the-settlements clause, which gave rise to collateral estoppel based on a Massachusetts case interpreting the cedent's certificate language. The appellate court disagreed with

this analysis, finding instead that there was no collateral estoppel and that the following clause was a follow form clause not a follow-the-settlements clause. The court's analysis of this issue is worth the read as many courts, commentators and parties conflate follow form clauses with follow-the-settlements clauses. The essence of the court's analysis is that the provision contained no reference to the cedent's claims handling and was therefore not a follow-the-settlements provision. Rather, the provision stated that the reinsurer's liability was to follow the cedent's liability in accordance with the terms and conditions of the reinsured policy.

Because there was no express follow-the-settlements clause in the certificate, the court held that it need not decide whether there was an implied duty of the reinsurer to follow the cedent's settlement based on the undeveloped record. Because on the limited record, the court had no way of telling whether the cedent's allocation of the settlement was reasonable, it affirmed the denial of the motion for summary judgment on allocation. The court also reversed the motion court and denied the cedent's motion to dismiss the reinsurer's affirmative defenses because there was a triable issue of fact as to whether the reinsurer was prejudiced by the late notice.

**Florida Federal Court Sustains Negligence Claim Based on Duty of Utmost Good Faith, But Dismisses Counterclaim Based on Breach of Duty of Utmost Good Faith**

*Old Republic Nat'l Title Ins. Co. v. First Am. Title Ins. Co.*, No. 8:15-cv-126-T-30EAJ, 2015 U.S. Dist. LEXIS 37747 (M.D. Fl. Mar. 25, 2015).

*Old Republic Nat'l Title Ins. Co. v. First Am. Title Ins. Co.*, No. 8:15-cv-126-T-30EAJ, 2015 U.S. Dist. LEXIS 44693 (M.D. Fl. Apr. 6, 2015).

In an unusual dispute between a title insurer and its reinsurer, a Florida federal court, in two separate opinions, denied the cedent's motion to dismiss a negligence claim brought by its reinsurer, but granted the reinsurer's motion to dismiss the cedent's counterclaim for breach of the duty of utmost good faith.

This dispute arose out of the settlement of mechanics liens for a power plant project. The reinsurer paid its share of the cedent's settlement under a full reservation of rights and brought an action seeking rescission, negligence, unjust enrichment and a declaratory judgment. The cedent moved to dismiss the reinsurer's negligence claim.

In the first opinion, the question before the court was whether the negligence claim could be sustained because it was pled in the alternative and because the allegations were sufficient to state that the cedent owed the reinsurer an independent duty in tort. Essentially, the reinsurer claimed that the cedent owed the reinsurer the duty to underwrite the title policies in a reasonably prudent manner inherent in the special relationship between cedents and reinsurers. In other words: the duty of utmost good faith.

In denying the motion to dismiss the negligence count, the court held that, in light of the duty of good faith that governs the relationship between cedent and reinsurer, the reinsurer presented a plausible claim for relief. Regardless, the claim was pled in the alternative and would have been sustained on that ground.

In the second opinion, the reinsurer moved to dismiss the cedent's counterclaims for breach of contract, breach of the duty of utmost good faith and for a declaratory judgment. The court dismissed the first two and sustained the third.

In dismissing the counterclaim for breach of contract, the court found that the cedent did not allege a breach of a specific contractual provision. The breach of contact allegations were merely that the reinsurer paid the loss under a reservation of rights, disputed its obligation to pay and sought to recoup the payment it had made under the reservation of rights. The court found that nothing in the counterclaim stated facts that could give rise to the reasonable conclusion that its reinsurance agreement prohibited the reinsurer's conduct. The court did sustain counterclaims on the issue of timeliness of the claim payment under the reservation of rights and on the issue of whether the reinsurer had to pay defense costs.

In dismissing the counterclaim for breach of the duty of utmost good faith, the court found multiple reasons to grant the motion. The court noted that as a matter of law a claim of breach of good faith cannot stand in the absence of a tenable breach of contract allegation. Here, because the duty of good faith between the cedent and the reinsurer was coextensive with the reinsurance contract, the failure of the cedent to allege that the reinsurer breached its duty of utmost good faith by violating specific contractual provisions precluded the claim. Nevertheless, the court sustained the cedent's claim that by failing to share in the defense costs the reinsurer may have breached its duty of utmost good faith.

**Indiana Supreme Court Reverses Summary Judgment in Favor of Excess Reinsurers and Finds Coverage**

*Wellpoint, Inc. v. Nat'l Union Fire Ins. Co.*, No. 49S05-1404-PL-244, 2015 Ind. LEXIS 316 (Ind. Sup. Ct. Apr. 22, 2015).

In an unusual case where a managed care organization self-insured for errors and omissions liability and purchased reinsurance for its self-issued primary and excess liability policies on a following form basis, the Indiana Supreme Court reversed summary judgment in favor of the excess reinsurers and found that the cedent/insured was entitled to errors and omissions coverage.

Here, the cedent/insured issued to itself a series of primary and excess liability policies covering itself for E&O liability. The excess policies were following form as were the various reinsurance certificates purchased to reinsure both the primary and excess policies. Thus, the language being construed by the courts concerning whether the excess reinsurers had to cover the alleged E&O loss was the language of the primary policy.

The cedent was sued by various plaintiffs for failing to pay claims and breaching contracts and laws in its managed care business. Claims under the Racketeer Influenced and Corrupt Organizations Act were also made. All the cases were consolidated into a single federal multidistrict litigation and ultimately were settled without any admission of wrongdoing or liability. The reinsurer for the self-insured primary policy paid the loss and exhausted coverage. The excess reinsurers denied coverage for both defense and settlement and this litigation ensued. Both the trial and intermediate appellate courts granted and affirmed summary judgment to the excess reinsurers, finding that because the allegations did not arise solely from the cedent's claims handling activities there was no coverage.

In reversing, the Indiana Supreme Court provided a detailed analysis of how the primary policy provided E&O coverage. The court found that to qualify for coverage, the cedent's entire liability need not arise solely out of its claims handling activities. The court also rejected the excess reinsurers' claim that public policy barred coverage for the allegations. The court found that "[i]n light of the very strong presumption of enforceability of contracts, and the relative equality of sophistication and bargaining power among the parties, we decline to find the covered risks to be uninsurable under Indiana law."

**New York Federal Court Grants Reinsurer's Motion to Remand Case to State Court**

*R&Q Reins. Co. v. Allianz Ins. Co.*, No. 15 Civ. 00166 (LGS), 2015 U.S. Dist. LEXIS 35154 (S.D.N.Y. Mar. 20, 2015).

A New York federal court remanded a reinsurance dispute back to state court from whence it came because it found that the cedent had waived its right to remove the case to federal court because it had asserted a counterclaim when the case was still in state court.

While we do not like to dwell on federal civil procedure in this Newsletter, this case is worth a mention because of the diverse nature of many reinsurance disputes and the predilection for parties to remove reinsurance disputes to federal court.

Here, after the reinsurer had brought the case in New York state court claiming that the cedent had overbilled the reinsurer, the cedent answered the complaint and interposed two counterclaims, including breach of contract and a declaratory judgment. The case was removed to federal court one day after the answer was filed.

The court held that the cedent waived its right to remove by seeking affirmative relief in state court. The court rejected the cedent's argument that its counterclaims only sought relief that would have been granted to it should the state court have denied the reinsurer's claims. The court found that the affirmative relief sought in the counterclaims sought more than just a denial of the reinsurer's claims.

**Reinsurer's Attempted Removal Thwarted by Its Own Untimeliness**

*Utica Mut. Ins. Co. v. Am. Re-insurance Co.*, No. 6:14-CV-1558 (MAD/TWD), 2015 U.S. Dist. LEXIS 54384 (N.D.N.Y. Apr. 27, 2015).

A New York federal court ordered the remand of a coverage dispute between a cedent and reinsurer. The cedent filed a breach of contract and declaratory judgment action in state court against two reinsurers, one of whom destroyed diversity. The diverse reinsurer sought severance of its claims from those of the non-diverse reinsurer. The state court granted the severance and paved the road for removal to federal court.

While the cedent appealed the severance order, the diverse reinsurer removed the action to federal court. Thereafter, the cedent moved for remand claiming that removal based on the severance order was improper because of the voluntary-involuntary rule, which prohibits removal where diversity is created without voluntary action by the plaintiff. The reinsurer responded arguing that the voluntary-involuntary rule should not apply because the cedent fraudulently joined the non-diverse reinsurer only to avoid a federal action where a prior ruling against it would preclude its current claims. The cedent replied asserting that the reinsurer's fraudulent misjoinder argument was untimely. The court agreed with the cedent.

First, the court held that the severance order was akin to an involuntary dismissal of a non-diverse party and, under Second Circuit precedent, it could not render the action removable. The court reasoned that the finality of a decision creating diversity was the determinative factor in whether an action was subsequently removable. And because the severance order (like a dismissal) was appealable and was, in fact, the subject of an appeal, it could not render the action removable.

The court also agreed with the cedent in that the reinsurer's fraudulent misjoinder argument was untimely. In its answer to the state-court complaint, the reinsurer asserted as a defense cedent's improper motivation in joining the non-diverse reinsurer solely to prevent removal of the action. Nevertheless, the reinsurer waited several months later, until after the severance order was issued, before seeking removal. The court concluded that it should have sought removal within 30 days of its answer, which was when it first ascertained that the party had been fraudulently joined. Because it did not do so, removal was deemed untimely and improper.

**Pennsylvania State Court Grants Partial Summary Judgment to Cedent for Interest on Late Payments**

*Century Indemn. Co. v. OneBeacon Ins. Co.*, No. 02928 (Ct. Comm. Pl. 1st Dist., Mar. 27, 2015).

In another opinion in a case discussed earlier in this Newsletter, a Pennsylvania state court granted partial summary judgment to the cedent on the issue of payment of interest under facultative certificates of reinsurance. This decision came after a similar earlier motion was denied because of factual issues. According to the court, those issues no longer remained.

In granting the motion, the court found, as a matter of law, that the reinsurer's obligation to make payment was triggered once it received a proof of loss. The court found no other conditions attached to the reinsurer's obligation to pay. Because the reinsurer was required to make payment promptly upon receiving a proof of loss, its failure to do so entitles the cedent to interest on the billing.

**New York Federal Court Holds Acquiring Company Satisfied Obligations Under Stock Purchase Agreement to Post-Closing Price Reduction on Failed Reinsurance Agreement**

*Harbinger F&G, LLC v. OM Group (UK) Ltd.*, No. 12 Civ. 05315 (CRK), 2015 U.S. Dist. LEXIS 33689 (S.D.N.Y. Mar. 18, 2015).

This complicated dispute involves litigation concerning the entitlement of the purchaser of a life insurance company to a post-closing price reduction because a post-closing reinsurance transaction was not approved by the relevant regulator. Under the stock purchase agreement, the acquirer agreed to purchase a life insurance company from the seller. If, however, after the purchase closed the acquirer could not obtain Maryland regulatory approval for a post-closing reinsurance transaction, the acquirer would be entitled

to a $50 million purchase price reduction. After the acquirer failed to obtain the approval of Maryland regulators, it sought the price reduction, which the seller refused to give. Both parties sued each other claiming breach of contract.

The court held after trial, based on the evidence presented, that the acquirer had satisfied its obligations under the contract. The court reasoned that the acquirer had used its best efforts to work with the Maryland regulators to seek approval of the transaction, both before and after the regulators' initial disapproval, and that the acquirer had a significant financial incentive to ensure the transaction's approval, if it could be obtained. Despite those efforts, which satisfied the terms of the purchase agreement, Maryland regulators refused to approve of the transaction. Accordingly, the court held that the acquirer was entitled to the $50 million price reduction.

**Massachusetts Appellate Court Sustains Claims of Tortious Interference and Statutory Violations**

*Resolute Mgmt Inc. v. Transatlantic Reins. Co.*, 87 Mass. App. Ct. 296 (2015).

In an unusual dispute between a reinsurer of legacy asbestos liabilities and a retrocessionaire, a Massachusetts appellate court reversed the retrocessionaire's successful motion to dismiss the complaint, sustained the claims for tortious interference with contractual relations and violation of statute, but affirmed the dismissal of the allegations of the reinsurer's claims manager.

The dispute between these parties is summarized by the court and concerns the alleged change in the retrocessionaire's responses to the retrocedent's asbestos billings following a failed attempt by the retrocedent to purchase the retrocessionaire. In reversing, the appellate court held that the claims for tortious interference and the statutory claims were viable for at least pleading purposes if Massachusetts law applied. The court held that the allegations in the complaint were sufficient to warrant discovery and the development of a factual record to adequately allow the trial judge to assess whether under the center of gravity test the claim is within Massachusetts. The court found that the allegations were insufficient to determine as a matter of law whether New York or Massachusetts law applied. Thus, discovery was necessary to resolve the choice-of-law question thereby sustaining the allegations for now. But the claim manager's claims dismissal was affirmed because it was not a party to the contracts and did not otherwise state a cognizable legal interest on its own behalf.

**New York State Court Denies Purchaser of a Reinsurer Leave to Renew Summary Judgment Asserting a New Measure of Damages**

*WT Holdings Inc. v. Argonaut Group. Inc.*, No. 600925/09, 2015 N.Y. Misc. LEXIS 648 (N.Y. Sup. Ct. Mar. 3, 2015).

In an interesting post-closing dispute arising from the purchase of the stock of a reinsurance company, a New York state court denied the purchaser's attempt to assert a new theory of damages. Here, the purchaser sued for indemnification for alleged breaches of representations and warranties made by the target reinsurance company in a stock purchase agreement. The essence of the alleged breaches had to do with the claim that the reinsurer understated its case reserves.

In a July 20, 2012 decision, the court denied the purchaser's motion seeking damages based on the difference between the value of the reinsurance company as warranted and the actual value of the reinsurance company. The court in 2012 held that the purchaser was entitled to damages only under the indemnification provision of the stock purchase agreement, which was the sole remedy permitted as the purchaser waived any right to a cause of action for damages for breach of contract measured by the benefit of its bargain.

The purchaser then attempted to renew its motion by arguing that it was entitled to a different measure of damages based on a purchase price theory, which seeks damages equal to the difference between the purchase price paid for the reinsurer and the price it would have paid but for the allegedly false representations and warranties. The court rejected this theory as new, denied the motion and held that the only measure of damages was for "loss" under the indemnification provision. "Loss," of course, was ambiguous and a trial is necessary to determine damages.

The point of this story is that this case has been around since 2009 and it still has not gone to trial. It also points out the need for careful drafting of stock purchase agreements in the reinsurance context especially where the measure of damages for breach of representations and warranties concerning reserves are concerned. The difference in the reserves made a huge difference in the valuation of the company and the purchase price. Careful due diligence and careful contract drafting helps to avoid these post-closing disputes. But as we all know, no amount of due diligence or careful contract drafting will help when there is buyer's remorse.

**Indiana Federal Court Limits Discovery of Reinsurance Documents**

*Indianapolis Airport Auth. v. Travelers Prop. Cas. Co. of Am.,* No. 1:13-cv-01316-JMS-TAB, 2015 U.S. Dist. LEXIS and 2015 U.S. Dist. LEXIS 45148 (S.D. Ind. Apr. 7, 2015).

In a pair of opinions issued in a coverage dispute between a cedent and its insured, an Indiana federal court limited the scope of discovery of reinsurance documents permitted. The limitations applied to documents both in the possession of a nonparty reinsurer and the cedent. While acknowledging the reinsurance contract as separate and distinct from the underlying policy, both opinions reconfirmed the very limited relevance of reinsurance documents on the issue of coverage under the original insurance policy. Further, the court held that this limited utility is far outweighed by the burden imposed when production of the commercially-sensitive reinsurance relationship is required.

The insured attempted to obtain reinsurance information on two fronts. It first sought to compel the cedent's production of its underwriting guideline provisions on reinsurance and then issued a subpoena on the reinsurer to produce its documents.

In the first opinion, the court denied the insured's motion to compel after concluding that the contractual relationship between a cedent and a reinsurer was not relevant to the coverage claims. The insured was therefore not entitled to discovery related to the cedent's reinsurance guidelines.

In the second opinion, after the court accepted the cedent's standing to challenge a subpoena issued to the reinsurer, the court acknowledged that reinsurance documents may be relevant in only the limited circumstance where (1) the original insurance policy contains ambiguous terms and (2) the reinsurance documents provide an indication as to the cedent's intent when issuing the original policy. The court conducted an *in camera* review of the subpoenaed documents and found that they did not address the cedent's intent in the original policy and did not clarify any ambiguous term. Further, because the subpoena requested documents for an extensive time period that exceeded the time when the reinsurance contract was in effect, it was deemed to be overbroad. Accordingly, the motion to quash was granted.

### New York Federal Court Denies Discovery of Executive Claim Summaries Containing Reinsurance Information

*Broadrock Gas Servs., LLC v. AIG Specialty Ins. Co.*, No. 14 cv. 3927 (AJN) (MHD), 2015 U.S. Dist. LEXIS 26462 (S.D.N.Y. Mar. 2, 2015).

A New York federal court has denied discovery of claims memoranda containing reinsurance information in a coverage dispute over the failure to cover two separate claims under a pollution liability policy. The policyholder sought discovery of a variety of documents, among which included redacted executive claim summaries. The redactions, the court stated, included a number of issues including reinsurance issues.

The court held that there was no reason to question the accuracy of counsel's description of the redactions of reinsurance calculations and treaty participation percentages. Rejecting the policyholder's arguments about the redactions, the court reasoned that reinsurance calculations were distinguishable from reserve information. Because the redactions related only to reinsurance calculations, and the policyholder sought only reserve information, discovery was not required.

Other discovery requests not related to reinsurance information was allowed by the court and the decision includes a good discussion of the applicability and waiver of privilege.

### Recent Speeches and Publications

- **Larry Schiffer** acted as a moderator and presenter for "Discussion of Neutral Rules by Arbitrators," at the ARIAS U.S. 2015 Spring Conference "Streamlining for Greatness: Paring the Process Down to its Potential," on May 8, 2015 in Palm Beach, Florida.
- **Larry Schiffer** is moderating a high-level expert panel at the American Bar Association's 2015 London Sessions on "Adapting to an Ever-changing and Risky World of Tort Liability," on June 12, 2015 in London. This ABA program celebrates the 800th Anniversary of the Magna Carta and this panel was one of 16 chosen out of 56 entries.
- **John Nonna** is speaking at the webinar "Uncovering Insurance Issues in M&A – What Every Firm Needs to Know," presented by The Knowledge Group, LLC, on August 7, 2015.
- **Larry Schiffer**'s co-authored article, "The New ARIAS•U.S. Neutral Rules for the Resolution of U.S. Insurance and Reinsurance Disputes," was published in the *ARIAS•U.S. Quarterly*, Vol. 22, No. 1, 1st Quarter 2015.
- **Larry Schiffer**, **Gary Timin**, **Andrew King**, **Gregory Schneider**, **Ben Tarbell** and **Martha Wrangham**'s article, "A Brief Review of Reinsurance Trends in 2014," was published in *Westlaw Journal, Insurance Coverage*, Vol. 25, Issue 27, April 10, 2015.
- **Larry Schiffer**'s Reinsurance Commentary, "The "Secret" World of Reinsurance," was published on IRMI.com in March 2015.

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