SQUIRE PATTON BOGGS

Reinsurance Newsletter

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Recent Case Summaries

7th Circuit Affirms Waiver of Removal Because of Reinsurance Agreement Service-of-Suit Clause

Pine Top Receivables of Ill., LLC. v. Transfercom, Ltd., No. 16-1073, 2016 U.S. App. LEXIS 16225 (7th Cir. Sept. 1, 2016).

In December 2015, an Illinois federal court held that the language of a service-of-suit clause in a reinsurance contract was a voluntary removal waiver and sent a case removed to federal court back to state court. See our March 2016 Reinsurance Newsletter. That case went up to the Seventh Circuit Court of Appeals for review. The Seventh Circuit has now affirmed.

The dispute was between two assignees of the accounts of the original cedent and reinsurer. The cedent sued in state court claiming a breach of two reinsurance treaties based on the failure of the reinsurer to pay under the reinsurance agreements. The reinsurer removed the case to federal court and the cedent moved to remand based on the theory that the reinsurer waived the right to remove based on the language of the service-of-suit clause in the reinsurance agreements.

The service-of-suit clause provided that if the reinsurer failed to pay any amount claimed to be due under the reinsurance agreements, the reinsurer, at the request of the cedent, "will submit to the jurisdiction of any Court of competent jurisdiction within the United States and will comply with all requirements necessary to give such Court jurisdiction and all maters arising here-under shall be determined in accordance with the law and practice of such Court." Both the district court and the circuit court found that language to constitute a waiver of the right to remove the case to federal court.

The reinsurer argued that the existence of an arbitration clause in the reinsurance contracts rendered the service-of-suit clause ambiguous and unenforceable. The Seventh Circuit rejected the reinsurer's argument, holding that the language of the arbitration clause "in no way muddies the water with respect to the meaning of the service of suit clause." The arbitration clause had the typical preamble: "As a condition precedent to any right of action hereunder, any irreconcilable dispute between the parties to this Agreement will be submitted for decision to a board of arbitration." The court rejected the reinsurer's request for the court to adopt a heightened clear and unequivocal interpretation standard.

As the court put it, "[r]ead as a whole, the reinsurance agreement requires [the reinsurer] to submit to the jurisdiction of any court of competent jurisdiction chosen by [the cedent], whether it be to determine the arbitrable nature of the dispute, to confirm an arbitration award, to compel arbitration, or to resolve on the merits, a claim not subject to arbitration–including [the cedent's] breach of contract claim." This analysis directly addresses the often confusing juxtaposition of an arbitration clause and a service-of-suit clause in the same reinsurance contract, which has caused problems in the past. Here, the court is not addressing an arbitrability issue, but uses arbitrability and other claims to explain how the service-of-suit clause has a purpose and stands as an unequivocal waiver of the right of removal. Essentially, what the Seventh Circuit concluded, which affirmed the district court's rationale, is that this service-of-suit language binds the reinsurer to the cedent's choice of court and that the reinsurer is bound to do what it can to make sure that choice of jurisdiction is sustained.

The court concluded that the service-of-suit clause unambiguously granted the cedent the absolute right to choose the forum for litigating this dispute and that to allow removal would be to ignore the contractual terms and the plain and ordinary meaning of the reinsurance agreements.

Second Circuit Affirms Order Declaring Arbitration Clause in Body of Certificate Controlling Over Endorsement

Infrassure, Ltd. v. First Mut. Transp. Assur. Co., No. 16-306, 2016 U.S. App. LEXIS 20529 (2d Cir. Nov. 16, 2016).

The US Court of Appeals for the Second Circuit affirmed an order that denied a cedent's request to compel arbitration under an endorsement and granted the reinsurer's request for a declaratory judgment that the arbitration provision contained in the body of the certificate of facultative reinsurance controlled. We discussed this case in the Squire Patton Boggs Reinsurance Newsletter, March 2016.

In affirming, the court held that the facultative certificate was not ambiguous. The arbitration clause in the body of the certificate controlled and was not displaced by the endorsement. The circuit court agreed with the district court that the endorsement was expressly limited to UK and Bermuda insurers, which was not the case here. The court also rejected the cedent's argument that the title clause required the court to ignore the context provided by the title of the endorsement. The court found that a number of provisions would be rendered meaningless if the title clause were applied in the way the cedent suggested.

Second Circuit Affirms Vacatur of Order Compelling Arbitration Where Arbitral Organization Rejects the Case

Moss v. First Premier Bank, Nos. 15-2513-cv, 15-2667-cv, 2016 U.S. App. LEXIS 15917 (2d Cir. Aug. 29, 2016).

In a non-reinsurance case, the US Court of Appeals for the Second Circuit affirmed an order vacating a prior order compelling the parties to arbitrate in a consumer contract. We included this case because of its ramification for all arbitration clauses that include provisions for arbitration only before a certain arbitral organization.

This case involved a payday lender dispute. The loan application had an arbitration clause specifying that all disputes were subject to arbitration under the Code of Procedure of the National Arbitration Forum (NAF) in effect at that time. After the borrower brought a class action, the lender sought to compel arbitration. When the district court ordered the parties to arbitration, the borrower sent a notice of intent to arbitrate to NAF. NAF, however, responded that because of a consent judgment concerning consumer arbitrations, it could not accept the arbitration. The borrower then returned to federal court and sought to vacate the order compelling arbitration. The district court granted the motion.

In affirming the district court, the Second Circuit focused on the language of the arbitration clause. The court noted that the clause did not address how the parties should proceed in the event that NAF was unable to accept the dispute. Citing an earlier case, *In re Salomon Inc. Shareholders' Derivative Litigation*, 68 F.3d 554 (2d Cir. 1995), the court held that the parties' agreement to arbitrate evinced an intent to designate an exclusive arbitral forum – arbitration before NAF. Because of this mandatory language, said the court, and the absence of any indication that the parties would assent to arbitration before a substitute, the order compelling arbitration was properly vacated.

The dispositive factor was whether the arbitral forum was exclusive. Where it is exclusive, the court held that Section 5 of the Federal Arbitration Act (FAA) could not be used to circumvent the parties' designation of an exclusive arbitral forum by compelling arbitration before a substitute.

The Second Circuit also noted that difference in opinion among the circuits on this issue, so at some point the US Supreme Court may weigh in. But for now, in the Second Circuit, if you designate an arbitral forum as the exclusive entity to hear the dispute, you are bound by that choice. While many reinsurance arbitration clauses do not designate an arbitral forum, some do and care needs to be taken to address contingencies like the unavailability of that forum when a dispute arises.

Third Circuit Court of Appeals Overturns District Court and Compels Arbitration Under a Reinsurance Participation Agreement

S. Jersey Sanitation Co. v. Applied Underwriters Captive Risk Assur. Co., No. 14-4010, 2016 U.S. App. LEXIS 19245 (3d Cir. Oct. 25, 2016).

The Third Circuit Court of Appeals reversed a district court's order denying a reinsurer's motion to compel arbitration of a dispute under a reinsurance participation agreement providing workers' compensation coverage. After the insured sued for rescission and other claims in state court, the reinsurer removed the action to federal court and moved to compel arbitration. The district court denied the reinsurer's motion.

The court of appeals vacated the district court's judgment, stating that, ordinarily, to render an arbitration clause unenforceable a party must allege that the party was fraudulently induced into entering the arbitration provision and not the contract as a whole. The court determined that the insured was challenging the participation agreement as a whole and thus the arbitration provision was enforceable. The court also determined that the arbitrator was to decide the nature of the parties' participation agreement.

California Federal Court Compels Arbitration in a Dispute Over Reinsurance Participation Agreements

Mike Rose's Auto Body, Inc. v. Applied Underwriters Captive Risk Assur. Co., 16-cv-1864-EMC, 2016 U.S. Dist. LEXIS 133747 (N.D. Calif. Sept. 28, 2016).

A California federal court granted a motion to compel arbitration of a dispute under two reinsurance participation agreements providing workers' compensation coverage using a protected cell company. After the policyholder brought an action for rescission and other claims after the insurer demanded additional premiums, the insurer moved to compel arbitration.

In granting the motion, the court construed the arbitration clause under the FAA. The court focused on whether the dispute came within the arbitration clause and, if so, whether the arbitration clause had a delegation provision allowing the arbitrators to determine arbitrability and validity of the participation agreements. The court held that the dispute was covered by the arbitration clause and that there was an unmistakable delegation of authority of gateway questions to the arbitrators.

On the first question, the court found that a reference to accounting issues was not a limiting provision on the scope of the arbitration clause. The clause, read as a whole, according to the court, revealed a general intent that the arbitration clause apply broadly to all disputes under the contracts.

On the second question, the court found that that language in the arbitration clause was an express delegation provision similar to others found by other courts, including the US Supreme Court. Moreover, held the court, the clause incorporated the American Arbitration Association rules, which have been interpreted to include a delegation provision. Accordingly, the court determined that, under the arbitration clause, the arbitrator had the sole power to determine the enforceability of the reinsurance participation agreements and all their provisions.

New Jersey Appellate Court Affirms Order Compelling Arbitration Against Non-Signatories Under a Reinsurance Participation Agreement

Jade Apparel, Inc. v. United Assur., Inc., No. A-2001-14T1, 2016 N.J. Super. Unpub. LEXIS 2250 (N.J. Super. Ct., App. Div., Oct. 13, 2016).

Similar to the case discussed above, a New Jersey appellate court affirmed an order compelling arbitration under a workers' compensation reinsurance participation agreement and a request to bind coverage and services agreement against non-signatory parties to the agreement.

The dispute arose when the insureds claimed they were overcharged and refused to make premium payments. After the policies were cancelled and replacement coverage was obtained, the insureds sued the parties to the workers' compensation program. The insurer and producer parties moved to compel arbitration and stay the litigation. The motion court granted that relief.

The appellate court affirmed in part and reversed in part. The court found that there was an agency agreement here that incorporated the reinsurance participation agreement by reference and, therefore, was sufficiently broad to cover the dispute between the insureds and the affiliates of the reinsurer. The court also held that the arbitration clause was unambiguous and that the agreements were between sophisticated business entities. The arbitration clause was broad enough to encompass all claims, including claims of enforceability of the agreement.

Where the appellate court reversed was in the composition of the arbitration panel. The motion court ordered that arbitration take place before a retired judge. The appellate court found that the requirements for the panel members set forth in the arbitration provision were unobjectionable. The court held that to enforce the unilateral change to the agreement would essentially rewrite the terms of the parties' agreement, which was not proper.

New York Federal Court Grants Motion to Compel Arbitration But Stays Arbitration

In re Residential Capital, LLC, No. 12-12020 (MG), 2016 Bankr. LEXIS 3799 (S.D.N.Y. Oct. 21, 2016).

In a non-reinsurance case, a New York bankruptcy court granted excess insurers' motion to compel arbitration, but stayed the arbitration until the coverage issues in the lower layers were resolved and denied the policyholder's motion to dismiss or require security under §1213 of New York's Insurance Law. The case is interesting for its analysis of core and non-core bankruptcy proceedings, when security under §1213 is required and why a stay of arbitration may be necessary when coverage issues underlying high excess policies are yet to be resolved.

The court found that there was no question that the parties agreed to arbitrate and that the arbitration provision was a broad provision that sent all disputes about the policies to arbitration. Because the arbitration would not seriously jeopardize the objectives of the Bankruptcy Code, the court found that it was not uniquely able to interpret and enforce the terms of the excess policies.

The court granted the stay, however, because of the possibility of inconsistent judgments and the risk of collateral estoppel and res judicata. The court also denied the request for a bond under §1213 because the contracts of insurance were not delivered in New York, the policies were delivered in Bermuda, and the insured's address was not in New York.

New York Federal Court Denies Motion to Vacate Award in Favor of Reinsurer

Yosemite Ins. Co. v. Nationwide Mut. Ins. Co., 16 Civ. 5290, 2016 U.S. Dist. LEXIS 157061 (S.D.N.Y. Nov. 10, 2016).

In 2013, the insured state, liable for remediation costs arising out of pollution, settled with the cedent. Decades earlier, the cedent had entered into an umbrella liability excess of loss reinsurance contract with the reinsurer. After the settlement, the cedent sought recovery under the treaty for the reinsurer's share of the settlement amount.

The reinsurer refused to pay, relying on an exclusion in the treaty for contamination and pollution. An arbitration ensued and a majority award was issued in favor of the reinsurer. Article II(1)(B) of the treaty provided that "this contract does not apply to but specifically excludes" an enumerated list of activities. Among these exclusions was one for "contamination and pollution." The cedent had argued that the next section, article II(1)(C), which provides that the exclusions do not apply where the insured's main operations are not excluded "hereunder," meant that the reinsurer had to pay the loss.

At the arbitration, the umpire questioned the cedent's reading of article II(1)(C) and suggested that the word "hereunder" referred to the sections following, rather than those preceding. The umpire supported this suggestion further by referring to the use of the word "above" in (C), thus concluding that "hereunder" did not include the preceding section listing the exclusions.

In seeking to vacate the award, the cedent made several arguments. The cedent claimed that the umpire's failure to disclose material information created the appearance of bias requiring the award to be vacated and that the panel's interpretation of the contract was irrational. The reinsurer cross-moved to confirm and sought attorney fees and costs.

In denying the motion to vacate the award, the court stated that the cedent's argument that the award was irrational was really an application for vacatur under either FAA §10(a)(4) or the manifest disregard doctrine. Because the arbitration panel anchored its reasoning in inferences drawn from the treaty's text, the court held that the award was beyond the scope of judicial review. According to the court, although the panel's majority reading of the treaty might not be the only feasible one, the panel was well within its authority to construe the treaty as it did. Thus, the court held that the award reflected neither manifest disregard of the law nor an instance "where the arbitrators exceeded their powers."

The cedent's challenge to the umpire's non-disclosure as giving rise to a "reasonable impression of partiality" was rejected by the court as well. The court found that the umpire's failure to disclose his involvement in a proceeding between the cedent and another party did not itself establish partiality to warrant vacatur.

Finally, the reinsurer's request for attorney fees and costs was denied because the court found that the cedent's petition was not frivolous.

New York Federal Court Denies Managing Underwriter's Motion to Dismiss Petition Seeking Turnover of Funds to Enforce Judgment Confirmed After Arbitration Award Against Affiliated Reinsurers

AmTrust N.A., Inc. v. Safebuilt Ins. Servs., Inc., No. 16-cv-6033 (CM), 2016 U.S. Dist. LEXIS 139886 (S.D.N.Y. Oct. 6, 2016).

We have previously reported on earlier decisions in related actions concerning the dispute between a retrocedent and affiliated retrocessional and cell companies and their ownership involved in a complex insurance and reinsurance program for small and mid-sized construction contractors. The disputes involved general agency agreements and participation agreements. Essentially, the retrocessionaires were allegedly undercapitalized and could not fulfill their reinsurance obligations. The retrocedent's dispute with the retrocessionaires resulted in an arbitration award that was confirmed and a judgment was entered on the award in New York federal court. This petition seeks to compel the underwriting manager to turn over funds to satisfy the judgment.

The underwriting manager moved to dismiss the petition. The court denied the motion. In denying the motion, the court found that the underwriting manager waived personal jurisdiction by purposely availing itself of the court's jurisdiction by seeking affirmative relief in the court. The court found that the underwriting manager failed to raise lack of personal jurisdiction in a related case in the same court and brought a counterclaim and third-party complaint in that related action. The court held that the waiver extended to this judgment enforcement action because it stemmed from the same set of facts and involved the same relevant parties.

In a couple of related actions concerning enforcing the judgment obtained by the retrocedent, the court granted a motion for entry of a judgment against the "participant" in the participation agreement and compelled a related risk-retention group to provide information about funds in its possession belonging to the retrocessionaire and to restrain the use of any of those funds. *AmTrust N.A., Inc. v. Safebuilt Ins. Servs., Inc.*, No. 16-cv-6033 (CM), 2016 U.S. Dist. LEXIS 153399 (S.D.N.Y. Nov. 3, 2016) and *AmTrust N.A., Inc. v. Preferred Contractors Ins. Co. Risk Retention Grp.*, No. 16-mc-0340 (CM), 2016 U.S. Dist. LEXIS 145705 (S.D.N.Y. Oct. 18, 2016). In the former case, the court rejected the argument that the participant was not a signatory because there was no signature block, when there were multiple judicial admissions that the party was in fact the participant under the reinsurance participation agreement. In the latter case, the court upheld an enforcement subpoena and restraining notice because it was clear that the risk retention group held an account as a liability to the retrocessionaire.

California Federal Court Dismisses Cedent's Claim for Lack of Personal Jurisdiction Over Reinsurer

Am. Ins. Co. v. R&Q Reins. Co., No. 16-cv-03044-JST, 2016 U.S. Dist. LEXIS 141467 (N.D. Calif. Oct. 12, 2016).

A California federal court granted a reinsurer's motion to dismiss the complaint for lack of personal jurisdiction. The dispute arises from the settlement of asbestos losses that were ceded to several facultative certificates. The reinsurer refused to pay the billing based on late notice and the cedent commenced an action for breach of contract and declaratory relief.

In granting the reinsurer's motion to dismiss, the court found that there was no general or specific personal jurisdiction over the reinsurer under California law. As to general jurisdiction, it was clear, said the court, that the reinsurer was not "at home" in California, in spite of its status as a California licensee. The court also found no specific jurisdiction given the limited contacts by an out-of-state party with an in-state party. The court held that the establishment of an agreement with a California entity alone is insufficient for the exercise of specific jurisdiction. In granting the motion to dismiss, the court also granted the cedent leave to amend the complaint to add facts establishing personal jurisdiction.

Pennsylvania Federal Court Dismisses Reinsurer's Claims Against Policyholder

Hartford Steam Boiler Insp. & Ins. Co. v. Int'l Glass Prods., LLC., No. 2:08 cv 1564 (W.D. Pa. Sep. 29, 2016).

A Pennsylvania federal court dismissed direct action claims by a reinsurer against a policyholder for lack of contractual privity. In this case, a business insurance policy was issued by the cedent to the policyholder. Included within the business insurance coverage was coverage for equipment breakdown, which was reinsured by the reinsurer at 100%. The reinsurance contract provided that, while the ceding company would make all direct payments and would handle all the communications with the policyholder, the reinsurer would investigate the claim at its own expense, including entering into settlement agreements and defending all claims, but the cedent could participate in those activities. Essentially, the reinsurer was responsible for addressing equipment breakdown claims as the real party in interest.

After paying substantial claims through the cedent for catastrophic equipment failures, the reinsurer brought accusations of fraud against the policyholder and sought a declaration that there was no coverage and that the underlying policy should be rescinded. The policyholder moved to dismiss all the reinsurer's claims, arguing that the reinsurer's claims against the policyholder should be dismissed for lack of contractual privity.

In granting the motion in favor of the policyholder, the court focused directly on the lack of privity argument. The court found that, while there was an insurance policy issued between the cedent and the policyholder, the reinsurer was not a party to that policy and was only a party to a separate reinsurance contract with the cedent. Because the reinsurer was never in contractual privity with the policyholder, held the court, the reinsurer's claims could not be sustained. Thus, the court found that the reinsurer was not entitled, in its capacity as the cedent's insurer, to a judicial declaration that the policy was void and was not entitled to recover payments. The reinsurer, said the court, could not enforce provisions of the underlying policy and could not use follow-the-fortunes concepts to overcome the lack of contractual privity.

Nor would the court accept the reinsurer's argument that the unique facts of this case established an exception to the general rule and would allow a contractual right of action against the policyholder. The lack of contractual privity was fatal to this argument. The court also rejected the reinsurer's claim for statutory insurance fraud and reverse bad faith for the same reason.

The lack of privity argument is regularly made by reinsurers when sued in direct actions by policyholders or other third parties. In most circumstances, a policyholder's direct action against a reinsurer will fail because of lack of privity. This is the unusual case where the claim was brought by the reinsurer, yet the same lack of contractual privity argument was used to dismiss the claims.

Illinois Federal Court Denies Motion to Vacate Summary Judgment in Favor of Reinsurer

Pine Top Receivables of Ill., Inc. v. Banco de Seguros del Estado, No. 12 C 6357, 2016 U.S. Dist. LEXIS 116181 (N.D. Ill. Aug. 30, 2016).

An Illinois federal court denied a cedent's motion to vacate judgment entered against it on statute of limitations grounds and to file a second amended complaint. See the September 2016 Squire Patton Boggs Reinsurance Newsletter for a summary of the earlier decision. Here, the cedent wanted to fix its complaint to add a missing element of its account stated theory.

In denying the motion, the court noted that this type of motion is only allowed where a court had misunderstood a party, made a decision outside of the issues presented, misapprehended an issue, where a significant law change had occurred or where significant new facts have come to light. Finding none of these factors, the court denied the motion. The court also commented that it would have been unduly prejudicial to the reinsurer to allow yet another amended complaint four years after the action had been commenced.

New York State Motion Court Grants Reinsurers' Partial Summary Judgment Dismissing Complaint on Costs in Addition to the Limits on Facultative Certificates

Utica Mut. Ins. Co. v. Abeille Gen. Ins. Co., No. CA2013-002320 (N.Y. Sup. Ct., Oneida Cty., Aug. 15, 2016).

A New York state motion court, following New York Court of Appeals precedent, granted the motion of a pool of reinsurers to dismiss the cedent's complaint insofar as it sought expenses in addition to the limits of the facultative certificates. This case is part of a long-running effort by the cedent to recover reinsurance proceeds on the settlement of asbestos losses arising out of Gould Pumps.

After settlement of Gould Pumps coverage litigation, the cedent sought recovery under facultative certificates issued by the ECRA reinsurance pool. Part of what the cedent sought was reimbursement for expenses in excess of the certificate limits.

In ruling for the reinsurers, the court noted that only the language of the certificates was presented for review. The court rejected the reinsurers' argument that the cedent should be estopped from seeking expenses based on a prior ruling in another case in federal court involving the same certificates. The court found that the decision in the other case may not be final and that collateral estoppel cannot preclude consideration of a question of law.

But relying on *Excess Ins. Co. Ltd. v. Factory Mut. Ins. Co.*, 3 N.Y.3d 577 (2004), the court ruled in favor of the moving reinsurers. The court noted that evidence of custom and practice, no matter how extensive and persuasive, cannot be used unless the contract is ambiguous. Here, the court held that the facultative certificates were not ambiguous and extrinsic evidence could not be used.

Even though the language in the certificates in this case was different from the language in Excess, the court said that there appeared to be no meaningful distinction. Accordingly, bound by Excess, the court granted the motion finding that the certificate limits were a cap on both liability and expense.

Tennessee Federal Court Grants Policyholders' Motion to Produce Reinsurance Contracts But Not Reinsurance-related Communications

First Horizon Nat'l Corp. v. Houston Cas. Co., No. 2:15-cv-2235-SHL, 2016 U.S. Dist. LEXIS 142330 (W.D. Tenn. Oct. 5, 2016).

A Tennessee federal court ordered production of reinsurance contracts, but denied a motion to compel production of reinsurance-related communications in an insurance coverage dispute. The coverage case involved the settlement with the federal government concerning mortgage loans.

Among the discovery disputes the court resolved were the policyholders' demand for reinsurance agreements and reinsurance-related communications. The information was sought to aid in the interpretation of the underlying insurance policy. The court held that the reinsurance agreements were discoverable and ordered their production.

As to the reinsurance-related communications, however, the court denied the motion because each of the carriers had submitted affidavits substantiating their position that the reinsurance-related communications reflected their business decisions to spread risk and not the substantive issues in the coverage dispute. Moreover, the reinsurance contracts involved were treaties, which the court found made the reinsurance-related communications even less relevant to the claims asserted by the policyholders.

Pennsylvania Dismisses Claims Against Bank on Private Mortgage Insurance and Related Reinsurance on Statute of Limitations

Weiss v. Bank of Am. Corp., No. 15-62, 2016 U.S. dist. LEXIS 161665 (W.D. Pa. Nov. 22, 2016).

A Pennsylvania federal court granted summary judgment dismissing alleged class action claims under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-68, in a dispute involving private mortgage insurance and reinsurance. The court found that disclosure forms and lack of affirmative conduct concerning the reinsurance issues made it clear that there were no material issues of fact concerning the untimeliness of the claim. The court also declined to exercise supplemental jurisdiction over state law claims of unjust enrichment.

Captive Reinsurance Arrangements in the Mortgage Insurance Industry Upheld

PHH Corp. v. Consumer Fin. Protection Bureau, No. 15-1177, 2016 U.S. App. LEXIS 18332 (D.C. Cir. Oct. 11, 2016).

While not the usual stuff that we report on, the DC Circuit's rejection of the Consumer Financial Protection Bureau's (CFPB) determination concerning captive insurance arrangements is important given the numerous cases we have digested on the issue of captive reinsurance arrangements in the mortgage industry. In its decision, the court essentially eviscerated the CRPB's decision-making structure.

The captive reinsurance arrangement issue is straightforward. A lender recommends a mortgage insurance company to its borrower. That mortgage insurance company is recommended because it purchases reinsurance from the lender's captive reinsurance company. The borrower's mortgage is protected by the insurance and the mortgage insurer is protected by the reinsurance.

Under the Real Estate Settlement Procedures Act (RESPA), this arrangement is legal, according to the court, as long as the mortgage insurance company pays no more than a reasonable market value premium to the lender's captive reinsurer for the services actually provided. If not, then the arrangement is essentially an illegal rebate that is not permitted under RESPA. The Department of Housing and Urban Development (HUD) promulgated regulations and issued regulatory guidance providing for proper captive reinsurance arrangements.

The CFPB took a dim view of captive reinsurance arrangements, ignored the statute and the HUD pronouncements, and retroactively applied its newly-developed opinion against captive reinsurance arrangements to a lender and issued a significant fine. The lender challenged the determination in court and the circuit court agreed with the lender.

The court plainly held that Sections 8(a) and 8(c) of RESPA allow captive reinsurance arrangements so long as the mortgage insurance companies pay no more than reasonable market value to the reinsurers for services actually provided. In other words, if the reinsurance deal is not arms-length and the reinsurance premiums are not reasonable, then the captive reinsurance arrangement violates RESPA as an illegal rebate.

If, however, the lender's captive reinsurer charges market rate and reasonable reinsurance premiums for providing reinsurance protection to the third-party mortgage insurer, then the arrangement is legal under RESPA and under previous HUD regulatory interpretations.

This is an important case because of the challenge to the CFPB's authority and constitutionality and we may have a Supreme Court ruling on this issue in the future.

North Carolina State Appellate Court Addresses Impact of Reinsurance on Homeowners' Insurance Rates

Commissioner of Insurance v. North Carolina Rate Bureau, No. COA 15-402, 2016 N.C. App. LEXIS 822 (N.C. Ct of App. Aug. 2, 2016).

A North Carolina state appellate court was asked to rule on a challenge to homeowners' insurance rate determination that included the allocation of reinsurance costs for catastrophic losses. The state rating bureau filed for new homeowners' rates and included a provision for the net cost of catastrophe reinsurance because of the proximity of the state to the coast. North Carolina law allows for property insurance rates to include a provision to reflect the cost of reinsurance to protect against catastrophic exposure within the state. The Insurance Commissioner rejected the rate filing and a hearing was held with expert testimony.

There were multiple issues, but on the reinsurance issue the focus was on whether the Commissioner erred in determining the net cost of reinsurance to be included in the rates.

The rating bureau's filing included a provision for the net cost of reinsurance at 17.5% of premium based on an analysis performed by its expert. The Insurance Department's witnesses determined that the rating bureau's model was overstated and not reflective of the reinsurance market in North Carolina. The Commissioner rejected the rating bureau's net cost provision and ordered a net cost of 10% of premium. The Commissioner's determination included an explanation why the rating bureau's methodology was rejected, including that the expert, an economist, had no discernible background in reinsurance.

In upholding the Commissioner's determination, the court held that the Commissioner did not abuse his discretion in discrediting the rating bureau's expert and his analysis. The court noted that the Commissioner directly addressed the methodology and made a record with findings that supported the Commissioner's decision. The court noted that the Commissioner had addressed the so-called real world evidence that the rating bureau presented and had rejected it because the data included quota share reinsurance or non-catastrophe reinsurance in almost all of the years considered. The court held that the Commissioner did not abuse his discretion in disregarding that evidence.

Finally, the court held that the Commissioner's selection of 10% was not arbitrary based on the evidence presented by the Insurance Department's witnesses. Court held that the Insurance Department witness was competent to testify given that he was an actuarial consultant with a professional designation as an Associate in Reinsurance. The court upheld the Commissioner's determination of the reinsurance provision as based on a reasoned analysis with a rational basis in the evidence and that it was from the middle range developed by the actuary.

DC Federal Court Dismisses Crop Insurer's Claims Against the Federal Crop Insurance Corporation

Ace Am. Ins. Co. v. Fed. Crop Ins. Corp., No. 14-1992(RCL), 2016 U.S. Dist. LEXIS 128123 (D. D.C. Sept. 20, 2016).

A DC federal court had before it a dispute between a crop insurer and the federal insurance provider that operates under the Federal Crop Insurance Act through a standard reinsurance agreement. The dispute was about the actuarial methodology allegedly modified and altering the premiums for several crops. The issue was handled administratively, resulting in a decision upholding the action of the government insurer. This action was brought on claims allegedly outside the scope of the administrative board's jurisdiction and a declaration that the board erred.

The government insurer moved to dismiss the complaint and the court granted the motion. The case is useful for its analysis of a challenge to this type of administrative proceeding and the jurisdictional issues involving the federal crop insurance program. Claims for promissory estoppel and unjust enrichment were dismissed because of the existence of a binding contract – the standard reinsurance agreement.

The case demonstrates the difficulty in challenging determinations under the standard reinsurance agreement in the federal crop insurance program.

South Carolina Federal Court Allows Beneficial Owner of Former Trustee to Pursue Contribution Claims Against Successor Trustee of Reinsurance Collateral Trusts

Companion Prop. & Cas. Ins. Co. v. United States Nat'l Ass'n, No. 3:15-cv-01300-JMC, 2016 U.S. Dist. LEXIS 152406 (D.S.C. Nov. 3, 2016).

The cedent participated in a fronted insurance program with two reinsurance companies under which the fronting company received a fee for allowing its name and paper to be used. As part of the program and in accordance with the reinsurance agreements, reinsurance collateral trusts were established, securing the reinsurers' obligations to the fronting company. The bank trustee was substituted as trustee under two trust agreements, which stated that the reinsurers could direct the trustee to substitute assets of comparable value for assets held in the trust account and that the trustee had to comply with any such direction. The trust agreements also provided that the reinsurers would make specific representations and warranties as to the quality and value of the assets.

The fronting company sued the trustee alleging that it had allowed for the substitution of offending assets. The trustee filed a third-party complaint, alleging that the reinsurers, their affiliated companies and/or the affiliates' beneficial owner were liable to the fronting company. The beneficial owner counterclaimed against the trustee. The court denied the trustee's motion to dismiss in part, finding that should the beneficial owner be found liable to the fronting company the beneficial owner could pursue a claim for contribution against the trustee.

Recent Speeches and Publications

Eridania Perez co-chaired and spoke at the ARIAS•U.S. umpire master class "The Umpire's Toolkit: Practical Advice on the Effective Management of the Arbitration Proceeding," on November 16, 2016 in New York.

Suman Chakraborty spoke on "Ultimate Dodgeball: How to Avoid Delaying Tactics by Arbitration Participants," at the ARIAS•U.S. Fall Conference, November 17-18, 2016 in New York; Larry Schiffer spoke on "Comparative Ethics: Lessons to be Learned from Other Arbitration Regimes," at the same conference.

Larry Schiffer and Tereza Horáková's article, "The Arbitrator's Affirmative Disclosure Duty," was published in the ARIAS•U.S. Quarterly, Quarter 3, 2016.

Larry Schiffer's Reinsurance Commentary, "What Is a Financial Interest Clause in a Reinsurance Contract," was published on IRMI.com in August 2016.

Authors of Squire Patton Boggs' Reinsurance Newsletter

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

Kelly Mihocik
Columbus
T +1 614 635 2836
E kelly.mihocik@squirepb.com

Neva Cirkveni – Intern
New York

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