SQUIRE PATTON BOGGS

Reinsurance Newsletter

June 2019

In This Issue

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

Recent Case Summaries

Does the Latest Supreme Court Ruling on Class Arbitration Affect Reinsurance Arbitration?

Lamps Plus, Inc. v. Varela, 138 S.Ct. 1697 (2019).

The US Supreme Court's latest pronouncement on class arbitration, while having little to do directly with reinsurance arbitrations, provided some useful tidbits on how the current Court views arbitration and the Federal Arbitration Act (FAA).

In *Lamps Plus*, the Court, in a 5-4 decision, held that under the FAA, an ambiguity in an arbitration provision does not provide the necessary contractual basis for a court to order class arbitration. The majority held that, for class arbitration to be ordered, the arbitration provision must provide an affirmative contractual basis for concluding that parties agreed to class arbitration. In reaching its conclusion, the majority provides guidance that affects all arbitrations, including reinsurance arbitrations.

The principle that underlies the Court's holding is that arbitration agreements are enforced according to their terms. The Court also emphasized that "ambiguities about the scope of an arbitration agreement must be resolved in favor of arbitration." The Court noted that, while state contract principles may be relied upon to interpret the contract, those principles are preempted where they obstruct the purposes and objectives of the FAA. In this case, a state law's construction of an ambiguity against the drafter (*contra proferentem*) was seen by the majority as interfering with the FAA objective of promoting individual arbitration unless there is mutual consent for class arbitration. The dissents were vigorous in opposition to this position.

In so holding, the Court stated that its "conclusion aligns with our refusal to infer consent when it comes to other fundamental arbitration questions." "For example, we presume that parties have not authorized arbitrators to resolve certain "gateway" questions, such as 'whether the parties have a valid arbitration agreement at all or whether a concededly binding arbitration clause applies to a certain type of controversy.'" *Green Tree Financial Corp. v. Bazzle*, 539 U. S. 444, 452 (2003) (plurality opinion). "Although parties are free to authorize arbitrators to resolve such questions, we will not conclude that they have done so based on 'silence or ambiguity' in their agreement, because 'doing so might too often force unwilling parties to arbitrate a matter they reasonably would have thought a judge, not an arbitrator, would decide.'" (Citations omitted).

This holding is important, because if there is a dispute about whether the panel or the court is to decide a gateway question, the majority has made it clear that "[n]either silence nor ambiguity provides a sufficient basis for concluding that parties to an arbitration agreement agreed to undermine the central benefits of arbitration itself." Fundamentally, the majority of this Supreme Court will not presume any rights under an agreement to arbitrate unless the contract clearly demonstrates that the parties mutually consented to those rights in arbitration. This construction applies to all FAA arbitrations, including reinsurance arbitration.

Second Circuit Postpones Enforcement of Arbitration Award

Nat'l Indemn. Co. v. IRB Brasil Resseguros S.A., No. 18-534-cv (2d Cir. Apr. 18, 2019)(Summary Order).

The Second Circuit vacated a district court order enforcing an arbitration award for a specific monetary amount because an underlying agreement between the retrocedent and the underlying cedent provided no basis, at present, for imposing liability for any particular amount on the retrocessionaire.

An arbitration award was issued in a dispute between the retrocedent and retrocessionaire requiring the retrocessionaire to hold the retrocedent harmless and indemnify the retrocedent for the underlying cedent's claim for a return of premium it paid to the retrocedent. In a separate court proceeding, where the retrocessionaire was voluntarily dismissed, the cedent and retrocedent entered into a settlement agreement on the issue of the return premium for a fixed sum. The cedent and retrocedent then sought to enforce that settlement against the retrocessionaire based on the arbitration award.

The circuit court held that the settlement agreement did not establish the liability of the retrocessionaire for the fixed sum. But the court was quick to reject the retrocessionaire's argument that the settlement agreement exonerated the retrocessionaire from any possible further liability under the arbitration award. While the private agreement between the cedent and retrocedent could not succeed in imposing liability on the retrocedent, that agreement, according to the court, did not relieve the retrocessionaire of liability for the return premium. To interpret the settlement that way, as the court said, would "undermine and defeat the arbitration award."

So, while the court did not enforce the award based on the settlement, the court made it clear that the retrocessionaire ultimately will have to pay up:

> We see no reason why a future judgment finding liability of [the retrocedent] to [the cedent] for return of the premium (in a specified amount) should not serve as a basis, pursuant to the arbitration award, for the imposition of an indemnification obligation on [the retrocessionaire], assuming [the retrocessionaire] received the procedural protections to which an indemnitor is entitled in the suit establishing [the retrocedent's) liability.

Fourth Circuit Affirms Order Sending Case to Arbitration

McDonnel Group, L.L.C. v. Great Lakes Ins. SE, UK Branch, No. 18-30817 (4th Cir. May 13, 2019).

In this non-reinsurance case, the Fourth Circuit affirmed a district court order holding that a state anti-arbitration statute was preempted by the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (Convention). That holding is not surprising, as the Fourth Circuit had previously held that a treaty is not a law passed by Congress and, therefore, is not reverse preempted by the McCarran-Ferguson Act.

What is new in this case, as the court stated, is how a "conformity to statute" provision in the insurance policy affects the analysis. A "conformity to statute" provision basically provides that if a provision of a policy is inconsistent with state law, then the policy is amended to conform to state law. Here, the policyholder argued that the state law anti-arbitration provision must "amend out" the arbitration provision in the insurance policy. The district court held, and the circuit court affirmed, that because the Convention preempts state law, the state anti-arbitration provision cannot apply to the policy in dispute. And because the statute does not apply to the policy, there is no conflict between the policy and state law. Therefore, the conformity provision is not triggered and the arbitration provision survives.

New York State Court Selects Umpire in Reinsurance Arbitration

Enstar EU Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA., No. 654089/2018 (N.Y. Sup. Ct., N.Y. Co. (Feb. 19, 2019).

The parties reached an impasse in an arbitration over asbestos-related claims ceded to three casualty excess reinsurance contracts. The contract provided that if the parties could not agree on an umpire they could apply to the court to appoint the umpire. The decision goes into detail about the various candidates proposed by the parties, which is in and of itself interesting when you know these people, but there were some other interesting things as well.

The judge, in a footnote, commented that "[i]n the future, the court urges the parties to consider diversity as a factor in selecting arbitrators and umpires." Why was the comment made? The judge is a woman and all the candidates the judge reviewed were white men. A diverse woman was initially proposed, but her candidacy, along with another white male, was not presented in the motion. This is certainly an issue the industry struggles with and one that ARIAS•U.S. is trying to address.

One of the candidates was disqualified because of expert witness work the candidate did for the reinsurer some years before. Because accumulation of asbestos exposures was an issue in the case, the prior expert testimony about "one event" language compelled the court to conclude that this candidate was "not entirely neutral as to this arbitration." Another candidate was disqualified because he was a party-appointed arbitrator in the same case as the expert witness and because his vote (voted against the expert's interpretation) "may be a predictor creating an appearance of possible bias." Two of the candidates were currently opposite each other in another case with an affiliate of the cedent. The court disqualified both because there were so many other qualified candidates and "there was no reason to put [them] in this untenable position."

The court went on to strike one candidate because, years ago, he was employed by cedent's law firm and that was enough in the court's mind to give rise to an impression of possible bias. The court struck the next candidate because his background was deemed less applicable to construing one event language in the reinsurance contracts (he was a CPA). The court finally accepted the last candidate, who was an attorney and was in-house counsel to several insurance entities. He was considered the candidate in the best position to understand the issues.

The interesting thing here, given familiarity with all the candidates, is that many of the candidates stricken would not necessarily have been stricken by those familiar with the candidates' backgrounds. For example, the CPA that the court considered less able to construe the issues, had worked for several insurance companies in management positions and was a deputy liquidator of several insolvent insurers that had reinsurance contracts with one event language. Nevertheless, the opinion provides an interesting exercise in umpire selection by a court without the industry familiarity with the various candidates.

Connecticut State Court Rules on Consolidation of Reinsurance Arbitrations

Employers Ins. Co. of Wausau v. The Hartford, No. HHDCV 186099158S, 2019 Conn. Super. LEXIS 354 (Ct. Super. Feb. 13, 2019).

In our *December 2018 Newsletter*, we reported on a reinsurance arbitration consolidation case. We mentioned that the reinsurer filed several other petitions to compel arbitration in various jurisdictions, all seeking to allow for consolidation of these disputes in three separate arbitrations based on the different reinsurance programs. The most recent decision in this series of cases came down in February 2019.

In this case, a Connecticut motion court denied a reinsurer's motion to compel arbitration and granted the cedent's cross-motion to compel arbitration. Sounds strange, but the issue is whether the arbitration would be before one arbitration panel as the cedent sought or multiple arbitration panels (three) as the reinsurer insisted. The cedent demanded arbitration on the treaty in issue and 18 other contracts arising out of eight different reinsurance programs (the underlying losses were asbestos losses). The cedent appointed one arbitrator and the reinsurer insisted on three separate arbitrations and appointed three arbitrators. When the parties reached an impasse on consolidation, suits were filed by the reinsurer, including this one requiring the cedent appoint an arbitrator under this specific treaty. This action was similar to the other collateral actions asking for the cedent to appoint an arbitrator on specific disputes.

In granting the cedent's motion and denying the reinsurer's motion, the court ruled that consolidation was for the arbitration panel to decide and not for the court. The court noted that the parties here did not dispute that they entered into a valid arbitration agreement and that their dispute falls within the scope of that agreement. "Thus, the court need not and cannot proceed with any further analysis. The procedural question of consolidation is for the arbitrators, not for the court, to decide." The court rejected each of the reinsurer's arguments, finding that by ordering the reinsurer to arbitrate it is merely enforcing the agreement as the parties drafted it. Essentially, the reinsurer's act of naming three arbitrators instead of one in response to the cedent's arbitration demand allowed the court to compel the reinsurer to comply with the treaty and appoint a single arbitrator and proceed to form a panel.

It will be the panel's job on this treaty to determine whether there should be consolidation or three separate arbitrations. But given the separate litigation, through which each court separately granted either the cedent's or the reinsurer's motion, there may be several arbitration panels addressing this same issue.

Liquidator's Motion to Dismiss Petition to Confirm Reinsurance Arbitration Award Denied

Catalina Holdings (Bermuda) Limited v. Hammer, No. 18 CV 5642, 2019 U.S. Dist. LEXIS 47783 (N.D. Ill. Mar. 22, 2019).

In this case, the Illinois Director of Insurance, after more than 10 years, sent the reinsurer a commutation offer to resolve balances due between the insolvent cedent and the successor reinsurer. The reinsurer declined to pay and the Director demanded arbitration. The reinsurer counterclaimed for unpaid premiums and attorney fees and costs. An arbitration hearing was held and an award was issued in favor of the reinsurer for amounts that were to be offset against future claims billed by the Director or that might qualify as a distribution under the Illinois liquidation statutes.

Having received a favorable award, the reinsurer petitioned the federal court to confirm the award under the FAA and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). Even though the Director had commenced a private arbitration, the director moved to dismiss the petition to confirm, claiming that Illinois insurance law, through the McCarran-Ferguson Act, reverse preempted the ability of the court to hear the petition to confirm.

In denying the motion to dismiss, the court rejected each of the Director's arguments and found that the court had jurisdiction to hear the petition to confirm. The court held that it had independent federal jurisdiction under the New York Convention (the successor reinsurer was a citizen of the UK and the liquidator or the cedent a citizen of Illinois), as well as diversity of citizenship. The court rejected the reverse preemption argument, finding that confirming an arbitration award does not require the court to construe any federal law in a way that invalidates, impairs or supersedes any state law. Notably, the court commented that "[t]he Director appears to have thought there was nothing inconsistent with arbitrating a claim that would eventually be dealt with in liquidation court right up until the panel ruled in Catalina's favor."

Given that the award already decided the liability and amount of damages, and had already perfected the reinsurer's claim, the court held that confirming the award would not interfere with, and in fact was consistent with, the liquidation proceedings. The court rejected the argument that the FAA or the New York Convention were reverse preempted under McCarran-Ferguson because neither would invalidate, impair nor supersede Illinois' insurance laws. The court also noted that, in confirming the award, the court was not called on to determine the priority of the reinsurer's claim or engage in any other way with Illinois' insurance or liquidation laws. All the court had to do was confirm or vacate the award and, with that decision, the Director was free to proceed before the liquidation court as they saw fit.

New York Federal Court Holds Partial Final Award Not Ripe for Confirmation

Standard Security Life Ins. Co. of N.Y. v. FCE Benefit Administrators, Inc., No. 19 CV 64, 2019 U.S. Dist. LEXIS 40231 (N.D. Ill. Mar. 13, 2019).

In a recent non-reinsurance case, an arbitration panel issued a Partial Final Award on the affirmative claims, saving a determination on counterclaims for Phase II, but a New York federal court declined to confirm. The court was asked to confirm an arbitration award against a benefits administrator under an administrative services agreement with an arbitration clause.

The arbitration panel had bifurcated the hearing between the affirmative claims for breach of contract and the benefits administrator's counterclaims (as amended) against the insurance carrier. The Phase I hearing took place and proposed awards were submitted. Both sides submitted a proposed award titled "Partial Final Award." The issued Partial Final Award – Phase I noted that a full hearing was held on Phase I and found for the insurance company against the benefits administrator and denied all other claims of relief by the parties. Nevertheless, the hearing on Phase II, on the counterclaims, was scheduled for a later date.

The insurance company petitioned to confirm the Partial Final Award and the benefits administrator argued that confirmation was premature. In deciding that confirmation was premature, the court noted that a jurisdictional question about whether an award can be confirmed or challenged may be raised. Here, even though the panel used the word "final" in the title of the award, it also used the term "partial." Thus, the court found the award incomplete because it left unresolved significant portions of the parties' dispute – the benefits administrator's counterclaims. The arbitrators, held the court, were not done with the case when they rendered the Phase I award, so the panel's assignment was not yet complete.

Because this is a jurisdictional issue, the court determined that the proceeding was not ripe for adjudication and dismissed the action without prejudice for lack of subject matter jurisdiction. The court stated that the parties may seek reinstatement of the case, if they wish, when the arbitration has concluded.

Pennsylvania Federal Court Seals Arbitration Documents

Pennsylvania Nat'l Mut. Cas. Ins. Co. v. Everest Reinsurance Co., No. 1:18-mc-653, 2019 U.S. Dist. LEXIS 41285 (M.D. Pa. Mar. 14, 2019).

A Pennsylvania federal court was asked to seal a series of arbitration documents in the context of motions to compel arbitration. The cedent filed four motions to seal documents, including the arbitration demand, arbitration correspondence post-demand and the six reinsurance treaties subject to the arbitration demand.

In analyzing the motion to seal, the court weighed the various factors outlined by the 3rd Circuit, including (1) whether disclosure will violate any privacy interests; (2) whether disclosure will cause embarrassment; (3) whether confidentiality is being sought over information important to public health and safety; (4) whether sharing information among litigants promotes fairness and efficiency; (5) whether the party seeking confidentiality is a public entity or official; and (6) whether the case involves issues important to the public. The court found that the documents are private commercial agreements setting forth the terms of a private business relationship such that the public interest in disclosure is minimal.

The court found that the cedent had a reasonably significant privacy interest in the reinsurance treaties. The court noted that the cedent negotiates with various reinsurers with specific percentages of interest. While the agreements are likely similar, disclosure of the precise terms of any one agreement could reasonably have a significant impact on the cedent's ability to negotiate with other reinsurers. For this reason, the court found that this privacy interest substantially outweighed the public's minimal interest in having access to these documents and granted the cedent's motion to seal.

New York Federal Court Rules for Reinsurer on Expenses in Addition to Facultative Limits After Trial

Utica Mut. Ins. Co. v. Munich Reinsurance Am., Inc., Nos. 6:12-cv-00196, 6:13-cv00743 (BKS/ATB), 2019 U.S. Dist. LEXIS 53470 (N.D.N.Y. Mar. 29, 2019).

A New York federal court, after a 10-day trial, ruled on whether a facultative reinsurer was responsible for expenses supplemental to the certificate's liability limits and also whether payments of expenses made by the facultative reinsurer to the cedent should be returned as improper billings. The underlying losses stem from asbestos settlements.

The cedent issued a series of primary and umbrella policies to the underlying insured. The primary policies were expense-supplemental. The cedent obtained facultative reinsurance for some of the umbrella policies. The dispute was whether a specific umbrella policy was modified by an endorsement so as to require the cedent to pay defense expenses in addition to the policy limits.

The opinion goes into the detail of the trial testimony. The court ultimately held that the reinsurer was not liable for any expenses in addition to the limit, but that the voluntary payment doctrine barred the reinsurer from recouping payments on expenses already made.

In making its findings, the court found that the facultative certificate did not contain a follow-the-settlements or follow-the fortunes provision. After taking testimony on whether the doctrine should be implied, the court concluded that the cedent failed to prove that the follow-the-fortunes or settlements doctrines were "so fixed and invariable at the time the parties agreed" to the certificate that it is implied in their agreement. The court did note that the expert testimony showed that cedents and reinsurers, in general, endeavored to work together and that reinsurers, whenever possible, deferred to the reasonable determinations by the cedents in interpreting policies and settling claims. But the experts had to concede that not all reinsurers included following provisions in their facultative certificates. Thus, there was no basis to imply the doctrine to this certificate.

In finding that the cedent was not responsible under the umbrella policy for supplemental defense expenses upon exhaustion of the primary policy, the court held that the asbestos claims were covered under the primary policy and did not come within the endorsement's umbrella drop-down coverage for occurrences not covered by the primary policy (which would have required coverage for expenses supplemental to the limit).

Ultimately, the court concluded that the facultative certificate did not contain an independent requirement obligating the reinsurer to pay defense or declaratory judgment expenses in excess of the limit. The court also found that the definition of allocated loss adjustment expense was unambiguous and did not include declaratory judgment expenses.

As to the expenses that the reinsurer already paid, the court found that the cedent proved, by a preponderance of the evidence, that the reinsurer made a voluntary payment. The court held that the reinsurer was fully aware that the cedent was billing on a costs-in-addition or expense-supplemental basis. Accordingly, the reinsurer's claim for a refund was denied.

Massachusetts Federal Court Retains Reinsurance Dispute Removed From State Court

Certain London Market Co. Reinsurers v. Lamorak Ins. Co., No. 18-10534-NMG, 2019 U.S. Dist. LEXIS 39429 (D. Ma. Feb. 20, 2019).

A US Magistrate Judge recommended that a reinsurance dispute removed by the cedent from state court to federal court not be remanded to state court. On March 8, 2019, the district court judge accepted the magistrate's recommendation.

The dispute involves underlying pollution liabilities insured under umbrella policies that were facultatively reinsured. As in many similar cases, the underlying liabilities were settled and ceded to the reinsurers. The reinsurers disputed their obligations. A similar state court case exists between the cedent and Lloyd's, which is seeking recoupment of its payments under a reservation of rights.

In denying the reinsurer's motion for remand, the court found that this case and the state court case with Lloyd's were not sufficiently parallel for the application of judicial doctrines that would require abstention. The decision outlines the similarities and differences between the two cases, but ultimately the court determined that there was no certainty that both courts will be called upon to interpret the same provisions in the reinsurance contracts. The court concluded that a remand would not be more efficient or promote wise judicial administration.

This case has been ordered to mediation later this year.

Insured's Breach of Implied Contract Claim Against Reinsurers Survives Motion to Dismiss

Vantage Commodities Fin. Servs. I, LLC v. Assured Risk Transfer PCC, LLC, No. 1:17-cv-01451, 2019 U.S. Dist. LEXIS 70417 (D.D.C. Apr. 26, 2019).

A District of Columbia federal court denied a motion to dismiss a claim for breach of implied contract in a credit insurance dispute. The insured extended US$44 million of credit to an energy company and insured up to US$22 million of its exposure through a credit insurance policy with the cedent. The cedent reinsured 90% of its exposure with the defendant reinsurers. The reinsurers provided the insured with credit insurance binders, which confirmed cedent's reinsurance of the credit insurance policy. When the energy company defaulted, the cedent refused to pay.

The insured recovered a multimillion-dollar arbitration award against the cedent and then sued the reinsurers in this case. The district court dismissed the insured's breach of contract claim against the reinsurers because there was no contract between the reinsurers and the insured, but the court allowed the insured to pursue claims for breach of an implied contract, promissory estoppel and unjust enrichment.

Pertinent to the court's decision was a finding that the insured had alleged sufficient facts that the cedent acted as the agent for the reinsurers. The reinsurers moved to dismiss the remaining claims or, alternatively, to compel arbitration. The reinsurers argued that if there was an implied contract, it incorporated the same terms as the credit insurance policy and thus the limitations and the arbitration provisions in the policy applied. The court rejected these arguments, noting that it was too soon to determine the contours of any implied contract and that there was no evidence that the reinsurers agreed to arbitrate a dispute with the insured.

South Carolina Federal Court Denies Trustee's Motion for Summary Judgment Against Fronting Company

Accident Ins. Co., Inc. v. U.S. Bank Nat'l Assn., No. 3:16-vc-02621-JMC, 2019 U.S. Dist. LEXIS 47656 (D.S.C. Mar. 22, 2019).

Generally, trustees involved in reinsurance transactions are insulated from disputes involving the funds placed in trust. In this case, a fronting carrier, who was the beneficiary of a trust agreement, sued the trustee bank for, among other things, civil conspiracy, when the reinsurer went insolvent and after a substantial segment of the assets in trust were deemed valueless.

The trustee bank moved for summary judgment dismissing the civil conspiracy claim and the court denied the motion. The court found a triable issue of fact regarding whether the trustee bank was part of a combination of two or more entities "that carried out an unlawful act in furtherance of such combination thereby causing" damage. The court viewed the evidence in the light most favorable to the fronting carrier and found that communications between the trustee bank and other entities could allow a jury to infer a nefarious agreement to use the value-deficient investments as eligible assets for the trust account.

California Federal Court Denies Intervention and Orders Disbursement of Funds to Reinsurer

Odyssey Reinsurance Co. v. Nagby, No. 16-vc-03038-BTM-WVG, 2019 U.S. Dist. LEXIS 37852 and 42894 (S.D. Ca. Mar. 7 & 14, 2019).

These two decisions arose out of a judgment in Connecticut federal court in favor of the reinsurer and against an underwriting agent for US$3.2 million. The agent underwrote certain risks on the paper of an insurer, which was reinsured by the reinsurer. The reinsurance agreements provided that the agent would receive a provisional commission, paid in part by the reinsurer, on all policies that the agent underwrote. At the end of the year, the commissions were adjusted depending on the profitability of the business underwritten and, where the commissions exceeded the amount to which the agent was entitled to after yearly adjustment, the agent was to pay the difference to the reinsurer. By 2013, the agent owed the reinsurer approximately US$2.7 million.

The reinsurer alleged that when the amount the agent owed became clear, the defendants – principals of the agent – embarked on a plan to strip the agent of its assets and to conceal funds from creditors, including the reinsurer. The reinsurer alleged that the defendants caused essentially all of the agent's assets to be transferred to its successor for the specific purpose of continuing business operations of the agent under a different name to delay or defraud creditors.

In the underlying case, the reinsurer filed an action against the agent and its successor for the amount owed. The court found in favor of the reinsurer for a total of US$3.2 million, plus interest. The reinsurer claimed that, three months before judgment was entered, defendants caused the agent's successor to sell essentially all of its assets to a third party for US$5 million. Out of the sale proceeds, the third party made payments of US$3 million to the defendants. The remainder was to be paid in three annual installments.

The reinsurer filed this action under several theories of liability, including the Uniform Fraudulent Transfer Act (UFTA) and California's alter ego and successor liability law. In its first decision, the court granted default judgment to the reinsurer for US$3.2 million, plus post-judgment interest, and a series of injunctions to stop defendants from dissipating all remaining sale proceeds, including those already paid out. The court ordered the third party to deposit with the court registry the remaining installment payments, a total of US$958,017.66.

The court also denied a third-party creditor's motion to intervene in the case. The third-party creditor presented similar claims as the reinsurer and claimed an interest in the funds deposited in the court registry. The court ultimately found that the third-party creditor had no protectable interest in the funds because, unlike the reinsurer, the third-party creditor did not have a money judgment in its favor. Additionally, the court held that the third-party creditor's intervention application was untimely because it should have known it had a claim over four and a half years ago, and permitting intervention would have prejudiced the existing parties.

The reinsurer eventually requested that the court direct payment of the money held in the court registry to the reinsurer. In its second decision, the court found that the money in the registry belonged to the successor, not the defendants, because the purchase agreement made clear that a sale was of the assets of the company rather than just personal property (as the defendants argued). Therefore, the consideration received for the sale became the property of the agent's successor and, because the reinsurer was a judgment creditor of the agent's successor, the reinsurer was able to execute its judgment by collecting the funds in the registry.

New York Federal Court Rules Communications With Reinsurer May Be Admissible in Breach of Duty of Good Faith and Fair Dealing Claim

Ohio Cas. Ins. Co. v. Twin City Fire Ins. Co., No. 14-CV-858, 2019 U.S. Dist. LEXIS 50504 (E.D.N.Y. Mar. 26, 2019).

An excess liability insurer sued a primary insurer, alleging that the primary insurer breached its duty of good faith and fair dealing by failing to settle an underlying personal injury action within the US$1 million primary policy limits. Before trial in the underlying action, the primary insurer prepared pretrial reports valuing the tort action at or around US$2.5 million; however, it rejected an US$850,000 settlement offer. Ultimately, the case settled for US$5 million. The excess insurer then sued the primary insurer.

The primary insurer filed a motion in limine seeking to introduce evidence that the excess insurer did not notify its reinsurer of the possibility of an excess verdict. The primary insurer argued that this evidence could be used to undermine the excess insurer's attempt to use at trial the pretrial reports to show the primary insurer's lack of good faith because the excess insurer did not rely on those valuations. The excess insurer raised several arguments in response, including that the primary insurer's duty to the excess insurer is different from the excess insurer's duty to its reinsurer. The court determined that the primary insurer had met the "very low" threshold for relevance and granted the motion in limine without prejudice.

Maryland Appeals Court Renders Tax Ruling on Captive

Comptroller of the Treasury v. Leadville Ins. Co., No. 2184, 2019 Md. App. LEXIS 264 (Md. App. Mar. 26, 2019).

This case is for all you insurance tax buffs. A captive insurer claimed that it qualified for exemption for certain corporate taxes because it engaged in reinsurance transactions even though it did not have a certificate of authority as an insurance company in Maryland. The appeals court reversed a Tax Court determination that ruled the initial tax assessment was in error.

In reversing, the appeals court held that just because the captive is authorized to engage in reinsurance transactions and did not need to possess a certificate of authority to do so was irrelevant to the court's determination that the captive was an unauthorized insurer and, therefore, was subject to the tax assessment. In other words, the exemption did not apply to an unauthorized insurer and acting as a reinsurer did not save the situation.

Recent Regulatory/Policy Developments

Credit for Reinsurance in the US – Nearing the End Zone

Where, exactly, is the US in its rules regarding credit for reinsurance?

Quick Summary of Current Status

Insurance regulators in the US have until September 22, 2022, to adopt regulatory provisions that implement the requirements of the two Covered Agreements the US has entered into with, respectively, the European Union and the United Kingdom. If the US regulators do not implement the necessary provisions by that time, the US federal government is authorized to preempt state rules, as necessary, to bring the US into compliance with its commitments under the Covered Agreements.

After many months of drafting and revision, numerous public comments, a hearing and extensive industry comment letters, it looks as if the US regulatory community is nearing the end zone for making the regulatory changes necessary required under the Covered Agreements. On May 1, 2019, the NAIC Reinsurance Task Force exposed another round of proposed changes to the existing NAIC Credit for Reinsurance Model Law (#785) and Model Regulation (#786). After additional comment letters and discussion, the Task Force approved those changes on May 28, 2019. The comprehensive set of amendments to the Credit for Reinsurance model law and model regulation are scheduled to be acted upon by the NAIC Executive Committee and Plenary on June 25, 2019.

Assuming the new language is approved when it is considered in June, the model law and regulation will then be available for individual states to adopt. Adoption by all impacted US jurisdictions will move the ball over the goal line for US regulators and extinguish the specter of federal preemption on issues under the Covered Agreements. Redline text of the pending amendments to the NAIC Credit for Reinsurance Model Law #785 and Model Regulation #786 is available at the NAIC E Committee Reinsurance Task Force section of the NAIC website.

What Are the Key Changes in US Credit for Reinsurance Rules?

The two Covered Agreements address three primary issues for insurers and reinsurers who meet certain financial and regulatory compliance conditions:

- Elimination of US local presence requirements for reinsurers domiciled in the EU or the UK (and vice versa)
- Elimination of US collateral requirements for reinsurers domiciled in the EU or the UK (and vice versa)
- Clarification that US reinsurers operating in the EU or UK will be subject to prudential, governance and financial supervision at the worldwide level **only** by relevant US regulators, and that EU or UK reinsurers operating in the US will be subject to prudential, governance and financial supervision at the worldwide level **only** by the relevant EU or UK regulators. Each jurisdiction may still regulate the operations of non-domiciliary companies operating within their jurisdictions.

The Covered Agreements also address exchange of information between supervisory authorities. See, EU Covered Agreement Signed September 22, 2017 and UK Covered Agreement Signed December 18, 2018.

In addition to defining rules that comply with the requirements of the Covered Agreements, the new NAIC models address other topics. If adopted, the new rules will apply to assuming reinsurers that meet specific financial and solvency requirements and are domiciled in a "Reciprocal Jurisdiction." A Reciprocal Jurisdiction is any non-US jurisdiction that: (1) has entered into or is subject to a Covered Agreement with the US; (2) is a US jurisdiction that meets the requirements for NAIC accreditation; or (3) is a "qualified jurisdiction" so designated by a US jurisdiction as meeting certain criteria identified in the model rules and any other criteria articulated by the relevant US Commissioner. The effect of the qualified jurisdiction language is to enable reinsurers domiciled in qualifying jurisdictions outside the US, EU or UK also to benefit from elimination of the US local presence and collateral rules. The new rules require the NAIC to publish the list of Reciprocal Jurisdictions.

Through a process called "passporting," the rules enable a US regulator to defer to other US jurisdictions' determinations regarding whether an assuming reinsurer is in compliance with applicable financial and other requirements. This passporting process is designed to encourage uniformity across US jurisdictions and facilitate multistate recognition of assuming reinsurers.

Recent Speeches and Publications

- Mary Jo Hudson spoke on "How Predictive Modeling and Artificial Intelligence is Transforming the Insurance Space – Assessing the Operational Challenges and Regulatory Risks," at the ACI's 15th Insurance Regulation Conference on March 12, 2019, in New York.
- Paul Kalish was on the organizing committee for the International Bar Association's Insurance Committee Annual Meeting, "Insurance – A Guide to a Changing Legal Landscape," on March 21 – 22, 2019, in London. Deirdre Johnson spoke on "Dispute Resolution Trends" at that meeting on March 21, 2019.
- Eridania Perez moderated a general session panel on "Reinsurance for Cannabis Related Business: A Business Opportunity or Risk," at the ARIAS•U.S. Spring Conference on May 8, 2019, in Palm Beach, Florida.
- Suman Chakraborty moderated a breakout panel on "Do I Qualify? Navigating the Life Requirement in Arbitration Clauses," also at ARIAS•U.S. Spring Conference on May 9, 2019, in Palm Beach, Florida.
- Deirdre Johnson spoke on a panel entitled "Ask the Experts: Ethics Session," also at ARIAS•U.S. Spring Conference on May 10, 2019, in Palm Beach, Florida.
- IRMI.com has published a selection of Larry Schiffer's Reinsurance Commentaries in a White Paper for new subscribers to its Captive Daily Wire service titled "Why Reinsurance Matters, and Other Must Know Reinsurance Concepts," IRMI.com White Paper, April 2019.
- Larry Schiffer's commentary, "Interplay of Loss Portfolio Transfers and Other Reinsurance Contracts," was published on IRMI.com in March 2019.
- Congratulations to #TeamSPB's great showing in *Chambers USA* 2019. The New York insurance and reinsurance disputes resolution team was ranked in Band 2 for New York: Insurance: Dispute Resolution: Insurer. Leading practitioners ranked were Paul Kalish, Nationwide: Insurance Dispute Resolution: Insurer; District of Columbia: Insurance: Insurer; Larry Schiffer: New York: Insurance: Dispute Resolution: Insurer; Suman Chakraborty: New York: Insurance: Dispute Resolution: Insurer; Mark Sheridan: New Jersey: Litigation: Insurance; and Deirdre Johnson: District of Columbia: Insurance: Insurer.
- Congratulations to #TeamSPB's excellent representation in *Who's Who Legal Insurance & Reinsurance* 2019: Deirdre Johnson, Paul Kalish, Suman Chakraborty and Larry Schiffer. Larry Schiffer was also recognized as a Thought Leader for Insurance & Reinsurance in 2019.

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

Authors

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

Patricia R. Hatler
Of Counsel, Columbus
T +614 365 2728
E patricia.hatler@squirepb.com

Kelly Mihocik
Associate, Columbus
T +1 614 365 2836
E kelly.mihocik@squirepb.com

India K. Scarver
Associate, Columbus
T +1 614 365 2719
E india.scarver@squirepb.com

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations nor should they be considered a substitute for taking legal advice.

© Squire Patton Boggs.

All Rights Reserved 2019