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Saul Ewing LLP

Insurance Practice

Reinsurance Redux

The redux on developments in the law of reinsurance

In This Issue

Assignment of Right to Collect on Reinsurance Treaty Held Not to Include Underlying Arbitration Clause

Pine Top Receivables of Ill. v. Banco de Seguros del Estado, 12 C 6357, 2013 WL 677986 (N.D. Ill. Feb. 25, 2013)

On February 25, 2013, the United States District Court for the Northern District of Illinois held that the assignment of a bankrupt reinsurer's right to receive payments under certain reinsurance treaties did not also assign the treaties' arbitration provision. The Court denied the assignee's request to compel arbitration.

Pine Top Insurance Company ("Pine Top") and Banco de Seguros del Estado ("Banco") were parties to five reinsurance treaties between 1977 and 1984 ("Treaties"). Then, in 1986, Pine Top entered into liquidation proceedings. The Liquidator provided a final account of amounts due to Pine Top under the Treaties, but Banco refused to pay.

Subsequently, a separate entity, Pine Top Receivables of Illinois ("PTRIL"), entered into a Purchase Agreement ("Agreement") to buy the amounts due to Pine Top from the Liquidator. The Liquidator assigned to PTRIL "all right, title and interest in all net balances due from known and unknown debtors" who owed debts to Pine Top. Banco refused to pay PTRIL, and refused to enter into arbitration. PTRIL sued, seeking to compel arbitration (and bringing an alternative claim for breach of contract).

The Treaties contained an arbitration provision. PTRIL asserted that its right to compel arbitration arose from the Agreement, which it asserted was an assignment of the Treaties, and thus, the arbitration provision was assigned to PTRIL. The Court disagreed.

The Court noted that the Agreement specifically stated that it "shall not be construed to be a novation or assignment of the [Treaties]," assigning only the "rights, title, benefit and interests in the Debts." This, the Court found, was not meant to assign to PTRIL all of Pine Top's rights and duties under the Treaties, but was instead only a limited right to collect contractual debts. The Court thus denied the count of PTRIL's complaint that sought to compel arbitration.

Redux in Context:

- An assignment of the right to collect payments due under a reinsurance contract does not automatically result in the assignment of the right to arbitrate under such contract.
- Unless an assignment explicitly assigns the right to arbitrate or assigns all rights under a reinsurance contract, courts may not allow the assignee to compel arbitration.

One Bad Apple: A Service of Suit Provision in Any Reinsurance Contract at Issue May Spoil a Defendant's Removal Power with Regard to All Contracts in the Suit

Insurance Co. of the State of Pa. v. TIG Ins. Co., 12 CV 6651 VM, 2013 WL 950819 (S.D.N.Y. Mar. 11, 2013)

The U.S. District Court for the Southern District of New York held on March 11, 2013 that where a reinsurer is sued for failure to pay amounts due under multiple reinsurance contracts, at least one of which contains a service of suit provision, the provision will apply to the entire action and not be limited to the contract or contracts that actually contain the provision.

The TIG Insurance Company ("TIG") issued six separate facultative reinsurance certificates to the Insurance Company of the State of Pennsylvania ("ICSOP"). Some of those certificates, but not all, contained a service of suit clause, the effect of which is to waive the defendant's ability to remove a state court action to federal court. When TIG refused to honor its contractual obligations under the reinsurance certificates, ICSOP sued, and TIG removed.

ICSOP contended that the presence of a service of suit provision in some of the certificates at issue prevented TIG from removing the action to federal court as the action related to all of the certificates – not just those that contained the provision. The Court agreed.

In reaching its conclusion, the Court found persuasive the Eleventh Circuit's decision *Russell Corp. v. Am. Home Assur. Co.*, 264 F.3d 1040 (11th Cir. 2001). In *Russell*, one insurance policy contained a service of suit provision out of the three insurance policies issued by a single defendant in an action proceeding against 23 total insurers and involving 79 insurance policies. The Eleventh Circuit, affirming the opinion below, which remanded the whole action to state court, found that the defendant had granted the plaintiff the right to choose the forum for suit regarding the policy *with* the provision, and that the defendant had made no exception for suits that also involved policies *without* such a provision.

The Southern District of New York remanded the action on the basis that the service of suit provisions in *some* of the certificates did not, as in Russell, contain any exception for cases involving other certificates, and added that on a motion to remand, any doubts about removal jurisdiction are resolved in favor of remand.

Redux in Context:

- In a suit involving multiple reinsurance treaties, the presence of a service of suit provision in any single treaty may prevent the defendant from removing to federal court – even with regard to the treaties that do not have such a provision.
- If a reinsurance contract is drafted with a service of suit provision, language limiting the waiver of removal to federal court to suits involving only contracts with an identical provision may preserve a defendant reinsurer's ability to remove cases to federal court when contracts without service of suit provisions are also involved.

Prejudice Not Required to Prove a Late Notice Defense Under Illinois Law

AIU Ins. Co. v. TIG Ins. Co., 07 CIV. 7052 SHS, 2013 WL 1195258 (S.D.N.Y. Mar. 25, 2013)

On March 25, 2013, the U.S. District Court for the Southern District of New York ruled that a late notice provision in reinsurance certificates prevented an insurance company's attempt to collect from its reinsurer after more than three years elapsed before it finally notified the reinsurer.

AIU Insurance Company ("AIU") had offered excess liability coverage to Foster Wheeler Corporation ("Foster Wheeler"), a manufacturer of industrial boilers and other heat exchange equipment. [AIU then obtained reinsurance certificates, now in the hands of TIG Insurance Company ("TIG") (the successor in interest to the original reinsurer)]. Foster Wheeler had used asbestos in its products, and was sued "hundreds of thousands" of times. As a result, Foster Wheeler demanded $20 million from AIU on the excess liability policies in October 2003, and the two eventually settled.

Not until January 2007 –more than three years later – did AIU notify TIG that a claim had been made against it. TIG disclaimed any obligation to pay under the reinsurance contracts

on the basis of AIU's late notice. When settlement negotiations failed, AIU sued in the Southern District of New York.

The Court's first task was to determine the applicable law. The District Court applied the forum state's choice of law principles. New York applies a "center of gravity" test to contract disputes, with two factors of particular importance in reinsurance disputes: the state where the reinsurance certificate was issued, and the state in which performance was expected to occur. AIU contended that New York law should govern, but the Court concluded that because the contract was entered into in Illinois, and because AIU was expected to perform in Illinois, Illinois law governed. Neither the fact that TIG's domicile was a contested issue nor any other factor pointed to by AIU was enough to disrupt the court's determination to apply Illinois law.

Next, the Court considered whether a reinsurer in Illinois needed to establish late notice only, or also that it suffered prejudice in order to stave off payment under the contract. On this point, the Court found only an unpublished trial court opinion discussing the issue in the reinsurance context, where it stated in dicta that prejudice need not be shown. The Court also identified a 70-year-old Seventh Circuit opinion which predicted Illinois law on prejudice in the reinsurance context. In the absence of intervening state law decisions on this unsettled state law issue, and in light of the Second Circuit's decision in *Factors Etc., Inc. v. Pro Arts, Inc.*, 652 F.2d 278 (2d Cir. 1981), the Southern District of New York found that it was bound by the Seventh Circuit's opinion stating that prejudice need not be established.

In *Factors*, the Second Circuit Court of Appeals held that when a federal appellate court sits in diversity and predicts an unsettled issue of state law for a state that falls within its territorial jurisdiction, other federal appellate courts should defer to that court's determination "perhaps always[.]" Subsequent case law suggested to the District Court that it would likewise be bound by the decision of any other appellate court determining Illinois state law on a matter of first impression, and was bound by *Factors* to apply the Seventh Circuit's holding that Illinois reinsurance law did not require a showing of prejudice.

This led the Court to the final issue: whether a delay of more than three years constituted late notice. Under Illinois law, a "prompt notice" provision requires notice within a "reasonable" amount of time. Finding that AIU was a sophisticated party with no excuse for the long delay, the Court assessed the notice as unreasonably late. Because TIG was not required to show prejudice, this ended the analysis. The Court entered summary judgment for TIG, ruling that it may properly refuse coverage under the certificates.

Redux in Context:

- When drafting reinsurance contracts, a cedent should consider including a choice of law provision if it wants to avoid unpredictability with respect to judicial interpretation of the notice requirements.
- Under Illinois law, prejudice is not required to avoid liability on the basis of a late notice defense.
- Under Illinois law, a delay of three years in providing notice of claims without explanation is unreasonable and constitutes late notice under a reinsurance contract that requires prompt notice.

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