SQUIRE PATTON BOGGS

REINSURANCE NEWSLETTER

September 2014

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Congratulations to John Nonna and Larry Schiffer for being named Leading Lawyers in *The Legal 500 US*: Insurance-Advice to Insurers.

Congratulations to John Nonna for being ranked in Band 1 in *Chambers USA* for Dispute Resolution: Insurer (Nationwide and New York) and Insurance: Dispute Resolution: Reinsurance (Nationwide), and to Larry Schiffer for being ranked in Band 2 in *Chambers USA* for Dispute Resolution: Insurer (New York).

Recent Case Summaries

Second Circuit Affirms Reinsurer's Late Notice Defense Under Illinois Law

AIU Ins. Co. v. TIG Ins. Co., No. 13-1580-cv, 2014 U.S. App. LEXIS 16513 (2d Cir. Aug. 27, 2014) (Summary Order – No Precedential Effect).

The Second Circuit Court of Appeals has affirmed summary judgment in favor of a reinsurer on a late notice defense under Illinois law. We discussed the underlying decision in our September 2012 Newsletter.

This case derives from the settlement of numerous asbestos-related lawsuits brought against Foster Wheeler. The cedent received tender of these suits in 2003 and settled its exposure to Foster Wheeler. In 2007, the cedent gave the reinsurer notice of its intent to bill the settlement to facultative certificates. The reinsurer refused to pay arguing late notice.

The district court granted summary judgment to the reinsurer based on its determination that Illinois law applied and that under Illinois law a reinsurer is not required to demonstrate prejudice resulting from the late notice. The Second Circuit affirmed, agreeing with the district court that the circumstances of the facultative certificates favored application of Illinois law. The court also adhered to the consensus it drew from various cases that Illinois law does not require a reinsurer to prove prejudice when it refuses to pay a claim for reinsurance coverage based on having received late notice of that claim. The court agreed that the three-year delay by the ceding company before notifying the reinsurer of the claim fell outside the bounds of reasonable notice.

Federal Court Denies Reinsurer's Request to Force a Third-Party to Join Arbitration

Transatlantic Reins. Co. v. Nat'l Indemn. Co, No. 14 C 1535, 2014 U.S. Dist. LEXIS 85533 (N.D. Ill. Jun. 24, 2014).

An Illinois federal court denied an application to compel a non-party to arbitrate. A reinsurance company brought an amended petition under the Federal Arbitration Act to compel a non-signatory to an agreement to join an arbitration between the reinsurer and its cedent. The reinsurer argued that the arbitration clause in the reinsurance agreement was sufficiently broad to bind a non-signatory to arbitration and required arbitration of disputes that arose out of or are in connection with the reinsurance agreement.

In denying the application, the court agreed that the reinsurance agreement contained broad language, but determined that the arbitration clause was narrow as to the participants because it stated that "the dispute must 'arise between the company and the reinsurers.'" Therefore, held the court, the agreement to arbitrate could not be construed broadly.

The reinsurer also argued that because the third-party acted as the agent of the cedent in certain situations it could be bound to the arbitration agreement because it assumed the obligation to arbitrate. The court determined that because the third-party entered in a separate agreement with the cedent it could not be considered to have assumed the obligation to arbitrate. The reinsurer further argued that the third-party's obligation to arbitrate was incorporated by reference through the agreements between the third-party and the cedent. The court rejected that argument, determining that the "mere reference" to another agreement was not sufficient to incorporate its terms into a contract. The reinsurer also argued estoppel. The court held that any benefits arising from the reinsurance agreement were indirect and, as a result of a separate agreement, were not directly from the reinsurance agreement. The court stated that a mere nexus to an agreement or indirect benefits was not enough to compel a non-signatory to arbitrate. Therefore, petition to compel the indemnity company to join the arbitration was denied.

New York Federal Court Denies Petition to Appoint Umpire

Odyssey Reins. Co. v. Certain Underwriters at Lloyd's London, No. 13 Civ. 9014 (PAC), 2014 U.S. Dist. LEXIS 96356 (S.D.N.Y. Jun. 30, 2014).

A New York federal court denied a retrocedent's petition to appoint an arbitrator. The court held that because there had not been a breakdown in the process that justifies court intervention, the parties should proceed to the next stage of the arbitrator selection process described in the retrocessional agreements. In response to the retrocedent's argument that the retrocessionaire's candidates were not qualified, the court also noted that a district court cannot entertain an attack on the qualifications or partiality of arbitrators until after the conclusion of the arbitration and the issuance of an award.

Missouri Federal Court Denies Motion for Reconsideration of Order Quashing Subpoena to Umpire Seeking Release of Arbitration Award

Jo Ann Howard & Assocs., P.C. v. Cassity, No. 4:09CV01252 ERW, 2014 U.S. Dist. LEXIS 95896 (E.D. Mo. July 15, 2014).

In our June 2014 Newsletter, we briefly discussed this unusual subpoena seeking to compel an umpire to release an arbitration award. The issuing party moved for reconsideration and the court denied the motion stating that the issuing party did not meet the criteria for a motion for reconsideration.

Cedent Denied Leave to Appeal Ruling on Who Decides Statute of Limitations

ROM Reins. Mgmt. Co., Inc., v. Continental Ins. Co., No. M-1783 (App. Div. 1st Dep't Jul. 24, 2014).

This case, which was summarized in our June 2014 Newsletter, held that the court and not the arbitrators was to determine the application of the statute of limitations. The cedent moved for reargument or, in the alternative, for leave to appeal to the New York Court of Appeals. That motion was denied.

New York Federal Court Caps Payments for Combined Loss and Expenses at Reinsurance Accepted Limits

Global Reins. Corp. of Am. v. Century Indemn. Co., No. 13 Civ. 06577 (LGS) 2014 U.S. Dist. LEXIS 113793 (S.D.N.Y. August 15, 2014).

In yet another *Bellefonte*-type case, a New York federal court adhered to the Second Circuit's overall cap on limits. This dispute arose over nine facultative certificates of reinsurance issued by a predecessor-in-interest of the reinsurer to a predecessor-in-interest of the cedent. Each certificate contained a "Reinsurance Accepted" value ranging from US$250,000 to US$2 million, which the reinsurer claimed constituted a cap on its liability for each certificate, and which the cedent asserted constituted a cap on losses only, leaving recovery for expenses uncapped.

After first concluding that New York law governed, because this was the reinsurer's state of incorporation and, therefore, where claims were expected to be made and performance was expected to occur, the court granted partial summary judgment to the reinsurer. Citing the two leading Second Circuit decisions, *Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co.*, 903 F.2d 910 (2d Cit. 1990) and *Unigard Sec. Ins. Co. v. N. River Ins. Co.*, 4 F.3d 1049 (2d Cit. 1993), the court found that, because each certificate contained a "Subject To" clause (stating that the reinsurance was in consideration of the payment of premiums and subject to the terms, conditions and amount of liability set forth in the certificates), and the certificates did not expressly state that expenses were to be excluded from the indemnification limits, the Reinsurance Accepted limit in each certificate capped the maximum amount the reinsurer could be obligated to pay for both loss and expenses.

While the cedent pointed to other provisions in the certificates indicating that the Reinsurance Accepted limits applied only to losses, including a "Follow the Fortunes" clause in each certificate (stating that the liability of the reinsurer would follow that of the cedent), and an "In Addition Thereto" clause, (stating that the reinsurer would be bound to pay its proportion of settlements, and in addition thereto, in the ratio that the reinsurer's loss payment bears to the cedent's gross loss payment, its proportion of expenses), the court found that, because of *Bellefonte*, these contractual provisions must be construed in light of the "Subject To" clause and the Reinsurance Accepted limits, and could not separately allow for recovery of expenses beyond the Reinsurance Accepted limits.

Cedents continue to try to distinguish contract language from *Bellefonte*, but the courts in the Second Circuit have yet to budge.

New York State Motion Court Denies Reargument or Renewal of Motion to Dismiss Affirmative Defenses Based on Cedents' Loss Portfolio Transfer

Granite State Ins. Co. v. Transatlantic Reins. Co., No. 652506-2012, 2014 N.Y. Misc. LEXIS 2686 (N.Y. Sup. Ct. N.Y. Co. Jun. 18, 2014).

This dispute was over an alleged failure of a reinsurer to make reinsurance payments to cedents under facultative certificates. In its answer to the complaint, the reinsurer asserted in several affirmative defenses, including that the cedents were not entitled to payments because the cedents had entered into a loss portfolio transfer with a third party in violation of two provisions in the parties' certificates: (a) a retention provision that required the cedents to retain the amount specified on the face of the certificates; and (b) an anti-assignment provision that prohibited assignment without the reinsurer's consent. The cedents moved to dismiss these affirmative defenses on the ground that their loss portfolio transaction constituted treaty reinsurance, which was allowed under the certificates, and did not violate the anti-assignment provision, because it did not transfer all liabilities and could not be considered an assignment.

The motion court denied the motion to dismiss in a previous opinion, citing to a lack of documentation to support the cedents' arguments and finding that the loss portfolio transfer could not be treaty reinsurance because it covered pre-existing insurance policies. The cedents moved to renew and reargue their motion, including additional documentation and asserting that treaty reinsurance can include the transfer of past liabilities.

In denying the cedents' motion to renew and reargue, the court found that the cedents' loss portfolio transfer may have violated both the retention requirement and the assignment provision in the parties' facultative certificates. On the retention requirement, the court found that the loss portfolio transfer could not be treaty reinsurance because it applied retroactively. The court stated that the New York Court of Appeals had previously held that treaty reinsurance must be obtained in advance of actual coverage. The court also rejected the argument that the relevant "coverage" for this analysis should be the coverage provided by the reinsurance contract, as opposed to the coverage provided by the underlying insurance that was being reinsured.

On the assignment provision, the court found that, while the loss portfolio transfer included an upper limit for the reinsurance coverage of US$5 billion, indicating that the transfer did not constitute an assignment, the reinsurer had argued that this cap was so high as to be illusory and the cedents had not come forth with sufficient evidence to refute this point. The court also found that it was not fatal to the reinsurer's defense as a whole that not all certificates had been assigned, because the defense could still apply to some certificates even if it did not apply to every certificate.

This is an interesting case because the court specifically held that treaty reinsurance is prospective only. Many in the reinsurance industry may find that formulation at odds with the concept of a treaty simply being the reinsurance of a broad portfolio of business regardless of retroactive or prospective risk assumption.

New York Federal Court Grants Motion for Summary Judgment on Breach of Guarantee of Payment for Debts Owed under Reinsurance and Retrocession Agreements

Greenlight Reins., Ltd. v. Appalachian Underwriters, Inc., No. 1:12-cv-8544-JPO-GWG, 2014 U.S. Dist. LEXIS 102779 (S.D.N.Y. Jul. 28, 2014).

Granting a motion for summary judgment, a New York federal court has concluded that amounts owed under reinsurance and retrocession agreements must be paid to a reinsurer/retrocedent by guarantors pursuant to a guarantee of payment.

The reinsurance agreements provided that a managing general agent ("MGA") could take provisional commissions on ceded premiums, with the true commissions calculated at year's end based on the performance of underlying insurance policies. The court found that the MGA had retained more in commissions than it was entitled based on the calculation of a contractually defined ultimate loss ratio as between premiums earned and losses incurred on underlying insurance policies.

Pursuant to the retrocession agreements, the retrocedent claimed that the retrocessionaire was required to post collateral to cover a portion of the retrocedent's projected losses under reinsurance agreements. Previously, an arbitration panel had awarded the retrocedent the amount of collateral sought in the lawsuit. The court determined that the net loss ratio was above a level requiring the retrocessionaire to post collateral based on the evidence presented, with the court observing that the evidence was bolstered by the arbitration panel's prior ruling.

The reinsurer/retrocedent further claimed that it was owed debts constituting the MGA's improperly withheld commissions and the retrocessionaire's improperly withheld collateral payments under two alleged guarantees of payment. The court found that one of the alleged "guarantees" was not in fact a guarantee of payment. Rather, it was a promise to fund certain companies with which the reinsurer/retrocedent conducted reinsurance and retrocessional business so that those companies remained solvent and capable of satisfying their obligations to the reinsurer/retrocedent. The court denied the reinsurer/retrocedent's motion for summary judgment for breach of this alleged guarantee.

Regarding the other alleged guarantee, the court found that it was a guarantee of payment because it guaranteed full and prompt payment as and when it comes due under "relevant contracts." The court determined that the reinsurance and retrocession agreements qualified as "relevant contracts," and granted the motion for summary judgment for breach of this guarantee by the guarantors.

The court also granted the reinsurer/retrocedent's request for a declaratory judgment that the guarantors are required to satisfy the MGA's present and future commission adjustment payments under the reinsurance agreements, and are required to satisfy the retrocessionaire's present and future collateral obligations under the retrocession agreements. Finally, the court granted the reinsurer/retrocedent's motion for summary judgment on breach of contract relating to a provision of the guarantee that prohibited the guarantors from breaching any "relevant contracts" or permitting their affiliates, including the MGA and the retrocessionaire, from doing so.

Eleventh Circuit Reverses Dismissal of Cedent's Complaint Against Reinsurer for Failure to Cover Underlying Defense Fees

Public Risk Mgmt. of Fla. v. One Beacon Ins. Co., No. 13-15254, 2014 U.S. App. LEXIS 11825 (11th Cir. Jun. 24, 2014).

The Eleventh Circuit has reversed a Florida district court's dismissal of a cedent's complaint against its reinsurer. The reinsurer refused to cover legal fees that the cedent, an intergovernmental risk management association, incurred defending one of its member cities in an underlying lawsuit. The reinsurer had argued that the cedent had no duty to defend the city, and, therefore, the reinsurer had no obligation to cover those defense fees under the reinsurance agreement.

The city had been sued by a construction company with which it had contracted for the removal of city-owned utilities. The construction company bid on the project based on the city's drawings identifying the location of utilities to be removed, and based on the city's representation that the Florida Department of Transportation (DOT) would remove all non-city-owned utilities before the construction company began its work. The construction company was unable to timely complete the project because the DOT failed to remove the non-city-owned utilities beforehand, and because there were far more city-owned utilities to remove than depicted on the city's project drawings. The construction company also damaged certain underground utilities that were not identified on the drawings when it dug into what it believed to be empty ground. The city withheld payment based on the construction company's alleged liability for liquidated and actual delay damages. The construction company then sued the city.

Based on its review of the underlying insurance policy and the construction company's complaint, the Eleventh Circuit concluded that the construction company's breach of contract claim against the city could have been covered. Specifically, allegations that the city made mistakes, misstatements, or omissions in the bid package could qualify as "wrongful acts" with resulting damages. A wrongful act under the policy could be rooted in a breach of a duty that the city had under a contract. The Eleventh Circuit observed that if the underlying defense fees were covered under the insurance policy, then those fees would also be covered under the reinsurance agreement. For separate reasons, however, the Eleventh Circuit affirmed the district court's dismissal of the cedent's equitable estoppel claim against the reinsurer.

Captive Reinsurance Affiliate Prevails Because the Claim Was Time-Barred

Hill v. Flagstar Bank, No. 12-2770, 2014 U.S. Dist. LEXIS 86889 (E.D. Pa. Jun. 26, 2014).

A Pennsylvania federal court granted summary judgment to a reinsurer and other defendants because the RESPA claim was time-barred. In this case, plaintiffs alleged a defendant bank, its captive reinsurance affiliate, and a mortgage insurer violated RESPA by colluding in an illegal scheme involving kickbacks. The plaintiffs failed to bring their claim within RESPA's one-year statute of limitations. In addition, the court found that the plaintiffs did not diligently pursue their claims against the defendants and thus, could not benefit from equitable tolling.

Iowa Federal Court Compels Production of Reinsurance Communications

Progressive Cas. Ins. Co. v. FDIC, No. C12-4041-MWB, 2014 U.S. Dist. LEXIS 116909 (N.D. Iowa Aug. 22, 2014).

Recent decisions by courts have compelled cedents and reinsurers to produce reinsurance communications and have rejected the shield of the common interest doctrine. This case is yet another example.

An Iowa federal court has granted a bank receiver's motion to compel both the cedent and a reinsurer to produce reinsurance communications. The court had issued a production order and the parties disagreed as to its scope. Finding for the cedent as to the scope, the court held that the cedent did not have to produce reinsurance documents beyond those concerning the insolvent bank's insurance policies and claims against the insolvent bank's officers and directors.

The cedent and the reinsurer, however, argued that the reinsurance communications were protected by the attorney-client and attorney work product privileges and the common interest doctrine. The court rejected these arguments. The court found that the reinsurance information was not protected because it was created in the ordinary course of the cedent's business and was provided to the reinsurer and the broker solely for business purposes. The court also held that the cedent had waived the attorney-client privilege by disclosing documents to the reinsurer and the broker.

Finally, the court rejected application of the common interest doctrine because the information disclosed was not provided to build a legal defense or strategy for litigation. The cedent, held the court, had not shown that its reinsurers were actively participating in the underlying litigation and legal defense or that they have any obligation to do so. In a telling statement, the court said that "[t]he unique circumstances of the reinsurance business do not automatically give rise to a common legal interest."

Minnesota Federal Court Upholds Order to Produce Reinsurer Communications

Nat'l Union Fire Ins. Co. v. Donaldson Co., No. 10-4948 (JRT/JJG), 2014 U.S. Dist. LEXIS 85621 (D. Minn. Jun. 24, 2014).

A Minnesota federal judge affirmed three nondispositive discovery orders, one of which ordered a cedent to produce communications with its reinsurer. In this case, the cedent filed suit seeking reimbursement from its insured for amounts that the cedent paid as part of a settlement that fell within the insured's deductible. The insured counterclaimed that that the cedent breached the covenant of good faith and fair dealing because the cedent waited eight years before notifying the insured that damages arising from multiple claims would be treated as separate occurrences rather than as a single occurrence under a batch clause provision.

A magistrate judge granted the insured's motion to compel the cedent to produce three types of documents: internal underwriting files, loss reserve information, and communications with reinsurers. The district court upheld the order. Regarding internal underwriting files, the court determined that the cedent's internal assessment of the insured's claims were relevant to the dispute about breach of good faith because the documents could indicate that the cedent planned to treat each claim as a separate occurrence long before revealing it to the insured. Similarly, the court concluded that loss reserve information was relevant to whether the insurer acted in bad faith because reserve estimates are evidence of how an insured would apply coverage under a policy at a point in time.

Third, the court determined that the cedent's communications with its reinsurer were relevant to the insured's bad faith claim. Because a cedent has an obligation to disclose known facts to its reinsurer, communications with a reinsurer could reveal what the cedent knew and when it knew its plans for applying coverage to the insured's claims. The court acknowledged that there was a split of authority on the issue of whether reinsurance communications are discoverable. Several courts have concluded that reinsurance communications are relevant and discoverable in claims of bad faith. But other courts have held that reinsurance communications are not discoverable under Federal Rule of Civil Procedure 26. Because there was a split of authority, the court deferred to the discretion of the magistrate judge and upheld the order to disclose reinsurance communications.

Recent Speeches and Publications

John Nonna will be speaking on "A Focus on Allocation of Toxic Tort, Asbestos and Other Long Tail Claims," at the American Conference Institute's National Forum on Insurance Allocation on October 29, 2014, in New York.

John Nonna is co-chairing the ARIAS•U.S. Fall Conference, "The Arbitrators Speak: Insight and Perspective from the Arbitrators Themselves," on November 13-14, 2014, in New York.

Larry Schiffer's Commentary, "When Contracts Collide: Complex Reinsurance Programs" was published on the website of the International Risk Management Institute, Inc., *IRMI.com*, in June 2014.

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