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Reinsurance Redux ←

The redux on developments in the law of reinsurance

In This Issue

Reinsurer's Obligation to Provide Coverage to Reinsured Not Contingent Upon Exhaustion of Limits of Primary Policy

In granting an insurer's motion for judgment on the pleadings, the United States District Court for the Southern District of New York held that a reinsurer's obligation to provide coverage to its reinsured was not contingent upon exhaustion of the limits of an underlying primary insurance policy. *Lexington Insurance Co. v. Tokio Marine & Nichido Fire Insurance Co. Ltd.*, No. 11 Civ. 391 (DAB) (S.D.N.Y. Mar. 28, 2012). **PAGE 2**

Court Articulates Methodology For Calculating Prejudgment Interest on Previously Remitted Indemnity Payments Under Reinsurance Agreement

When awarding prejudgment interest against a reinsurer on previously remitted indemnification payments, the United States District Court for the District of New Jersey held that prejudgment interest would be calculated from the date the complaint was filed for payments demanded prior to that date and declined to enhance the interest rate. *Munich Reinsurance America, Inc. v. Tower Insurance Co. of New York*, Civ. A. No. 09-2598, 2012 WL 1018799 (D.N.J. March 26, 2012). **PAGE 3**

Non-Signatory to Arbitration Agreement Does Not Waive Right to Have Court, Not an Arbitrator, Determine Issue of Arbitrability

On March 6, 2012, the Eighth Circuit held that a non-signatory to an arbitration agreement did not waive its right to have the court, not an arbitrator, determine the issue of arbitrability despite the fact that the non-signatory had notice of the arbitration and affirmatively chose not to participate. The Eighth Circuit held that although such conduct might waive the right of a non-signatory to have a court determine the issue of arbitrability, such a case was not warranted here. *Local 36 Sheet Metal Workers' Int'l Assoc. v. Whitney*, 670 F.3d 865 (8th Cir. 2012). **PAGE 4**

Reinsurer's Obligation to Provide Coverage to Reinsured was Not Contingent Upon Exhaustion of Limits of Primary Policy

Lexington Insurance Co. v. Tokio Marine & Nichido Fire Insurance Co. Ltd., No. 11 Civ. 391 (DAB) (S.D.N.Y. Mar. 28, 2012).

This is an update from the October 2011 *Redux*. By way of background, Plaintiff Lexington Insurance Co. ("Lexington") issued two layers of excess property coverage to Port Authority as fronting policies for Defendant Tokio Marine & Nichido Fire Insurance Co. Ltd. ("Tokio Marine"). Tokio Marine allegedly agreed to reinsure 100 percent of the risk under both coverage layers. Lexington's first coverage layer provided a per-occurrence limit of an \$11.5 million portion of a \$40 million layer in excess of \$10 million. Lexington's second coverage layer provided a per-occurrence limit of a \$9.5 million portion of a \$50 million layer in excess of \$50 million.

As a result of the September 11, 2001 terrorist attacks on the World Trade Center, Port Authority sustained more than \$1 billion in damages. When submitting its insurance claim to insurers, Port Authority took the position that there were two occurrences, which would double its coverage. Lexington, however, only paid one per-occurrence limit for each coverage layer, as did Port Authority's other insurers. Tokio Marine fully reimbursed Lexington for both payments, totaling \$20 million.

After Port Authority litigated with its insurers over whether it could recover a second payment for its full per-occurrence limits, a settlement was reached whereby Port Authority's insurers agreed to pay their pro rata shares of an \$11 million settlement.

When Lexington submitted a claim to Tokio Marine to recover the nearly \$7.5 million it paid in the settlement, Tokio Marine rejected the claim because it did not agree with the allocation of settlement funds and maintained that until the primary \$10 million policy was exhausted, Lexington, and in turn Tokio Marine, had no reinsurance obligation. Lexington filed suit against Tokio Marine for a declaration that its obligation to provide excess insurance coverage to Port Authority was not contingent upon exhaustion of the limits of the underlying primary insurance policy, breach of contract and unjust enrichment.

The unjust enrichment claim was dismissed in September 2011.

Lexington subsequently filed a motion for judgment on the pleadings as to its claim for declaratory judgment, arguing under Second Circuit law that an insured is entitled to coverage from an excess insurer even when the insured has not received payment from the primary insurer sufficient to exhaust the underlying primary limit so long as the total loss exceeds the primary policy and ventures into the scope of the excess policy. In contrast, Tokio Marine argued that Lexington's policies were not required to provide coverage unless the underlying insurer itself actually paid the full amount of its policy limits of liability, and specifically contended that Lexington's coverage obligation was not triggered until the \$10 million per-occurrence limit of the primary policy was exhausted (and that the settlement fell \$6.4 million short of exhausting that limit).

In granting Lexington's motion, the Court reasoned that absent an unambiguous condition in the excess policy requiring the primary insurer to pay the full limit of its policy before excess coverage would be triggered, so long as the total loss exceeds the attachment point of the excess policy, the law in the Second Circuit does not require exhaustion of the primary policy to trigger the excess insurer's obligations, regardless of what settlement the primary insurer may have reached. Thus, Tokio Marine's argument that exhaustion of the primary policy here required a payout of the full \$10 million was unavailing.

Redux in Context:

- Case stands for the proposition that where a total loss exceeds the attachment point of an applicable excess policy, exhaustion of the primary policy is not required to trigger the excess insurer's obligations regardless of any settlement the primary insurer may have reached;

- But, an unambiguous condition in an excess policy requiring the primary insurer to pay the full limit of its policy before excess coverage would be triggered is enforceable; and
- A condition requiring a primary insurer to pay the full limit of its policy before excess coverage can be triggered will not be inferred into an agreement.

Court Articulates Methodology For Calculating Prejudgment Interest on Previously Remitted Indemnity Payments Under Reinsurance Agreement

Munich Reinsurance America, Inc. v. Tower Insurance Co. of New York, Civ. A. No. 09-2598, 2012 WL 1018799 (D.N.J. March 26, 2012).

On March 26, 2012, the United States District Court for the District of New Jersey entered an award for prejudgment interest against a reinsurer. *Munich Reinsurance America, Inc. v. Tower Insurance Co. of New York*, Civ. A. No. 09-2598, 2012 WL 1018799, at *7 (D.N.J. March 26, 2012). The court had previously held that Munich Reinsurance America, Inc. (“Munich”) was entitled to prejudgment interest on the total amount of indemnification payments that Tower Insurance Company of New York (“Tower”) had remitted to Munich while the action was pending.

The parties disagreed on the accrual date from which prejudgment interest would be calculated and the interest rate to be used. The district court applied New Jersey law, which provides that prejudgment interest in contract actions is governed by equitable principles. Nonetheless, courts may use New Jersey Court Rule 4:42-11, which governs post-judgment interest and prejudgment interest in tort cases, as a guide when determining prejudgment interest in a contract action.

Rule 4:42-11 provides that the post-judgment interest rate shall be the average rate of return on the State of New Jersey’s Cash Management Fund (the “CMF rate”) and that a 2 percent enhancement to the CMF rate shall be applied for judgments in excess of \$15,000. The rule sets the CMF rate as the prejudgment interest rate in tort actions and also provides that pre-judgment interest in tort actions shall be calculated from the later of the date the complaint was filed or six

months after the cause of action accrued.

The district court first examined the date on which interest began to accrue, noting that under New Jersey law, interest is generally owed from the time payment is due. Munich requested that the court calculate prejudgment interest from 30 days after the date each payment was demanded, beginning as early as July 2007, while Tower requested that it be calculated from the date of an account reconciliation in March 2011 which determined the amounts owed by Tower. The district court rejected both approaches and instead looked to Rule 4:42-11 for guidance. The court held that the equities were best balanced by calculating interest from the date the complaint was filed in May 2009 for any amounts demanded prior to that date. For amounts demanded after institution of the action, the court held that interest would be calculated from the date of the reconciliation.

The district court next analyzed the interest rate to be applied. Munich requested that the court follow Rule 4:42-11 and apply the 2 percent enhancement to the CMF rate because the judgment was in excess of \$15,000. The court held that the enhancement was only justified in contract actions in unusual circumstances or when it was warranted by the equities. The court concluded that the equities did not warrant the 2 percent enhancement because there were not unusual circumstances and the enhancement would create a windfall for Munich.

Redux in Context:

- Under New Jersey law, equitable principles govern an award of prejudgment interest for a contract action;
- Courts applying New Jersey law will not automatically calculate prejudgment interest from the date

payment was demanded, particularly if there is a dispute as to the amounts owed; and

- Courts applying New Jersey law will likely use the default interest rate unless unusual circumstances or the equities justify an enhancement of the default rate.

Non-Signatory to Arbitration Agreement Does Not Waive Right to Have Court, Not an Arbitrator, Determine Issue of Arbitrability

Local 36 Sheet Metal Workers' Int'l Assoc. v. Whitney, 670 F.3d 865 (8th Cir. 2012)

On March 6, 2012, the U.S. Court of Appeals for the Eighth Circuit held that a non-signatory to an arbitration agreement did not waive its right to have the court, not an arbitrator, determine the issue of arbitrability despite the fact that the non-signatory had notice of the arbitration and affirmatively chose not to participate. The Eighth Circuit held that although such conduct might waive the right of a non-signatory to have a court determine the issue of arbitrability, such a case was not warranted here.

In this case, a union brought an arbitration proceeding against the alleged alter ego of a family-owned general contracting company ("Whitney Industrial"). The union and the general contractor ("Whitney Mechanical") were parties to a collective bargaining agreement which contained an arbitration clause. Whitney Mechanical closed in 2006 without paying certain union benefit funds required under the collective bargaining agreement. In 2008, the Whitney family opened Whitney Industrial and conducted a new general contracting business. Later that year, the union sued Whitney Industrial claiming it was the alter ego of Whitney Mechanical and was required to pay the union benefit funds. Whitney Industrial was aware of the arbitration but failed to appear at the hearing.

The arbitration panel held that Whitney Industrial was the alter ego of Whitney Mechanical and ordered Whitney Industrial to pay the union benefit funds due to the union. Whitney Industrial appealed the arbitrator's decision to the Western

District of Missouri arguing that the award was unenforceable because the arbitrators did not have jurisdiction over it. The district court affirmed the arbitration decision and held that Whitney Industrial had waived its right to challenge the arbitrator's substantive jurisdiction by not taking affirmative action. The district court held that Whitney Industrial should have acted in one of four ways: (i) object to the arbitrator's authority but proceed to the merits before the arbitrator, while expressly reserving the jurisdiction question for the courts; (ii) seek pre-emptive declaratory or injunctive relief in court before the arbitration commences; (iii) notify the arbitrator of the refusal to arbitrate, thereby forcing the other party to file a motion in court to compel arbitration; or (iv) timely file a motion to vacate the arbitrator's award following arbitration.

The Eighth Circuit reversed, holding that signatories, not non-signatories, were required to act in one of the above affirmative ways to preserve their substantive jurisdictional challenges. Although it was possible for a non-signatory to waive this right by participating in the arbitration proceeding, Whitney Industrial had not done so here. The Eighth Circuit explained that there is a distinction between procedural and substantive jurisdictional challenges. Procedural challenges "relate to whether the party who seeks arbitration, and the arbitrators themselves, abided by the procedural safeguards set forth in the collective bargaining agreement and in the rules of the arbitral body." Procedural jurisdictional challenges are appropriate for the arbitrators to consider. In contrast, substantive jurisdic-

tional challenges are generally for the courts to consider and address whether the parties are subject to a valid contract that must be arbitrated.

Whitney Industrial presented a substantive jurisdictional challenge which should have been determined by the court. Accordingly, the Eighth Circuit remanded for the district court to determine whether Whitney Industrial was the alter ego of Whitney Mechanical and thus bound to arbitrate the dispute.

Redux in Context:

- Arbitrators may generally decide procedural jurisdictional challenges but the courts must

generally resolve substantive jurisdictional challenges;

- Signatories to an arbitration agreement must generally act in certain affirmative ways in order to preserve their substantive jurisdictional challenges; and
- Non-signatories to an arbitration agreement are not generally required to act in certain affirmative ways in order to preserve their substantive jurisdictional challenges. However, it is possible for non-signatories to waive their right to substantive jurisdictional challenges through their affirmative participation in arbitration proceedings.

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